

107<sup>TH</sup> CONGRESS  
1<sup>ST</sup> SESSION

# H. R. 86

To amend the Internal Revenue Code of 1986 to restructure and replace the income tax system of the United States to meet national priorities, and for other purposes.

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## IN THE HOUSE OF REPRESENTATIVES

JANUARY 3, 2001

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

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## A BILL

To amend the Internal Revenue Code of 1986 to restructure and replace the income tax system of the United States to meet national priorities, and for other purposes.

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; AMENDMENT OF 1986 CODE;**

4 **TABLE OF CONTENTS.**

5 (a) **SHORT TITLE.**—This Act may be cited as the  
6 “Simplified USA Tax Act of 2001”.

7 (b) **AMENDMENT OF 1986 CODE.**—Except as other-  
8 wise expressly provided, whenever in this Act a reference  
9 is made to the Code or to a section or provision of the

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

4 (c) TABLE OF CONTENTS.—

Sec. 1. Short title; amendment of 1986 Code; table of contents.

TITLE I—FINDINGS; NEED TO REPLACE THE INCOME TAX

Sec. 101. Replacing the income tax of the United States.

TITLE II—SIMPLIFIED USA TAX FOR INDIVIDUALS

Sec. 201. Simplified USA Tax for individuals.

Sec. 202. Reorganization of the Code.

TITLE III—SIMPLIFIED USA TAX FOR BUSINESSES

Sec. 301. Repeal of present corporate income tax; new tax paid by corporations  
and other businesses.

Sec. 302. Repeal of chapter 6.

TITLE IV—DEFERRED COMPENSATION PLANS

Sec. 401. Provisions saved.

Sec. 402. Clerical Amendments.

Sec. 403. Clerical Amendments.

TITLE V—REPEAL OF ESTATE AND GIFT TAXES

Sec. 501. Repeal of gratuitous transfer taxes.

Sec. 502. Effective Date.

TITLE VI—TECHNICAL AND ADMINISTRATIVE CHANGES;  
EFFECTIVE DATES

Sec. 601. USA Tax Code.

Sec. 602. Revisions to the Code.

Sec. 603. Application of subtitle F.

Sec. 604. Clerical amendment.

5 **TITLE I—FINDINGS; NEED TO**  
6 **REPLACE THE INCOME TAX**

7 **SEC. 101. REPLACING THE INCOME TAX OF THE UNITED**  
8 **STATES.**

9 (a) FINDINGS.—The Congress finds that—

1           (1) the current Tax Code is irreparably flawed  
2 and must be replaced;

3           (2) to enhance the liberty and protect the pri-  
4 vacy of individuals, the Tax Code must be made sim-  
5 pler and nonintrusive, and it must be applied  
6 evenhandedly to all;

7           (3) to be fair and to provide for the prosperity  
8 of current and future generation, the Tax Code must  
9 give all individuals at all income levels an oppor-  
10 tunity to save, invest and raise their standard of liv-  
11 ing and that of their children; and

12           (4) future economic growth requires a tax sys-  
13 tem that facilitates successful competition in the  
14 global marketplace.

15       (b) MAIN FEATURES OF SIMPLIFIED USA TAX SYS-  
16 TEM.—

17           (1) REPLACEMENT OF OLD TAX SYSTEM.—  
18 Chapter 1 of subtitle A (related to income taxes) of  
19 the Code is repealed and replaced for years begin-  
20 ning after 2001.

21           (2) ESTATE AND GIFT TAX REPEALED.

22           (3) NEW TAX SYSTEM.—The Simplified USA  
23 Tax consists of—

24                   (A) a simplified tax collected from individ-  
25 uals, that for years after 2001 replaces the in-

1           come tax imposed on individuals by section 1 of  
2           the Code, and

3                   (B) a simplified tax collected from corpora-  
4                   tions and other businesses, that for years after  
5                   2001 replaces the income tax imposed on cor-  
6                   porations by section 11 of the Code.

7           (3) SIMPLIFIED USA TAX ON GROSS PROFITS.—  
8           Corporations and other businesses pay tax on their  
9           annual gross profits from business conducted in the  
10          United States, except that—

11                   (A) export revenues are excluded, and

12                   (B) imports are taxed.

13          (4) SIMPLIFIED USA TAX ON INCOME.—Individ-  
14          uals pay tax on their annual income from wages,  
15          dividends, interest, and other financial income (in-  
16          cluding sales of property), except that—

17                   (A) investment earnings on previously  
18                   taxed income that is placed in a Roth IRA is  
19                   exempt from further taxation,

20                   (B) a portion of each family's income is ex-  
21                   empt from tax, and

22                   (C) deductions are allowed for—

23                           (i) education costs,

24                           (ii) religious, charitable, and other  
25                   philanthropic donations,

1 (iii) home mortgage interest pay-  
2 ments, and

3 (iv) contributions to qualified IRAs.

4 (5) CREDIT FOR FICA PAYROLL TAXES PAID.—

5 The amount of tax due is reduced by the payroll tax  
6 that is—

7 (A) in the case of an employee, withheld  
8 from wages, or

9 (B) in the case of a corporation or other  
10 business, paid by the employer.

11 (c) CONCEPTS AND STRUCTURE OF NEW TAX SYS-  
12 TEM.—

13 (1) GUIDING PRINCIPLES OF THE SIMPLIFIED  
14 USA TAX SYSTEM.—The Simplified USA Tax is  
15 based on the following principles:

16 (A) National wealth and well-being depend  
17 on the work, skill, and savings and investment  
18 of people.

19 (B) Businesses are people and their capital  
20 working together.

21 (C) Capital makes people more productive.

22 (D) Everyone benefits from a growing  
23 stock of national savings which in turn allows  
24 for a growing stock of physical and human cap-  
25 ital.

1           (E) Under the Simplified USA Tax, the  
2           deferral of taxation on investments in human  
3           capital represents an investment by the Federal  
4           government in the nation's capital stock and  
5           the Federal government shares in the return on  
6           its investment in the form of higher economic  
7           output and revenues in the future.

8           (2) SINGLE TAX IN 2 PARTS.—The Simplified  
9           USA Tax is composed of a business tax and an indi-  
10          vidual tax which are 2 parts of a single tax system  
11          that subjects all income produced and received to  
12          taxation once and only once. The 2 parts are as fol-  
13          lows:

14               (A) BUSINESS TAX AT THE SOURCE OF IN-  
15               COME.—Tax is paid by corporations and other  
16               businesses which produce and sell goods and  
17               services that are—

18                       (i) the source of nearly all the gross  
19                       domestic product of the United States, and

20                       (ii) the ultimate source of income re-  
21                       ceived by individuals.

22               (B) INDIVIDUAL TAX ON INCOME RE-  
23               CEIVED.—Tax is paid by individuals when they  
24               receive wages and salaries as compensation for  
25               gross domestic product created by their work.

1           (3) SAVING AND INVESTMENT.—The Simplified  
2           USA Tax allows people to save and businesses to in-  
3           vest as follows:

4                   (A) FAIR OPPORTUNITY FOR PEOPLE TO  
5           SAVE.—

6                           (i) OPTIONAL ELIMINATION OF DOU-  
7           BLE TAXATION.—When an individual earns  
8           income and is taxed on that income, the  
9           individual can save that income in a Roth  
10          IRA and not pay income taxes on the in-  
11          vestment earnings.

12                          (ii) DEDUCTIBLE AND EXCLUDABLE  
13          SAVINGS.—The Simplified USA Tax con-  
14          tinues provisions of present law that  
15          allow—

16                           (I) lower income individuals and  
17                           certain others to make deductible con-  
18                           tributions to individual retirement ac-  
19                           counts, and

20                           (II) encourage employer spon-  
21                           sored savings and retirement plans  
22                           that defer taxation of income through  
23                           use of 401(k) plans and other quali-  
24                           fied retirement plans.

1 (B) FAIR OPPORTUNITY FOR BUSINESSES  
2 TO INVEST.—

3 (i) NO PREPAYMENT OF TAX.—When  
4 a business invests in plant and  
5 equipment—

6 (I) a deduction is allowed for the  
7 cost, and

8 (II) tax is deferred.

9 (ii) TAX ON EARNINGS AND RECOVERY  
10 OF COST.—When recovered out of business  
11 revenues, both the cost of the investment  
12 and the earnings on the investment are in-  
13 cluded in gross profit subject to tax.

14 (iii) EXPENSING.—The deduction for  
15 investment is the equivalent of allowing the  
16 cost of plant and equipment to be expensed  
17 instead of depreciated.

18 (4) FAIR OPPORTUNITY TO COMPETE IN THE  
19 GLOBAL MARKETPLACE.—The Simplified USA Tax  
20 serves the strategic interests of the United States in  
21 international markets as follows:

22 (A) BORDER ADJUSTABLE TAX.—

23 (i) AMERICAN-MADE EXPORTS.—  
24 Goods and services produced in the United

1 States can be sold into world markets free  
2 of tax.

3 (ii) FOREIGN-MADE IMPORTS.—Goods  
4 and services imported into the United  
5 States bear a fair and proportionate share  
6 of the tax burden in the United States.

7 (iii) LEVELING THE INTERNATIONAL  
8 PLAYING FIELD.—Border adjustments for  
9 exports and imports are consistent with  
10 international standards and practice.

11 (5) A SIMPLE AND UNDERSTANDABLE TAX.—  
12 The Simplified USA Tax for individuals—

13 (A) is written in a simple, understandable  
14 form,

15 (B) contains only a few exemptions, deduc-  
16 tions, and credits, and can be reported on a tax  
17 return only a small fraction the size of Form  
18 1040.

19 (6) A NONINTRUSIVE, EVENHANDED TAX.—

20 (A) TAXPAYERS ARE IN CONTROL.—When  
21 the rules are few and clear, taxpayers can cal-  
22 culate their own tax correctly and file their own  
23 returns without fear of mistake or of getting  
24 caught up in an argument with the IRS.

1           (B) LIMITED ROLE FOR IRS.—When the  
2 rules are few and clear, the IRS does not have  
3 the broad interpretive power that puts tax-  
4 payers at risk of being treated unfairly and un-  
5 evenly.

6           (C) RESTORING VOLUNTARY COMPLI-  
7 ANCE.—When the rules are few and clear, the  
8 IRS can concentrate on helping taxpayers vol-  
9 untarily pay their correct share of tax revenues  
10 for public use and benefit under a tax system  
11 that is understood and respected.

12           (7) MAINTAINING TAX PROGRESSIVITY FOR IN-  
13 DIVIDUALS.—

14           (A) GRADUATED TAX.—Like the tax im-  
15 posed by section 1 of the current Code, the  
16 Simplified USA Tax for individuals is a grad-  
17 uated tax.

18           (B) FAMILY LIVING ALLOWANCE.—The  
19 Simplified USA Tax recognizes that every fam-  
20 ily’s budget includes necessities. The Simplified  
21 USA Tax provides a family living allowance  
22 that exempts from taxation the first dollars  
23 earned and spent to maintain a basic standard  
24 of living.

1           (8) BUSINESSES AND INDIVIDUAL SHARE THE  
2 TAX BURDEN.—

3           (A) BUSINESS PORTION OF TAX BUR-  
4 DEN.—Corporations and other businesses pay  
5 about the same portion of the total tax as  
6 under the current Code.

7           (B) INDIVIDUAL PORTION OF TAX BUR-  
8 DEN.—Individuals pay about the same portion  
9 of the total tax as under the current Code.

10          (9) EMPHASIZING PERSONAL INDEPENDENCE  
11 AND RESPONSIBILITY.—

12          (A) REINFORCING A CULTURE OF WORK  
13 AND THRIFT.—Instead of being solely a calcula-  
14 tion of how much they must pay to the govern-  
15 ment, the Simplified USA Tax converts the in-  
16 come tax into an annual calculation of how  
17 much people produce and contribute to the  
18 economy.

19          (B) GREATER CONTROL AND RESPONSI-  
20 BILITY.—Because people are not double taxed  
21 on their saving, they have—

22                 (i) more control over their own income  
23                 and taxes,

24                 (ii) a greater ability to plan and pro-  
25                 vide for their own future, and

1 (iii) a fair opportunity to do so.

2 (10) MORE OPPORTUNITY FOR WAGE EARNERS  
3 AT LOWER INCOME LEVELS.—

4 (A) REFUNDABLE CREDIT FOR EMPLOYEE  
5 PAYROLL TAX.—The amount of the payroll tax  
6 paid or withheld under the Code from an em-  
7 ployee’s wages (and paid into the Social Secu-  
8 rity and Hospital Insurance Trust Funds) is—

9 (i) credited against the employee’s in-  
10 come tax, and

11 (ii) refunded to the employee to the  
12 extent in excess of the employee’s income  
13 tax.

14 (B) NO EFFECT ON TRUST FUND OR BEN-  
15 EFITS.—The income tax credit allowed for pay-  
16 roll taxes deposited in the Social Security Trust  
17 Fund does not—

18 (i) reduce the amount in such fund, or

19 (ii) reduce the payment of any per-  
20 son’s benefits from the fund.

21 **TITLE II—SIMPLIFIED USA TAX**  
22 **FOR INDIVIDUALS**

23 **SEC. 201. SIMPLIFIED USA TAX FOR INDIVIDUALS.**

24 (a) IN GENERAL.—Chapter 1 of the Code is amended  
25 to read as follows:

1     **“CHAPTER 1—SIMPLIFIED USA TAX FOR**  
 2                                   **INDIVIDUALS**

- “Subchapter A. Basic rules.
- “Subchapter B. Roth IRA and other savings provisions.
- “Subchapter C. Basis, business transactions, and nonrecognition transactions.
- “Subchapter D. Rules for exclusions from gross income.
- “Subchapter E. Rules relating to deductions.
- “Subchapter F. Special business activities.
- “Subchapter G. Accounting methods.
- “Subchapter H. Nonresident aliens.
- “Subchapter I. Trusts and estates.
- “Subchapter J. Definitions and rules of application.

3                                   **“Subchapter A—Basic Rules**

- “Sec. 1. Simplified USA tax for individuals.
- “Sec. 2. Persons liable for the Simplified USA for individuals.
- “Sec. 3. Gross income.
- “Sec. 4. Exclusions from gross income.
- “Sec. 5. Alimony and child support deductions.
- “Sec. 6. Personal and dependency deduction.
- “Sec. 7. Family Living Allowance.
- “Sec. 8. USA deductions.
- “Sec. 9. Homeowner deduction.
- “Sec. 10. Education deduction.
- “Sec. 11. Philanthropic transfer deduction.
- “Sec. 13. Limitation on deductions.
- “Sec. 15. Tax rates.
- “Sec. 16. Kiddie tax.
- “Sec. 17. Rules for filing status and rate tables.
- “Sec. 20. USA tax credits.
- “Sec. 21. Payroll tax credit.
- “Sec. 22. Taxes-paid tax credit.
- “Sec. 23. Indexing for inflation.

4     **“SEC. 1. SIMPLIFIED USA TAX FOR INDIVIDUALS.**

5             “(a) IMPOSITION OF TAX.—An income tax is imposed  
 6 on each individual described in section 2. The income tax  
 7 shall equal the amount determined by applying the tax  
 8 schedules in section 15 to the taxable income of the tax-  
 9 payer for the taxable year and reducing the tax so deter-  
 10 mined by the USA tax credits for the taxable year.

1       “(b) TAXABLE INCOME.—‘Taxable income’ means  
2 adjusted gross income, reduced by—

3               “(1) the personal and dependency deduction,

4               “(2) the Family Living Allowance, and

5               “(3) the USA deductions, including—

6                       “(A) the homeowner deduction,

7                       “(B) the education deduction, and

8                       “(C) the philanthropic transfer deduction.

9       “(c) ADJUSTED GROSS INCOME.—‘Adjusted gross in-  
10 come’ means gross income, reduced by—

11               “(1) the alimony and child support deductions,

12       and

13               “(2) the qualified IRA deduction.

14       “(d) NAME.—The tax imposed by this chapter shall  
15 be known as the ‘Simplified USA Tax for Individuals’.

16 **“SEC. 2. PERSONS LIABLE FOR THE SIMPLIFIED USA TAX**  
17 **FOR INDIVIDUALS.**

18       “(a) INDIVIDUALS ONLY.—The Simplified USA Tax  
19 for Individuals shall apply only to individuals.

20       “(b) CITIZENS AND RESIDENT ALIENS.—The Sim-  
21 plified USA Tax for Individuals shall apply to all citizens  
22 of the United States and to all resident aliens of the  
23 United States. Except as specifically provided in this chap-  
24 ter, the Simplified USA Tax for Individuals shall not  
25 apply to nonresident aliens.

1       “(c) NONRESIDENT ALIENS.—For rules applicable to  
2 the compensation income of nonresident aliens, see sub-  
3 chapter H (sections 131 and 132). For rules on the with-  
4 holding of tax on nonresident aliens, see chapter 5 (sec-  
5 tions 1441–1464).

6       “(d) TAXPAYER.—For purposes of this chapter, ‘tax-  
7 payer’ means an individual, or, in the case of a joint re-  
8 turn, the husband and the wife.

9       **“SEC. 3. GROSS INCOME.**

10       “(a) GENERAL DEFINITION.—Except as otherwise  
11 provided in this chapter, ‘gross income for the taxable  
12 year’ means all income from whatever source derived by  
13 a taxpayer during the taxable year, including (but not lim-  
14 ited to) the following items:

15               “(1) Compensation for services, including (but  
16 not limited to)—

17                       “(A) salaries,

18                       “(B) wages,

19                       “(C) commissions,

20                       “(D) tips, and

21                       “(E) distributions from business entities

22                       (as defined in section 171).

23               “(2) Fringe benefits (except as specifically ex-  
24 cluded by section 4(a)), including (but not limited  
25 to)—

1           “(A) the cost of health, disability, life or  
2 other similar insurance paid by an employer if  
3 the taxpayer is indirectly or directly the bene-  
4 ficiary of the policy or has the right to name  
5 the beneficiary of the policy,

6           “(B) employer-paid parking (unless the  
7 employee uses the automobile parked in the  
8 space regularly on employer business),

9           “(C) employer-paid educational benefits,

10           “(D) employer-paid housing (other than  
11 housing provided for the convenience of the em-  
12 ployer),

13           “(E) employer-paid meals (other than  
14 meals provided for the convenience of the em-  
15 ployer or reimbursement for the reasonable cost  
16 of meals incurred on overnight travel),

17           “(F) amounts contributed by an employer  
18 on behalf of an employee to a group legal serv-  
19 ices plan, and

20           “(G) dependent care assistance received  
21 from an employer.

22           “(3) Distributions from business entities (as de-  
23 fined in section 171) constituting—

24           “(A) compensation for use of capital, in-  
25 cluding interest, or

1           “(B) shares of profits (including divi-  
2           dends).

3           “(4) Interest not described in paragraph (3)(A).

4           “(5) Rents.

5           “(6) Royalties.

6           “(7) Alimony, child support, and separate  
7           maintenance payments.

8           “(8) Includible social security benefits.

9           “(9) Income from the discharge of indebted-  
10          ness.

11          “(10) Gains on the sale or disposition of assets.

12          “(11) Amounts stolen or embezzled.

13          “(12) Distributions from retirement plans and  
14          annuities (other than USA Roth IRAs) to the extent  
15          not previously included as income, as determined in  
16          accordance with section 33.

17          “(13) Amounts received through health, acci-  
18          dent or disability insurance to the extent that—

19                 “(A) the cost of such insurance was paid  
20                 by an employer and not included in the employ-  
21                 ee’s taxable income and

22                 “(B) such amounts exceed the actual med-  
23                 ical expenses incurred and not paid or treated  
24                 as paid with amounts otherwise excluded from  
25                 income.

1       “(b) DEFINITIONS.—For purposes of subsection (a)  
2 and section 4—

3           “(1) EMPLOYER.—‘Employer’ includes—

4               “(A) in the case of a partner who provides  
5 services for a partnership, the partnership,

6               “(B) in the case of a proprietor, the pro-  
7 prietorship, and

8               “(C) in the case of an independent con-  
9 tractor, any business or individual that hires  
10 the independent contractor.

11          “(2) SOCIAL SECURITY BENEFITS.—

12               “(A) IN GENERAL.—‘Social Security bene-  
13 fits’ means any amount received by the tax-  
14 payer by reason of entitlement to—

15                   “(i) a monthly benefit under title II of  
16 the Social Security Act, or

17                   “(ii) a tier 1 railroad retirement ben-  
18 efit. The amount received by a taxpayer  
19 shall be determined as if the Social Secu-  
20 rity Act did not contain section 203(i)  
21 thereof.

22               “(B) TIER 1 RAILROAD RETIREMENT BEN-  
23 EFIT.—‘Tier 1 railroad retirement benefit’  
24 means—

1           “(i) the amount of the annuity under  
2           the Railroad Retirement Act of 1974 equal  
3           to the amount of the benefit to which the  
4           taxpayer would have been entitled under  
5           the Social Security Act if all of the service  
6           after December 31, 1936, of the employee  
7           (on whose record the annuity is being  
8           paid) has been included in the term ‘em-  
9           ployment’ as defined in the Social Security  
10          Act, and

11          “(ii) a monthly annuity amount under  
12          section 3(f)(3) of the Railroad Retirement  
13          Act of 1974.

14          “(C) WORKERS’ COMPENSATION SUB-  
15          STITUTES.—If by reason of section 224 of the  
16          Social Security Act or section 3(a)(1) of the  
17          Railroad Retirement Act of 1974, any social se-  
18          curity benefit is reduced because of the receipt  
19          of a benefit under a workers’ compensation act,  
20          the term ‘social security benefit’ includes that  
21          portion of such benefit which equals such reduc-  
22          tion.

23          “(D) EFFECT OF EARLY PAYMENT.—If so-  
24          cial security benefits checks are delivered before  
25          the end of the calendar month for which they

1           are issued and are not deposited until the  
2           month for which they are issued, they will be  
3           treated as received in the month for which they  
4           are issued.

5           “(3) INCLUDIBLE SOCIAL SECURITY BENE-  
6           FITS.—‘Includible social security benefits’ means the  
7           portion of social security benefits that would be in-  
8           cluded in gross income under section 86(a) of the  
9           Internal Revenue Code of 1986, except that for pur-  
10          poses of applying such section, the term ‘modified  
11          adjusted gross income’ means adjusted gross income  
12          (as defined in section 1(c)), determined without re-  
13          gard to the inclusion of any social security benefits.

14          “(c) PROPERTY RECEIVED FOR SERVICES.—

15                 “(1) IN GENERAL.—If, in connection with the  
16                 performance of services, property is transferred to  
17                 any person other than the person for whom such  
18                 services are performed, the excess of—

19                         “(A) the fair market value of such prop-  
20                         erty (determined without regard to any restric-  
21                         tion other than a restriction which by its terms  
22                         will never lapse) at the first time the rights of  
23                         the person having the beneficial interest in such  
24                         property are transferable or are not subject to

1 a substantial risk of forfeiture, whichever oc-  
2 curs earlier, over

3 “(B) the amount (if any) paid for such  
4 property, shall be included in the gross income  
5 of the person who performed such services in  
6 the first taxable year in which the rights of the  
7 person having the beneficial interest in such  
8 property are transferable or are not subject to  
9 a substantial risk of forfeiture, whichever is ap-  
10 plicable. The preceding sentence shall not apply  
11 if such person sells or otherwise disposes of  
12 such property in an arm’s length transaction  
13 before his rights in such property become trans-  
14 ferable or not subject to a substantial risk of  
15 forfeiture.

16 “(2) RULES AND REGULATIONS.—The Sec-  
17 retary shall prescribe rules and regulations similar  
18 to those applicable under section 83 of the Internal  
19 Revenue Code of 1986 for purposes of implementing  
20 this subsection.

21 **“SEC. 4. EXCLUSIONS FROM GROSS INCOME.**

22 “(a) GENERAL RULE.—Gross income does not in-  
23 clude:

24 “(1) RETURNS OR BENEFITS FROM PRE-  
25 VIOUSLY TAXED INCOME.—

1           “(A) Social security benefits (as defined in  
2 section 3(b)(2)), other than includible social se-  
3 curity benefits (as defined in section 3(b)(3)).

4           “(B) Amounts received under accident or  
5 health benefit plans (except as provided in sec-  
6 tion 3(a)(13)).

7           “(C) Value of services provided pursuant  
8 to a group legal service plan (but only if the  
9 cost of such services was paid by the employee  
10 or paid by the employer and included in the  
11 gross income of the employee).

12           “(D) Amounts received under an insurance  
13 contract for certain living expenses in the case  
14 of an individual whose principal residence is  
15 damaged or destroyed or who is denied access  
16 because of the threat of such occurrence.

17           “(E) Amounts treated as recovery of basis  
18 under any other provision of chapter 1.

19           “(2) COMPENSATION FOR SPECIAL KINDS OF  
20 SERVICE.—

21           “(A) In the case of a minister of the  
22 gospel—

23                   “(i) the rental value of a home fur-  
24 nished to him, or

1           “(ii) the rental allowance paid to him  
2           as part of his compensation, to the extent  
3           used by him to rent or provide a home.

4           “(B) Certain combat pay of members of  
5           the Armed Forces of the United States (as pro-  
6           vided in section 92).

7           “(C) Certain reduced uniform services re-  
8           tirement pay (as defined in section 122 of the  
9           Internal Revenue Code of 1986).

10          “(D) Qualified military benefits (as defined  
11          in section 93).

12          “(E) Moving allowances for active military  
13          personnel (as defined in section 217(g) of the  
14          Internal Revenue Code of 1986).

15          “(F) Certain foster care payments (as de-  
16          fined in section 94).

17          “(3) GRATUITOUS, CHARITABLE, AND GOVERN-  
18          MENTAL TRANSFERS.—

19                 “(A) Gifts.

20                 “(B) Inheritances.

21                 “(C) Supplemental security income, aid to  
22                 families with dependent children, food stamps,  
23                 section 8 low-income rental assistance, benefits  
24                 under the low-income home energy assistance  
25                 program, and benefits under other similar Fed-

1           eral and State assistance programs for low-in-  
2           come individuals and families.

3           “(D) Benefits or assistance received from  
4           a charitable organization as the result of a dis-  
5           aster or by reason of financial need.

6           “(4) TAX-EXEMPT BOND INTEREST.—Interest  
7           on State and local bonds (as provided in section 91);

8           “(5) COMPENSATION FOR INJURY AND SICK-  
9           NESS.—

10           “(A) Amounts received as compensation  
11           for personal injury or sickness (as provided in  
12           section 95).

13           “(B) Reimbursement and direct payments  
14           under Medicare and Medicaid.

15           “(6) BENEFITS PRIMARILY FOR THE CONVEN-  
16           IENCE OF THE EMPLOYER AND CERTAIN FRINGE  
17           BENEFITS.—

18           “(A) Meals or lodging furnished for the  
19           convenience of the employer (as provided in sec-  
20           tion 96).

21           “(B) Value of a parking space if employee  
22           uses the car parked in the space regularly on  
23           company business.

24           “(C) A fringe benefit that is a no-addi-  
25           tional-cost service (as defined in section 97(b)),

1 subject to rules prohibiting discrimination in  
2 favor of the highly compensated.

3 “(D) A qualified employee discount (as de-  
4 fined in section 97(c)), subject to rules prohib-  
5 iting discrimination in favor of the highly com-  
6 pensated.

7 “(E) Any property or services provided to  
8 an employee to the extent that if the employee  
9 were treated as a business and the business  
10 paid for those services, the employee could de-  
11 duct the cost of such property or services under  
12 the business tax.

13 “(F) A de minimis fringe benefit (as de-  
14 fined in section 97(d)).

15 “(G) Transportation in a commuter high-  
16 way vehicle if such transportation is in connec-  
17 tion with travel between the employee’s resi-  
18 dence and place of employment.

19 “(H) Any amount received directly or indi-  
20 rectly by an individual from an employer for  
21 moving expenses if—

22 “(i) the move is associated with a  
23 change in job locations for the same em-  
24 ployer, and

1                   “(ii) the expenses of such move would  
2                   have been deductible under the rules under  
3                   section 217 of the Internal Revenue Code  
4                   of 1986 if paid directly by the employee.

5                   “(I) Employer provided coverage under an  
6                   accident or health plan.

7                   “(7) REPAYABLE RECEIPTS.—The proceeds of  
8                   borrowing or any other amounts legally received that  
9                   the taxpayer is legally obligated to return (except  
10                  that the imputed interest rules of section 7872 may  
11                  apply if there is inadequate stated interest).

12                  “(8) CERTAIN INCOME EARNED ABROAD.—Cer-  
13                  tain income and housing costs of citizens and resi-  
14                  dents of the United States living outside the United  
15                  States in accordance with the rules under section  
16                  911 of the Internal Revenue Code of 1986.

17                  “(9) DISCHARGE OF INDEBTEDNESS.—The  
18                  amount of indebtedness discharged unless the dis-  
19                  charge is for services, property, or other valuable  
20                  right.

21                  “(10) NONRECOGNITION TRANSACTIONS.—  
22                  Amounts to which the nonrecognition transaction  
23                  rules of section 77 apply.

24                  “(11) PROCEEDS FROM SALE OF PRINCIPAL  
25                  RESIDENCE.—Amounts excludable under section 76

1 (relating to certain proceeds from the sale of the  
2 taxpayer's principal residence).

3 “(12) TAXABLE RECEIPTS OF A BUSINESS EN-  
4 TITY.—Amounts that are treated as taxable receipts  
5 of a business entity under the Simplified USA Tax  
6 for businesses and are not distributed to the indi-  
7 vidual taxpayer.

8 “(13) QUALIFIED RETIREMENT CONTRIBU-  
9 TIONS.—Employer contributions to retirement plans  
10 that are exempt from taxation under chapter 3, in-  
11 cluding contributions pursuant to a cash or deferred  
12 payment plan described in section 401(k).

13 “(b) CROSS REFERENCES.—

14 “(1) ROTH IRAS.—For rules excluding from in-  
15 come earnings on, and distributions from, Roth  
16 IRAs, see sections 30 and 408A.

17 “(2) OTHER RETIREMENT PLANS.—For rules  
18 excluding or deferring from income earnings on  
19 other retirement plans, see chapter 3.

20 **“SEC. 5. ALIMONY AND CHILD SUPPORT DEDUCTIONS.**

21 “(a) GENERAL RULE.—A taxpayer shall be allowed  
22 an alimony and child support deductions for an amount  
23 equal to the alimony, child support, or separate mainte-  
24 nance payments paid during the taxpayer's taxable year.

1       “(b) DEFINITION OF ALIMONY, CHILD SUPPORT,  
2 AND SEPARATE MAINTENANCE PAYMENTS.—‘Alimony,  
3 child support, and separate maintenance payments’ means  
4 any alimony, child support, or separate maintenance pay-  
5 ment which is includible in gross income of the recipient  
6 under section 3.

7 **“SEC. 6. PERSONAL AND DEPENDENCY DEDUCTION.**

8       “(a) AMOUNT OF EXEMPTION.—The personal and  
9 dependency deduction for an individual shall equal the  
10 number of exemptions multiplied by \$2,700.

11       “(b) NUMBER OF EXEMPTIONS.—

12               “(1) TAXPAYER.—One exemption shall be al-  
13 lowed for the taxpayer unless the taxpayer files a  
14 joint return with a spouse, in which case 1 exemp-  
15 tion shall be allowed for the husband and 1 for the  
16 wife.

17               “(2) ELIGIBLE DEPENDENT.—An exemption  
18 shall be allowed for each eligible dependent.

19       “(c) DEPENDENT.—

20               “(1) DEFINITION.—‘Dependent’ means any of  
21 the following individuals over half of whose support,  
22 for the calendar year was received from the taxpayer  
23 or is treated as received from the taxpayer:

24                       “(A) A son or daughter of the taxpayer, or  
25                       a descendant of either.

1           “(B) A stepson, stepdaughter, stepfather,  
2 or stepmother of the taxpayer.

3           “(C) A brother, sister, stepbrother, or  
4 stepsister of the taxpayer.

5           “(D) The father or mother of the taxpayer,  
6 or an ancestor of either.

7           “(E) A son or daughter of a brother or sis-  
8 ter of the taxpayer.

9           “(F) A brother or sister of the mother or  
10 father of the taxpayer.

11           “(G) A son-in-law, daughter-in-law, father-  
12 in-law, mother-in-law, brother-in-law, or sister-  
13 in-law of the taxpayer.

14           “(H) An individual (other than an indi-  
15 vidual who at any time during the taxable year  
16 was the spouse, determined without regard to  
17 section 7703, of a taxpayer) who, for the tax-  
18 able year of the taxpayer, has as his principal  
19 place of abode the home of the taxpayer and  
20 is a member of the taxpayer’s household.

21           “(2) RULES RELATING TO THE GENERAL DEFINI-  
22 TION.—The Secretary shall prescribe rules similar  
23 to the rules under section 152 of the Internal Rev-  
24 enue Code of 1986 that shall apply to the general  
25 definition of ‘dependent’, including definitional rules,

1 rules relating to multiple support agreements, and  
2 support tests in cases of children of divorced par-  
3 ents.

4 “(d) ELIGIBLE DEPENDENT.—

5 “(1) IN GENERAL.—‘Eligible dependent’ means  
6 a dependent—

7 “(A) whose gross income for the calendar  
8 year in which the taxable year of the taxpayer  
9 begins is less than the exemption amount, or

10 “(B) who is a child of the taxpayer and  
11 who—

12 “(i) has not attained the age of 19 at  
13 the close of the calendar year in which the  
14 taxable year of the taxpayer begins, or

15 “(ii) is a student who has not attained  
16 the age of 24 at the close of such calendar  
17 year.

18 “(2) EXCLUSIONS.—A dependent who files a  
19 joint return with a spouse for the calendar year is  
20 not an eligible dependent.

21 “(3) RULES RELATING TO DEFINITIONS.—The  
22 Secretary shall prescribe rules similar to those in-  
23 cluded in or applicable under the Internal Revenue  
24 Code of 1986 relating to this subsection, including

1 rules defining ‘child’ and ‘student’ and rules relating  
2 to the income of handicapped dependents.

3 “(e) INFLATION ADJUSTMENT.—The dollar amount  
4 contained in subsection (a) shall be adjusted for inflation  
5 beginning with calendar year 2002 in accordance with the  
6 procedures of section 23.

7 **“SEC. 7. FAMILY LIVING ALLOWANCE.**

8 “(a) AMOUNT OF ALLOWANCE.—The Family Living  
9 Allowance for a taxpayer shall be determined in accord-  
10 ance with the following schedule:

<b>“Form of Return:</b>	<b>Family Living Allowance:</b>
Taxpayers filing joint return .....	\$8,140.
Surviving spouse .....	\$8,140.
Head of household .....	\$5,940.
Individual who is not married or a head of household.	\$4,840.
Married filing separate return .....	\$4,070.

11 “(b) LIMITATION IN THE CASE OF CERTAIN DE-  
12 PENDENTS.—In the case of an individual for whom an-  
13 other taxpayer can claim an exemption under section 6,  
14 the Family Living Allowance for such individual shall not  
15 exceed the greater of \$700 or such individual’s earned in-  
16 come (as defined in section 171(a)(6)).

17 “(c) ADJUSTMENTS FOR INFLATION.—The dollar  
18 amounts contained in subsections (a) and (b) shall be ad-  
19 justed for inflation beginning with calendar year 2002 in  
20 accordance with the procedures of section 23.

1 **“SEC. 8. USA DEDUCTIONS.**

2 “In computing taxable income, an individual shall be  
3 entitled to the following deductions:

4 “(1) The homeowner deduction described in  
5 section 9.

6 “(2) The education deduction described in sec-  
7 tion 10.

8 “(3) The philanthropic transfer deduction de-  
9 scribed in section 11.

10 **“SEC. 9. HOMEOWNER DEDUCTION.**

11 “(a) IN GENERAL.—The homeowner deduction shall  
12 equal the amount of interest paid by the taxpayer during  
13 the taxable year on acquisition indebtedness with respect  
14 to any qualified residence of the taxpayer.

15 “(b) DEFINITIONS.—

16 “(1) ACQUISITION INDEBTEDNESS.—‘Acquisi-  
17 tion indebtedness’ means any indebtedness that is  
18 secured by a qualified residence and that—

19 “(A) was incurred in acquiring, con-  
20 structing, or substantially improving the quali-  
21 fied residence, or

22 “(B) was incurred to refinance any indebt-  
23 edness that is described in subparagraph (A) or  
24 this subparagraph (B) but only to the extent  
25 that the refinancing does not exceed the  
26 amount refinanced.

1       The aggregate amount treated as acquisition indebt-  
2       edness shall not exceed \$1,000,000 (\$500,000 in the  
3       case of a married individual filing separately).

4           “(2) QUALIFIED RESIDENCE.—‘Qualified resi-  
5       dence’ means the principal residence of the taxpayer  
6       and 1 other residence of the taxpayer that is des-  
7       ignated by the taxpayer and which—

8           “(A) is used by the taxpayer as a residence  
9       for more than 14 days during such year for  
10      which such unit is rented, and

11           “(B) is not rented for more than 14 days  
12      during such year.

13       “(c) COOPERATIVE HOUSING CORPORATION TEN-  
14      ANT.—Any indebtedness secured by stock held by a tax-  
15      payer as a tenant-stockholder in a cooperative housing cor-  
16      poration shall be treated as secured by the house or apart-  
17      ment which the taxpayer is entitled to occupy as a tenant-  
18      stockholder. If such stock cannot be used to secure indebt-  
19      edness, the indebtedness will be treated as so secured if  
20      the taxpayer establishes that such indebtedness was in-  
21      curred to acquire stock.

22      **“SEC. 10. EDUCATION DEDUCTION.**

23           “(a) IN GENERAL.—The education deduction shall  
24      equal the sum of the qualified educational expenses for  
25      each eligible student.

1 “(b) QUALIFIED EDUCATION EXPENSES.—

2 “(1) IN GENERAL.—‘Qualified education ex-  
3 penses’ means with respect to an eligible student the  
4 lesser of—

5 “(A) \$4,000, or

6 “(B) the qualified higher education ex-  
7 penses of the eligible student paid by the tax-  
8 payer during the taxable year.

9 “(2) QUALIFIED HIGHER EDUCATION EX-  
10 PENSES.—

11 “(A) IN GENERAL.—‘Qualified higher edu-  
12 cation expenses’ means tuition and fees re-  
13 quired for the enrollment of an eligible student  
14 at an eligible education institution. Such term  
15 shall not include expenses with respect to any  
16 course or other education involving sports,  
17 games, or hobbies other than as part of a de-  
18 gree program.

19 “(B) ELIGIBLE EDUCATIONAL INSTITU-  
20 TION.—‘Eligible educational institution’  
21 means—

22 “(i) an institution which is described  
23 in section 481 of the Higher Education  
24 Act of 1965 (as in effect on May 15,  
25 1998), and which is eligible to participate

1 in a program under title IV of such Act,  
2 and

3 “(ii) in the case of a student who has  
4 attained the age of 18 before the beginning  
5 of the taxable year, and not graduated  
6 from high school before the beginning of  
7 the taxable year, an accredited school pro-  
8 viding remedial education.

9 “(3) ELIGIBLE STUDENT.—‘Eligible student’  
10 means—

11 “(A) the taxpayer, but only if no other tax-  
12 payer treats the taxpayer as a dependent for  
13 which an exemption is allowed in computing the  
14 dependency deduction under section 6,

15 “(B) the taxpayer’s spouse if a joint return  
16 is filed, and

17 “(C) any dependent of the taxpayer for  
18 whom the taxpayer is allowed an exemption in  
19 computing the dependency deduction under sec-  
20 tion 6.

21 “(c) LIMITATION.—The maximum education deduc-  
22 tion in a taxable year is \$12,000 (\$6,000 in the case of  
23 married individuals filing separate returns).

24 “(d) INFLATION ADJUSTMENTS.—The dollar  
25 amounts contained in subsections (b)(1)(A) and (c) shall

1 be adjusted for inflation beginning with calendar year  
2 2002 in accordance with section 23.

3 **“SEC. 11. PHILANTHROPIC TRANSFER DEDUCTION.**

4 “(a) IN GENERAL.—The philanthropic transfer de-  
5 duction shall equal the amount of charitable contributions  
6 made by the taxpayer in the taxable year, subject to the  
7 limitations in subsection (b). A deduction shall be allow-  
8 able as a deduction only if verified under regulations pre-  
9 scribed by the Secretary.

10 “(b) LIMITATION ON AMOUNT.—

11 “(1) GENERAL RULE.—A deduction for con-  
12 tributions to regular charities in any taxable year  
13 shall be allowed only to the extent that such con-  
14 tributions do not exceed 50 percent of the taxpayer’s  
15 adjusted gross income. Other charitable contribu-  
16 tions shall be allowed only to the extent that such  
17 contributions do not exceed the lesser of—

18 “(A) 30 percent of the taxpayer’s adjusted  
19 gross income, or

20 “(B) the excess, if any, of 50 percent of  
21 the taxpayer’s adjusted gross income over the  
22 amount of charitable contributions to regular  
23 charities.

24 “(2) CARRYOVER.—If the amount of charitable  
25 contributions made in a taxable year exceeds the

1 amount which can be deducted in such year, the ex-  
2 cess shall be carried over for a period of up to 5  
3 years in accordance with rules to be prescribed by  
4 the Secretary.

5 “(3) REGULAR CHARITY.—For purposes of this  
6 subsection, ‘regular charity’ means an organization  
7 described in section 101, that is not a private foun-  
8 dation (other than a private operating foundation)  
9 (as such terms are defined in section 102).

10 “(c) CHARITABLE CONTRIBUTION.—‘Charitable con-  
11 tribution’ means a contribution or gift to or for the use  
12 of a governmental or charitable recipient (as defined in  
13 section 101).

14 “(d) CONTRIBUTIONS OF PROPERTY.—

15 “(1) GENERAL RULE.—In the case of a chari-  
16 table contribution of property, the amount of the  
17 contribution shall equal the lesser of the fair market  
18 value of the property or the taxpayer’s basis in the  
19 property.

20 “(2) FAIR MARKET VALUE DEDUCTIONS IN  
21 CERTAIN CASES.—Notwithstanding paragraph (1),  
22 in the case of a charitable contribution (other than  
23 a contribution to a private foundation that is not a  
24 private operating foundation) of—

25 “(A) real property,

1           “(B) tangible property if the use by the  
2           donee is related to its purpose or function con-  
3           stituting the basis for its exemption from the  
4           business tax or in the case of a governmental  
5           unit, to any governmental unit, and

6           “(C) stocks, bonds, or other securities held  
7           for more than one year,  
8           the amount of the charitable contribution shall equal  
9           the fair market value of the property.

10           “(3) CONTRIBUTIONS OF STOCK FOR WHICH  
11           MARKET QUOTATIONS ARE READILY AVAILABLE.—

12           “(A) IN GENERAL.—In the case of con-  
13           tributions of qualified appreciated stock, para-  
14           graph (2) shall apply without regard to whether  
15           the stock is contributed to a private foundation.

16           “(B) QUALIFIED APPRECIATED STOCK.—  
17           ‘Qualified appreciated stock’ means any stock  
18           of a corporation for which (as of the date of the  
19           contribution) market quotations are readily  
20           available on an established securities market,  
21           except that in the case of a donor to a private  
22           foundation, the term does not include stock to  
23           the extent that the amount so contributed,  
24           when increased by prior contributions by the  
25           donor of stock in the same corporation, exceeds

1           10 percent in value of the outstanding stock of  
2           such corporation.

3           “(e) OTHER RULES.—The Secretary shall prescribe  
4 rules limiting the availability of the philanthropic transfer  
5 deduction in certain cases, including rules for—

6           “(1) contributions of property placed in trust,

7           “(2) contributions of partial interests in prop-  
8 erty,

9           “(3) contributions subject to liabilities that are  
10 assumed,

11           “(4) out-of-pocket expenditures on behalf of a  
12 charity to influence legislation,

13           “(5) substantiation of contributions in excess of  
14 \$250,

15           “(6) contributions designated for lobbying activ-  
16 ity,

17           “(7) amounts paid to maintain certain students  
18 as members of taxpayer’s household,

19           “(8) qualified conservation contributions, and

20           “(9) deductions for travel expenses on behalf of  
21 a charity where there is a significant element of per-  
22 sonal pleasure.

23 **“SEC. 13. LIMITATION ON DEDUCTIONS.**

24           “(a) IN GENERAL.—A taxpayer’s deductions shall  
25 not reduce the taxpayer’s taxable income below zero. Ex-

1 cept as provided in section 11(b) (relating to the limitation  
 2 on the philanthropic transfer deduction), a taxpayer shall  
 3 not be entitled to carry over any unused deductions.

4 “(b) DEDUCTIONS.—For purposes of this section,  
 5 ‘deductions’ means—

6 “(1) the alimony and child support deductions,

7 “(2) the personal and dependency deduction,

8 “(3) the Family Living Allowance,

9 “(4) the USA deductions, and

10 “(5) the qualified IRA deduction.

11 **“SEC. 15. TAX RATES.**

12 “(a) MARRIED INDIVIDUALS FILING JOINT RETURNS  
 13 AND SURVIVING SPOUSES.—The tax schedule for every  
 14 married individual who files a joint return with a spouse  
 15 and for every surviving spouse (as defined in section  
 16 17(a)) is—

<b>“If taxable income is:</b>	<b>The tax is:</b>
Not over \$40,000 .....	15% of taxable income.
Over \$40,000, but not over \$80,000.	\$6,000, plus 25% of the excess over \$40,000.
Over \$80,000 .....	\$16,000, plus 30% of the excess over \$80,000.

17 “(b) HEADS OF HOUSEHOLDS.—The tax schedule for  
 18 every head of household (as defined in section 17(b)) is—

<b>“If taxable income is:</b>	<b>The tax is:</b>
Not over \$35,000 .....	15% of taxable income.
Over \$35,000, but not over \$70,000.	\$5,250, plus 25% of the excess over \$35,000.
Over \$70,000 .....	\$14,000, plus 30% of the excess over \$70,000.

1           “(c) UNMARRIED INDIVIDUALS.—The tax schedule  
2 for an unmarried individual who is not a head of a house-  
3 hold or a surviving spouse is—

<b>“If taxable income is:</b>	<b>The tax is:</b>
Not over \$24,000 .....	15% of taxable income.
Over \$24,000, but not over \$48,000.	\$3,600, plus 25% of the excess over \$24,000.
Over \$48,000 .....	\$9,600, plus 30% of the excess over \$48,000.

4           “(d) MARRIED INDIVIDUALS FILING SEPARATE RE-  
5 TURNS.—The tax schedule for a married individual filing  
6 a separate return is—

<b>“If taxable income is:</b>	<b>The tax is:</b>
Not over \$20,000 .....	15% of taxable income.
Over \$20,000, but not over \$40,000.	\$3,000, plus 25% of the excess over \$20,000.
Over \$40,000 .....	\$8,000, plus 30% of the excess over \$40,000.

7           “(e) ADJUSTMENTS FOR INFLATION.—Beginning  
8 with calendar year 2002, the tax schedules in subsections  
9 (a) through (d) shall be adjusted so that inflation will not  
10 result in tax increases in accordance with the procedures  
11 under section 23.

12           “(f) DEFINITIONS.—See section 17 for rules on filing  
13 status.

14 **“SEC. 16. KIDDIE TAX.**

15           “(a) GENERAL RULE.—If a child has a living parent  
16 and net unearned income and the child has not attained  
17 the age of 14 before the close of the taxable year—

18                   “(1) the net unearned income of the child shall  
19           be included in the taxable income of the eligible par-

1 ent for purposes of determining the parent’s tax li-  
2 ability, or

3 “(2) the tax calculated under the tax rate  
4 schedules for the child as a separate taxpayer shall  
5 not be less than the sum of—

6 “(A) the tax which would have been deter-  
7 mined under the rate schedule if the taxable in-  
8 come of the child were reduced by the net un-  
9 earned income of the child, plus

10 “(B) such child’s share of the allocable pa-  
11 rental tax.

12 “(b) CHILD’S SHARE OF ALLOCABLE PARENTAL  
13 TAX.—

14 “(1) ALLOCABLE PARENTAL TAX.—‘Allocable  
15 parental tax’ means the excess of—

16 “(A) the tax that would have been deter-  
17 mined under the rate schedules on the eligible  
18 parent’s taxable income if such income included  
19 the net unearned income of all of the eligible  
20 parent’s children to which this section applies,  
21 over

22 “(B) the tax actually determined under the  
23 rate schedules without regard to this section.

24 “(2) CHILD’S SHARE.—A child’s share of the  
25 allocable parental tax is equal to the amount that

1 bears the same ratio to the total allocable parental  
2 tax as the child's net unearned income bears to the  
3 aggregate net unearned income of all children to  
4 whom this section applies for whom the eligible par-  
5 ent is the eligible parent.

6 “(c) ELIGIBLE PARENT.—‘Eligible parent’ means—

7 “(1) both parents of the child if the parents file  
8 a joint return,

9 “(2) the surviving parent of a child if the child  
10 has only 1 surviving parent,

11 “(3) the custodial parent if the child's parents  
12 are not married, or

13 “(4) the parent with the greater taxable income  
14 if the parents are married and filing separate re-  
15 turns.

16 “(d) NET UNEARNED INCOME.—‘Net unearned in-  
17 come’ means the excess, if any, of—

18 “(1) the adjusted gross income of the child,  
19 over

20 “(2) the sum of—

21 “(A) the earned income (as defined in sec-  
22 tion 171(a)(6)) of the child, and

23 “(B) an amount equal to the Family Liv-  
24 ing Allowance for a dependent child.

1 **“SEC. 17. RULES FOR FILING STATUS AND RATE TABLES.**

2 “(a) DEFINITION OF SURVIVING SPOUSE.—

3 “(1) IN GENERAL.—‘Surviving spouse’ means  
4 an individual—

5 “(A) whose spouse died during either of  
6 his 2 calendar years immediately preceding the  
7 calendar year, and

8 “(B) who maintains as his home a house-  
9 hold which constitutes for the taxable year the  
10 principal place of abode (as a member of such  
11 household) of a dependent—

12 “(i) who (within the meaning of sec-  
13 tion 6) is a son, stepson, daughter, or step-  
14 daughter of the taxpayer, and

15 “(ii) who the taxpayer is entitled to  
16 treat as an exemption for purposes of com-  
17 puting the personal dependency deduction  
18 for the taxable year under section 6.

19 For purposes of this paragraph, an individual shall  
20 be considered as maintaining a household only if  
21 over half of the cost of maintaining the household  
22 during the taxable year is furnished by such indi-  
23 vidual.

24 “(2) LIMITATIONS.—Notwithstanding para-  
25 graph (1), for purposes of section 15, an individual  
26 shall not be considered to be a surviving spouse—

1           “(A) if the individual has remarried at any  
2 time before the close of the taxable year, or

3           “(B) unless, for the individual’s taxable  
4 year during which his spouse died, a joint re-  
5 turn could have been made under the provisions  
6 of section 6013 (without regard to subsection  
7 (a)(3) thereof).

8           “(3) SPECIAL RULE WHERE DECEASED SPOUSE  
9 WAS IN MISSING STATUS.—If an individual was in a  
10 missing status (within the meaning of section  
11 6013(f)(3)) as a result of service in a combat zone  
12 and if such individual remains in such status until  
13 the date referred to in subparagraph (A) or (B),  
14 then, for purposes of paragraph (1)(A), the date on  
15 which such individual died shall be treated as the  
16 earlier of the date determined under subparagraph  
17 (A) or the date determined under subparagraph (B):

18           “(A) the date on which the determination  
19 is made under section 556 of title 37 of the  
20 United States Code or under section 5566 of  
21 title 5 of such Code (whichever is applicable)  
22 that such individual died while in such missing  
23 status, or

24           “(B) the date which is 2 years after the  
25 date designated under section 92 (relating to

1 exemption for combat zones) as the date of ter-  
2 mination of combatant activities in that zone.

3 “(b) DEFINITION OF HEAD OF HOUSEHOLD.—

4 “(1) IN GENERAL.—An individual shall be con-  
5 sidered a head of a household if, and only if, such  
6 individual is not married at the close of his taxable  
7 year, is not a surviving spouse (as defined in sub-  
8 section (a)), and either—

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

13 “(i) a son, stepson, daughter, or step-  
14 daughter of the taxpayer, or a descendant  
15 of a son or daughter of the taxpayer, but  
16 if such son, stepson, daughter, step-  
17 daughter, or descendant is married at the  
18 close of the taxpayer’s taxable year, only if  
19 the taxpayer is entitled to claim such per-  
20 son as an exemption for the taxable year  
21 for purposes of computing the dependency  
22 deduction under section 6 (or would be so  
23 entitled but for the release of a claim to  
24 such exemption by the custodial parent),

1           “(ii) any other person who is a de-  
2           pendent of the taxpayer, if the taxpayer is  
3           entitled to claim such person as an exemp-  
4           tion in determining the personal depend-  
5           ency deduction for the taxable year, or

6           “(B) maintains a household which con-  
7           stitutes for such taxable year the principal place  
8           of abode of the father or mother of the tax-  
9           payer, if the taxpayer is entitled to a personal  
10          dependency deduction for the taxable year for  
11          such father or mother.

12          For purposes of this paragraph, an individual shall  
13          be considered as maintaining a household only if  
14          over half of the cost of maintaining the household  
15          during the taxable year is furnished by such indi-  
16          vidual.

17          “(2) DETERMINATION OF STATUS.—For pur-  
18          poses of this subsection—

19                 “(A) a legally adopted child of a person  
20                 shall be considered a child of such person by  
21                 blood;

22                 “(B) an individual who is legally separated  
23                 from his spouse under a decree of divorce or of  
24                 separate maintenance shall not be considered as  
25                 married;

1           “(C) a taxpayer shall be considered as not  
2 married at the close of his taxable year if at  
3 any time during the taxable year his spouse is  
4 a nonresident alien; and

5           “(D) a taxpayer shall be considered as  
6 married at the close of his taxable year if his  
7 spouse (other than a spouse described in sub-  
8 paragraph (C)) died during the taxable year.

9           “(3) LIMITATIONS.—Notwithstanding para-  
10 graph (1), for purposes of this chapter, a taxpayer  
11 shall not be considered to be a head of a  
12 household—

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

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

18           “(i) subparagraph (H) of section  
19 6(c)(1), or

20           “(ii) multiple support rules prescribed  
21 by the Secretary.

22           “(c) CERTAIN MARRIED INDIVIDUALS LIVING  
23 APART.—For purposes of this part, an individual shall be  
24 treated as not married at the close of the taxable year

1 if such individual is so treated under the provisions of sec-  
2 tion 7703(b).

3 “(d) NONRESIDENT ALIENS.—In the case of a non-  
4 resident alien individual, the taxes imposed by section 1  
5 shall not apply.

6 **“SEC. 20. USA TAX CREDITS.**

7 “(a) IN GENERAL.—The USA tax credits are and  
8 shall be applied in the following order:

9 “(1) The foreign tax credit as prescribed by the  
10 Secretary under rules similar to the rules of subpart  
11 A of part III of subchapter N of chapter 1 of the  
12 Internal Revenue Code of 1986, but only with re-  
13 spect to foreign taxes on amounts that are included  
14 in the gross income of the taxpayer.

15 “(2) The payroll tax credit under section 21.

16 “(3) The taxes-paid tax credit under section 22.

17 “(b) REFUNDABLE CREDITS.—If a taxpayer’s USA  
18 tax credits (other than the foreign tax credit) for a taxable  
19 year exceed the taxpayer’s tax liability for the taxable year  
20 (after application of the foreign tax credit but before appli-  
21 cation of the other USA tax credits), the taxpayer shall  
22 be entitled to a refund for such excess. The taxpayer may  
23 elect in lieu of a refund to apply such excess as a tax paid  
24 for the following taxable year.

1 **“SEC. 21. PAYROLL TAX CREDIT.**

2 “(a) IN GENERAL.—A taxpayer shall be allowed a  
3 payroll tax credit in an amount equal to the sum of—

4 “(1) the employee’s share of the basic FICA  
5 tax,

6 “(2) the employee’s share of the basic Tier 1  
7 railroad retirement tax, and

8 “(3) one-half of the basic SECA tax payable  
9 with respect to the taxpayer’s compensation or earn-  
10 ings during the taxable year.

11 “(b) DEFINITIONS.—

12 “(1) EMPLOYEE’S SHARE OF THE BASIC FICA  
13 TAX.—‘Employee’s share of the basic FICA tax’  
14 means the old-age, survivors and disability insurance  
15 tax imposed by section 3101(a) and the portion of  
16 the hospital insurance tax imposed by section  
17 3101(b) that is attributable to the wage base on  
18 which the section 3101(a) tax is imposed.

19 “(2) EMPLOYEE’S SHARE OF THE BASIC TIER 1  
20 RAILROAD RETIREMENT TAX.—Employee’s share of  
21 the basic Tier 1 railroad retirement tax’ means—

22 “(A) the portion of the tax imposed by sec-  
23 tion 3201 with respect to compensation below  
24 the applicable base (as defined in section  
25 3231(e)(2)); and

1           “(B) the portion of the tax imposed by sec-  
2           tion 3211(a)(1) on railroad employee represent-  
3           atives attributable to the tax imposed by section  
4           3101(a) and the portion of the hospital insur-  
5           ance tax imposed by section 3101(b) that is at-  
6           tributable to the wage base on which the section  
7           3101(a) tax is imposed.

8           “(3) BASIC SECA TAX.—‘Basic SECA tax’  
9           means the old-age, survivors and disability insurance  
10          tax imposed by section 1401(a) on self-employment  
11          income and the portion of the hospital insurance tax  
12          imposed by section 1401(b) on self-employment in-  
13          come that is attributable to the amount of self-em-  
14          ployment income (as determined under section  
15          1402(b)) on which the section 1401(a) tax is im-  
16          posed.

17          “(c) NO CREDIT FOR REFUNDABLE TAX.—No credit  
18          shall be allowed with respect to any FICA tax or railroad  
19          retirement tax for which a taxpayer is entitled to a refund  
20          because of overpayment of tax on the applicable wage  
21          base.

22          **“SEC. 22. TAXES-PAID TAX CREDIT.**

23          “The taxes-paid tax credit shall equal the sum of:

24                  “(1) WAGE WITHHOLDING.—The amount with-  
25          held as tax under chapter 24.

1           “(2) SPECIAL REFUNDS OF SOCIAL SECURITY  
2           TAX WHEN WAGES EARNED FROM MORE THAN 1 EM-  
3           PLOYER.—The amount allowable under section  
4           6413(e) as a special refund of taxes imposed on  
5           wages.

6           “(3) OVERPAYMENTS OF PRIOR-YEAR TAX.—  
7           Any overpayment of a prior tax obligation that the  
8           taxpayer or the Secretary applies to the tax for the  
9           taxable year.

10           “(4) ESTIMATED TAXES.—Any estimated taxes  
11           paid by the taxpayer with respect to the taxpayer’s  
12           tax liability for the taxable year which are treated as  
13           payment on account of income tax for purposes of  
14           section 6315 (relating to estimated taxes).

15   **“SEC. 23. INDEXING FOR INFLATION.**

16           “(a) PUBLICATION OF TABLES AND NUMBERS.—Not  
17           later than December 15 of 2001, and each subsequent cal-  
18           endar year, the Secretary shall prescribe tables and dollar  
19           amounts which shall apply in the immediately following  
20           calendar year in lieu of the tables and dollar amounts that  
21           are required to be adjusted for inflation in accordance with  
22           this section.

23           “(b) METHOD OF ADJUSTMENT.—

24           “(1) IN GENERAL.—The dollar amounts which  
25           are required to be adjusted pursuant to this section

1 for a calendar year shall be the dollar amounts as  
2 stated in this chapter multiplied by the cost of living  
3 adjustment for such calendar year, rounded as pro-  
4 vided in subsection (d).

5 “(2) TAX RATE TABLES.—In the case of a tax  
6 rate table, the dollar amounts to be adjusted in ac-  
7 cordance with paragraph (1) are the minimum and  
8 maximum dollar amounts for each rate bracket for  
9 which a tax is imposed. The amounts setting forth  
10 the bottom tax for each bracket shall be adjusted to  
11 the extent necessary to reflect the adjustments in  
12 the rate brackets.

13 “(c) COST-OF-LIVING ADJUSTMENT.—

14 “(1) IN GENERAL.—The cost-of-living adjust-  
15 ment for any calendar year is the percentage (if any)  
16 by which—

17 “(A) the CPI for the preceding calendar  
18 year, exceeds

19 “(B) the CPI for the calendar year 2000.

20 “(2) CPI FOR ANY CALENDAR YEAR.—For pur-  
21 poses of paragraph (1), the CPI for any calendar  
22 year is the average of the Consumer Price Index as  
23 of the close of the 12-month period ending on Au-  
24 gust 31 of such calendar year.

1           “(3) CONSUMER PRICE INDEX.—For purposes  
 2           of paragraph (2), ‘Consumer Price Index’ means the  
 3           last Consumer Price Index for all-urban consumers  
 4           published by the Department of Labor. For pur-  
 5           poses of the preceding sentence, the revision of the  
 6           Consumer Price Index which is most consistent with  
 7           the Consumer Price Index for calendar year 2001  
 8           shall be used.

9           “(d) ROUNDING.—

10           “(1) IN GENERAL.—If any increase determined  
 11           under subsection (b) is not a multiple of \$50, such  
 12           increase shall be rounded to the next lowest multiple  
 13           of \$50.

14           “(2) MULTIPLES OF \$25.—Paragraph (1) shall  
 15           be applied by substituting ‘\$25’ for ‘\$50’ in the case  
 16           of—

17                   “(A) amounts for married individuals filing  
 18                   separately, and

19                   “(B) any other dollar amount that is to be  
 20                   adjusted for inflation if that dollar amount is  
 21                   less than \$1,000.

22           **“Subchapter B—Roth IRA and Other Savings**  
 23   **Provisions**

“Sec. 30. Roth IRAs.

“Sec. 31. Deductible IRAs.

“Sec. 32. Effect of repeal of special savings provisions.

1 **“SEC. 30. ROTH IRAS.**

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

5       “(b) ROTH IRA.—‘Roth IRA’ means an individual  
6 retirement plan (as defined in section 7701(a)(37)) which  
7 is designated (in such manner as the Secretary may pre-  
8 scribe) at the time of establishment of the plan as a Roth  
9 IRA. Such designation shall be made in such manner as  
10 the Secretary may prescribe.

11       “(c) TREATMENT OF CONTRIBUTIONS.—

12               “(1) NO DEDUCTION ALLOWED.—No deduction  
13 shall be allowed for a contribution to a Roth IRA.

14               “(2) CONTRIBUTION LIMIT.—The aggregate  
15 amount of contributions for any taxable year to all  
16 Roth IRAs maintained for the benefit of an indi-  
17 vidual (or, in the case of individuals filing a joint re-  
18 turn, either spouse) shall not exceed the taxpayer’s  
19 adjusted gross income for the taxable year.

20               “(3) ROLLOVER FROM IRA.—

21                       “(A) ROLLOVER CONTRIBUTIONS.—No  
22 rollover contribution may be made to a Roth  
23 IRA unless it is a qualified rollover contribu-  
24 tion.

25                       “(B) LIMITS.—A taxpayer shall not be al-  
26 lowed to make a qualified rollover contribution

1 to a Roth IRA from an individual retirement  
2 plan other than a Roth IRA during any taxable  
3 year if—

4 “(i) the taxpayer’s adjusted gross in-  
5 come for such taxable year exceeds  
6 \$100,000, or

7 “(ii) the taxpayer is a married indi-  
8 vidual filing a separate return.

9 “(C) MARITAL STATUS.—Section 31(g)(4)  
10 shall apply for purposes of this paragraph.

11 “(4) CONTRIBUTIONS PERMITTED AFTER AGE  
12 70½.—CONTRIBUTIONS TO A ROTH IRA MAY BE  
13 MADE EVEN AFTER THE INDIVIDUAL FOR WHOM  
14 THE ACCOUNT IS MAINTAINED HAS ATTAINED AGE  
15 70½.

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

21 “(A) Section 401(a)(9)(A).

22 “(B) The incidental death benefit require-  
23 ments of section 401(a).

24 “(6) TIME WHEN CONTRIBUTIONS MADE.—A  
25 taxpayer shall be deemed to have made a contribu-

1       tion to a Roth IRA during a year if the contribution  
2       is made on account of such year and is made not  
3       later than April 15 of the following year.

4       “(d) EXCLUSION FROM INCOME.—For purposes of  
5 this chapter—

6           “(1) GENERAL RULES.—A distribution from a  
7 Roth IRA shall not be includible in gross income.

8           “(2) NONQUALIFIED DISTRIBUTION.—The  
9 automatic exclusion from gross income under para-  
10 graph (1) shall not apply to any distribution, other  
11 than a qualified special purpose distribution if—

12           “(A) it is made within the 5-taxable year  
13 period beginning with the 1st taxable year for  
14 which the individual made a contribution to a  
15 Roth IRA (or such individual’s spouse made a  
16 contribution to a Roth IRA) established for  
17 such individual, or

18           “(B) in the case of a payment or distribu-  
19 tion properly allocable (as determined in the  
20 manner prescribed by the Secretary) to a quali-  
21 fied rollover contribution from an individual re-  
22 tirement plan other than a Roth IRA (or in-  
23 come allocable thereto), it is made within the 5-  
24 taxable year period beginning with the taxable

1           year in which the rollover contribution was  
2           made.

3           “(3) NONQUALIFIED DISTRIBUTIONS.—In ap-  
4           plying section 33 to any distribution from a Roth  
5           IRA described in paragraph (2), such distribution  
6           shall be treated as made from contributions to the  
7           Roth IRA to the extent that such distribution, when  
8           added to all previous distributions from the Roth  
9           IRA, does not exceed the aggregate amount of con-  
10          tributions to the Roth IRA. Only distributions at-  
11          tributable to earnings on accounts (as opposed to  
12          distributions of contributions) shall be included in  
13          gross income.

14          “(4) ROLLOVERS FROM AN IRA OTHER THAN A  
15          ROTH IRA.—

16                 “(A) IN GENERAL.—Notwithstanding sec-  
17                 tion 408(d)(3), in the case of any distribution  
18                 to which this paragraph applies there shall be  
19                 included in gross income any amount which  
20                 would be includible were it not part of a quali-  
21                 fied rollover contribution.

22                 “(B) DISTRIBUTIONS TO WHICH PARA-  
23                 GRAPH APPLIES.—This paragraph shall apply  
24                 to a distribution from an individual retirement  
25                 plan (other than a Roth IRA) maintained for

1 the benefit of an individual which is contributed  
2 to a Roth IRA maintained for the benefit of  
3 such individual in a qualified rollover contribu-  
4 tion.

5 “(C) CONVERSIONS.—The conversion of an  
6 individual retirement plan (other than a Roth  
7 IRA) to a Roth IRA shall be treated for pur-  
8 poses of this paragraph as a distribution to  
9 which this paragraph applies.

10 “(D) CONVERSION OF EXCESS CONTRIBU-  
11 TIONS.—If, no later than the due date for filing  
12 the return of tax for any taxable year (without  
13 regard to extensions), an individual transfers,  
14 from an individual retirement plan (other than  
15 a Roth IRA), contributions for such taxable  
16 year (and any earnings allocable thereto) to a  
17 Roth IRA, no such amount shall be includible  
18 in gross income to the extent no deduction was  
19 allowed with respect to such amount.

20 “(E) ADDITIONAL REPORTING REQUIRE-  
21 MENTS.—Trustees of Roth IRAs, trustees of in-  
22 dividual retirement plans, or both, whichever is  
23 appropriate, shall include such additional infor-  
24 mation in reports required under section 408(i)  
25 as the Secretary may require to ensure that

1 amounts required to be included in gross in-  
2 come under subparagraph (A) are so included.

3 “(4) COORDINATION WITH INDIVIDUAL RETIRE-  
4 MENT ACCOUNTS.—Section 408(d)(2) shall be ap-  
5 plied separately with respect to Roth IRAs and other  
6 individual retirement plans.

7 “(5) QUALIFIED SPECIAL PURPOSE DISTRIBUTION.—‘Qualified special purpose distribution’  
8 means—  
9

10 “(i) DISTRIBUTIONS UPON DEATH.—  
11 Distributions made to a beneficiary (or to  
12 the estate of the individual) on or after the  
13 death of the individual.

14 “(ii) DISTRIBUTIONS UPON DIS-  
15 ABILITY.—Distributions attributable to the  
16 individual’s being disabled.

17 “(iii) DISTRIBUTIONS TO PAY MED-  
18 ICAL EXPENSES.—Distributions made to  
19 the individual for amounts paid during the  
20 year for medical care, but only to the ex-  
21 tent that the amounts paid for medical  
22 care exceed 7.5% of the adjusted gross in-  
23 come of the taxpayer. (determined without  
24 regard to whether the employee itemizes  
25 deductions for such taxable year).

1           “(iv) QDROS.—Any distribution to  
2           an alternate payee pursuant to a qualified  
3           domestic relations order (within the mean-  
4           ing of section 414(p)(1)).

5           “(v) DISTRIBUTIONS TO UNEMPLOYED  
6           INDIVIDUALS FOR HEALTH INSURANCE  
7           PREMIUMS.—Distributions to an  
8           individual—

9                   “(I) if such individual has re-  
10                   ceived unemployment compensation  
11                   for 12 consecutive weeks under any  
12                   Federal or State unemployment com-  
13                   pensation law by reason of such sepa-  
14                   ration (or in the case of a self-em-  
15                   ployed individual, to the extent pro-  
16                   vided in regulations, if the individual  
17                   would have received unemployment  
18                   compensation but for the fact the in-  
19                   dividual was self-employed),

20                   “(II) if such distributions are  
21                   made during any taxable year during  
22                   which such unemployment compensa-  
23                   tion is paid or the succeeding taxable  
24                   year,

1           “(III) to the extent such distribu-  
2           tions do not exceed the amount paid  
3           during the taxable year for insurance  
4           for the diagnosis, cure, mitigation,  
5           treatment, or prevention of disease, or  
6           for the purpose of affecting any struc-  
7           ture or function of the body (or for  
8           transportation primarily for and es-  
9           sential to such medical care) (includ-  
10          ing amounts paid as premiums under  
11          part B of title XVIII of the Social Se-  
12          curity Act, relating to supplementary  
13          medical insurance for the aged) or for  
14          any qualified long-term care insurance  
15          contract (as defined in section  
16          7702B(b)) with respect to the indi-  
17          vidual and the individual’s spouse and  
18          dependents, and

19           “(IV) such distributions are not  
20          made after the individual has been  
21          employed for at least 60 days after  
22          the separation from employment to  
23          which clause (I) applies.

24           “(V) DISTRIBUTIONS TO PAY HIGHER  
25          EDUCATION EXPENSES.—Distributions to

1 the extent such distributions do not exceed  
2 the qualified higher education expenses (as  
3 defined in section 10(a)(2)) of—

4 “(I) the taxpayer,

5 “(II) the taxpayer’s spouse, or

6 “(III) any child or grandchild of  
7 the taxpayer or the taxpayer’s spouse.

8 “(vi) DISTRIBUTIONS FOR FIRST  
9 HOME PURCHASES.—Distributions which  
10 are qualified first-time homebuyer distribu-  
11 tions (as defined in paragraph (6)).

12 “(6) QUALIFIED FIRST-TIME HOMEBUYER DIS-  
13 TRIBUTIONS.—

14 “(A) IN GENERAL.—‘Qualified first-time  
15 homebuyer distribution’ means any payment or  
16 distribution received by an individual to the ex-  
17 tent such payment or distribution is used by the  
18 individual before the close of the 120th day  
19 after the day on which such payment or dis-  
20 tribution is received to pay qualified acquisition  
21 costs with respect to a principal residence of a  
22 first-time homebuyer who is such individual, the  
23 spouse of such individual, or any child, grand-  
24 child, or ancestor of such individual or the indi-  
25 vidual’s spouse.

1           “(B) LIFETIME DOLLAR LIMITATION.—

2           The aggregate amount of payments or distribu-  
3           tions received by an individual which may be  
4           treated as qualified first-time homebuyer dis-  
5           tributions for any taxable year shall not exceed  
6           the excess (if any) of—

7                   “(i) \$10,000, over

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

12           “(C) QUALIFIED ACQUISITION COSTS.—

13           ‘Qualified acquisition costs’ means the costs of  
14           acquiring, constructing, or reconstructing a res-  
15           idence. Such term includes any usual or reason-  
16           able settlement, financing, or other closing  
17           costs.

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

21                   “(i) FIRST-TIME HOMEBUYER.—

22                   ‘First-time homebuyer’ means any indi-  
23                   vidual if such individual (and if married,  
24                   such individual’s spouse) had no present  
25                   ownership interest in a principal residence

1                   during the 2-year period ending on the  
2                   date of acquisition of the principal resi-  
3                   dence to which this paragraph applies, and

4                   “(ii) DATE OF ACQUISITION.—‘Date  
5                   of acquisition’ means the date—

6                   “(I) on which a binding contract  
7                   to acquire the principal residence to  
8                   which subparagraph (A) applies is en-  
9                   tered into, or

10                   “(II) on which construction or re-  
11                   construction of such a principal resi-  
12                   dence is commenced.

13                   “(E) SPECIAL RULE WHERE DELAY IN AC-  
14                   QUISITION.—The Secretary shall prescribe rules  
15                   under which a distribution will not be penalized  
16                   if made in anticipation of being a qualified  
17                   first-time homeowner distribution but construc-  
18                   tion delays or other unanticipated factors delay  
19                   the closing.

20                   “(e) QUALIFIED ROLLOVER CONTRIBUTION.—For  
21                   purposes of this section, the term qualified rollover con-  
22                   tribution means a rollover contribution to a Roth IRA  
23                   from another such account, or from an individual retire-  
24                   ment plan, but only if such rollover contribution meets the  
25                   requirements of section 408(d)(3). For purposes of section

1 408(d)(3)(B), there shall be disregarded any qualified roll-  
2 over contribution from an individual retirement plan  
3 (other than a Roth IRA) to a Roth IRA.

4 “(f) PERMITTED INVESTMENTS.—

5 “(1) INVESTMENT PERMITTED.—A Roth IRA  
6 shall not cease to be an individual retirement ac-  
7 count pursuant to section 408(e)(2) solely because  
8 funds from such account are used to make a debt  
9 or equity investment in a controlled business entity.

10 “(2) LOANS TO A CONTROLLED BUSINESS ENTI-  
11 TY.—

12 “(A) EXCESS RETURN.—If funds in a  
13 Roth IRA are loaned to a controlled business  
14 entity, any return on such loans in excess of a  
15 fair return shall be treated as gross income of  
16 the beneficiary that is then deposited in the  
17 Roth IRA.

18 “(B) LOAN.—For purposes of this section,  
19 an amount shall be treated as loaned to a con-  
20 trolled business entity only if—

21 “(i) the amount is treated in the  
22 books and records of the business entity as  
23 a loan,

1           “(ii) the transaction is reflected in a  
2           written note or other evidence of indebted-  
3           ness, and

4           “(iii) the business entity is required to  
5           pay interest at least once per year and at  
6           the time such loan is made it is reasonable  
7           to expect that such interest will be paid on  
8           a timely basis.

9           “(C) FAIR RETURN.—For purposes of this  
10          subsection, a ‘fair return’ with respect to a loan  
11          is interest at a rate not in excess of 3 percent-  
12          age points plus the minimum rate of interest  
13          that would have to be charged with respect to  
14          such loan to prevent it from being a below-mar-  
15          ket loan for purposes of section 7872 (deter-  
16          mined as if section 7872 applied to such loan).

17          “(3) EQUITY INVESTMENT IN A CONTROLLED  
18          BUSINESS ENTITY.—If funds in a Roth IRA are con-  
19          tributed to the capital of, applied to acquire stock or  
20          other equity interest in, or otherwise transferred to,  
21          a controlled business entity in a transaction that is  
22          not considered a loan for purposes of this sub-  
23          section, any return on such equity shall be treated  
24          as gross income of the beneficiary that is then de-

1       posited in the Roth IRA. The preceding sentence  
2       shall not apply to—

3               “(A) the proceeds of the sale of such eq-  
4               uity interest to a third party, or

5               “(B) the proceeds received by the Roth  
6               IRA as the result of a complete redemption of  
7               the beneficiary’s interest in the business entity  
8               (including any interests held through a Roth  
9               IRA).

10              “(4) CONTROLLED BUSINESS ENTITY.—‘Con-  
11              trolled business entity’ means any business entity in  
12              which the beneficiary of the Roth IRA holds at least  
13              a 5 percent interest in the profits and losses (after  
14              taking into account the investment through the Roth  
15              IRA) and in which an investment would cause the  
16              Roth IRA to cease to be an individual retirement  
17              account by reason of section 408(e)(2) but for this  
18              subsection.

19              “(5) APPLICATION OF SECTION 4975.—Section  
20              4975 shall not apply to a loan or equity investment  
21              by a Roth IRA in a controlled business entity.

22              “(6) TAX AND PENALTY AVOIDANCE.—The Sec-  
23              retary shall prescribe regulations that prohibit the  
24              provisions of this subsection to be used to cir-  
25              cumvent the application of subsection (d)(2) (relat-

1       ing to taxable distributions). The regulations shall  
2       not prohibit bona fide investments in controlled busi-  
3       ness entities. The regulations shall address loans to  
4       and investments in a controlled business entity that  
5       are used to fund distributions or dividends from the  
6       business entity to the account beneficiary or a mem-  
7       ber of the beneficiary’s family.

8       **“SEC. 31. DEDUCTIBLE IRAS.**

9       “**(a) ALLOWANCE OF DEDUCTION.**—The ‘qualified  
10      IRA deduction’ shall be an amount equal to the qualified  
11      retirement contributions of the individual for the taxable  
12      year, except as limited by subsection (b).

13      “**(b) MAXIMUM AMOUNT OF DEDUCTION.**—

14              “(1) **IN GENERAL.**—The amount allowable as a  
15      deduction under subsection (a) to any individual for  
16      any taxable year shall not exceed the lesser of—

17                      “(A) \$2,000, or

18                      “(B) an amount equal to the compensation  
19      includible in the individual’s gross income for  
20      such taxable year.

21              “(2) **SPECIAL RULE FOR EMPLOYER CONTRIBU-**  
22      **TIONS UNDER SIMPLIFIED EMPLOYEE PENSIONS.**—  
23      This section shall not apply with respect to an em-  
24      ployer contribution to a simplified employee pension.

1           “(3) GRANDFATHERED PLANS.—Notwith-  
2 standing paragraph (1), the amount allowable as a  
3 deduction under subsection (a) with respect to any  
4 contributions on behalf of an employee to a plan de-  
5 scribed in section 501(c)(18) of the Internal Rev-  
6 enue Code of 1986 shall not exceed the lesser of—

7                   “(A) \$7,000, or

8                   “(B) an amount equal to 25 percent of the  
9 compensation (as defined in section 415(c)(3))  
10 includible in the individual’s gross income for  
11 such taxable year.

12           “(4) SPECIAL RULE FOR SIMPLE RETIREMENT  
13 ACCOUNTS.—This section shall not apply with re-  
14 spect to any amount contributed to a simple retire-  
15 ment account established under section 408(p).

16           “(c) SPECIAL RULES FOR CERTAIN MARRIED INDI-  
17 VIDUALS.—

18           “(1) IN GENERAL.—In the case of an individual  
19 to whom this paragraph applies for the taxable year,  
20 the limitation of paragraph (1) of subsection (b)  
21 shall be equal to the lesser of—

22                   “(A) the dollar amount in effect under  
23 subsection (b)(1)(A) for the taxable year, or

24                   “(B) the sum of—

1           “(i) the compensation includible in  
2           such individual’s gross income for the tax-  
3           able year, plus

4           “(ii) the compensation includible in  
5           the gross income of such individual’s  
6           spouse for the taxable year reduced by—

7                   “(I) the amount allowed as a de-  
8                   duction under subsection (a) to such  
9                   spouse for such taxable year, and

10                   “(II) the amount of any contribu-  
11                   tion on behalf of such spouse to a  
12                   Roth IRA under section 30 for such  
13                   taxable year.

14           “(2) INDIVIDUALS TO WHOM PARAGRAPH (1)  
15           APPLIES.—Paragraph (1) shall apply to any indi-  
16           vidual if—

17                   “(A) such individual files a joint return for  
18                   the taxable year, and

19                   “(B) the amount of compensation (if any)  
20                   includible in such individual’s gross income for  
21                   the taxable year is less than the compensation  
22                   includible in the gross income of such individ-  
23                   ual’s spouse for the taxable year.

24           “(d) OTHER LIMITATIONS AND RESTRICTIONS.—

1           “(1) BENEFICIARY MUST BE UNDER AGE  
2           70½.—No deduction shall be allowed under this sec-  
3           tion with respect to any qualified retirement con-  
4           tribution for the benefit of an individual if such indi-  
5           vidual has attained age 70½ before the close of such  
6           individual’s taxable year for which the contribution  
7           was made.

8           “(2) RECONTRIBUTED AMOUNTS.—No deduc-  
9           tion shall be allowed under this section with respect  
10          to a rollover contribution described in section 402(c),  
11          403(a)(4), 403(b)(8), or 408(d)(3).

12          “(3) AMOUNTS CONTRIBUTED UNDER ENDOW-  
13          MENT CONTRACT.—In the case of an endowment  
14          contract described in section 408(b), no deduction  
15          shall be allowed under this section for that portion  
16          of the amounts paid under the contract for the tax-  
17          able year which is properly allocable, under regula-  
18          tions prescribed by the Secretary, to the cost of life  
19          insurance.

20          “(4) DENIAL OF DEDUCTION FOR AMOUNT  
21          CONTRIBUTED TO INHERITED ANNUITIES OR AC-  
22          COUNTS.—No deduction shall be allowed under this  
23          section with respect to any amount paid to an inher-  
24          ited individual retirement account or individual re-

1       tirement annuity (within the meaning of section  
2       408(d)(3)(C)(ii)).

3       “(e) QUALIFIED RETIREMENT CONTRIBUTION.—For  
4 purposes of this section, the term ‘qualified retirement  
5 contribution’ means—

6           “(1) any amount paid in cash for the taxable  
7 year by or on behalf of an individual to an individual  
8 retirement plan for such individual’s benefit, and

9           “(2) any amount contributed on behalf of any  
10 individual to a plan described in section 501(c)(18)  
11 of the Internal Revenue Code of 1986.

12       “(f) OTHER DEFINITIONS AND SPECIAL RULES.—

13           “(1) COMPENSATION.—For purposes of this  
14 section, the term ‘compensation’ includes earned in-  
15 come (as defined in section 401(c)(2)). The term  
16 ‘compensation’ does not include any amount received  
17 as a pension or annuity and does not include any  
18 amount received as deferred compensation. The term  
19 ‘compensation’ shall include any alimony, child sup-  
20 port and separate maintenance payments includible  
21 in the individual’s gross income with respect to a di-  
22 vorce or separation instrument. For purposes of this  
23 paragraph, section 401(c)(2) shall be applied as if  
24 the term trade or business for purposes of section  
25 1402 included service described in subsection (c)(6).

1           “(2) MARRIED INDIVIDUALS.—The maximum  
2 deduction under subsection (b) shall be computed  
3 separately for each individual, and this section shall  
4 be applied without regard to any community prop-  
5 erty laws.

6           “(3) TIME WHEN CONTRIBUTIONS DEEMED  
7 MADE.—For purposes of this section, a taxpayer  
8 shall be deemed to have made a contribution to an  
9 individual retirement plan during a year if the con-  
10 tribution is made on account of such year and is  
11 made not later than April 15 of the following year.

12           “(4) REPORTS.—The Secretary shall prescribe  
13 regulations which prescribe the time and the manner  
14 in which reports to the Secretary and plan partici-  
15 pants shall be made by the plan administrator of a  
16 qualified employer or government plan receiving  
17 qualified voluntary employee contributions.

18           “(5) EMPLOYER PAYMENTS.—For purposes of  
19 this title, any amount paid by an employer to an in-  
20 dividual retirement plan shall be treated as payment  
21 of compensation to the employee (other than a self-  
22 employed individual who is an employee within the  
23 meaning of section 401(c)(1)) includible in his gross  
24 income in the taxable year for which the amount was  
25 contributed, whether or not a deduction for such

1 payment is allowable under this section to the em-  
2 ployee.

3 “(6) EXCESS CONTRIBUTIONS TREATED AS  
4 CONTRIBUTION MADE DURING SUBSEQUENT YEAR  
5 FOR WHICH THERE IS AN UNUSED LIMITATION.—

6 “(A) IN GENERAL.—If for the taxable year  
7 the maximum amount allowable as a deduction  
8 under this section for contributions to an indi-  
9 vidual retirement plan exceeds the amount con-  
10 tributed, then the taxpayer shall be treated as  
11 having made an additional contribution for the  
12 taxable year in an amount equal to the lesser  
13 of—

14 “(i) the amount of such excess, or

15 “(ii) the amount of the excess con-  
16 tributions for such taxable year (deter-  
17 mined under section 4973(b)(2) without  
18 regard to subparagraph (C) thereof).

19 “(B) AMOUNT CONTRIBUTED.—For pur-  
20 poses of this paragraph, the amount  
21 contributed—

22 “(i) shall be determined without re-  
23 gard to this paragraph, and

24 “(ii) shall not include any rollover  
25 contribution.

1           “(C) SPECIAL RULE WHERE EXCESS DE-  
2           DUCTION WAS ALLOWED FOR CLOSED YEAR.—  
3           Proper reduction shall be made in the amount  
4           allowable as a deduction by reason of this para-  
5           graph for any amount allowed as a deduction  
6           under this section for a prior taxable year for  
7           which the period for assessing deficiency has ex-  
8           pired if the amount so allowed exceeds the  
9           amount which should have been allowed for  
10          such prior taxable year.

11          “(7) ELECTION NOT TO DEDUCT CONTRIBU-  
12          TIONS.—For election not to deduct contributions to  
13          individual retirement plans, see section  
14          408(o)(2)(B)(ii).

15          “(g) LIMITATION ON DEDUCTION FOR ACTIVE PAR-  
16          TICIPANTS IN CERTAIN PENSION PLANS.—

17                 “(1) IN GENERAL.—If (for any part of any plan  
18                 year ending with or within a taxable year) an indi-  
19                 vidual is an active participant, each of the dollar  
20                 limitations contained in subsections (b)(1)(A) and  
21                 (c)(1)(A) for such taxable year shall be reduced (but  
22                 not below zero) by the amount determined under  
23                 paragraph (2).

24                 “(2) AMOUNT OF REDUCTION.—

1           “(A) IN GENERAL.—The amount deter-  
2           mined under this paragraph with respect to any  
3           dollar limitation shall be the amount which  
4           bears the same ratio to such limitation as—

5                   “(i) the excess of—

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

9                           “(II) the applicable dollar  
10                          amount, bears to

11                          “(ii) \$10,000 (\$20,000 in the case of  
12                          a joint return for a taxable year beginning  
13                          after December 31, 2009).

14           “(B) NO REDUCTION BELOW \$200 UNTIL  
15           COMPLETE PHASE-OUT.—No dollar limitation  
16           shall be reduced below \$200 under paragraph  
17           (1) unless (without regard to this subpara-  
18           graph) such limitation is reduced to zero.

19           “(C) ROUNDING.—Any amount determined  
20           under this paragraph which is not a multiple of  
21           \$10 shall be rounded to the next lowest \$10.

22           “(3) ADJUSTED GROSS INCOME; APPLICABLE  
23           DOLLAR AMOUNT.—For purposes of this  
24           subsection—

1                   “(A) ADJUSTED GROSS INCOME.—Ad-  
 2                   justed gross income of any taxpayer shall be de-  
 3                   termined without regard to the qualified IRA  
 4                   deduction.

5                   “(B) APPLICABLE DOLLAR AMOUNT.—The  
 6                   term ‘applicable dollar amount’ means the fol-  
 7                   lowing:

8                   “(i) In the case of a taxpayer filing a  
 9                   joint return:

<b>“For taxable years beginning in:</b>	<b>“The applicable dollar amount is:</b>
2002 .....	\$51,000
2003 .....	\$52,000
2004 .....	\$53,000
2005 .....	\$54,000
2006 .....	\$60,000
2007 .....	\$65,000
2008 .....	\$70,000
2009 .....	\$75,000
2010 and thereafter .....	\$80,000.

10                   “(ii) In the case of any other taxpayer  
 11                   (other than a married individual filing a  
 12                   separate return):

<b>For taxable years beginning in:</b>	<b>The applicable dollar amount is:</b>
2002 .....	\$31,000
2003 .....	\$32,000
2004 .....	\$33,000
2005 .....	\$34,000
2006 .....	\$40,000
2007 .....	\$45,000
2008 and thereafter .....	\$50,000.

13                   “(iii) In the case of a married indi-  
 14                   vidual filing a separate return, zero.

1           “(4) SPECIAL RULE FOR MARRIED INDIVIDUALS  
2 FILING SEPARATELY AND LIVING APART.—A hus-  
3 band and wife who—

4           “(A) file separate returns for any taxable  
5 year, and

6           “(B) live apart at all times during such  
7 taxable year, shall not be treated as married in-  
8 dividuals for purposes of this subsection.

9           “(5) ACTIVE PARTICIPANT.—For purposes of  
10 this subsection, the term ‘active participant’ means,  
11 with respect to any plan year, an individual—

12           “(A) who is an active participant in—

13           “(i) a plan described in section 401(a)  
14 which includes a trust exempt from tax,

15           “(ii) an annuity plan described in sec-  
16 tion 403(a),

17           “(iii) a plan established for its em-  
18 ployees by the United States, by a State or  
19 political subdivision thereof, or by an agen-  
20 cy or instrumentality of any of the fore-  
21 going,

22           “(iv) an annuity contract described in  
23 section 403(b),

24           “(v) a simplified employee pension  
25 (within the meaning of section 408(k)), or

1                   “(vi) any simple retirement account  
2                   (within the meaning of section 408(p), or  
3                   “(B) who makes deductible contributions  
4                   to a trust described in section 501(e)(18).

5                   The determination of whether an individual is an ac-  
6                   tive participant shall be made without regard to  
7                   whether or not such individual’s rights under a plan,  
8                   trust, or contract are nonforfeitable. An eligible de-  
9                   ferred compensation plan (within the meaning of  
10                  section 457(b) of the Internal Revenue Code of  
11                  1986) shall not be treated as a plan described in  
12                  subparagraph (A)(iii).

13                  “(6) CERTAIN INDIVIDUALS NOT TREATED AS  
14                  ACTIVE PARTICIPANTS.—For purposes of this sub-  
15                  section, any individual described in any of the fol-  
16                  lowing subparagraphs shall not be treated as an ac-  
17                  tive participant for any taxable year solely because  
18                  of any participation so described:

19                  “(A) MEMBERS OF RESERVE COMPO-  
20                  NENTS.—Participation in a plan described in  
21                  subparagraph (A)(iii) of paragraph (5) by rea-  
22                  son of service as a member of a reserve compo-  
23                  nent of the Armed Forces (as defined in section  
24                  10101 of title 10, unless such individual has  
25                  served in excess of 90 days on active duty

1 (other than active duty for training) during the  
2 year.

3 “(B) VOLUNTEER FIREFIGHTERS.—A vol-  
4 unteer firefighter—

5 “(i) who is a participant in a plan de-  
6 scribed in subparagraph (A)(iii) of para-  
7 graph (5) based on his activity as a volun-  
8 teer firefighter, and

9 “(ii) whose accrued benefit as of the  
10 beginning of the taxable year is not more  
11 than an annual benefit of \$1,800 (when  
12 expressed as a single life annuity com-  
13 mencing at age 65).

14 “(7) SPECIAL RULE FOR CERTAIN SPOUSES.—  
15 In the case of an individual who is an active partici-  
16 pant at no time during any plan year ending with  
17 or within the taxable year but whose spouse is an  
18 active participant for any part of any such plan  
19 year—

20 “(A) the applicable dollar amount under  
21 paragraph (3)(B)(i) with respect to the tax-  
22 payer shall be \$150,000, and

23 “(B) the amount applicable under para-  
24 graph (2)(A)(ii) shall be \$10,000.

1       “(h) CROSS REFERENCE.—For failure to provide re-  
2       quired reports, see section 6652(g).

3       **“SEC. 32. EFFECT OF REPEAL OF SPECIAL SAVINGS PROVI-  
4       SIONS.**

5       “(a) EDUCATION IRA’S.—

6               “(1) IN GENERAL.—An account that qualifies  
7       as an education IRA under the Internal Revenue  
8       Code of 1986 as in effect immediately before adop-  
9       tion of the Simplified USA Tax Act shall be treated  
10      as a Roth IRA for purposes of this chapter (includ-  
11      ing rules allowing for tax-free rollover).

12              “(2) NO NEW CONTRIBUTIONS.—Neither para-  
13      graph (1) nor section 530 of the Internal Revenue  
14      Code of 1986 shall apply to an education IRA to  
15      which contributions are made after December 31,  
16      2001.

17              “(3) SPECIAL RULE.—For purposes of applying  
18      section 30 to an account that was an educational  
19      IRA, the designated beneficiary of such account  
20      shall be treated as described in a subclause of clause  
21      (vi) of section 30(d)(5).

22      “(b) MEDICAL SAVINGS ACCOUNTS.—

23              “(1) EQUIVALENT OF DEDUCTIBLE IRA.—A  
24      medical savings account shall be treated as an indi-

1       vidual retirement plan other than a Roth IRA for  
2       purposes of this chapter and chapter 3.

3           “(2) SPECIAL ROLLOVER RULES.—

4               “(A) NO INCOME LIMIT.—The income lim-  
5               its of section 30(c)(3)(B) shall not apply to the  
6               rollover of a medical savings account into a  
7               Roth IRA.

8               “(B) MEDICAL DISTRIBUTIONS.—For pur-  
9               poses of applying section 30 to the amount of  
10              any medical savings account rolled over to a  
11              Roth IRA, subclause (iii) of section 30(d)(5)  
12              shall apply without regard to the limitation  
13              based on adjusted gross income.

14           “(3) MEDICAL SAVINGS ACCOUNT.—‘Medical  
15           savings account’ means an account established under  
16           section 220 of the Internal Revenue Code of 1986.

17           “(c) QUALIFIED STATE TUITION PROGRAMS.—

18               “(1) EDUCATION SAVINGS ACCOUNT PRO-  
19               GRAMS.—No account shall fail to qualify as a Roth  
20               IRA merely because in addition to the beneficiary of  
21               the account, there is a ‘designated beneficiary’ whose  
22               education expenses the beneficiary expects to pay or  
23               have paid with the proceeds of the account. The pay-  
24               ment of such expenses with the proceeds of an ac-

1 count shall be treated as a distribution from the ac-  
2 count.

3 “(2) PREPAID TUITION CERTIFICATES.—

4 “(A) CONTRIBUTION TO ACCOUNTS.—An  
5 individual may contribute prepaid tuition cer-  
6 tificates to a Roth IRA before January 1, 2005,  
7 without recognizing gross income on the con-  
8 tribution of such certificates. For purposes of  
9 section 30, the amount contributed shall equal  
10 the cost of the certificates.

11 “(B) PURCHASE OF PREPAID TUITION  
12 CERTIFICATES.—A Roth IRA account may pur-  
13 chase prepaid tuition certificates without vio-  
14 lating section 408.

15 “(C) PREPAID TUITION CERTIFICATES.—  
16 ‘Prepaid tuition certificates’ means credits or  
17 certificates that entitle a designated beneficiary  
18 of such certificates to the waiver or payment of  
19 qualified higher education expenses of the des-  
20 ignated beneficiary.

21 “(3) ROLLOVER OF ACCOUNTS.—An account to  
22 which section 529 of the Internal Revenue Code of  
23 1986 (before adoption of the Simplified USA Tax  
24 Act) shall be treated as a Roth IRA for purposes of  
25 rules relating to qualified rollovers (except that in

1 the case of any such rollover, any contributions  
2 made to the section 529 account after July 1, 2001,  
3 shall be treated as contributions to the Roth IRA in  
4 the year of the rollover for purposes of section  
5 30(c)(2)).

6 “(4) TRANSITION.—

7 “(A) TRANSITION PERIOD.—Subsections  
8 (a) and (c) of section 529 of the Internal Rev-  
9 enue Code of 1986 shall apply until January 1,  
10 2005.

11 “(B) TRANSITION.—The Secretary shall  
12 prescribe rules to facilitate use of the Roth IRA  
13 rules to exempt earnings on accounts and cer-  
14 tificates previously exempted under section 529  
15 of the Internal Revenue Code of 1986.

16 “(5) QUALIFIED HIGHER EDUCATION EX-  
17 PENSES.—For purposes of this subsection, the defi-  
18 nition ‘qualified higher education expenses’ in sec-  
19 tion 529(e)(3) of the Internal Revenue Code of 1986  
20 shall apply.

21 **“SEC. 33. ANNUITIES, CERTAIN PROCEEDS OF ENDOWMENT**  
22 **AND LIFE INSURANCE CONTRACTS.**

23 “(a) GENERAL RULE FOR ANNUITIES.—Except as  
24 otherwise provided in this chapter, gross income includes  
25 any amount received as an annuity (whether for a period

1 certain or during one or more lives) under an annuity, en-  
2 dowment, or life insurance contract.

3 “(b) EXCLUSION RATIO.—

4 “(1) IN GENERAL.—Gross income does not in-  
5 clude that part of any amount received as an annu-  
6 ity under an annuity, endowment, or life insurance  
7 contract which bears the same ratio to such amount  
8 as the investment in the contract (as of the annuity  
9 starting date) bears to the expected return under the  
10 contract (as of such date).

11 “(2) EXCLUSION LIMITED TO INVESTMENT.—

12 The portion of any amount received as an annuity  
13 which is excluded from gross income under para-  
14 graph (1) shall not exceed the unrecovered invest-  
15 ment in the contract immediately before the receipt  
16 of such amount.

17 “(3) DEDUCTION WHERE ANNUITY PAYMENTS  
18 CEASE BEFORE ENTIRE INVESTMENT RECOVERED.—

19 “(A) IN GENERAL.—If—

20 “(i) after the annuity starting date,  
21 payments as an annuity under the contract  
22 cease by reason of the death of an annu-  
23 itant, and

1                   “(ii) as of the date of such cessation,  
2                   there is unrecovered investment in the con-  
3                   tract,  
4                   the amount of such unrecovered investment (in  
5                   excess of any amount specified in subsection  
6                   (e)(5) which was not included in gross income)  
7                   shall be allowed as a deduction from adjusted  
8                   gross income in determining taxable income of  
9                   the annuitant for his last taxable year.

10                   “(B) PAYMENTS TO OTHER PERSONS.—In  
11                   the case of any contract which provides for pay-  
12                   ments meeting the requirements of subpara-  
13                   graphs (B) and (C) of subsection (c)(2), the de-  
14                   duction under subparagraph (A) shall be al-  
15                   lowed to the person entitled to such payments  
16                   for the taxable year in which such payments are  
17                   received.

18                   “(c) DEFINITIONS.—

19                   “(1) INVESTMENT IN THE CONTRACT.—For  
20                   purposes of subsection (b), the investment in the  
21                   contract as of the annuity starting date is—

22                   “(A) the aggregate amount of premiums or  
23                   other consideration paid for the contract (in-  
24                   cluding any amounts earned on the contract

1           which were included in gross income and rein-  
2           vested in the contract), minus

3           “(B) the aggregate amount received under  
4           the contract before such date, to the extent that  
5           such amount was excludable from gross income  
6           under this subtitle or prior income tax laws.

7           “(2) OTHER TERMS USED IN SUBSECTION  
8           (b).—Calculations under subsections (a) and (b)  
9           shall be made in accordance with regulations pre-  
10          scribed by the Secretary, which regulations shall  
11          generally be consistent with the section 72 of the In-  
12          ternal Revenue Code of 1986.

13          “(d) SPECIAL RULES FOR QUALIFIED EMPLOYER  
14          RETIREMENT PLANS.—

15                 “(1) SIMPLIFIED METHOD OF TAXING ANNUITY  
16          PAYMENTS.—

17                 “(A) IN GENERAL.—In the case of any  
18                 amount received as an annuity under a quali-  
19                 fied employer retirement plan—

20                         “(i) subsection (b) shall not apply,  
21                         and

22                         “(ii) the investment in the contract  
23                         shall be recovered as provided in this para-  
24                         graph.

1           “(B) METHOD OF RECOVERING INVEST-  
2           MENT IN CONTRACT.—

3           “(i) IN GENERAL.—Gross income  
4           shall not include so much of any monthly  
5           annuity payment under a qualified em-  
6           ployer retirement plan as does not exceed  
7           the amount obtained by dividing—

8                       “(I) the investment in the con-  
9                       tract (as of the annuity starting date),  
10                      by

11                     “(II) the number of anticipated  
12                     payments determined under the table  
13                     contained in clause (iii) (or, in the  
14                     case of a contract to which subsection  
15                     (c)(3)(B) applies, the number of  
16                     monthly annuity payments under such  
17                     contract).

18           “(ii) CERTAIN RULES MADE APPLICA-  
19           BLE.—Rules similar to the rules of para-  
20           graphs (2) and (3) of subsection (b) shall  
21           apply for purposes of this paragraph.

22           “(iii) NUMBER OF ANTICIPATED PAY-  
23           MENTS.—If the annuity is payable over the  
24           life of a single individual, the number of

1                    anticipated payments shall be determined  
 2                    as follows:

<b>If the age of the annuitant on the annuity starting date is:</b>	<b>The number:</b>
Not more than 55 .....	360
More than 55 but not more than 60.	310
More than 60 but not more than 65.	260
More than 65 but not more than 70.	210
More than 70 .....	160

3                    “(iv) NUMBER OF ANTICIPATED PAY-  
 4                    MENTS WHERE MORE THAN ONE LIFE.—If  
 5                    the annuity is payable over the lives of  
 6                    more than 1 individual, the number of an-  
 7                    ticipated payments shall be determined as  
 8                    follows:

<b>If the combined ages of the annuitants are:</b>	<b>The number:</b>
Not more than 110 .....	410
More than 110 but not more than 120.	360
More than 120 but not more than 130.	310
More than 130 but not more than 140.	260
More than 140 .....	210

9                    “(C) SPECIAL RULE WHERE LUMP SUM  
 10                    PAID IN CONNECTION WITH COMMENCEMENT  
 11                    OF ANNUITY PAYMENTS.—If, in connection with  
 12                    the commencement of annuity payments under  
 13                    any qualified employer retirement plan, the tax-  
 14                    payer receives a lump sum payment—

1           “(i) such payment shall be taxable  
2           under subsection (e) as if received before  
3           the annuity starting date, and

4           “(ii) the investment in the contract  
5           for purposes of this paragraph shall be de-  
6           termined as if such payment had been so  
7           received.

8           “(D) EXCEPTION.—This paragraph shall  
9           not apply in any case where the primary annu-  
10          tant has attained age 75 on the annuity start-  
11          ing date unless there are fewer than 5 years of  
12          guaranteed payments under the annuity.

13          “(E) ADJUSTMENT WHERE ANNUITY PAY-  
14          MENTS NOT ON A MONTHLY BASIS.—In any  
15          case where the annuity payments are not made  
16          on a monthly basis, appropriate adjustments in  
17          the application of this paragraph shall be made  
18          to take into account the period on the basis of  
19          which such payments are made.

20          “(F) QUALIFIED EMPLOYER RETIREMENT  
21          PLAN.—For purposes of this paragraph, the  
22          term ‘qualified employer retirement plan’ means  
23          any plan or contract described in paragraph  
24          (1), (2), or (3) of section 4974(c).

1           “(2) TREATMENT OF EMPLOYEE CONTRIBU-  
2           TIONS UNDER DEFINED CONTRIBUTION PLANS.—  
3           For purposes of this section, employee contributions  
4           (and any income allocable thereto) under a defined  
5           contribution plan may be treated as a separate con-  
6           tract.

7           “(e) AMOUNTS NOT RECEIVED AS ANNUITIES.—

8           “(1) APPLICATION OF SUBSECTION.—

9           “(A) IN GENERAL.—This subsection shall  
10          apply to any amount which—

11                   “(i) is received under an annuity, en-  
12                   dowment, or life insurance contract, and

13                   “(ii) is not received as an annuity,  
14          if no provision of this subtitle (other than this  
15          subsection) applies with respect to such  
16          amount.

17           “(B) DIVIDENDS.—For purposes of this  
18          section, any amount received which is in the na-  
19          ture of a dividend or similar distribution shall  
20          be treated as an amount not received as an an-  
21          nuity.

22           “(2) GENERAL RULE.—Any amount to which  
23          this subsection applies—

1           “(A) if received on or after the annuity  
2 starting date, shall be included in gross income,  
3 or

4           “(B) if received before the annuity starting  
5 date—

6                   “(i) shall be included in gross income  
7 to the extent allocable to income on the  
8 contract, and

9                   “(ii) shall not be included in gross in-  
10 come to the extent allocable to the invest-  
11 ment in the contract.

12           “(3) ALLOCATION OF AMOUNTS TO INCOME  
13 AND INVESTMENT.—For purposes of paragraph  
14 (2)(B):

15           “(A) Any amount to which this subsection  
16 applies shall be treated as allocable to income  
17 on the contract to the extent that such amount  
18 does not exceed the excess (if any) of—

19                   “(i) the cash value of the contract  
20 (determined without regard to any sur-  
21 render charge) immediately before the  
22 amount is received, over

23                   “(ii) the investment in the contract at  
24 such time.

1           “(B) Any amount to which this subsection  
2 applies shall be treated as allocable to invest-  
3 ment in the contract to the extent that such  
4 amount is not allocated to income under sub-  
5 paragraph (A).

6           “(4) SPECIAL RULES FOR APPLICATION OF  
7 PARAGRAPH (2)(B).—For purposes of paragraph  
8 (2)(B):

9           “(A) LOANS TREATED AS DISTRIBUTIONS.—If, during any taxable year, an  
10 individual—  
11 individual—

12           “(i) receives (directly or indirectly)  
13 any amount as a loan under any contract  
14 to which this subsection applies, or

15           “(ii) assigns or pledges (or agrees to  
16 assign or pledge) any portion of the value  
17 of any such contract,

18 such amount or portion shall be treated as re-  
19 ceived under the contract as an amount not re-  
20 ceived as an annuity. The preceding sentence  
21 shall not apply for purposes of determining in-  
22 vestment in the contract, except that the invest-  
23 ment in the contract shall be increased by any  
24 amount included in gross income by reason of

1 the amount treated as received under the pre-  
2 ceding sentence.

3 “(B) TREATMENT OF TRANSFERS WITH-  
4 OUT ADEQUATE CONSIDERATION.—

5 “(i) IN GENERAL.—If an individual  
6 who holds an annuity contract transfers it  
7 without full and adequate consideration,  
8 such individual shall be treated as receiv-  
9 ing an amount equal to the excess of—

10 “(I) the cash surrender value of  
11 such contract at the time of transfer,  
12 over

13 “(II) the investment in such con-  
14 tract at such time,  
15 under the contract as an amount not re-  
16 ceived as an annuity.

17 “(ii) EXCEPTION FOR CERTAIN  
18 TRANSFERS BETWEEN SPOUSES OR  
19 FORMER SPOUSES.—Clause (i) shall not  
20 apply to any transfer to which section  
21 77(c) (relating to transfers of property be-  
22 tween spouses or incident to divorce) ap-  
23 plies.

24 “(iii) ADJUSTMENT TO INVESTMENT  
25 IN CONTRACT OF TRANSFEREE.—If under

1 clause (i) an amount is included in the  
2 gross income of the transferor of an annu-  
3 ity contract, the investment in the contract  
4 of the transferee in such contract shall be  
5 increased by the amount so included.

6 “(5) RETENTION OF EXISTING RULES IN CER-  
7 TAIN CASES.—Paragraph (5) of section 72(e) of the  
8 Internal Revenue Code of 1986 shall apply to con-  
9 tracts described in subparagraph (B) of such para-  
10 graph to the extent provided therein.

11 “(6) INVESTMENT IN THE CONTRACT.—For  
12 purposes of this subsection, the investment in the  
13 contract as of any date is—

14 “(A) the aggregate amount of premiums or  
15 other consideration paid for the contract before  
16 such date, minus

17 “(B) the aggregate amount received under  
18 the contract before such date, to the extent that  
19 such amount was excludable from gross income  
20 under this subtitle or prior income tax laws.

21 “(7) APPLICATION OF PARAGRAPH (2)(B) TO  
22 QUALIFIED PLANS.—

23 “(A) IN GENERAL.—Notwithstanding any  
24 other provision of this subsection, in the case of  
25 any amount received before the annuity starting

1 date from a trust or contract described in para-  
2 graph (5)(D), paragraph (2)(B) shall apply to  
3 such amounts.

4 “(B) ALLOCATION OF AMOUNT RE-  
5 CEIVED.—For purposes of paragraph (2)(B),  
6 the amount allocated to the investment in the  
7 contract shall be the portion of the amount de-  
8 scribed in subparagraph (A) which bears the  
9 same ratio to such amount as the investment in  
10 the contract bears to the account balance. The  
11 determination under the preceding sentence  
12 shall be made as of the time of the distribution  
13 or at such other time as the Secretary may pre-  
14 scribe.

15 “(C) TREATMENT OF FORFEITABLE  
16 RIGHTS.—If an employee does not have a non-  
17 forfeitable right to any amount under any trust  
18 or contract to which subparagraph (A) applies,  
19 such amount shall not be treated as part of the  
20 account balance.

21 “(D) INVESTMENT IN THE CONTRACT BE-  
22 FORE 1987.—In the case of a plan which on  
23 May 5, 1986, permitted withdrawal of any em-  
24 ployee contributions before separation from  
25 service, subparagraph (A) shall apply only to

1 the extent that amounts received before the an-  
2 nuity starting date (when increased by amounts  
3 previously received under the contract after De-  
4 cember 31, 1986) exceed the investment in the  
5 contract as of December 31, 1986.

6 “(8) TREATMENT OF MODIFIED ENDOWMENT  
7 CONTRACTS.—

8 “(A) IN GENERAL.—Notwithstanding para-  
9 graph (5)(C), in the case of any modified en-  
10 dowment contract (as defined in section  
11 7702A)—

12 “(i) paragraphs (2)(B) and (4)(A)  
13 shall apply, and

14 “(ii) in applying paragraph (4)(A),  
15 ‘any person’ shall be substituted for ‘an in-  
16 dividual’.

17 “(B) TREATMENT OF CERTAIN BURIAL  
18 CONTRACTS.—Notwithstanding subparagraph  
19 (A), paragraph (4)(A) shall not apply to any as-  
20 signment (or pledge) of a modified endowment  
21 contract if such assignment (or pledge) is solely  
22 to cover the payment of expenses referred to in  
23 section 7702(e)(2)(C)(iii) and if the maximum  
24 death benefit under such contract does not ex-  
25 ceed \$25,000.

1 “(9) ANTI-ABUSE RULES.—

2 “(A) IN GENERAL.—For purposes of deter-  
3 mining the amount includible in gross income  
4 under this subsection—

5 “(i) all modified endowment contracts  
6 issued by the same company to the same  
7 policyholder during any calendar year shall  
8 be treated as 1 modified endowment con-  
9 tract, and

10 “(ii) all annuity contracts issued by  
11 the same company to the same policyholder  
12 during any calendar year shall be treated  
13 as 1 annuity contract.

14 The preceding sentence shall not apply to any  
15 contract described in paragraph (5)(D).

16 “(B) REGULATORY AUTHORITY.—The Sec-  
17 retary may by regulations prescribe such addi-  
18 tional rules as may be necessary or appropriate  
19 to prevent avoidance of the purposes of this  
20 subsection through serial purchases of contracts  
21 or otherwise.

22 “(f) SPECIAL RULES FOR COMPUTING EMPLOYEES’  
23 CONTRIBUTIONS.—In computing, for purposes of sub-  
24 section (c)(1)(A), the aggregate amount of premiums or  
25 other consideration paid for the contract, and for purposes

1 of subsection (e)(6), the aggregate premiums or other con-  
2 sideration paid, amounts contributed by the employer shall  
3 be included, but only to the extent that—

4           “(1) such amounts were includible in the gross  
5 income of the employee under this subtitle or prior  
6 income tax laws; or

7           “(2) if such amounts had been paid directly to  
8 the employee at the time they were contributed, they  
9 would not have been includible in the gross income  
10 of the employee under the law applicable at the time  
11 of such contribution.

12       “(g) RULES FOR TRANSFEREE WHERE TRANSFER  
13 WAS FOR VALUE.—Where any contract (or any interest  
14 therein) is transferred (by assignment or otherwise) for  
15 a valuable consideration, to the extent that the contract  
16 (or interest therein) does not, in the hands of the trans-  
17 feree, have a basis which is determined by reference to  
18 the basis in the hands of the transferor, then—

19           “(1) for purposes of this section, only the ac-  
20 tual value of such consideration, plus the amount of  
21 the premiums and other consideration paid by the  
22 transferee after the transfer, shall be taken into ac-  
23 count in computing the aggregate amount of the  
24 premiums or other consideration paid for the con-  
25 tract;

1           “(2) for purposes of subsection (c)(1)(B), there  
2 shall be taken into account only the aggregate  
3 amount received under the contract by the trans-  
4 feree before the annuity starting date, to the extent  
5 that such amount was excludable from gross income  
6 under this subtitle or prior income tax laws; and

7           “(3) the annuity starting date is January 1,  
8 1954, or the first day of the first period for which  
9 the transferee received an amount under the con-  
10 tract as an annuity, whichever is the later.

11       “(h) OPTION TO RECEIVE ANNUITY IN LIEU OF  
12 LUMP SUM.—If—

13           “(1) a contract provides for payment of a lump  
14 sum in full discharge of an obligation under the con-  
15 tract, subject to an option to receive an annuity in  
16 lieu of such lump sum;

17           “(2) the option is exercised within 60 days after  
18 the day on which such lump sum first became pay-  
19 able; and

20           “(3) part or all of such lump sum would (but  
21 for this subsection) be includible in gross income by  
22 reason of subsection (e)(1),

23 then, for purposes of this subtitle, no part of such lump  
24 sum shall be considered as includible in gross income at  
25 the time such lump sum first became payable.

1       “(i) INTEREST.—Notwithstanding any other provi-  
2 sion of this section, if any amount is held under an agree-  
3 ment to pay interest thereon, the interest payments shall  
4 be included in gross income.

5       “(j) FACE-AMOUNT CERTIFICATES.—For purposes of  
6 this section, the term ‘endowment contract’ includes a  
7 face-amount certificate, as defined in section 2(a)(15) of  
8 the Investment Company Act of 1940 (15 U.S.C., sec.  
9 80a-2), issued after December 31, 1954.

10       “(k) SPECIAL RULES APPLICABLE TO EMPLOYEE  
11 ANNUITIES AND DISTRIBUTIONS UNDER EMPLOYEE  
12 PLANS.—

13               “(1) COMPUTATION OF CONSIDERATION PAID  
14 BY THE EMPLOYEE.—In computing—

15                       “(A) the aggregate amount of premiums or  
16 other consideration paid for the contract for  
17 purposes of subsection (c)(1)(A) (relating to the  
18 investment in the contract), and

19                       “(B) the aggregate premiums or other con-  
20 sideration paid for purposes of subsection (e)(6)  
21 (relating to certain amounts not received as an  
22 annuity),

23 any amount allowed as a deduction with respect to  
24 the contract under section 404 which was paid while  
25 the employee was an employee within the meaning of

1 section 401(c)(1) shall be treated as consideration  
2 contributed by the employer, and there shall not be  
3 taken into account any portion of the premiums or  
4 other consideration for the contract paid while the  
5 employee was an owner-employee which is properly  
6 allocable (as determined under regulations pre-  
7 scribed by the Secretary) to the cost of life, accident,  
8 health, or other insurance.

9 “(2) LIFE INSURANCE CONTRACTS.—

10 “(A) This paragraph shall apply to any life  
11 insurance contract—

12 “(i) purchased as a part of a plan de-  
13 scribed in section 403(a), or

14 “(ii) purchased by a trust described in  
15 section 401(a) which is exempt from tax if  
16 the proceeds of such contract are payable  
17 directly or indirectly to a participant in  
18 such trust or to a beneficiary of such par-  
19 ticipant.

20 “(B) Any contribution to a plan described  
21 in subparagraph (A)(i) or a trust described in  
22 subparagraph (A)(ii) which is allowed as a de-  
23 duction under section 404, and any income of  
24 a trust described in subparagraph (A)(ii), which  
25 is determined in accordance with regulations

1 prescribed by the Secretary to have been ap-  
2 plied to purchase the life insurance protection  
3 under a contract described in subparagraph  
4 (A), is includible in the gross income of the par-  
5 ticipant for the taxable year when so applied.

6 “(C) In the case of the death of an indi-  
7 vidual insured under a contract described in  
8 subparagraph (A), an amount equal to the cash  
9 surrender value of the contract immediately be-  
10 fore the death of the insured shall be treated as  
11 a payment under such plan or a distribution by  
12 such trust, and the excess of the amount pay-  
13 able by reason of the death of the insured over  
14 such cash surrender value shall not be includ-  
15 ible in gross income under this section and shall  
16 be treated as provided in section 101.

17 “(3) PENALTIES APPLICABLE TO CERTAIN  
18 AMOUNTS RECEIVED BY 5-PERCENT OWNERS.—

19 “(A) This paragraph applies to amounts  
20 which are received from a qualified trust de-  
21 scribed in section 401(a) or under a plan de-  
22 scribed in section 403(a) at any time by an in-  
23 dividual who is, or has been, a 5-percent owner,  
24 or by a successor of such an individual, but only  
25 to the extent such amounts are determined,

1 under regulations prescribed by the Secretary,  
2 to exceed the benefits provided for such indi-  
3 vidual under the plan formula.

4 “(B) If a person receives an amount to  
5 which this paragraph applies, his tax under this  
6 chapter for the taxable year in which such  
7 amount is received shall be increased by an  
8 amount equal to 10 percent of the portion of  
9 the amount so received which is includible in  
10 his gross income for such taxable year.

11 “(C) For purposes of this paragraph, the  
12 term ‘5-percent owner’ means any individual  
13 who, at any time during the 5 plan years pre-  
14 ceeding the plan year ending in the taxable year  
15 in which the amount is received, is a 5-percent  
16 owner (as defined in section 416(i)(1)(B)).

17 “(4) OWNER-EMPLOYEE DEFINED.—For pur-  
18 poses of this subsection, the term ‘owner-employee’  
19 has the meaning assigned to it by section 401(c)(3)  
20 and includes an individual for whose benefit an indi-  
21 vidual retirement account or annuity described in  
22 section 408(a) or (b) is maintained. For purposes of  
23 the preceding sentence, the term ‘owner-employee’  
24 shall include an employee within the meaning of sec-  
25 tion 401(c)(1).

1           “(5) MEANING OF DISABLED.—For purposes of  
2 this section, an individual shall be considered to be  
3 disabled if he is unable to engage in any substantial  
4 gainful activity by reason of any medically deter-  
5 minable physical or mental impairment which can be  
6 expected to result in death or to be of long-continued  
7 and indefinite duration. An individual shall not be  
8 considered to be disabled unless he furnishes proof  
9 of the existence thereof in such form and manner  
10 as the Secretary may require.

11           “(6) DETERMINATION OF INVESTMENT IN THE  
12 CONTRACT IN THE CASE OF QUALIFIED DOMESTIC  
13 RELATIONS ORDERS.—Under regulations prescribed  
14 by the Secretary, in the case of a distribution or  
15 payment made to an alternate payee who is the  
16 spouse or former spouse of the participant pursuant  
17 to a qualified domestic relations order (as defined in  
18 section 414(p)), the investment in the contract as of  
19 the date prescribed in such regulations shall be allo-  
20 cated on a pro rata basis between the present value  
21 of such distribution or payment and the present  
22 value of all other benefits payable with respect to the  
23 participant to which such order relates.

24           “(1) ANNUITIES UNDER RETIRED SERVICEMAN’S  
25 FAMILY PROTECTION PLAN OR SURVIVOR BENEFIT

1 PLAN.—Subsection (b) shall not apply in the case of  
2 amounts received after December 31, 1965, as an annuity  
3 under chapter 73 of title 10 of the United States Code,  
4 but all such amounts shall be excluded from gross income  
5 until there has been so excluded (under section 122(b)(1)  
6 of the Internal Revenue Code of 1986, section 93, or this  
7 section, including amounts excluded before January 1,  
8 1966) an amount equal to the consideration for the con-  
9 tract (as defined by section 122(b)(2) of the Internal Rev-  
10 enue Code of 1986). Thereafter all amounts so received  
11 shall be included in gross income.

12 “(m) SPECIAL RULES FOR DISTRIBUTIONS FROM  
13 QUALIFIED PLANS TO WHICH EMPLOYEE MADE DE-  
14 DUCTIBLE CONTRIBUTIONS.—

15 “(1) TREATMENT OF CONTRIBUTIONS.—For  
16 purposes of this section and sections 402 and 403,  
17 notwithstanding section 414(h), any deductible em-  
18 ployee contribution made to a qualified employer  
19 plan or government plan shall be treated as an  
20 amount contributed by the employer which is not in-  
21 cludible in the gross income of the employee.

22 “(2) AMOUNTS CONSTRUCTIVELY RECEIVED.—

23 “(A) IN GENERAL.—For purposes of this  
24 subsection, rules similar to the rules provided

1 by subsection (n) (other than the exception con-  
2 tained in paragraph (2) thereof) shall apply.

3 “(B) PURCHASE OF LIFE INSURANCE.—To  
4 the extent any amount of accumulated deduct-  
5 ible employee contributions of an employee are  
6 applied to the purchase of life insurance con-  
7 tracts, such amount shall be treated as distrib-  
8 uted to the employee in the year so applied.

9 “(3) SPECIAL RULE FOR TREATMENT OF ROLL-  
10 OVER AMOUNTS.—For purposes of sections 402(c),  
11 403(a)(4), and 408(d)(3), the Secretary shall pre-  
12 scribe regulations providing for such allocations of  
13 amounts attributable to accumulated deductible em-  
14 ployee contributions, and for such other rules, as  
15 may be necessary to insure that such accumulated  
16 deductible employee contributions do not become eli-  
17 gible for additional tax benefits (or freed from limi-  
18 tations) through the use of rollovers.

19 “(4) ORDERING RULES.—Unless the plan speci-  
20 fies otherwise, any distribution from such plan shall  
21 not be treated as being made from the accumulated  
22 deductible employee contributions, until all other  
23 amounts to the credit of the employee have been dis-  
24 tributed.

1       “(n) LOANS TREATED AS DISTRIBUTIONS.—For pur-  
2 poses of this section—

3           “(1) TREATMENT AS DISTRIBUTIONS.—

4               “(A) LOANS.—If during any taxable year a  
5 participant or beneficiary receives (directly or  
6 indirectly) any amount as a loan from a quali-  
7 fied employer plan, such amount shall be treat-  
8 ed as having been received by such individual as  
9 a distribution under such plan.

10           “(B) ASSIGNMENTS OR PLEDGES.—If dur-  
11 ing any taxable year a participant or beneficiary  
12 assigns (or agrees to assign) or pledges (or  
13 agrees to pledge) any portion of his interest in  
14 a qualified employer plan, such portion shall be  
15 treated as having been received by such indi-  
16 vidual as a loan from such plan.

17           “(2) EXCEPTION FOR CERTAIN LOANS.—

18               “(A) GENERAL RULE.—Paragraph (1)  
19 shall not apply to any loan to the extent that  
20 such loan (when added to the outstanding bal-  
21 ance of all other loans from such plan whether  
22 made on, before, or after August 13, 1982),  
23 does not exceed the lesser of—

24                   “(i) \$50,000, reduced by the excess (if  
25 any) of—

1           “(I) the highest outstanding bal-  
2           ance of loans from the plan during the  
3           1-year period ending on the day be-  
4           fore the date on which such loan was  
5           made, over

6           “(II) the outstanding balance of  
7           loans from the plan on the date on  
8           which such loan was made, or

9           “(ii) the greater of (I) one-half of the  
10          present value of the nonforfeitable accrued  
11          benefit of the employee under the plan, or  
12          (II) \$10,000.

13          for purposes of clause (ii), the present value of  
14          the nonforfeitable accrued benefit shall be de-  
15          termined without regard to any accumulated  
16          deductible employee contributions (as defined in  
17          subsection (m)(5)(B)).

18          “(B) REQUIREMENT THAT LOAN BE RE-  
19          PAYABLE WITHIN 5 YEARS.—

20          “(i) IN GENERAL.—Subparagraph (A)  
21          shall not apply to any loan unless such  
22          loan, by its terms, is required to be repaid  
23          within 5 years.

24          “(ii) EXCEPTION FOR HOME LOANS.—  
25          Clause (i) shall not apply to any loan used

1 to acquire any dwelling unit which within  
2 a reasonable time is to be used (deter-  
3 mined at the time the loan is made) as the  
4 principal residence of the participant.

5 “(C) REQUIREMENT OF LEVEL AMORTIZA-  
6 TION.—Except as provided in regulations, this  
7 paragraph shall not apply to any loan unless  
8 substantially level amortization of such loan  
9 (with payments not less frequently than quar-  
10 terly) is required over the term of the loan.

11 “(D) RELATED EMPLOYERS AND RELATED  
12 PLANS.—For purposes of this paragraph—

13 “(i) the rules of subsections (b), (c),  
14 and (m) of section 414 shall apply, and

15 “(ii) all plans of an employer (deter-  
16 mined after the application of such sub-  
17 sections) shall be treated as 1 plan.

18 “(o) 10-PERCENT PENALTY FOR PREMATURE DIS-  
19 TRIBUTIONS FROM ANNUITY CONTRACTS.—

20 “(1) IMPOSITION OF PENALTY.—If any tax-  
21 payer receives any amount under an annuity con-  
22 tract, the taxpayer’s tax under this chapter for the  
23 taxable year in which such amount is received shall  
24 be increased by an amount equal to 10 percent of

1 the portion of such amount which is includible in  
2 gross income.

3 “(2) SUBSECTION NOT TO APPLY TO CERTAIN  
4 DISTRIBUTIONS.—Paragraph (1) shall not apply to  
5 any distribution—

6 “(A) made on or after the date on which  
7 the taxpayer attains age 59½,

8 “(B) made on or after the death of the  
9 holder (or, where the holder is not an indi-  
10 vidual, the death of the primary annuitant),

11 “(C) attributable to the taxpayer’s becom-  
12 ing disabled within the meaning of subsection  
13 (k)(5),

14 “(D) which is a part of a series of substan-  
15 tially equal periodic payments (not less fre-  
16 quently than annually) made for the life (or life  
17 expectancy) of the taxpayer or the joint lives  
18 (or joint life expectancies) of such taxpayer and  
19 his designated beneficiary,

20 “(E) from a plan, contract, account, trust,  
21 or annuity described in section 72(e)(5)(D) of  
22 the Internal Revenue Code of 1986,

23 “(F) allocable to investment in the con-  
24 tract before August 14, 1982,

25 “(G) under a qualified funding asset,

1           “(H) to which subsection (r) applies (with-  
2           out regard to paragraph (2) thereof),

3           “(I) under an immediate annuity contract,  
4           or

5           “(J) which is purchased by an employer  
6           upon the termination of a plan described in sec-  
7           tion 401(a) or 403(a) and which is held by the  
8           employer until such time as the employee sepa-  
9           rates from service.

10          “(3) CHANGE IN SUBSTANTIALLY EQUAL PAY-  
11          MENTS.—If—

12           “(A) paragraph (1) does not apply to a  
13           distribution by reason of paragraph (2)(D), and

14           “(B) the series of payments under such  
15           paragraph are subsequently modified (other  
16           than by reason of death or disability)—

17           “(i) before the close of the 5-year pe-  
18           riod beginning on the date of the first pay-  
19           ment and after the taxpayer attains age  
20           59½, or

21           “(ii) before the taxpayer attains age  
22           59½,

23           the taxpayer’s tax for the 1st taxable year in which  
24           such modification occurs shall be increased by an  
25           amount, determined under regulations, equal to the

1 tax which (but for paragraph (2)(D)) would have  
2 been imposed, plus interest for the deferral period  
3 (within the meaning of subsection (r)(4)(B)).

4 “(p) CERTAIN RAILROAD RETIREMENT BENEFITS  
5 TREATED AS RECEIVED UNDER EMPLOYER PLANS.—

6 “(1) IN GENERAL.—Notwithstanding any other  
7 provision of law, any benefit provided under the  
8 Railroad Retirement Act of 1974 (other than a tier  
9 1 railroad retirement benefit) shall be treated for  
10 purposes of this title as a benefit provided under an  
11 employer plan which meets the requirements of sec-  
12 tion 401(a).

13 “(2) TIER 2 TAXES TREATED AS CONTRIBU-  
14 TIONS.—For purposes of paragraph (1)—

15 “(i) the tier 2 portion of the tax im-  
16 posed by section 3201 (relating to tax on  
17 employees) shall be treated as an employee  
18 contribution,

19 “(ii) the tier 2 portion of the tax im-  
20 posed by section 3211 (relating to tax on  
21 employee representatives) shall be treated  
22 as an employee contribution, and

23 “(iii) the tier 2 portion of the tax im-  
24 posed by section 3221 (relating to tax on

1           employers) shall be treated as an employer  
2           contribution.

3           “(B) TIER 2 PORTION.—For purposes of  
4           subparagraph (A)—

5           “(1) AFTER 1984.—With respect to compensa-  
6           tion paid after 1984, the tier 2 portion shall be the  
7           taxes imposed by sections 3201(b), 3211(a)(2), and  
8           3221(b).

9           “(2) BEFORE 1985.—With respect to compensa-  
10          tion paid before 1985, see section 72(r) of Internal  
11          Revenue Code of 1986 for the definition of tier 2  
12          portion.

13          “(C) CONTRIBUTIONS NOT ALLOCABLE TO  
14          SUPPLEMENTAL ANNUITY OR WINDFALL BENE-  
15          FITS.—For purposes of paragraph (1), no  
16          amount treated as an employee contribution  
17          under this paragraph shall be allocated to—

18                 “(i) any supplemental annuity paid  
19                 under section 2(b) of the Railroad Retire-  
20                 ment Act of 1974, or

21                 “(ii) any benefit paid under section  
22                 3(h), 4(e), or 4(h) of such Act.

23          “(3) TIER 1 RAILROAD RETIREMENT BEN-  
24          EFIT.—For purposes of paragraph (1), the term

1 ‘tier 1 railroad retirement benefit’ has the meaning  
2 given such term by section 3(b)(2)(B).

3 “(q) REQUIRED DISTRIBUTIONS WHERE HOLDER  
4 DIES BEFORE ENTIRE INTEREST IS DISTRIBUTED.—

5 “(1) IN GENERAL.—A contract shall not be  
6 treated as an annuity contract for purposes of this  
7 chapter unless it provides that—

8 “(A) if any holder of such contract dies on  
9 or after the annuity starting date and before  
10 the entire interest in such contract has been  
11 distributed, the remaining portion of such inter-  
12 est will be distributed at least as rapidly as  
13 under the method of distributions being used as  
14 of the date of his death, and

15 “(B) if any holder of such contract dies be-  
16 fore the annuity starting date, the entire inter-  
17 est in such contract will be distributed within 5  
18 years after the death of such holder.

19 “(2) EXCEPTION FOR CERTAIN AMOUNTS PAY-  
20 ABLE OVER LIFE OF BENEFICIARY.—If—

21 “(A) any portion of the holder’s interest is  
22 payable to (or for the benefit of) a designated  
23 beneficiary,

24 “(B) such portion will be distributed (in  
25 accordance with regulations) over the life of

1 such designated beneficiary (or over a period  
2 not extending beyond the life expectancy of  
3 such beneficiary), and

4 “(C) such distributions begin not later  
5 than 1 year after the date of the holder’s death  
6 or such later date as the Secretary may by reg-  
7 ulations prescribe,

8 then for purposes of paragraph (1), the portion re-  
9 ferred to in subparagraph (A) shall be treated as  
10 distributed on the day on which such distributions  
11 begin.

12 “(3) SPECIAL RULE WHERE SURVIVING SPOUSE  
13 BENEFICIARY.—If the designated beneficiary re-  
14 ferred to in paragraph (2)(A) is the surviving spouse  
15 of the holder of the contract, paragraphs (1) and (2)  
16 shall be applied by treating such spouse as the hold-  
17 er of such contract.

18 “(4) DESIGNATED BENEFICIARY.—For pur-  
19 poses of this subsection, the term ‘designated bene-  
20 ficiary’ means any individual designated a bene-  
21 ficiary by the holder of the contract.

22 “(5) EXCEPTION FOR CERTAIN ANNUITY CON-  
23 TRACTS.—This subsection shall not apply to any an-  
24 nuity contract—

25 “(A) which is provided—

1           “(i) under a plan described in section  
2           401(a) which includes a trust exempt from  
3           tax under section 501, or

4           “(ii) under a plan described in section  
5           403(a),

6           “(B) which is described in section 403(b),

7           “(C) which is an individual retirement an-  
8           nuity or provided under an individual retire-  
9           ment account or annuity, or

10          “(D) which is a qualified funding asset.

11          “(6) SPECIAL RULE WHERE HOLDER IS COR-  
12          PORATION OR OTHER NON-INDIVIDUAL.—

13           “(A) IN GENERAL.—For purposes of this  
14           subsection, if the holder of the contract is not  
15           an individual, the primary annuitant shall be  
16           treated as the holder of the contract.

17           “(B) PRIMARY ANNUITANT.—For purposes  
18           of subparagraph (A), the term ‘primary annu-  
19           itant’ means the individual, the events in the  
20           life of whom are of primary importance in af-  
21           fecting the timing or amount of the payout  
22           under the contract.

23          “(7) TREATMENT OF CHANGES IN PRIMARY AN-  
24          NUITANT WHERE HOLDER OF CONTRACT IS NOT AN  
25          INDIVIDUAL.—For purposes of this subsection, in

1 the case of a holder of an annuity contract which  
2 is not an individual, if there is a change in a pri-  
3 mary annuitant (as defined in paragraph (6)(B)),  
4 such change shall be treated as the death of the  
5 holder.

6 “(r) 10-PERCENT ADDITIONAL TAX ON EARLY DIS-  
7 TRIBUTIONS FROM QUALIFIED RETIREMENT PLANS.—

8 “(1) IMPOSITION OF ADDITIONAL TAX.—If any  
9 taxpayer receives any amount from a qualified re-  
10 tirement plan (as defined in section 4974(c)), the  
11 taxpayer’s tax under this chapter for the taxable  
12 year in which such amount is received shall be in-  
13 creased by an amount equal to 10 percent of the  
14 portion of such amount which is includible in gross  
15 income.

16 “(2) SUBSECTION NOT TO APPLY TO CERTAIN  
17 DISTRIBUTIONS.—Except as provided in paragraphs  
18 (3) and (4), paragraph (1) shall not apply to any of  
19 the following distributions:

20 “(A) IN GENERAL.—Distributions which  
21 are—

22 “(i) made on or after the date on  
23 which the employee attains age 59½,

1           “(ii) made to a beneficiary (or to the  
2           estate of the employee) on or after the  
3           death of the employee,

4           “(iii) attributable to the employee’s  
5           being disabled within the meaning of sub-  
6           section 72(m)(7) of the Internal Revenue  
7           Code of 1986,

8           “(iv) part of a series of substantially  
9           equal periodic payments (not less fre-  
10          quently than annually) made for the life  
11          (or life expectancy) of the employee or the  
12          joint lives (or joint life expectancies) of  
13          such employee and his designated bene-  
14          ficiary,

15          “(v) made to an employee after sepa-  
16          ration from service after attainment of age  
17          55,

18          “(vi) dividends paid with respect to  
19          stock of a corporation which are described  
20          in section 404(k), or

21          “(vii) made from a Roth IRA (other  
22          than a distribution described in section  
23          30(d)(2)).

24          “(B) MEDICAL EXPENSES.—Distributions  
25          made to the employee (other than distributions

1 described in subparagraph (A), (C), or (D)) to  
2 the extent such distributions do not exceed the  
3 amount allowable as a deduction under section  
4 31 to the employee for amounts paid during the  
5 taxable year for medical care (determined with-  
6 out regard to whether the employee itemizes de-  
7 ductions for such taxable year).

8 “(C) PAYMENTS TO ALTERNATE PAYEES  
9 PURSUANT TO QUALIFIED DOMESTIC RELA-  
10 TIONS ORDERS.—Any distribution to an alter-  
11 nate payee pursuant to a qualified domestic re-  
12 lations order (within the meaning of section  
13 414(p)(1)).

14 “(D) DISTRIBUTIONS TO UNEMPLOYED IN-  
15 DIVIDUALS FOR HEALTH INSURANCE PRE-  
16 MIUMS.—

17 “(i) IN GENERAL.—Distributions from  
18 an individual retirement plan to an indi-  
19 vidual after separation from employment—

20 “(I) if such individual has re-  
21 ceived unemployment compensation  
22 for 12 consecutive weeks under any  
23 Federal or State unemployment com-  
24 pensation law by reason of such sepa-  
25 ration,

1           “(II) if such distributions are  
2           made during any taxable year during  
3           which such unemployment compensa-  
4           tion is paid or the succeeding taxable  
5           year, and

6           “(III) to the extent such distribu-  
7           tions do not exceed the amount paid  
8           during the taxable year for insurance  
9           described in section 213(d)(1)(D) of  
10          the Internal Revenue Code of 1986  
11          with respect to the individual and the  
12          individual’s spouse and dependents.

13          “(ii) DISTRIBUTIONS AFTER REEM-  
14          PLOYMENT.—Clause (i) shall not apply to  
15          any distribution made after the individual  
16          has been employed for at least 60 days  
17          after the separation from employment to  
18          which clause (i) applies.

19          “(iii) SELF-EMPLOYED INDIVID-  
20          UALS.—To the extent provided in regula-  
21          tions, a self-employed individual shall be  
22          treated as meeting the requirements of  
23          clause (i)(I) if, under Federal or State law,  
24          the individual would have received unem-

1           employment compensation but for the fact the  
2           individual was self-employed.

3           “(E) DISTRIBUTIONS FROM INDIVIDUAL  
4           RETIREMENT PLANS FOR HIGHER EDUCATION  
5           EXPENSES.—Distributions to an individual  
6           from an individual retirement plan to the extent  
7           such distributions do not exceed the qualified  
8           higher education expenses (as defined in para-  
9           graph (7)) of the taxpayer for the taxable year.  
10          Distributions shall not be taken into account  
11          under the preceding sentence if such distribu-  
12          tions are described in subparagraph (A), (C), or  
13          (D) or to the extent paragraph (1) does not  
14          apply to such distributions by reason of sub-  
15          paragraph (B).

16          “(F) DISTRIBUTIONS FROM CERTAIN  
17          PLANS FOR FIRST HOME PURCHASES.—Dis-  
18          tributions to an individual from an individual  
19          retirement plan which are qualified first-time  
20          homebuyer distributions (as defined in para-  
21          graph (8)). Distributions shall not be taken into  
22          account under the preceding sentence if such  
23          distributions are described in subparagraph (A),  
24          (C), (D), or (E) or to the extent paragraph (1)

1 does not apply to such distributions by reason  
2 of subparagraph (B).

3 “(3) LIMITATIONS.—

4 “(A) CERTAIN EXCEPTIONS NOT TO APPLY  
5 TO INDIVIDUAL RETIREMENT PLANS.—Sub-  
6 paragraphs (A)(v), and (C) of paragraph (2)  
7 shall not apply to distributions from an indi-  
8 vidual retirement plan.

9 “(B) PERIODIC PAYMENTS UNDER QUALI-  
10 FIED PLANS MUST BEGIN AFTER SEPARA-  
11 TION.—Paragraph (2)(A)(iv) shall not apply to  
12 any amount paid from a trust described in sec-  
13 tion 401(a) which is exempt from tax under  
14 section 501(a) or from a contract described in  
15 section 72(e)(5)(D)(ii) of the Internal Revenue  
16 Code of 1986 unless the series of payments be-  
17 gins after the employee separates from service.

18 “(4) CHANGE IN SUBSTANTIALLY EQUAL PAY-  
19 MENTS.—

20 “(A) IN GENERAL.—If—

21 “(i) paragraph (1) does not apply to  
22 a distribution by reason of paragraph  
23 (2)(A)(iv), and

24 “(ii) the series of payments under  
25 such paragraph are subsequently modified

1 (other than by reason of death or dis-  
2 ability)—

3 “(I) before the close of the 5-year  
4 period beginning with the date of the  
5 first payment and after the employee  
6 attains age 59½, or

7 “(II) before the employee attains  
8 age 59½, the taxpayer’s tax for the  
9 1st taxable year in which such modi-  
10 fication occurs shall be increased by  
11 an amount, determined under regula-  
12 tions, equal to the tax which (but for  
13 paragraph (2)(A)(iv)) would have  
14 been imposed, plus interest for the de-  
15 ferral period.

16 “(B) DEFERRAL PERIOD.—For purposes  
17 of this paragraph, the term ‘deferral period’  
18 means the period beginning with the taxable  
19 year in which (without regard to paragraph  
20 (2)(A)(iv)) the distribution would have been in-  
21 cludible in gross income and ending with the  
22 taxable year in which the modification described  
23 in subparagraph (A) occurs.

24 “(5) EMPLOYEE.—For purposes of this sub-  
25 section, the term ‘employee’ includes any partici-

1       pant, and in the case of an individual retirement  
2       plan, the individual for whose benefit such plan was  
3       established.

4               “(6) SPECIAL RULES FOR SIMPLE RETIREMENT  
5       ACCOUNTS.—In the case of any amount received  
6       from a simple retirement account (within the mean-  
7       ing of section 408(p) during the 2-year period begin-  
8       ning on the date such individual first participated in  
9       any qualified salary reduction arrangement main-  
10      tained by the individual’s employer under section  
11      408(p)(2), paragraph (1) shall be applied by sub-  
12      stituting ‘25 percent’ for ‘10 percent’.

13              “(7) QUALIFIED HIGHER EDUCATION EX-  
14      PENSES.—For purposes of paragraph (2)(E)—

15              “(A) IN GENERAL.—The term ‘qualified  
16      higher education expenses’ means qualified  
17      higher education expenses (as defined in section  
18      10(b)(2)) for education furnished to—

19                      “(i) the taxpayer,

20                      “(ii) the taxpayer’s spouse, or

21                      “(iii) any child or grandchild of the  
22      taxpayer or the taxpayer’s spouse, at an el-  
23      igible educational institution (as defined in  
24      section 10(b)(2)(B)).

1           “(B) COORDINATION WITH OTHER PROVI-  
2           SIONS.—For purposes of this subsection, sec-  
3           tion 30 and section 32, qualified higher edu-  
4           cation expenses in any taxable year shall be  
5           treated as first paid with distributions under  
6           section 32, next with distributions to which sec-  
7           tion 30(d)(5)(v) (relating to early withdrawals  
8           from Roth IRAs to pay higher education ex-  
9           penses) applies, and finally from withdrawals to  
10          which this subsection applies.

11          “(8) QUALIFIED FIRST-TIME HOMEBUYER DIS-  
12          TRIBUTIONS.—For purposes of this subsection, the  
13          term ‘qualified first-time homebuyer distribution’  
14          has the meaning given to it in section 30(d)(6) and  
15          the limits contained in such section shall apply on a  
16          combined basis to this subsection and section 30.  
17          Qualified acquisition costs (as defined in section  
18          30(d)(6)) taken into account for purposes of section  
19          30(d)(5)(vi) shall not also be taken into account sep-  
20          arately for purposes of this subsection. A taxpayer  
21          may elect to treat distributions from an account  
22          other than Roth IRAs to which this subsection ap-  
23          plies as a qualified first-time homeowner distribution  
24          before determining whether a distribution from a

1 Roth IRA is a qualified first-time homeowner dis-  
2 tribution.

3 “(r) 10-PERCENT ADDITIONAL TAX FOR TAXABLE  
4 DISTRIBUTIONS FROM MODIFIED ENDOWMENT CON-  
5 TRACTS.—

6 “(1) IMPOSITION OF ADDITIONAL TAX.—If any  
7 taxpayer receives any amount under a modified en-  
8 dowment contract (as defined in section 7702A), the  
9 taxpayer’s tax under this chapter for the taxable  
10 year in which such amount is received shall be in-  
11 creased by an amount equal to 10 percent of the  
12 portion of such amount which is includible in gross  
13 income.

14 “(2) SUBSECTION NOT TO APPLY TO CERTAIN  
15 DISTRIBUTIONS.—Paragraph (1) shall not apply to  
16 any distribution—

17 “(A) made on or after the date on which  
18 the taxpayer attains age 59½,

19 “(B) which is attributable to the tax-  
20 payer’s becoming disabled (within the meaning  
21 of subsection (m)(7)), or

22 “(C) which is part of a series of substan-  
23 tially equal periodic payments (not less fre-  
24 quently than annually) made for the life (or life  
25 expectancy) of the taxpayer or the joint lives

1 (or joint life expectancies) of such taxpayer and  
2 his beneficiary.

3 **“Subchapter C—Basis, Business Transactions**  
4 **and Nonrecognition Transactions**

“Sec. 71. Gain or loss on the sale of an asset.

“Sec. 72. Basis.

“Sec. 73. Basis in business entities.

“Sec. 74. Gratuitous transfers.

“Sec. 75. Transactions involving business entities.

“Sec. 76. Rollover on residence sale.

“Sec. 77. Other nonrecognition transactions.

“Sec. 78. Wash sales and straddles.

5 **“SEC. 71. GAIN OR LOSS ON THE SALE OF AN ASSET.**

6 “(a) IN GENERAL.—Except as otherwise provided in  
7 this chapter, the amount of gross income to be recognized  
8 on the sale, exchange, or other disposition of property  
9 equals the excess of—

10 “(1) the amount realized from the disposition,  
11 over

12 “(2) the taxpayer’s adjusted basis in the prop-  
13 erty.

14 “(b) AMOUNT REALIZED.—The amount realized from  
15 the disposition of property shall be sum of money received  
16 plus the fair market value of the property (other than  
17 money) received. See section 122(c) for the treatment of  
18 installment sales.

19 “(c) NONRECOGNITION TRANSACTION.—Subsection  
20 (a) shall not apply to nonrecognition transactions de-  
21 scribed in this chapter.

1 “(d) CONTRACTS MARKED TO MARKET.—

2 “(1) IN GENERAL.—Under regulations pre-  
3 scribed by the Secretary, a markable contract held  
4 by the taxpayer at the end of the year shall be treat-  
5 ed as sold and reacquired for its fair market value  
6 on the last business day of the taxable year. The  
7 regulations shall adopt principles and definitions  
8 similar to those that applied under section 1256 of  
9 the Internal Revenue Code of 1986.

10 “(2) MARKABLE CONTRACT.—For purposes of  
11 this subsection, ‘markable contract’ means—

12 “(A) any regulated futures contract,

13 “(B) any foreign currency contract,

14 “(C) any nonequity option,

15 “(D) any dealer equity option

16 as such terms were defined for purposes of section  
17 1256 of the Internal Revenue Code of 1986.

18 **“SEC. 72. BASIS.**

19 “(a) BASIS, SALE, OR EXCHANGE.—Except to the ex-  
20 tent inconsistent with provisions of this chapter, adjusted  
21 basis and the existence of a sale or exchange shall be de-  
22 termined in accordance with principles applicable under  
23 the Internal Revenue Code of 1986.

24 “(b) DEFINITION OF BASIS.—For purposes of this  
25 chapter, ‘basis’ means the adjusted basis of property. The

1 adjusted basis of property is generally its cost, as adjusted  
2 for actions or transactions that increase or decrease the  
3 basis of property. Except as provided in section 73 (relat-  
4 ing to business entities and basis in business entities), the  
5 taxpayer's adjusted basis on January 1, 2002, in an asset  
6 acquired before that date, shall be its adjusted basis as  
7 of December 31, 2001, as determined under the Internal  
8 Revenue Code of 1986.

9 **“SEC. 73. BASIS IN BUSINESS ENTITIES.**

10 “(a) RULES FOR ALL BUSINESS ENTITIES.—

11 “(1) IN GENERAL.—A taxpayer's basis in an in-  
12 terest in a business entity shall equal—

13 “(A) the cost of acquiring the interest,

14 “(B) increased by the amount of cash and  
15 basis of any property contributed to the entity,  
16 and

17 “(C) decreased by the portion of any liqui-  
18 dating distributions from the entity that are  
19 treated as returns of capital in accordance with  
20 rules prescribed by the Secretary.

21 “(2) INITIAL BASIS.—Except as otherwise pro-  
22 vided in this section, a taxpayer's basis on January  
23 1, 2002, or any interest in a business entity held as  
24 of December 31, 2001, shall be the basis of such in-

1       terest as of December 31, 2001, as determined  
2       under the Internal Revenue Code of 1986.

3               “(3) CROSS REFERENCES.—See section 75 for  
4       rules relating to the effect of certain business trans-  
5       actions on a taxpayer’s basis.

6               “(4) SPECIAL RULE FOR CONTRIBUTION OF  
7       PERSONAL USE PROPERTY.—If a taxpayer contrib-  
8       utes personal-use property (as defined in section  
9       210(b)(3)(B)), the taxpayer’s basis in the property  
10       shall not be increased by an amount in excess of the  
11       fair market value of the property contributed.

12              “(b) SPECIAL RULES FOR PARTNERSHIP INTER-  
13       ESTS.—

14              “(1) INITIAL BASIS IN OLD PARTNERSHIPS.—A  
15       partner’s basis in a partnership interest as of Janu-  
16       ary 1, 2002, equals—

17                      “(A) the partner’s basis in the partnership  
18                      as of the end of the taxable year ending on De-  
19                      cember 31, 2001, minus

20                      “(B) the amount of the partner’s share of  
21                      the indebtedness of the partnership taken into  
22                      account in determining such basis.

23              “(2) NEGATIVE BASIS.—If the amount deter-  
24       mined under paragraph (1) is negative, the taxpayer  
25       has a negative basis in the partnership and such

1 negative basis shall increase the gain on the sale or  
2 disposition of the partnership interest (except to the  
3 extent such negative basis has been adjusted by rea-  
4 son of capital contributions).

5 “(3) ADJUSTMENT TO BASIS.—Except as other-  
6 wise provided in this section, a partner’s basis in a  
7 partnership interest shall be determined in accord-  
8 ance with the general principles of this chapter ap-  
9 plicable to an individual’s basis in an interest in a  
10 business entity. A partner’s basis in a partnership  
11 shall not be adjusted by reason of any—

12 “(A) distribution from the partnership (ex-  
13 cept to the extent such distribution is treated as  
14 distribution of basis in accordance with the gen-  
15 eral principles of this chapter applicable to an  
16 individual’s basis in an interest in a business  
17 entity),

18 “(B) income, earnings, or loss of the part-  
19 nership, or

20 “(C) any change in the partner’s share of  
21 the partnership’s indebtedness.

22 “(4) SPECIAL RULE FOR TRANSITION DISTRIBU-  
23 TIONS.—

1           “(A) EFFECT OF TRANSITION DISTRIBUTION.—A transition distribution from partnership to a partner shall—

2                           “(i) reduce the partner’s basis in the  
3                           partnership, and

4                           “(ii) not be included in gross income.

5           “(B) DEFINITION.—A ‘transition distribution’ is a distribution by a business entity to an  
6           individual made during the first three months  
7           of 2002 but only to the extent that such distribution, when added to all other distributions  
8           of the entity to the individual after March 31,  
9           2001, does not exceed the amount of taxable income allocated by the entity to the individual  
10          during the taxable year of the entity ending on  
11          December 31, 2001.

12          “(5) PARTNERSHIP.—For purposes of this section, ‘partnership’ includes a limited liability company that was taxable as a partnership under the  
13          Internal Revenue Code of 1986.

14          “(c) SPECIAL RULES FOR SHARES OF S CORPORATIONS.—Rules similar to those contained in subsection (b)  
15          shall apply with respect to the basis of stock of a corporation that was treated as an S corporation under the Internal Revenue Code of 1986.  
16          Internal Revenue Code of 1986.

1 “(d) SPECIAL RULES FOR PROPRIETORSHIPS.—

2 “(1) OLD PROPRIETORSHIP.—A proprietor’s  
3 basis in any business activity conducted before Janu-  
4 ary 1, 2002, which is treated as a business activity  
5 as of such date equals—

6 “(A) the proprietor’s adjusted basis in the  
7 assets of such business entity as of the end of  
8 the taxable year ending on December 31, 2001,  
9 minus

10 “(B) the balance of any indebtedness the  
11 interest on which the proprietor had treated as  
12 business interest under section 163(h)(2)(A) of  
13 the Internal Revenue Code of 1986.

14 “(2) NEGATIVE BASIS.—If the amount deter-  
15 mined under paragraph (1) is negative, the propri-  
16 etor has a negative basis in the proprietorship and  
17 such negative basis shall increase the gain on the  
18 sale or disposition of the entity (except to the extent  
19 such negative basis has been adjusted by reason of  
20 capital contributions).

21 “(3) ADJUSTMENT TO BASIS.—Except as other-  
22 wise provided in this section, a proprietor’s basis in  
23 a proprietorship shall be determined in accordance  
24 with the general principles of this chapter applicable

1 to an individual's basis in an interest in a business  
2 entity.

3 “(4) PROPRIETORSHIP.—‘Proprietorship’  
4 includes—

5 “(A) any family business that is not a  
6 partnership, and

7 “(B) any business activity conducted by a  
8 taxpayer other than as an employee if such ac-  
9 tivity constitutes a business entity.

10 “(e) ANTI-AVOIDANCE RULE.—

11 “(1) IN GENERAL.—If a pass-through entity's  
12 distributions to an individual in its taxable year or  
13 taxable years ending in 2001 exceeds 125 percent of  
14 the individual's distributive share of income for such  
15 period, the amount of such excess distribution shall  
16 be treated as a cash distribution to the partner on  
17 January 1, 2002, and shall not reduce the partner's  
18 basis in his partnership interest.

19 “(2) PASS THROUGH ENTITY.—‘Pass through  
20 entity’ means a partnership, proprietorship, or S  
21 corporation.

22 **“SEC. 74. GRATUITOUS TRANSFERS.**

23 “(a) IN GENERAL.—If after December 31, 2001, a  
24 taxpayer receives any property by gift, inheritance, or

1 other gratuitous transfer, the taxpayer's basis in the prop-  
2 erty shall be the lesser of—

3           “(1) the fair market value of the property at  
4           the time of transfer, or

5           “(2) the transferee's basis in the property at  
6           the time of transfer.

7           “(b) **PROOF REQUIRED.**—A taxpayer's basis in an  
8 asset received by gift, inheritance, or other gratuitous  
9 transfer shall be presumed to be zero unless the taxpayer  
10 can demonstrate to the satisfaction of the Secretary the  
11 basis claimed by the taxpayer.

12 **“SEC. 75. DISTRIBUTIONS FROM BUSINESS ENTITIES.**

13           “(a) **IN GENERAL.**—Except as otherwise provided in  
14 this section or in regulations issued by the Secretary in  
15 accordance with this section—

16           “(1) **CASH DISTRIBUTIONS.**—Distributions of  
17 cash by a business entity with respect to its equity  
18 ownership shall be treated as dividends and included  
19 in gross income.

20           “(2) **DISTRIBUTIONS OF PROPERTY.**—If a busi-  
21 ness entity distributes property (other than stock or  
22 other equity ownership described in paragraph (3) in  
23 connection with a merger, acquisition or reorganiza-  
24 tion), the fair market value of the property received

1 shall be treated as a dividend and included in gross  
2 income.

3 “(3) DISTRIBUTIONS OF STOCK OR OTHER EQ-  
4 UITY OWNERSHIP.—If a taxpayer receives with re-  
5 spect to its ownership interest in a business entity  
6 stock or other ownership interests in such business  
7 entity (as reorganized) or in another business entity  
8 that is controlled by such business entity or is ac-  
9 quiring or merging with such business entity, no  
10 gain or loss shall be recognized on the distribution.

11 “(b) BASIS IN BUSINESS DIVISIONS.—In the case of  
12 a spin-off, split-off, or split-up of a business entity in  
13 which a taxpayer has basis, the taxpayer’s basis in the  
14 original business entity shall be allocated among the new  
15 and surviving entities in accordance with the relative fair  
16 market values of the taxpayer’s interests in those entities.  
17 If interests in the entities are publicly traded, fair market  
18 values shall be based on public trading prices. In other  
19 cases, the Secretary shall accept any reasonable allocation  
20 made by the taxpayer if the taxpayer notifies the Secretary  
21 of the allocation in an attachment to its tax return for  
22 the taxable year of the transaction.

23 “(c) DISTRIBUTIONS CONSTITUTING RETURN OF  
24 BASIS.—

25 “(1) COMPLETE LIQUIDATIONS.—

1           “(A) IN GENERAL.—In the case of a dis-  
2           tribution in complete liquidation of a business  
3           entity, a taxpayer shall be treated as receiving  
4           cash and assets of the entity in exchange for  
5           the taxpayer’s equity in the business entity. In  
6           such case, the taxpayer shall recognize gain to  
7           the extent that the sum of the cash and fair  
8           market value of assets received exceeds the tax-  
9           payer’s basis in its interest in the business enti-  
10          ty or shall recognize loss to the extent that the  
11          basis exceeds the fair market value of cash and  
12          assets received.

13           “(B) DISTRIBUTION OF EQUITY INTER-  
14          ESTS.—In the case of a complete liquidation in  
15          which at least 90 percent of the value of assets  
16          and cash distributed to an equity holder is eq-  
17          uity interests in other business entities con-  
18          trolled by the distributing entity—

19                   “(i) subparagraph (A) shall not apply,

20                   “(ii) paragraph (3) of subsection (a)  
21                   shall apply,

22                   “(iii) the cash and fair market value  
23                   of assets other than equity interests in  
24                   controlled entities shall be applied to re-  
25                   duce the taxpayer’s basis in the distrib-

1           uting entity and gain will be recognized  
2           only to the extent that the cash and such  
3           fair market value exceeds the taxpayer's  
4           basis in the distributing entity, and

5           “(iv) the taxpayer's remaining basis  
6           shall be allocated among the distributed  
7           equity interests in controlled entities in ac-  
8           cordance with the relative fair market val-  
9           ues of such interests.

10           “(C) DISTRIBUTION OF BUSINESS PROP-  
11           PERTY.—Under regulations prescribed by the  
12           Secretary, rules similar to those that applied to  
13           partnerships under the Internal Revenue Code  
14           of 1986 shall apply in lieu of subparagraph (A)  
15           to distributions that include property used in a  
16           trade or business if such property is contributed  
17           to a new business entity within 180 days of the  
18           distribution.

19           “(2) TRANSITION RULES.—See subsections (b)  
20           and (d) of section 73 for transition rules relating to  
21           partnerships and proprietorships.

22           “(c) DEFINITIONS AND SPECIAL RULES.—

23           “(1) CERTAIN RULES OF APPLICATION.—

1           “(A) PRINCIPLES APPLICABLE TO INTER-  
2           NAL REVENUE CODE.—This section shall be ap-  
3           plied without regard to—

4                   “(i) continuity of business interest,

5                   “(ii) continuity of ownership interest,

6                   “(iii) requirements of section 355 of  
7           the Internal Revenue Code of 1986 for  
8           spin-offs, split-offs and split-ups,

9                   “(iv) business purposes for a cor-  
10          porate reorganization or restructuring (ex-  
11          cept if the transaction is potentially abu-  
12          sive), and

13                  “(v) except as provided in paragraph  
14          (3), rules treating dividends as returns of  
15          capital because of the absence of earnings  
16          and profits.

17           “(B) CONSTRUCTIVE RECEIPT.—If a tax-  
18          payer is given the choice of receiving cash or an  
19          equity interest in a business entity, the tax-  
20          payer will be treated for purposes of this sec-  
21          tion as if he received the cash and purchased  
22          the equity interest.

23           “(C) DEBT VERSUS EQUITY.—The prin-  
24          ciples distinguishing debt and equity that ap-  
25          plied prior to the adopt of the Simplified USA

1 Tax generally shall apply for purposes of apply-  
2 ing this section. An investment in a business  
3 entity shall not be considered debt unless—

4 “(i) it is reflected in the books and  
5 records of the business entity as debt, and

6 “(ii) there is written evidence of the  
7 investment that treats such investment as  
8 indebtedness.

9 “(2) CONTROL.—For purposes of this section,  
10 ‘control’ of a business entity means—

11 “(A) ownership of more than 50% of the  
12 voting power held by equity holders of such en-  
13 tity, or

14 “(B) ownership of rights to more than  
15 50% of the periodic distributions that the busi-  
16 ness entity may make to its equity holders and  
17 50% of the distributions if the business entity  
18 were liquidated.

19 “(3) REGULATIONS.—

20 “(A) SIGNIFICANT DOWNSIZING AND PAR-  
21 TIAL LIQUIDATIONS.—The Secretary is author-  
22 ized to issue regulations under which distribu-  
23 tions resulting from a significant downsizing of  
24 a business entity will be treated in part as re-  
25 turn of equity holders’ capital.

1           “(B) ASSUMPTION AND RELEASE OF LI-  
2           ABILITY.—The Secretary shall prescribe regula-  
3           tions addressing the consequences of a  
4           distributee’s assumption of the liabilities of the  
5           distributor.

6   **“SEC. 76. EXCLUSION OF GAIN FROM SALE OF PRINCIPAL**  
7           **RESIDENCE.**

8           “(a) EXCLUSION.—Gross income shall not include  
9           gain from the sale or exchange of property if, during the  
10          5-year period ending on the date of the sale or exchange,  
11          such property has been owned and used by the taxpayer  
12          as the taxpayer’s principal residence for periods aggre-  
13          gating 2 years or more.

14          “(b) LIMITATIONS.—

15                  “(1) IN GENERAL.—The amount of gain ex-  
16                  cluded from gross income under subsection (a) with  
17                  respect to any sale or exchange shall not exceed  
18                  \$250,000.

19                  “(2) \$500,000 LIMITATION FOR CERTAIN JOINT  
20                  RETURNS.—Paragraph (1) shall be applied by sub-  
21                  stituting ‘\$500,000’ for ‘\$250,000’ if—

22                          “(A) a husband and wife make a joint re-  
23                          turn for the taxable year of the sale or ex-  
24                          change of the property,

1           “(B) either spouse meets the ownership re-  
2           quirements of subsection (a) with respect to  
3           such property,

4           “(C) both spouses meet the use require-  
5           ments of subsection (a) with respect to such  
6           property, and

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

10          “(3) APPLICATION TO ONLY 1 SALE OR EX-  
11          CHANGE EVERY 2 YEARS.—

12           “(A) IN GENERAL.—Subsection (a) shall  
13           not apply to any sale or exchange by the tax-  
14           payer if, during the 2-year period ending on the  
15           date of such sale or exchange, there was any  
16           other sale or exchange by the taxpayer to which  
17           subsection (a) applied.

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

22          “(c) EXCLUSION FOR TAXPAYERS FAILING TO MEET  
23          CERTAIN REQUIREMENTS.—

24           “(1) IN GENERAL.—In the case of a sale or ex-  
25           change to which this subsection applies, the owner-

1 ship and use requirements of subsection (a) shall not  
2 apply and subsection (b)(3) shall not apply; but the  
3 amount of gain excluded from gross income under  
4 subsection (a) with respect to such sale or exchange  
5 shall not exceed—

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

10 “(B) the shorter of—

11 “(i) the aggregate periods, during the  
12 5-year period ending on the date of such  
13 sale or exchange, such property has been  
14 owned and used by the taxpayer as the  
15 taxpayer’s principal residence, or

16 “(ii) the period after the date of the  
17 most recent prior sale or exchange by the  
18 taxpayer to which subsection (a) applied  
19 and before the date of such sale or ex-  
20 change,

21 bears to 2 years.

22 “(2) SALES AND EXCHANGES TO WHICH SUB-  
23 SECTION APPLIES.—This subsection shall apply to  
24 any sale or exchange if—

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

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

6                   “(ii) subsection (b)(3), and

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

11       “(d) SPECIAL RULES.—

12           “(1) JOINT RETURNS.—If a husband and wife  
13           make a joint return for the taxable year of the sale  
14           or exchange of the property, subsections (a) and (c)  
15           shall apply if either spouse meets the ownership and  
16           use requirements of subsection (a) with respect to  
17           such property.

18           “(2) PROPERTY OF DECEASED SPOUSE.—For  
19           purposes of this section, in the case of an unmarried  
20           individual whose spouse is deceased on the date of  
21           the sale or exchange of property, the period such un-  
22           married individual owned and used such property  
23           shall include the period such deceased spouse owned  
24           and used such property before death.

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

3           “(A) PROPERTY TRANSFERRED TO INDI-  
4 VIDUAL FROM SPOUSE OR FORMER SPOUSE.—

5           In the case of an individual holding property  
6 transferred to such individual by such individ-  
7 ual’s spouse or former spouse in a transaction  
8 incident to divorce, the period such individual  
9 owns such property shall include the period the  
10 transferor owned the property.

11           “(B) PROPERTY USED BY FORMER SPOUSE  
12 PURSUANT TO DIVORCE DECREE, ETC.—Solely  
13 for purposes of this section, an individual shall  
14 be treated as using property as such individ-  
15 ual’s principal residence during any period of  
16 ownership while such individual’s spouse or  
17 former spouse is granted use of the property  
18 under a divorce or separation instrument.

19           “(4) TENANT-STOCKHOLDER IN COOPERATIVE  
20 HOUSING CORPORATION.—For purposes of this sec-  
21 tion, if the taxpayer holds stock as a tenant-stock-  
22 holder in a cooperative housing corporation—

23           “(A) the holding requirements of sub-  
24 section (a) shall be applied to the holding of  
25 such stock, and

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

5           “(5) INVOLUNTARY CONVERSIONS.—For pur-  
6           poses of this section, the destruction, theft, seizure,  
7           requisition, or condemnation of property shall be  
8           treated as the sale of such property.

9           “(6) DETERMINATION OF USE DURING PERIODS  
10          OF OUT-OF-RESIDENCE CARE.—In the case of a tax-  
11          payer who—

12                 “(A) becomes physically or mentally in-  
13                 capable of self-care, and

14                 “(B) owns property and uses such property  
15                 as the taxpayer’s principal residence during the  
16                 5-year period described in subsection (a) for pe-  
17                 riods aggregating at least 1 year,

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

1           “(7) SALES OF REMAINDER INTERESTS.—For  
2 purposes of this section—

3           “(A) IN GENERAL.—At the election of the  
4 taxpayer, this section shall not fail to apply to  
5 the sale or exchange of an interest in a prin-  
6 cipal residence by reason of such interest being  
7 a remainder interest in such residence, but this  
8 section shall not apply to any other interest in  
9 such residence which is sold or exchanged sepa-  
10 rately.

11           “(B) EXCEPTION FOR SALES TO RELATED  
12 PARTIES.—Subparagraph (A) shall not apply to  
13 any sale to, or exchange with, a related party  
14 (as defined in section 171).

15           “(e) DENIAL OF EXCLUSION FOR EXPATRIATES.—  
16 This section shall not apply to any sale or exchange by  
17 an individual if rules relating to expatriation to avoid tax  
18 apply to such individual.

19           “(f) ELECTION TO HAVE SECTION NOT APPLY.—  
20 This section shall not apply to any sale or exchange with  
21 respect to which the taxpayer elects not to have this sec-  
22 tion apply.

23           “(g) RESIDENCES ACQUIRED IN ROLLOVERS UNDER  
24 SECTION 1034.—For purposes of this section, in the case  
25 of property the acquisition of which by the taxpayer re-

1 sulted under section 1034 of the Internal Revenue Code  
2 of 1986 (as in effect on the day before the date of the  
3 enactment of the Taxpayer Relief Act of 1997) in the non-  
4 recognition of any part of the gain realized on the sale  
5 or exchange of another residence, in determining the pe-  
6 riod for which the taxpayer has owned and used such  
7 property as the taxpayer's principal residence, there shall  
8 be included the aggregate periods for which such other  
9 residence (and each prior residence taken into account in  
10 determining the holding period of such property) had been  
11 so owned and used.

12 **“SEC. 77. OTHER NONRECOGNITION TRANSACTIONS.**

13       “(a) INVOLUNTARY CONVERSIONS.—Under regula-  
14 tions prescribed by the Secretary, the involuntary conver-  
15 sion of property held by an individual shall not result in  
16 gross income to the individual to the extent that the indi-  
17 vidual receives property in exchange for the involuntarily  
18 converted property. To the extent that income is not rec-  
19 ognized under this subsection, the taxpayer's basis in the  
20 converted property shall carry over to the new property.

21       “(b) CERTAIN REACQUISITIONS OF REAL PROP-  
22 erty.—Under regulations prescribed by the Secretary,  
23 gross income shall not be recognized in the case of certain  
24 reacquisitions of real property. The regulations shall adopt

1 principles similar to those under section 1038 of the Inter-  
2 nal Revenue Code of 1986.

3 “(c) TRANSFERS OF PROPERTY BETWEEN SPOUSES  
4 OR INCIDENT TO DIVORCE.—

5 “(1) GENERAL RULE.—Gross income shall not  
6 be recognized on the transfer of property from an  
7 individual to (or in trust for the benefit of)—

8 “(A) a spouse, or

9 “(B) a former spouse, but only if the  
10 transfer is incident to divorce.

11 “(2) TRANSFER TREATED AS A GIFT.—

12 Any transfer described in paragraph (1) shall  
13 be treated as a gift.

14 “(d) CERTAIN EXCHANGES OF INSURANCE POLI-  
15 CIES.—Under regulations prescribed by the Secretary,  
16 gross income shall not be recognized on the exchange of  
17 insurance policies or another life insurance policy or an  
18 annuity contract or the exchange of annuity contracts.  
19 The regulations shall adopt principles similar to those  
20 under section 1035 of the Internal Revenue Code of 1986.

21 “(e) CERTAIN EXCHANGES OF UNITED STATES OB-  
22 LIGATIONS.—When so provided by regulations promul-  
23 gated by the Secretary in connection with the issue of obli-  
24 gations of the United States, no gain or loss shall be rec-  
25 ognized on the surrender to the United States of obliga-

1 tions of the United States issued under chapter 31 of title  
2 31 in exchange solely for other obligations issued under  
3 such chapter.

4 **“SEC. 78. WASH SALES AND STRADDLES.**

5       “(a) LOSSES FROM WASH SALES OF STOCK OR SE-  
6 CURITIES.—Under regulations prescribed by the Sec-  
7 retary, no loss shall be recognized on the wash sale of  
8 stock or securities. The regulations shall adopt principles  
9 similar to those under section 1091 of the Internal Rev-  
10 enue Code of 1986.

11       “(b) STRADDLES.—Under regulations prescribed by  
12 the Secretary, the loss that can be taken into account from  
13 1 or more straddle positions shall be limited. The regula-  
14 tions shall adopt principles similar to those under section  
15 1038 of the Internal Revenue Code of 1986.

16 **“SEC. 79. LIMITATION ON LOSSES FROM CAPITAL TRANS-**  
17 **ACTIONS.**

18       “(a) NO LOSS ON PERSONAL USE PROPERTY.—No  
19 loss shall be recognized on the sale or exchange of personal  
20 use property (as defined in section 210(b)(3)(B)).

21       “(b) LIMITATION ON NET CAPITAL LOSS.—

22               “(1) IN GENERAL.—Losses from sales or ex-  
23 changes of capital assets in a taxable year shall be  
24 allowed only to the extent of the gains from such

1 sales or exchanges, plus \$3,000 (\$1,500 in the case  
2 of a married individual filing a separate return).

3 “(2) CAPITAL LOSS CARRYOVERS.—Under regu-  
4 lations prescribed by the Secretary, any loss not al-  
5 lowed by reason of paragraph (1) shall be carried  
6 over to the following taxable year and treated as a  
7 capital loss incurred in such year. There shall be no  
8 limit on the number of years that a capital loss can  
9 be carried forward.

10 “(3) CAPITAL ASSETS.—Under regulations pre-  
11 scribed by the Secretary, the principles of the Inter-  
12 nal Revenue Code of 1986 (including, without limi-  
13 tation, sections 1234 (relating to options), 1234A  
14 (relating to gains or losses from certain termi-  
15 nations), 1253 (relating to franchises and trade-  
16 marks) and 1258 (gain from certain financial trans-  
17 actions) shall apply for purposes of determining  
18 what is a capital asset and whether an event is to  
19 be treated as a sale or exchange of capital assets, ex-  
20 cept to the extent inconsistent with principles of this  
21 chapter.

22 “(4) RECAPTURE.—If a taxpayer claimed de-  
23 preciation, amortization or other cost recovery de-  
24 ductions under the Internal Revenue Code of 1986  
25 with respect to property which is subsequently sold

1 or exchanged in a transaction that is not treated as  
 2 transaction of a business entity, the amount of gain  
 3 on the exchange of such property which is treated as  
 4 gain from the sale or exchange of a capital asset  
 5 shall be reduced (but not below zero) by the amount  
 6 of such deductions claimed with respect to the prop-  
 7 erty.

8 **“Subchapter D—Rules for Exclusions from**  
 9 **Gross Income**

“Sec. 91. Interest on tax-exempt bonds.

“Sec. 92. Combat pay.

“Sec. 93. Qualified military benefits.

“Sec. 94. Qualified foster care payments.

“Sec. 95. Compensation for injury and sickness.

“Sec. 96. Meals or lodging for convenience of employer.

“Sec. 97. Certain fringe benefits.

10 **“SEC. 91. INTEREST ON TAX-EXEMPT BONDS.**

11 “(a) EXCLUSION.—Except as provided in subsection  
 12 (b), gross income does not include interest on any State  
 13 or local bond.

14 “(b) EXCEPTIONS.—Subsection (a) shall not apply  
 15 to—

16 “(1) PRIVATE ACTIVITY BOND WHICH IS NOT A  
 17 QUALIFIED BOND.—Any private activity bond which  
 18 is not a qualified bond (within the meaning of para-  
 19 graph (3) of subsection (c)).

20 “(2) ARBITRAGE BOND.—Any arbitrage bond.

1           “(3) BOND NOT IN REGISTERED FORM, ETC.—  
2 Any bond unless such bond meets the applicable re-  
3 quirements set forth in regulations.

4           “(c) DEFINITIONS—For purposes of this section—

5           “(1) STATE OR LOCAL BOND.—‘State or local  
6 bond’ means an obligation of a State or political  
7 subdivision thereof.

8           “(2) STATE.—‘State’ includes the District of  
9 Columbia and any possession of the United States.

10           “(3) QUALIFIED BOND.—‘Qualified bond’  
11 means any private activity bond if—

12           “(A) IN GENERAL.—Such bond is—

13                   “(i) an exempt facility bond,

14                   “(ii) a qualified mortgage bond,

15                   “(iii) a qualified veterans’ mortgage  
16 bond,

17                   “(iv) a qualified small issue bond,

18                   “(v) a qualified student loan bond,

19                   “(vi) a qualified 253(c)(3) bond.

20           “(B) VOLUME CAP.—Such bond is issued  
21 as part of an issue which meets the applicable  
22 volume cap requirements set forth in regula-  
23 tions.

1           “(C) OTHER REQUIREMENTS.—Such bond  
2           meets the applicable requirements set forth in  
3           regulations.

4           “(d) REGULATIONS.—

5           “(1) STATUTORY REGULATIONS.—The Sec-  
6           retary shall publish as regulations governing the ap-  
7           plication of this section the text of part IV of sub-  
8           chapter B of chapter 1 of the Internal Revenue Code  
9           of 1986 (sections 141 through 149) with only such  
10          changes as are required to conform cross references.

11          “(2) OTHER REGULATIONS.—The Secretary  
12          shall have the authority to promulgate such other  
13          regulations as he deems necessary or proper to im-  
14          plement this section, except that no such regulations  
15          shall conflict with the regulations mandated by para-  
16          graph (1) except as provided in this subtitle.

17   **“SEC. 92. COMBAT PAY.**

18          “(a) ENLISTED PERSONNEL.—Gross income does not  
19          include compensation received for active service as a mem-  
20          ber below the grade of commissioned officer in the Armed  
21          Forces of the United States for any month during any  
22          part of which such member—

23                  “(1) served in a combat zone, or

24                  “(2) was hospitalized as a result of wounds, dis-  
25          ease, or injury incurred while serving in a combat

1 zone; but this paragraph shall not apply for any  
2 month beginning more than 2 years after the date  
3 of the termination of combatant activities in such  
4 zone.

5 “(b) COMMISSIONED OFFICERS.—Gross income does  
6 not include so much of the compensation as does not ex-  
7 ceed \$500 received for active service as a commissioned  
8 officer in the Armed Forces of the United States for any  
9 month during any part of which such officer—

10 “(1) served in a combat zone, or

11 “(2) was hospitalized as a result of wounds, dis-  
12 ease, or injury incurred while serving in a combat  
13 zone; but this paragraph shall not apply for any  
14 month beginning more than 2 years after the date  
15 of the termination of combatant activities in such  
16 zone.

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

18 “(1) ‘Commissioned officer’ does not include a  
19 commissioned warrant officer.

20 “(2) ‘Combat zone’ means any area which the  
21 President of the United States by Executive Order  
22 designates, for purposes of this section or cor-  
23 responding provisions of prior income tax laws, an  
24 area in which Armed Forces of the United States

1 are or have (after June 24, 1950) engaged in com-  
2 bat.

3 “(3) Service is performed in a combat zone only  
4 if performed on or after the date designated by the  
5 President by Executive Order as the date of the  
6 commencing of combatant activities in such zone,  
7 and on or before the date designated by the Presi-  
8 dent by Executive Order as the date of the termi-  
9 nation of combatant activities in such zone; except  
10 that June 25, 1950, shall be considered the date of  
11 the commencing of combatant activities in the com-  
12 bat zone designated in Executive Order 10195.

13 “(4) The term ‘compensation’ does not include  
14 pensions and retirement pay.

15 **“SEC. 93. QUALIFIED MILITARY BENEFIT.**

16 “(a) IN GENERAL.—‘Qualified military benefit’  
17 means any allowance or in-kind benefit (other than per-  
18 sonal use of a vehicle) which—

19 “(1) is received by any member or former mem-  
20 ber of the uniformed service of the United States or  
21 any dependent of such member by reason of such  
22 member’s status or service as a member of such uni-  
23 formed services, and

24 “(2) was excludable from gross income on Sep-  
25 tember 9, 1986, under any provision of law, regula-

1       tion, or administrative practice which was in effect  
2       on such date (other than a provision of this title).

3       “(b) NO OTHER BENEFIT TO BE EXCLUDABLE AS  
4 PROVIDED BY THIS TITLE.—Notwithstanding any other  
5 provision of law, no benefit shall be treated as a qualified  
6 military benefit unless such benefit—

7               “(1) is a benefit described in subsection (a), or  
8               “(2) is excludable from gross income under this  
9 title without regard to any provision of law which is  
10 not contained in this title and which is not contained  
11 in a revenue Act.

12       “(c) LIMITATIONS ON MODIFICATIONS.—

13               “(1) IN GENERAL.—Except as provided in para-  
14 graph (2), no modification or adjustment of any  
15 qualified military benefit after September 9, 1986,  
16 shall be taken into account.

17               “(2) EXCEPTION FOR CERTAIN ADJUSTMENTS  
18 TO CASH BENEFITS.—Paragraph (1) shall not apply  
19 to any adjustment to any qualified military benefit  
20 payable in cash which—

21                       “(A) is pursuant to a provision of law or  
22 regulation (as in effect on September 9, 1986),  
23 and

1           “(B) is determined by reference to any  
2           fluctuation in cost, price, currency, or other  
3           similar index.

4 **“SEC. 94. QUALIFIED FOSTER CARE PAYMENTS.**

5           “(a) QUALIFIED FOSTER CARE PAYMENT DE-  
6 FINED.—

7           “(1) IN GENERAL.—‘Qualified foster care pay-  
8           ment’ means any amount—

9                   “(A) which is paid by a state or political  
10                  subdivision thereof or by a placement agency  
11                  which is described in section 253(c)(3) and ex-  
12                  empt from tax under section 253(a), and

13                  “(B) which is—

14                           “(i) paid to the foster care provider  
15                           for caring for a qualified foster individual  
16                           in the foster care provider’s home, or

17                           “(ii) a difficulty of care payment.

18           “(2) QUALIFIED FOSTER INDIVIDUAL.—‘Quali-  
19           fied foster individual’ means any individual who is  
20           living in a foster family home in which such indi-  
21           vidual was placed by—

22                   “(A) an agency of a State or a political  
23                   subdivision thereof, or

24                   “(B) in the case of an individual who has  
25                   not attained age 19, an organization which is li-

1 censed by a State (or political subdivision there-  
2 of) as a placement agency and which is de-  
3 scribed in section 253(c)(3) and exempt from  
4 tax under section 253(a).

5 “(3) LIMITATION BASED ON NUMBER OF INDI-  
6 VIDUALS OVER THE AGE OF 18.—In the case of any  
7 foster home in which there is a qualified foster care  
8 individual who has attained age 19, foster care pay-  
9 ments (other than difficulty of care payments) for  
10 any period to which such payments relate shall not  
11 be excludable from gross income under subsection  
12 (a) to the extent such payments are made for more  
13 than 5 such qualified foster individuals.

14 “(b) DIFFICULTY OF CARE PAYMENTS.—For pur-  
15 poses of this section—

16 “(1) DIFFICULTY OF CARE PAYMENTS.—‘Dif-  
17 ficulty of care payments’ means payments to individ-  
18 uals which are not described in subsection  
19 (a)(1)(B)(i), and which—

20 “(A) are compensation for providing the  
21 additional care of a qualified foster individual  
22 which is—

23 “(i) required by reason of a physical,  
24 mental, or emotional handicap of such in-  
25 dividual with respect to which the State

1           has determined that there is a need for ad-  
2           ditional compensation, and

3                   “(ii) provided in the home of the fos-  
4           ter care provider, and

5                   “(B) are designated by the payor as com-  
6           pensation described in subparagraph (A).

7           “(2) LIMITATION BASED ON NUMBER OF INDI-  
8           VIDUALS.—In the case of any foster home, difficulty  
9           of care payments for any period to which such pay-  
10          ments relate shall not be excludable from gross in-  
11          come under subsection (a) to the extent such pay-  
12          ments are made for more than—

13                   “(A) 10 qualified foster individuals who  
14          have not attained age 19, and

15                   “(B) 5 qualified foster individuals not de-  
16          scribed in subparagraph (A).

17 **“SEC. 95. COMPENSATION FOR INJURIES OR SICKNESS.**

18          “(a) IN GENERAL.—Gross income does not include—

19                   “(1) amounts received under workers’ com-  
20          pensation acts as compensation for personal injuries  
21          or sickness;

22                   “(2) the amount of any damages received  
23          (whether by suit or agreement and whether as lump  
24          sums or as periodic payments) on account of per-  
25          sonal injuries or sickness;

1           “(3) amounts received through accident or  
2 health insurance for medical care;

3           “(4) amounts received through accident or  
4 health insurance for personal injuries or sickness  
5 (other than for medical care), but only to the extent  
6 such amounts (A) are not attributable to contribu-  
7 tions by the employer which were not includible in  
8 the gross income of the employee, and are (B) not  
9 paid by the employer;

10           “(5) amounts received as pension, annuity, or  
11 similar allowance for personal injuries or sickness re-  
12 sulting from active service in the armed forces of  
13 any country or in the Coast and Geodetic Survey or  
14 the Public Health Service, or as a disability annuity  
15 payable under the provisions of section 808 of the  
16 Foreign Service Act of 1980; and

17           “(6) amounts received by an individual as dis-  
18 ability income attributable to injuries incurred as a  
19 direct result of a violent attack which the Secretary  
20 of State determines to be a terrorist attack and  
21 which occurred while such individual was an em-  
22 ployee of the United States engaged in the perform-  
23 ance of his official duties outside the United States.

1 Paragraph (2) shall not apply to any punitive dam-  
2 ages in connection with a case not involving physical  
3 injury or physical sickness.

4 “(b) TERMINATION OF APPLICATION OF SUBSECTION  
5 (a)(4) IN CERTAIN CASES.—

6 “(1) IN GENERAL.—Subsection (a)(4) shall not  
7 apply in the case of an individual who is not de-  
8 scribed in paragraph (2).

9 “(2) INDIVIDUALS TO WHOM SUBSECTION  
10 (a)(4) CONTINUES TO APPLY.—An individual is de-  
11 scribed in this paragraph if—

12 “(A) on or before September 24, 1975, he  
13 was entitled to receive any amount described in  
14 subsection (a)(4),

15 “(B) on September 24, 1975, he was a  
16 member of any organization (or reserve compo-  
17 nent thereof) referred to in subsection (a)(4) or  
18 under a binding written commitment to become  
19 such a member,

20 “(C) he receives an amount described in  
21 subsection (a)(4) by reason of a combat-related  
22 injury, or

23 “(D) on application therefore, he would be  
24 entitled to receive disability compensation from  
25 the Veterans’ Administration.

1           “(3) SPECIAL RULES FOR COMBAT-RELATED IN-  
2           JURIES.—For purposes of this subsection, the term  
3           ‘combat-related injury’ means personal injury or  
4           sickness—

5                   “(A) which is incurred—

6                           “(i) as a direct result of armed con-  
7                           flict,

8                           “(ii) while engaged in extrahazardous  
9                           service, or

10                           “(iii) under conditions simulating war;

11                           or

12                           “(B) which is caused by an instrumentality  
13                           of war.

14           In the case of an individual who is not described in  
15           subparagraph (A) or (B) of paragraph (2), except as  
16           provided in paragraph (4), the only amounts taken  
17           into account under subsection (a)(4) shall be the  
18           amounts which he receives by reason of a combat-  
19           related injury.

20           “(4) AMOUNT EXCLUDED TO BE NOT LESS  
21           THAN VETERANS’ DISABILITY COMPENSATION.—In  
22           the case of any individual described in paragraph  
23           (2), the amounts excludable under subsection (a)(4)  
24           for any period with respect to any individual shall  
25           not be less than the maximum amount which such

1 individual, on application therefor, would be entitled  
2 to receive as disability compensation from the Vet-  
3 erans' Administration.

4 **“SEC. 96. MEALS OR LODGING FURNISHED FOR THE CON-**  
5 **VENIENCE OF THE EMPLOYER.**

6 “(a) MEALS AND LODGING FURNISHED TO EM-  
7 PLOYEE, HIS SPOUSE, AND HIS DEPENDENTS, PURSU-  
8 ANT TO EMPLOYMENT.—There shall be excluded from  
9 gross income of an employee the value of any meals or  
10 lodging furnished to him, his spouse, or any of his depend-  
11 ents by or on behalf of his employer for the convenience  
12 of the employer, but only if—

13 “(1) in the case of meals, the meals are fur-  
14 nished on the business premises of the employer, or

15 “(2) in the case of lodging, the employee is re-  
16 quired to accept such lodging on the business prem-  
17 ises of his employer as a condition of his employ-  
18 ment.

19 “(b) SPECIAL RULES.—For the purposes of sub-  
20 section (a)—

21 “(1) PROVISIONS OF EMPLOYMENT CONTRACT  
22 OR STATE STATUTE NOT TO BE DETERMINATIVE.—

23 In determining whether meals or lodging are fur-  
24 nished for the convenience of the employer, the pro-  
25 visions of an employment contract or of a State stat-

1       ute fixing terms of employment shall not be deter-  
2       minative of whether the meals or lodging are in-  
3       tended as compensation.

4               “(2) CERTAIN FACTORS NOT TAKEN INTO AC-  
5       COUNT WITH RESPECT TO MEALS.—In determining  
6       whether meals are furnished for the convenience of  
7       the employer, the fact that a charge is made for  
8       such meals, and the fact that the employee may ac-  
9       cept or decline such meals, shall not be taken into  
10      account.

11              “(3) CERTAIN FIXED CHARGES FOR MEALS.—

12                      “(A) IN GENERAL.—If—

13                              “(i) an employee is required to pay on  
14                              a periodic basis a fixed charge for his  
15                              meals, and

16                              “(ii) such meals are furnished by the  
17                              employer for the convenience of the em-  
18                              ployer,

19                      there shall be excluded from the employee’s  
20                      gross income an amount equal to such fixed  
21                      charge.

22                      “(B) APPLICATION OF SUBPARAGRAPH  
23                      (A).—Subparagraph (A) shall apply—

1           “(i) whether the employee pays the fixed charge  
2 out of his stated compensation or out of his own  
3 funds, and

4           “(ii) only if the employee is required to make  
5 the payment whether he accepts or declines the  
6 meals.

7           “(c) EMPLOYEES LIVING IN CERTAIN CAMPS.—

8           “(1) IN GENERAL.—In the case of an individual  
9 who is furnished lodging in a camp located in a for-  
10 eign country by or on behalf of his employer, such  
11 camp shall be considered to be part of the business  
12 premises of the employer.

13           “(2) CAMP.—For purposes of this section, a  
14 camp constitutes lodging which is—

15           “(A) provided by or on behalf of the em-  
16 ployer for the convenience of the employer be-  
17 cause the place at which such individual renders  
18 services is in a remote area where satisfactory  
19 housing is not available on the open market,

20           “(B) located, as near as practicable, in the  
21 vicinity of the place at which such individual  
22 renders services, and

23           “(C) furnished in a common area (or en-  
24clave) which is not available to the public and

1           which normally accommodates 10 or more em-  
2           ployees.

3           “(d) LODGING FURNISHED BY CERTAIN EDU-  
4           CATIONAL INSTITUTIONS TO EMPLOYEES.—

5           “(1) IN GENERAL.—In the case of an employee  
6           of an educational institution, gross income shall not  
7           include the value of qualified campus lodging fur-  
8           nished to such employee during the taxable year.

9           “(2) EXCEPTION IN CASES OF INADEQUATE  
10          RENT.—Paragraph (1) shall not apply to the extent  
11          of the excess of—

12                   “(A) the lesser of—

13                           “(i) 5 percent of the appraised value  
14                           of the qualified campus lodging, or

15                           “(ii) the average of the rentals paid  
16                           by individuals (other than employees or  
17                           students of the educational institution)  
18                           during such calendar year for lodging pro-  
19                           vided by the educational institution which  
20                           is comparable to the qualified campus lodg-  
21                           ing provided to the employee, over

22                           “(B) the rent paid by the employee for the  
23                           qualified campus lodging during such calendar  
24                           year.

1 The appraised value under subparagraph (A)(i) shall  
2 be determined as of the close of the calendar year  
3 in which the taxable year begins, or, in the case of  
4 a rental period not greater than 1 year, at any time  
5 during the calendar year in which such period be-  
6 gins.

7 “(3) QUALIFIED CAMPUS LODGING.—For pur-  
8 poses of this subsection, the term ‘qualified campus  
9 lodging’ means lodging to which subsection (a) does  
10 not apply and which is—

11 “(A) located on, or in the proximity of, a  
12 campus of the educational institution, and

13 “(B) furnished to the employee, his spouse,  
14 and any of his dependents by or on behalf of  
15 such institution for use as a residence.

16 “(4) EDUCATIONAL INSTITUTION.—For pur-  
17 poses of this paragraph, the term ‘educational insti-  
18 tution’ means an eligible educational institution as  
19 defined in section 10(b)(2)(B).

20 **“SEC. 97. CERTAIN FRINGE BENEFITS.**

21 “(a) PURPOSE.—This section includes definitions and  
22 rules applicable to the exclusion from gross income for cer-  
23 tain fringe benefits.

1       “(b) NO-ADDITIONAL-COST SERVICE DEFINED.—

2 ‘No-additional-cost service’ means any service provided by

3 an employer to an employee for use by such employee if—

4           “(1) such service is offered for sale to cus-

5 tomers in the ordinary course of the line of business

6 of the employer in which the employee is performing

7 services, and

8           “(2) the employer incurs no substantial addi-

9 tional cost (including forgone revenue) in providing

10 such service to the employee (determined without re-

11 gard to any amount paid by the employee for such

12 service).

13       “(c) QUALIFIED EMPLOYEE DISCOUNT DEFINED.—

14           “(1) QUALIFIED EMPLOYEE DISCOUNT.—The

15 term ‘qualified employee discount’ means any em-

16 ployee discount with respect to qualified property or

17 services to the extent such discount does not

18 exceed—

19           “(A) in the case of property, the gross

20 profit percentage of the price at which the prop-

21 erty is being offered by the employer to cus-

22 tomers, or

23           “(B) in the case of services, 20 percent of

24 the price at which the services are being offered

25 by the employer to customers.

1           “(2) GROSS PROFIT PERCENTAGE.—

2                   “(A) IN GENERAL.—‘Gross profit percent-  
3           age’ means the percent which—

4                           “(i) the excess of the aggregate sales  
5                           price of property sold by the employer to  
6                           customers over the aggregate cost of such  
7                           property to the employer, is of

8                           “(ii) the aggregate sales price of such  
9                           property.

10                   “(B) DETERMINATION OF GROSS PROFIT  
11           PERCENTAGE.—Gross profit percentage shall be  
12           determined on the basis of—

13                           “(i) all property offered to customers  
14                           in the ordinary course of the line of busi-  
15                           ness of the employer in which the employee  
16                           is performing services (or a reasonable  
17                           classification of property selected by the  
18                           employer), and

19                           “(ii) the employer’s experience during a  
20           representative period.

21                   “(3) EMPLOYEE DISCOUNT DEFINED.—‘Em-  
22           ployee discount’ means the amount by which—

23                           “(A) the price at which the property or  
24                           services are provided by the employer to an em-  
25                           ployee for use by such employee, is less than

1           “(B) the price at which such property or  
2           services are being offered by the employer to  
3           customers.

4           “(4) QUALIFIED PROPERTY OR SERVICES.—  
5           ‘Qualified property or services’ means any property  
6           (other than real property and other than personal  
7           property of a kind held for investment) or services  
8           which are offered for sale to customers in the ordi-  
9           nary course of the line of business of the employer  
10          in which the employee is performing services.

11          “(c) DE MINIMIS FRINGE DEFINED.—

12           “(1) IN GENERAL.—‘De minimis fringe’ means  
13           any property or service the value of which is (after  
14           taking into account the frequency with which similar  
15           fringes are provided by the employer to the employ-  
16           er’s employees) so small as to make accounting for  
17           it unreasonable or administratively impracticable.

18           “(2) TREATMENT OF CERTAIN EATING FACILI-  
19           TIES.—The operation by an employer of any eating  
20           facility for employees shall be treated as a de mini-  
21           mis fringe if—

22           “(A) such facility is located on or near the  
23           business premises of the employer, and

1           “(B) revenue derived from such facility  
2           normally equals or exceeds the direct operating  
3           costs of such facility.

4           The preceding sentence shall apply with respect to  
5           any highly compensated employee only if access to  
6           the facility is available on substantially the same  
7           terms to each member of a group of employees  
8           which is defined under a reasonable classification set  
9           up by the employer which does not discriminate in  
10          favor of highly compensated employees.

11          “(3) ON-PREMISES GYMS AND OTHER ATHLETIC  
12          FACILITIES.—

13                 “(A) IN GENERAL.—De minimis fringe  
14                 benefits include the provision of on-premises  
15                 athletic facility by an employer to its employees.

16                 “(B) ON-PREMISES ATHLETIC FACILITY.—  
17                 For purposes of this paragraph, ‘on-premises  
18                 athletic facility’ means any gym or other ath-  
19                 letic facility—

20                         “(i) which is located on the premises  
21                         of the employer,

22                         “(ii) which is operated by the em-  
23                         ployer, and

1                   “(iii) substantially all the use of which  
2                   is by employees of the employer, their  
3                   spouses, and their dependent children.

4           “(d) CERTAIN EDUCATIONAL TRAINING BENE-  
5 FITS.—Amounts paid or expenses incurred by the em-  
6 ployer for education or training provided to the employee  
7 shall be excluded from gross income under section 4 if  
8 (and only if) such amounts or expenses are ordinary and  
9 necessary business expenses and are not for an advanced  
10 degree or to qualify an employee for a new line of work.

11           “(e) REGULATIONS.—The Secretary shall prescribe  
12 regulations under this section, including regulations that  
13 continue certain rules contained in section 132 to the In-  
14 ternal Revenue Code of 1986 related to the fringe benefits  
15 described in this section.

## 16 **“Subchapter E—Rules Relating to Deductions**

“Sec. 101. Charitable, etc. organizations.

“Sec. 102. Private foundations.

### 17 **“SEC. 101. CHARITABLE, ETC. ORGANIZATIONS.**

18           “(a) PURPOSE.—This section provides definitions for  
19 purposes of determining the philanthropic transfer deduc-  
20 tion and for other purposes of this chapter and chapter  
21 2.

22           “(b) REGULAR CHARITY.—

23                   “(1) IN GENERAL.—

1           “(A) REGULAR CHARITY.—‘Regular char-  
2           ity’ means—

3                   “(i) a church or a convention or asso-  
4                   ciation of churches,

5                   “(ii) an educational organization  
6                   which normally maintains a regular faculty  
7                   and curriculum and normally has a regu-  
8                   larly enrolled body of pupils or students in  
9                   attendance at the place where its edu-  
10                  cational activities are regularly carried on,

11                  “(iii) an organization the principal  
12                  purpose or functions of which are the pro-  
13                  viding of medical or hospital care or med-  
14                  ical education or medical research, if the  
15                  organization is a hospital, or if the organi-  
16                  zation is a medical research organization  
17                  directly engaged in the continuous active  
18                  conduct of medical research in conjunction  
19                  with a hospital,

20                  “(iv) an organization which normally  
21                  receives a substantial part of its support  
22                  (exclusive of income received in the exer-  
23                  cise or performance by such organization  
24                  of its charitable, educational, or other pur-  
25                  pose or function constituting the basis for

1 its exemption under section 253(a)) from  
2 the United States or any State or political  
3 subdivision thereof or from direct or indi-  
4 rect contributions from the general public,  
5 and which is organized and operated exclu-  
6 sively to receive, hold, invest, and admin-  
7 ister property and to make expenditures to  
8 or for the benefit of a college or university  
9 which is an organization referred to in  
10 clause (ii) of this subparagraph and which  
11 is an agency or instrumentality of a State  
12 or political subdivision thereof, or which is  
13 owned or operated by a State or political  
14 subdivision thereof or by an agency or in-  
15 strumentality of one or more States or po-  
16 litical subdivisions,

17 “(v) a governmental unit referred to  
18 in subsection (c)(1),

19 “(vi) an organization referred to in  
20 subsection (c)(2) which normally receives a  
21 substantial part of its support (exclusive of  
22 income received in the exercise or perform-  
23 ance by such organization of its charitable,  
24 educational, or other purpose or function  
25 constituting the basis for its exemption

1 under section 253(a)) from a governmental  
2 unit referred to in subsection (c)(1) or  
3 from direct or indirect contributions from  
4 the general public,

5 “(vii) a private foundation described  
6 in subparagraph (C), or

7 “(viii) an organization described in  
8 section 102(a) (2) or (3).

9 “(B) SPECIAL RULE FOR MEDICAL RE-  
10 SEARCH ORGANIZATIONS.—For purposes of de-  
11 termining whether a contribution is to a regular  
12 charity, a medical research organization shall  
13 not be treated as described in clause (iii) of  
14 paragraph (2) unless during the calendar year  
15 in which the contribution is made such organi-  
16 zation is committed to spend such contributions  
17 for such research before January 1 of the fifth  
18 calendar year which begins after the date such  
19 contribution is made,

20 “(C) CERTAIN PRIVATE FOUNDATIONS.—  
21 The private foundations referred to in subpara-  
22 graph (A)(vii) and subsection (e)(1)(B) are—

23 “(i) a private operating foundation (as  
24 defined in section 4942(j)(3)),

1           “(ii) any other private foundation (as  
2           defined in section 102(a)) which, not later  
3           than the 15th day of the third month after  
4           the close of the foundation’s taxable year  
5           in which contributions are received, makes  
6           qualifying distributions (as defined in sec-  
7           tion 4942(g), without regard to paragraph  
8           (3) thereof), which are treated, after the  
9           application of section 4942(g)(3), as dis-  
10          tributions out of corpus (in accordance  
11          with section 4942(h)) in an amount equal  
12          to 100 percent of such contributions, and  
13          with respect to which the taxpayer obtains  
14          adequate records or other sufficient evi-  
15          dence from the foundation showing that  
16          the foundation made such qualifying dis-  
17          tributions, and

18          “(iii) a private foundation all of the  
19          contributions to which are pooled in a com-  
20          mon fund and which would be described in  
21          section 102(a)(3) but for the right of any  
22          substantial contributor (hereafter in this  
23          clause called ‘donor’) or his spouse to des-  
24          ignate annually the recipients, from among  
25          organizations described in paragraph (1) of

1 section 102(a), of the income attributable  
2 to the donor's contribution to the fund and  
3 to direct (by deed or by will) the payment,  
4 to an organization described in such para-  
5 graph (1), of the corpus in the common  
6 fund attributable to the donor's contribu-  
7 tion; but this clause shall apply only if all  
8 of the income of the common fund is re-  
9 quired to be (and is) distributed to one or  
10 more organizations described in such para-  
11 graph (1) not later than the 15th day of  
12 the third month after the close of the tax-  
13 able year in which the income is realized  
14 by the fund and only if all of the corpus  
15 attributable to any donor's contribution to  
16 the fund is required to be (and is) distrib-  
17 uted to one or more of such organizations  
18 not later than one year after his death or  
19 after the death of his surviving spouse if  
20 she has the right to designate the recipi-  
21 ents of such corpus.

22 “(2) REFERENCES.—Any reference in other law  
23 or in legal documents to an organization described  
24 in a clause of section 170(b)(1)(A) of the Internal  
25 Revenue Code of 1986 shall constitute a reference to

1 an organization described in the same clause of sec-  
2 tion 101(b)(1)(A).

3 “(c) CHARITY.—For purposes of determining the de-  
4 ductibility of a philanthropic transfer, ‘charitable contribu-  
5 tion’ means a contribution or gift for the use of—

6 “(1) A State, a possession of the United States,  
7 or any political subdivision of any of the foregoing,  
8 or the United States or the District of Columbia,  
9 but only if the contribution or gift is made for exclu-  
10 sively public purposes.

11 “(2) A corporation, trust, or community chest,  
12 fund, or foundation—

13 “(A) created or organized in the United  
14 States or in any possession thereof, or under  
15 the law of the United States, any State, the  
16 District of Columbia, or any possession of the  
17 United States;

18 “(B) organized and operated exclusively  
19 for religious, charitable, scientific, literary, or  
20 educational purposes (but only if no part of its  
21 activities involve the provision of athletic facili-  
22 ties or equipment) or for the prevention of cru-  
23 elty to children or animals,

1           “(C) no part of the net earnings of which  
2           inures to the benefit of any private shareholder  
3           or individual, and

4           “(D) which qualifies for exemption from  
5           the business tax under section 253(c) and is not  
6           disqualified for tax exemption by reason of at-  
7           tempting to influence legislation, and which  
8           does not participate in, or intervene in (includ-  
9           ing the publishing or distributing of state-  
10          ments), any political campaign on behalf of (or  
11          in opposition to) any candidate for public office.

12          “(3) [intentionally deleted]

13          “(4) In the case of a contribution or gift by an  
14          individual, a domestic fraternal society, order, or as-  
15          sociation, operating under the lodge system, but only  
16          if such contribution or gift is to be used exclusively  
17          for religious, charitable, scientific, literary, or edu-  
18          cational purposes, or for the prevention of cruelty to  
19          children or animals.

20          “(5) A cemetery company owned and operated  
21          exclusively for the benefit of its members, or any  
22          corporation chartered solely for burial purposes as a  
23          cemetery corporation and not permitted by its char-  
24          ter to engage in any business not necessarily inci-  
25          dent to that purpose, if such company or corporation

1 is not operated for profit and no part of the net  
2 earnings of such company or corporation inures to  
3 the benefit of any private shareholder or individual.

4 “(d) RULES FOR SUBSECTION (c).—

5 “(1) LIMITATIONS.—A contribution or gift by a  
6 corporation to a trust, chest, fund, or foundation  
7 shall be deductible by reason of subsection (c)(2)(B)  
8 only if it is to be used within the United States or  
9 any of its possessions exclusively for purposes speci-  
10 fied in subparagraph (B).

11 “(2) REFERENCES.—Any reference in other law  
12 or in legal documents to an organization described  
13 in a paragraph of section 170(c) of the Internal Rev-  
14 enue Code of 1986 shall constitute a reference to an  
15 organization described in the same paragraph num-  
16 ber of section 101(c) if an organization is described  
17 in such paragraph.

18 “(e) QUALIFIED CONSERVATION CONTRIBUTION.—

19 “(1) IN GENERAL.—‘Qualified conservation con-  
20 tribution’ means a contribution—

21 “(A) of a qualified real property interest,

22 “(B) to a qualified organization,

23 “(C) exclusively for conservation purposes.

1           “(2) QUALIFIED REAL PROPERTY INTEREST.—  
2           ‘Qualified real property interest’ means any of the  
3           following interests in real property:

4                   “(A) the entire interest of the donor other  
5                   than a qualified mineral interest,

6                   “(B) a remainder interest, and

7                   “(C) a restriction (granted in perpetuity)  
8                   on the use which may be made of the real prop-  
9                   erty.

10           “(3) QUALIFIED ORGANIZATION.—For purposes  
11           of paragraph (1), the term ‘qualified organization’  
12           means an organization which—

13                   “(A) is described in clause (v) or (vi) of  
14                   subsection (b)(1)(A), or

15                   “(B) is described in section 253(c)(3)  
16                   and—

17                           “(i) meets the requirements of section  
18                           102(a)(2), or

19                           “(ii) meets the requirements of sec-  
20                           tion 102(a)(3) and is controlled by an or-  
21                           ganization described in subparagraph (A)  
22                           or in clause (i) of this subparagraph.

23           “(4) CONSERVATION PURPOSE DEFINED.—

1           “(A) IN GENERAL.—For purposes of this  
2 subsection, the term ‘conservation purpose’  
3 means—

4           “(i) the preservation of land areas for  
5 outdoor recreation by, or the education of,  
6 the general public,

7           “(ii) the protection of a relatively nat-  
8 ural habitat of fish, wildlife, or plants, or  
9 similar ecosystem,

10           “(iii) the preservation of open space  
11 (including farmland and forest land) where  
12 such preservation is—

13           “(I) for the scenic enjoyment of  
14 the general public, or

15           “(II) pursuant to a clearly delin-  
16 eated Federal, State, or local govern-  
17 mental conservation policy, and will  
18 yield a significant public benefit, or

19           “(iv) the preservation of an histori-  
20 cally important land area or a certified his-  
21 toric structure.

22           “(B) CERTIFIED HISTORIC STRUCTURE.—  
23 For purposes of subparagraph (A)(iv), the term  
24 ‘certified historic structure’ means any building,  
25 structure, or land area which—

1                   “(i) is listed in the National Register,  
2                   or

3                   “(ii) is located in a registered historic  
4                   district and is certified by the Secretary of  
5                   the Interior to the Secretary as being of  
6                   historic significance to the district.

7                   A building, structure, or land area satisfies the  
8                   preceding sentence if it satisfies such sentence  
9                   either at the time of the transfer or on the due  
10                  date (including extensions) for filing the trans-  
11                  feror’s return under this chapter for the taxable  
12                  year in which the transfer is made.

13                  “(5) EXCLUSIVELY FOR CONSERVATION PUR-  
14                  POSES.—For purposes of this subsection—

15                  “(A) CONSERVATION PURPOSE MUST BE  
16                  PROTECTED.—A contribution shall not be treat-  
17                  ed as exclusively for conservation purposes un-  
18                  less the conservation purpose is protected in  
19                  perpetuity.

20                  “(B) NO SURFACE MINING PERMITTED.—

21                  “(i) IN GENERAL.—Except as pro-  
22                  vided in clause (ii), in the case of a con-  
23                  tribution of any interest where there is a  
24                  retention of a qualified mineral interest,  
25                  subparagraph (A) shall not be treated as

1 met if at any time there may be extraction  
2 or removal of minerals by any surface min-  
3 ing method.

4 “(ii) SPECIAL RULE.—With respect to  
5 any contribution of property in which the  
6 ownership of the surface estate and min-  
7 eral interests were separated before June  
8 13, 1976, and remain so separated, sub-  
9 paragraph (A) shall be treated as met if  
10 the probability of surface mining occurring  
11 on such property is so remote as to be neg-  
12 ligible.

13 “(6) QUALIFIED MINERAL INTEREST.—For  
14 purposes of this subsection, the term ‘qualified min-  
15 eral interest’ means—

16 “(A) subsurface oil, gas, or other minerals,  
17 and

18 “(B) the right to access to such minerals.

19 “(f) DENIAL OF DEDUCTION FOR CERTAIN TRAVEL  
20 EXPENSES.—No deduction shall be allowed under section  
21 211 for traveling expenses (including amounts expended  
22 for meals and lodging) while away from home, whether  
23 paid directly or by reimbursement, unless there is no sig-  
24 nificant element of personal pleasure, recreation, or vaca-  
25 tion in such travel.

1       “(g) TREATMENT OF CERTAIN AMOUNTS PAID TO OR  
 2 FOR THE BENEFIT OF INSTITUTIONS OF HIGHER EDU-  
 3 CATION.—For purposes of section 11, if as the result of  
 4 a contribution to or for the benefit of an educational  
 5 organization—

6           “(1) which is described in subsection  
 7 (b)(1)(A)(ii), and

8           “(2) which is an institution of higher education  
 9 (as defined in section 3304(f))

10 the taxpayer receives (directly or indirectly) as a result  
 11 of paying such amount the right to purchase tickets for  
 12 seating at an athletic event in an athletic stadium of such  
 13 institution, 80 percent of such contribution shall be treat-  
 14 ed as a charitable contribution (but only if such amount  
 15 would be allowable as a deduction but for the fact that  
 16 the taxpayer received the right to purchase tickets). If any  
 17 portion of a payment is for the purchase of such tickets,  
 18 such portion and the remaining portion (if any) of such  
 19 payment shall be treated as separate amounts for purposes  
 20 of this subsection.

## 21   **“Subchapter F—Special Business Activities**

“Sec. 111. Rules for rental of real estate.

### 22   **“SEC. 111. RULES FOR RENTAL OF REAL ESTATE.**

23       “(a) IN GENERAL.—Except as provided in subsection

24 (b)—

1           “(1) the activity of rental of real estate is a  
2 business activity to which the Simplified USA Tax  
3 for businesses under chapter 2 applies,

4           “(2) a taxpayer shall not be entitled to any de-  
5 ductions under this chapter with respect to rental  
6 property, and

7           “(3) a taxpayer shall recognize gross income  
8 only with respect to distributions from the rental ac-  
9 tivity.

10          “(b) INSUBSTANTIAL RENTAL ACTIVITY.—

11           “(1) NOT RENTAL PROPERTY.—If an individual  
12 or individuals own property, such individual or indi-  
13 viduals and their families use the property on more  
14 than 14 days during the taxable year for nonbusi-  
15 ness purposes, the property is rented for no more  
16 than 14 days during the taxable year, and the total  
17 rental received by the individuals with respect to  
18 such property does not exceed \$10,000, the property  
19 shall not be considered rental property or used in  
20 the activity of rental of real estate during the tax-  
21 able year for purposes of subsection (a) and the  
22 Simplified USA Tax for businesses under chapter 2.

23           “(2) RENTS FROM NONRENTAL PROPERTY.—  
24 Any rent from property described in paragraph (1)

1 shall be included in gross income for purposes of the  
2 Simplified USA Income Tax.

3 “(c) USE FOR A NONBUSINESS PURPOSE.—For pur-  
4 poses of this section, ‘use for a nonbusiness purpose’  
5 means use other than—

6 “(1) use for which fair rent is paid,

7 “(2) use in connection with the preparation of  
8 the property for rental, or

9 “(3) use that serves a clear business purpose.

10 Use during any part of a day shall constitute use for that  
11 day.

## 12 **“Subchapter G—Accounting Methods and** 13 **Periods**

“Sec. 121. Taxable year.

“Sec. 122. Cash method of accounting; installment sales.

### 14 **“SEC. 121. TAXABLE YEAR.**

15 “(a) IN GENERAL.—The taxable year for all individ-  
16 uals subject to tax under this chapter shall be the calendar  
17 year except as provided in subsection (b).

18 “(b) SHORT TAXABLE YEARS.—

19 “(1) BIRTH.—An individual’s taxable year in  
20 year of his birth shall begin on the date of his birth.

21 “(2) DEATH.—An individual’s taxable year in  
22 the year of his death shall end on the date of his  
23 death.

1 **“SEC. 122. CASH METHOD OF ACCOUNTING; INSTALLMENT**  
2 **SALES.**

3 “(a) IN GENERAL.—All individuals shall determine  
4 their income and deductions using the cash receipts and  
5 disbursement method.

6 “(b) OID RULES.—

7 “(1) IN GENERAL.—Original issue discount  
8 shall not be included in gross income until received.

9 “(2) PREVIOUSLY RECOGNIZED OID.—Original  
10 issue discount included in income under the Internal  
11 Revenue Code of 1986 shall increase the adjusted  
12 basis of the instrument to which the original issue  
13 discount related and shall not again be included in  
14 income when received.

15 “(c) INSTALLMENT SALES.—

16 “(1) IN GENERAL.—Taxpayers shall take into  
17 account income from installment sales when re-  
18 ceived.

19 “(2) REGULATIONS.—The Secretary shall pro-  
20 mulgate regulations implementing paragraph (1).  
21 Such regulations shall generally follow the principles  
22 of sections 453, 453A and 453B of the Internal Rev-  
23 enue Code of 1986, except to the extent such prin-  
24 ciples are inconsistent with other provisions of this  
25 chapter.

1 “(d) CONSTRUCTIVE RECEIPT.—Income shall be  
2 treated as received when constructively received.

3 “(e) EFFECT OF CHANGE OF ACCOUNTING METH-  
4 OD.—Rules similar to those under section 226 shall apply  
5 to ensure that a taxpayer does not deduct the same ex-  
6 pense twice or include the same item in income twice.

### 7 **“Subchapter H—Nonresident Aliens**

“Sec. 131. Tax on nonresident alien individuals.

“Sec. 132. Tax treatment of certain community income of nonresident aliens.

### 8 **“SEC. 131. TAX ON NONRESIDENT ALIEN INDIVIDUALS.**

9 “(a) NONBUSINESS INCOME.—

10 “(1) INCOME OTHER THAN CERTAIN GAINS.—  
11 There is hereby imposed for each taxable year a tax  
12 of 30 percent of the amount received from sources  
13 within the United States by a nonresident alien indi-  
14 vidual as—

15 “(A) interest (other than portfolio interest  
16 (as defined in subsection (b)(2)), deposit inter-  
17 est (as defined in subsection (b)(3)) and origi-  
18 nal issue discount, dividends, rents, salaries,  
19 wages, premiums, annuities, compensations, re-  
20 munerations, emoluments, and other fixed or  
21 determinable annual periodical gains, profits  
22 and income,

1           “(B) gains from the disposal of timber,  
2           coal, or iron ore with a retained economic inter-  
3           est,

4           “(C) in the case of the sale of an original  
5           discount obligation or payment on an original  
6           issue discount obligation, the interest accrued  
7           while the individual was a nonresident alien,  
8           and

9           “(D) includible social security benefits (as  
10          defined in section 3(b)(2)).

11          “(2) CAPITAL GAINS OF CERTAIN ALIENS.—In  
12          the case of a nonresident alien individual present in  
13          the United States for a period or periods aggregating 183 days or more during the taxable year,  
14          there is hereby imposed a tax of 30 percent of the  
15          amount by which the gains, derived from sources  
16          within the United States, from the sale or exchange  
17          at any time during such year exceeds his losses, allo-  
18          cable to sources within the United States, from the  
19          sale or exchange at any time during such year of  
20          capital assets.

21          “(3) TAX DOES NOT APPLY TO BUSINESS IN-  
22          COME.—The taxes imposed by this section shall not  
23          apply to the income of any business entity, except to  
24

1 the extent such income is distributed as compensa-  
2 tion, dividends, or interest.

3 “(b) SPECIAL RULES AND DEFINITIONS.—

4 “(1) CERTAIN ANNUITIES.—The taxes imposed  
5 by subsection (a) shall not apply to any amount re-  
6 ceived as an annuity under a qualified annuity plan  
7 described in section 403(a)(1), or from a qualified  
8 trust described in section 401(a) and exempt under  
9 section 253(a) if—

10 “(A) all of the personal services by reason  
11 of which the annuity is payable were either—

12 “(i) personal services performed out-  
13 side the United States by an individual  
14 who, at the time of performance of such  
15 personal services, was a nonresident alien,  
16 or

17 “(ii) personal services by a non-  
18 resident alien temporarily present in the  
19 United States for a period or periods not  
20 exceeding 90 days during a taxable year,  
21 whose compensation for such services did  
22 not exceed \$3,000, and who performed  
23 such services for—

24 “(I) a nonresident alien indi-  
25 vidual, foreign partnership, or foreign

1 corporation, not engaged in a trade or  
2 business within the United States, or  
3 “(II) for an office or place of  
4 business maintained in a foreign coun-  
5 try or in a possession of the United  
6 States by an individual who is a cit-  
7 izen or resident of the United States  
8 or by a domestic partnership or a do-  
9 mestic corporation, and

10 “(B) at the time the first amount is paid  
11 as annuity under the annuity plan or by the  
12 trust, 90 percent or more of the employees for  
13 whom contributions or benefits are provided  
14 under such plan are citizens or residents of the  
15 United States.

16 “(2) PORTFOLIO INTEREST.—

17 “(A) IN GENERAL.—‘Portfolio interest’  
18 means—

19 “(i) interest on obligations in reg-  
20 istered form if the United States person  
21 who would otherwise be required to with-  
22 hold tax on such interest under section  
23 1441(a) receives a statement that the ben-  
24 efiticial owner of the obligation is not a  
25 United States person, and

1           “(ii) interest on obligations in nonreg-  
2           istered form if appropriate precautions are  
3           taken to ensure that such obligations will  
4           be sold only to persons who are not United  
5           States persons and such interest is paid  
6           outside the United States.

7           “(B) EXCEPTIONS.—Under rules to be  
8           prescribed by the Secretary, portfolio interest  
9           does not include—

10                  “(i) interest received by a 10-percent  
11                  equity owner, or

12                  “(ii) contingent interest.

13           “(3) DEPOSIT INTEREST.—‘Deposit interest’  
14           means interest on deposits which are—

15                  “(A) deposits with persons carrying on a  
16                  banking business (including savings and loans),  
17                  and

18                  “(B) amounts held by an insurance com-  
19                  pany under an agreement to pay interest there-  
20                  on.

21           “(4) OTHER EXCEPTIONS.—The taxes imposed  
22           by subsection (a) shall not apply to—

23                  “(A) a percentage of any dividend paid by  
24                  a business entity, 80 percent of whose gross re-  
25                  ceipts are not taken into account under chapter

1           1 because they are from outside the United  
2           States, equal to the percentage of gross receipts  
3           not so taken into account,

4           “(B) gambling winnings (except to the ex-  
5           tent that the Secretary determines by regula-  
6           tion that the collection of the tax is administra-  
7           tively feasible),

8           “(C) compensation paid by a foreign em-  
9           ployer to a nonresident alien individual for the  
10          period he is temporarily present in the United  
11          States as a nonimmigrant under subparagraph  
12          (F) or (J) of section 101(a)(15) of the Immi-  
13          gration and Nationality Act, as amended,

14          “(D) interest from a series E or series H  
15          savings bond if the individual acquired the bond  
16          while a resident of the Ryuku Islands or the  
17          Trust Territory of the Pacific Islands, or

18          “(E) amounts earned or payable to any  
19          person who is a bona fide resident of Puerto  
20          Rico, Guam, American Samoa, or the Northern  
21          Mariana Islands (and, therefore, is subject to  
22          the tax imposed by subchapter A).

23          “(c) EXPATRIATION TO AVOID TAX.—

24                 “(1) IN GENERAL.—A nonresident alien indi-  
25          vidual who at any time within the 10-year period im-

1       mediately preceding the close of the taxable year lost  
2       United States citizenship shall be taxable in the  
3       manner described in paragraph (2) unless none of  
4       the principal purposes of losing citizenship was  
5       avoidance of tax under subchapter A or subtitle B.

6               “(2) ALTERNATIVE TAX.—A nonresident alien  
7       individual described in paragraph (1) shall be sub-  
8       ject to tax on the items taxable under subsection (a)  
9       as determined without regard to exceptions listed or  
10       based on definitions contained in subsection (b)  
11       using the rate schedule for single individuals under  
12       section 215. If the taxes determined under sub-  
13       section (a) are greater than the tax determined  
14       under this subsection, the greater tax shall apply.

15       **“SEC. 132. TAX TREATMENT OF CERTAIN COMMUNITY IN-**  
16               **COME OF NONRESIDENT ALIENS.**

17               “(a) GENERAL RULE.—In the case of a married cou-  
18       ple one or both of whom are nonresident alien individuals  
19       and who have community income for the taxable year,  
20       such community income shall be treated as follows:

21               “(1) Compensation income shall be treated as  
22       income of the spouse who rendered the services,

23               “(2) Partnership distributions shall be treated  
24       as the related distributive shares of partnership in-  
25       come would be treated under section 1402(a)(5),

1           “(3) Community income which is derived from  
2           the separate property of a spouse shall be treated as  
3           income of that spouse, and

4           “(4) All other such community income shall be  
5           treated as provided in the applicable community  
6           property law.

7           “(b) EXCEPTION WHERE ELECTION UNDER SEC-  
8           TION 6013(g) IS IN EFFECT.—Subsection (a) shall not  
9           apply if an election under subsection (g) or (h) of section  
10          6013 (relating to election to treat nonresident alien indi-  
11          viduals as residents of the United States) is in effect.

12          **“SEC. 133. RELATIONSHIP WITH TREATIES.**

13          “(a) STATEMENT OF POLICY.—It is the intention of  
14          the USA Tax Code to promote a worldwide tax system  
15          in which each nation taxes—

16                 “(1) under an individual tax, only the income of  
17                 individuals who are residents or citizens of that na-  
18                 tion, and

19                 “(2) under a business tax only the business ac-  
20                 tivity in such nation.

21          “(b) EFFECT OF TREATIES.—No tax shall be im-  
22          posed under section 131(a) on income that is exempt from  
23          tax by reason of a treaty between the nation of which the  
24          nonresident alien is a citizen or resident and the United  
25          States. If any such treaty requires that a lower rate of

1 tax be imposed on some or all of the items of income sub-  
 2 ject to tax under section 331(a), such lower rate shall  
 3 apply to such items in the case of persons to whom such  
 4 treaty applies.

5 “(c) EFFECT OF UNILATERAL ACTION BY FOREIGN  
 6 NATION.—No tax shall be imposed under section 331(a)  
 7 on nonresident aliens who are citizens or residents of an-  
 8 other nation if—

9 “(1) such nation exempts from its income and  
 10 withholding taxes nonresident alien individuals who  
 11 are residents or citizens of the United States,

12 “(2) such nation has entered into a tax infor-  
 13 mation sharing agreement with the United States,  
 14 and

15 “(3) the Secretary certifies that the preceding  
 16 two requirements have been satisfied.

## 17 **“Subchapter I—Trusts and Estates**

“Sec. 140. Prepayment of tax by trusts and estates.

“Sec. 141. Application of tax.

“Sec. 142. Special rules for credits and deductions.

“Sec. 143. Definitions and rules applicable to subchapter I.

“Sec. 144. Deduction for trusts distributing current income only.

“Sec. 145. Inclusion of amounts in gross income of beneficiaries of trusts dis-  
 tributing current income only.

“Sec. 146. Deduction for estates and trusts accumulating income or distrib-  
 uting corpus.

“Sec. 147. Inclusion of amounts in gross income of beneficiaries of estates and  
 trusts accumulating income or distributing corpus.

“Sec. 148. Special rules applicable to sections 146 and 147.

“Sec. 149. Charitable remainder trusts.

“Sec. 150. Definitions applicable to excess distribution rules.

“Sec. 151. Accumulation distribution allocated to preceding years.

“Sec. 152. Treatment of amounts deemed distributed by trust in preceding  
 years.

“Sec. 153. Trust income, deductions, and credits attributable to grantors and others as substantial owners.

“Sec. 154. Definitions and rules.

“Sec. 155. Reversionary interests.

“Sec. 156. Power to control beneficial enjoyment.

“Sec. 157. Administrative powers.

“Sec. 158. Power to revoke.

“Sec. 159. Income for benefit of grantor.

“Sec. 160. Person other than grantor treated as substantial owner.

“Sec. 161. Foreign trusts having one or more United States beneficiaries.

“Sec. 162. Limitation on charitable deduction.

“Sec. 163. Income of an estate or trust in case of divorce, etc.

“Sec. 164. Recognition of gain on certain transfers to certain foreign persons and estates.

“Sec. 165. Treatment of funeral trusts.

“Sec. 166. Income in respect of a decedent.

1 **“SEC. 140. PREPAYMENT OF TAX BY TRUSTS AND ESTATES.**

2       “(a) PREPAYMENT OF TAX.—A trust or estate shall  
3 prepay the Simplified USA Tax for individuals in accord-  
4 ance with the provisions of this subchapter.

5       “(b) IMPOSITION OF TAX.—There is hereby imposed  
6 a tax on the taxable income of trusts and estates (as deter-  
7 mined in accordance with this subchapter) a tax deter-  
8 mined as follows:

<b>“If taxable income is:</b>	<b>The tax is:</b>
Not over \$1,600 .....	15% of taxable income.
Over \$1,600, but not over \$3,800	\$240, plus 25% of the excess over \$1,600.
Over \$3,800 .....	\$790, plus 30% of the excess over \$3,800.

9       “(c) INFLATION ADJUSTMENT.—The schedule in  
10 subsection (b) shall be adjusted for inflation in accordance  
11 with section 23.

12       “(d) BUSINESS ACTIVITIES.—

13               “(1) TAX ON BUSINESS ACTIVITY DETERMINED  
14 AT BUSINESS LEVEL.—If a trust engages in business  
15 activity (as defined in section 206(b)), it shall be

1 considered a business entity with respect to such ac-  
2 tivities for purposes of the business tax under chap-  
3 ter 2. The business entity shall be considered an  
4 asset of the trust.

5 “(2) BUSINESS ENTITY AS SOLE BENE-  
6 FICIARY.—If the only beneficiaries of a trust are  
7 business entities, no tax shall be imposed on such  
8 trust under this subchapter.

9 **“SEC. 141. APPLICATION OF TAX.**

10 “(a) IN GENERAL.—The tax imposed by section 140  
11 shall apply to the taxable income of estates or of any kind  
12 of property held in trust, including—

13 “(1) income accumulated in trust for the ben-  
14 efit of unborn or unascertained persons or persons  
15 with contingent interests, and income accumulated  
16 or held for future distribution under the terms of  
17 the will or trust;

18 “(2) income which is to be distributed currently  
19 by the fiduciary to the beneficiaries, and income col-  
20 lected by a guardian of an infant which is to be held  
21 or distributed as the court may direct;

22 “(3) income received by estates of deceased per-  
23 sons during the period of administration or settle-  
24 ment of the estate; and

1           “(4) income which, in the discretion of the fidu-  
2           ciary, may be either distributed to the beneficiaries  
3           or accumulated.

4           “(b) COMPUTATION AND PAYMENT.—The taxable in-  
5           come of an estate or trust shall be computed in the same  
6           manner as in the case of an individual, except as otherwise  
7           provided in this subchapter. The tax shall be computed  
8           on such taxable income and shall be paid by the fiduciary.  
9           For purposes of this subsection, a foreign trust or foreign  
10          estate shall be treated as a nonresident alien individual  
11          who is not present in the United States at any time.

12          “(c) EXCLUSION OF INCLUDIBLE GAIN FROM TAX-  
13          ABLE INCOME.—The taxable income of a trust does not  
14          include the amount of any includible gain as defined in  
15          section 144(b) reduced by any deductions properly allo-  
16          cable thereto.

17          **“SEC. 142. SPECIAL RULES FOR CREDITS AND DEDUCTIONS.**

18          “(a) USA DEDUCTION AND FAMILY LIVING ALLOW-  
19          ANCE.—

20                 “(1) NO DEDUCTION OR ALLOWANCE.—A trust  
21                 or estate shall not be allowed any USA Deductions  
22                 or a Family Living Allowance.

23                 “(2) SPECIAL DEDUCTION.—For purposes of  
24                 determining taxable income, trusts and estates shall

1 be entitled to the following deductions from gross  
2 income—

3 “(A) ESTATE.—An estate shall be allowed  
4 a deduction of \$600.

5 “(B) DISTRIBUTING TRUST.—A trust  
6 which, under its governing instrument, is re-  
7 quired to distribute all of its income currently  
8 shall be allowed a deduction of \$300.

9 “(C) OTHER TRUSTS.—Trusts not de-  
10 scribed in subparagraph (B) shall be allowed a  
11 deduction of \$100.

12 “(b) DEDUCTION FOR AMOUNTS PAID OR PERMA-  
13 NENTLY SET ASIDE FOR A CHARITABLE PURPOSE.—

14 “(1) GENERAL RULE.—In the case of an estate  
15 or trust, there shall be allowed as a deduction in  
16 computing its taxable income (in lieu of the philan-  
17 thropic transfer deduction) any amount of the gross  
18 income, without limitation, which pursuant to the  
19 terms of the governing instrument is, during the  
20 taxable year, paid for a purpose specified in section  
21 101(c) (determined without regard to section  
22 101(c)(2)(A)). If a charitable contribution is paid  
23 after the close of such taxable year and on or before  
24 the last day of the year following the close of such  
25 taxable year, then the trustee or administrator may

1 elect to treat such contribution as paid during such  
2 taxable year. The election shall be made at such  
3 time and in such manner as the Secretary prescribes  
4 by regulations.

5 “(2) POOLED INCOME FUNDS.—In the case of  
6 a pooled income fund (as defined in paragraph (3)),  
7 there shall also be allowed as a deduction in com-  
8 puting its taxable income any amount of the gross  
9 income attributable to gain from the sale of a capital  
10 asset held for more than 1 year, without limitation,  
11 which pursuant to the terms of the governing instru-  
12 ment is, during the taxable year, permanently set  
13 aside for a purpose specified in section 101(c).

14 “(3) DEFINITION OF POOLED INCOME FUND.—  
15 For purposes of paragraph (2), a pooled income  
16 fund is a trust—

17 “(A) to which each donor transfers prop-  
18 erty, contributing an irrevocable remainder in-  
19 terest in such property to or for the use of an  
20 organization described in section 101(b)(1)(A)  
21 (other than in clauses (vii) or (viii)), and retain-  
22 ing an income interest for the life of one or  
23 more beneficiaries (living at the time of such  
24 transfer),

1           “(B) in which the property transferred by  
2 each donor is commingled with property trans-  
3 ferred by other donors who have made or make  
4 similar transfers,

5           “(C) which cannot have investments in se-  
6 curities which are exempt from taxes imposed  
7 by this subtitle,

8           “(D) which includes only amounts received  
9 from transfers which meet the requirements of  
10 this paragraph,

11           “(E) which is maintained by the organiza-  
12 tion to which the remainder interest is contrib-  
13 uted and of which no donor or beneficiary of an  
14 income interest is a trustee, and

15           “(F) from which each beneficiary of an in-  
16 come interest receives income, for each year for  
17 which he is entitled to receive the income inter-  
18 est referred to in subparagraph (A), determined  
19 by the rate of return earned by the trust for  
20 such year.

21 For purposes of determining the amount of any  
22 charitable contribution allowable by reason of a  
23 transfer of property to a pooled fund, the value of  
24 the income interest shall be determined on the basis  
25 of the highest rate of return earned by the fund for

1 any of the 3 taxable years immediately preceding the  
2 taxable year of the fund in which the transfer is  
3 made. In the case of funds in existence less than 3  
4 taxable years preceding the taxable year of the fund  
5 in which a transfer is made the rate of return shall  
6 be deemed to be 6 percent per annum, except that  
7 the Secretary may prescribe a different rate of re-  
8 turn.

9 “(c) UNUSED LOSS CARRYOVERS.—If on the termi-  
10 nation of an estate or trust, the estate or trust has a loss  
11 carryover then such carryover shall be allowed as a deduc-  
12 tion, in accordance with regulations prescribed by the Sec-  
13 retary, to the beneficiaries succeeding to the property of  
14 the estate or trust.

15 “(d) CERTAIN DISTRIBUTIONS BY CEMETERY PER-  
16 PETUAL CARE FUNDS.—In the case of a cemetery per-  
17 petual care fund which—

18 “(1) was created pursuant to local law by a tax-  
19 able cemetery corporation for the care and mainte-  
20 nance of cemetery property, and

21 “(2) is treated for the taxable year as a trust  
22 for purposes of this subchapter,  
23 any amount distributed by such fund for the care and  
24 maintenance of gravesites which have been purchased  
25 from the cemetery corporation before the beginning of the

1 taxable year of the trust and with respect to which there  
2 is an obligation to furnish care and maintenance shall be  
3 considered to be a distribution solely for purposes of sec-  
4 tions 144 and 146, but only to the extent that the aggre-  
5 gate amount so distributed during the taxable year does  
6 not exceed \$5 multiplied by the aggregate number of such  
7 gravesites.

8 **“SEC. 143. DEFINITIONS AND RULES APPLICABLE TO SUB-**  
9 **CHAPTER I.**

10 “For purposes of this subchapter—

11 “(a) **DISTRIBUTABLE NET INCOME.**—‘Distributable  
12 net income’ means, with respect to any taxable year, the  
13 taxable income of the estate or trust computed with the  
14 following modifications—

15 “(1) No deduction shall be taken under sections  
16 144 and 146 (relating to additional deductions).

17 “(2) No deduction shall be taken under section  
18 142(a)(2) (relating to deduction for personal exemp-  
19 tions).

20 “(3) Gains from the sale or exchange of capital  
21 assets shall be excluded to the extent that such gains  
22 are allocated to corpus and are not (A) paid, cred-  
23 ited, or required to be distributed to any beneficiary  
24 during the taxable year, or (B) paid, permanently  
25 set aside, or to be used for the purposes specified

1 in section 142(b). Losses from the sale or exchange  
2 of capital assets shall be excluded, except to the ex-  
3 tent such losses are taken into account in deter-  
4 mining the amount of gains from the sale or ex-  
5 change of capital assets which are paid, credited, or  
6 required to be distributed to any beneficiary during  
7 the taxable year.

8 “(4) For purposes only of rules under section  
9 \_\_\_\_\_, there shall be excluded those items of gross in-  
10 come constituting extraordinary dividends or taxable  
11 stock dividends which the fiduciary, acting in good  
12 faith, does not pay or credit to any beneficiary by  
13 reason of his determination that such dividends are  
14 allocable to corpus under the terms of the governing  
15 instrument and applicable local law.

16 “(5) There shall be included any tax-exempt in-  
17 terest.

18 “(6) In the case of a foreign trust—

19 “(A) There shall be included the amounts  
20 of gross income from sources without the  
21 United States, reduced by any amounts which  
22 would be deductible in respect of disbursements  
23 allocable to such income but for the provisions  
24 of section 265(a)(1) (relating to disallowance of  
25 certain deductions).

1           “(B) Gross income from sources within the  
2           United States shall be determined without re-  
3           gard to section 894 (relating to income exempt  
4           under treaty).

5           “(C) Paragraph (3) shall not apply to a  
6           foreign trust. In the case of such a trust, there  
7           shall be included gains from the sale or ex-  
8           change of capital assets, reduced by losses from  
9           such sales or exchanges to the extent such  
10          losses do not exceed gains from such sales or  
11          exchanges.

12 If the estate or trust is allowed a deduction under section  
13 142(b), the amount of the modifications specified in para-  
14 graphs (5) and (6) shall be reduced to the extent that the  
15 amount of income which is paid, permanently set aside,  
16 or to be used for the purposes specified in section 142(b)  
17 is deemed to consist of items specified in those para-  
18 graphs. For this purpose, such amount shall (in the ab-  
19 sence of specific provisions in the governing instrument)  
20 be deemed to consist of the same proportion of each class  
21 of items of income of the estate or trust as the total of  
22 each class bears to the total of all classes.

23          “(b) INCOME.—‘Income’, when not preceded by the  
24 words ‘taxable’, ‘distributable net’, ‘undistributed net’, or  
25 ‘gross’, means the amount of income of the estate or trust

1 for the taxable year determined under the terms of the  
2 governing instrument and applicable local law. Items of  
3 gross income constituting extraordinary dividends or tax-  
4 able stock dividends which the fiduciary, acting in good  
5 faith, determines to be allocable to corpus under the terms  
6 of the governing instrument and applicable local law shall  
7 not be considered income.

8       “(c) BENEFICIARY.—‘Beneficiary’ includes heir, leg-  
9 atee, devisee.

10       “(d) TREATMENT OF PROPERTY DISTRIBUTED IN  
11 KIND.—

12               “(1) BASIS OF BENEFICIARY.—The basis of any  
13 property received by a beneficiary in a distribution  
14 from an estate or trust shall be—

15                       “(A) the adjusted basis of such property in  
16 the hands of the estate or trust immediately be-  
17 fore the distribution, adjusted for

18                       “(B) any gain or loss recognized to the es-  
19 tate or trust on the distribution.

20               “(2) AMOUNT OF DISTRIBUTION.—In the case  
21 of any distribution of property (other than cash), the  
22 amount taken into account under sections 146(a)(2)  
23 and 147(a)(2) shall be the lesser of—

1           “(A) the basis of such property in the  
2 hands of the beneficiary (as determined under  
3 paragraph (1)), or

4           “(B) the fair market value of such prop-  
5 erty.

6           “(3) ELECTION TO RECOGNIZE GAIN.—

7           “(A) IN GENERAL.—In the case of any dis-  
8 tribution of property (other than cash) to which  
9 an election under this paragraph applies—

10           “(i) paragraph (2) shall not apply,

11           “(ii) gain or loss shall be recognized  
12 by the estate or trust in the same manner  
13 as if such property had been sold to the  
14 distributee at its fair market value, and

15           “(iii) the amount taken into account  
16 under sections 146(a)(2) and 147(a)(2)  
17 shall be the fair market value of such  
18 property.

19           “(B) ELECTION.—Any election under this  
20 paragraph shall apply to all distributions made  
21 by the estate or trust during a taxable year and  
22 shall be made on the return of such estate or  
23 trust for such taxable year.

24           Any such election, once made, may be revoked  
25 only with the consent of the Secretary.

1           “(4) EXCEPTION FOR DISTRIBUTIONS DE-  
2           SCRIBED IN SECTION 148(a).—This subsection shall  
3           not apply to any distribution described in section  
4           148(a).

5           “(f) TREATMENT OF MULTIPLE TRUSTS.—For pur-  
6           poses of this subchapter, under regulations prescribed by  
7           the Secretary, 2 or more trusts shall be treated as 1 trust  
8           if—

9           “(1) such trusts have substantially the same  
10          grantor or grantors and substantially the same pri-  
11          mary beneficiary or beneficiaries, and

12          “(2) a principal purpose of such trusts is the  
13          avoidance of the tax imposed by this chapter.

14          For purposes of the preceding sentence, a husband and  
15          wife shall be treated as 1 person.

16          “(g) CERTAIN PAYMENTS OF ESTIMATED TAX  
17          TREATED AS PAID BY BENEFICIARY.—Under rules pre-  
18          scribed by the Secretary, a trustee may elect to treat any  
19          portion of a payment of estimated tax made by such trust  
20          for any taxable year of the trust as a payment made by  
21          a beneficiary of such trust. This rule shall also apply in  
22          the case of a taxable year reasonably expected to be the  
23          last taxable year of an estate.

24          “(h) FOREIGN TRUSTS AND FOREIGN INCOME.—The  
25          Secretary shall prescribe special rules for foreign trusts

1 and foreign income of trusts. Those rules should generally  
2 be consistent with the rules under subchapter J of chapter  
3 1 of the Internal Revenue Code of 1986, except that they  
4 shall take into account the principles of the Simplified  
5 USA Tax.

6 “(i) CERTAIN REVOCABLE TRUSTS TREATED AS  
7 PART OF ESTATE.—

8 “(1) IN GENERAL.—If both the executor (if  
9 any) of an estate and the trustee of a qualified rev-  
10 ocable trust elect the treatment provided in this sec-  
11 tion, such trust shall be treated and taxed as part  
12 of such estate (and not as a separate trust) for all  
13 taxable years of the estate ending after the date of  
14 the decedent’s death and before the applicable date.

15 “(2) QUALIFIED REVOCABLE TRUST.—For pur-  
16 poses of this subsection, ‘qualified revocable trust’  
17 means any trust (or portion thereof) which was  
18 treated under section 158 as owned by the decedent  
19 of the estate referred to in paragraph (1) by reason  
20 of a power in the grantor (determined without re-  
21 gard to section 154(e).

22 “(3) APPLICABLE DATE.—For purposes of this  
23 subsection, ‘applicable date’ means—

24 “(A) if no return of tax imposed by chap-  
25 ter 11 is required to be filed, the date which is

1           2 years after the date of the decedent's death,  
2           and

3                   “(B) if such a return is required to be  
4           filed, the date which is 6 months after the date  
5           of the final determination of the liability for tax  
6           imposed by chapter 11.

7           “(4) ELECTION.—The election under this sub-  
8           section shall be made not later than the time pre-  
9           scribed for filing the return of tax imposed by this  
10          chapter for the first taxable year of the estate (de-  
11          termined with regard to extensions) and, once made,  
12          shall be irrevocable.

13   **“SEC. 144. DEDUCTION FOR TRUSTS DISTRIBUTING CUR-**  
14                   **RENT INCOME ONLY.**

15          “(a) DEDUCTION.—In the case of any trust the terms  
16          of which—

17                   “(1) provide that all of its income is required  
18          to be distributed currently, and

19                   “(2) do not provide that any amounts are to be  
20          paid, permanently set aside, or used for the purposes  
21          specified in section 142(b) (relating to deduction for  
22          charitable, etc., purposes),

23          there shall be allowed as a deduction in computing the  
24          taxable income of the trust the amount of the income for  
25          the taxable year which is required to be distributed cur-

1 rently. This section shall not apply in any taxable year  
2 in which the trust distributes amounts other than amounts  
3 of income described in paragraph (1).

4       “(b) LIMITATION ON DEDUCTION.—If the amount of  
5 income required to be distributed currently exceeds the  
6 distributable net income of the trust for the taxable year,  
7 the deduction shall be limited to the amount of the distrib-  
8 utable net income. For this purpose, the computation of  
9 distributable net income shall not include items of income  
10 which are not included in the gross income of the trust  
11 and the deductions allocable thereto.

12 **“SEC. 145. INCLUSION OF AMOUNTS IN GROSS INCOME OF**  
13 **BENEFICIARIES OF TRUSTS DISTRIBUTING**  
14 **CURRENT INCOME ONLY.**

15       “(a) INCLUSION.—Subject to subsection (b), the  
16 amount of income for the taxable year required to be dis-  
17 tributed currently by a trust described in section 144 shall  
18 be included in the gross income of the beneficiaries to  
19 whom the income is required to be distributed, whether  
20 distributed or not. If such amount exceeds the distribut-  
21 able net income, there shall be included in the gross in-  
22 come of each beneficiary an amount which bears the same  
23 ratio to distributable net income as the amount of income  
24 required to be distributed to such beneficiary bears to the

1 amount of income required to be distributed to all bene-  
2 ficiaries.

3       “(b) CHARACTER OF AMOUNTS.—The amounts speci-  
4 fied in subsection (a) shall have the same character in the  
5 hands of the beneficiary as in the hands of the trust. For  
6 this purpose, the amounts shall be treated as consisting  
7 of the same proportion of each class of items entering into  
8 the computation of distributable net income of the trust  
9 as the total of each class bears to the total distributable  
10 net income of the trust, unless the terms of the trust spe-  
11 cifically allocate different classes of income to different  
12 beneficiaries. In the application of the preceding sentence,  
13 the items of deduction entering into the computation of  
14 distributable net income shall be allocated among the  
15 items of distributable net income in accordance with regu-  
16 lations prescribed by the Secretary.

17 **“SEC. 146. DEDUCTION FOR ESTATES AND TRUSTS ACCU-**  
18 **MULATING INCOME OR DISTRIBUTING COR-**  
19 **PUS.**

20       “(a) DEDUCTION.—In any taxable year there shall be  
21 allowed as a deduction in computing the taxable income  
22 of an estate or trust (other than a trust described in sec-  
23 tion 144), the sum of—

24               “(1) any amount of income for such taxable  
25       year required to be distributed currently (including

1 any amount required to be distributed which may be  
2 paid out of income or corpus to the extent such  
3 amount is paid out of income for such taxable year);  
4 and

5 “(2) any other amounts properly paid or cred-  
6 ited or required to be distributed for such taxable  
7 year;

8 but such deduction shall not exceed the distributable  
9 net income of the estate or trust.

10 “(b) CHARACTER OF AMOUNTS DISTRIBUTED.—The  
11 amount determined under subsection (a) shall be treated  
12 as consisting of the same proportion of each class of items  
13 entering into the computation of distributable net income  
14 of the estate or trust as the total of each class bears to  
15 the total distributable net income of the estate or trust  
16 in the absence of the allocation of different classes of in-  
17 come under the specific terms of the governing instru-  
18 ment. In the application of the preceding sentence, the  
19 items of deduction entering into the computation of dis-  
20 tributable net income (including the deduction allowed  
21 under section 142(b)) shall be allocated among the items  
22 of distributable net income in accordance with regulations  
23 prescribed by the Secretary.

24 “(c) LIMITATION ON DEDUCTION.—No deduction  
25 shall be allowed under subsection (a) in respect of any por-

1 tion of the amount allowed as a deduction under that sub-  
2 section (without regard to this subsection) which is treated  
3 under subsection (b) as consisting of any item of distribut-  
4 able net income which is not included in the gross income  
5 of the estate or trust.

6 **“SEC. 147. INCLUSION OF AMOUNTS IN GROSS INCOME OF**  
7 **BENEFICIARIES OF ESTATES AND TRUSTS AC-**  
8 **CUMULATING INCOME OR DISTRIBUTING**  
9 **CORPUS.**

10 “(a) INCLUSION.—Subject to subsection (b), there  
11 shall be included in the gross income of a beneficiary to  
12 whom an amount specified in section 146(a) is paid, cred-  
13 ited, or required to be distributed (by an estate or trust  
14 described in section 146), the sum of the following  
15 amounts:

16 “(1) AMOUNTS REQUIRED TO BE DISTRIBUTED  
17 CURRENTLY.—The amount of income for the taxable  
18 year required to be distributed currently to such  
19 beneficiary, whether distributed or not. If the  
20 amount of income required to be distributed cur-  
21 rently to all beneficiaries exceeds the distributable  
22 net income (computed without the deduction allowed  
23 by section 142(b), relating to deduction for chari-  
24 table, etc., purposes) of the estate or trust, then, in  
25 lieu of the amount provided in the preceding sen-

1       tence, there shall be included in the gross income of  
2       the beneficiary an amount which bears the same  
3       ratio to distributable net income (as so computed) as  
4       the amount of income required to be distributed cur-  
5       rently to such beneficiary bears to the amount re-  
6       quired to be distributed currently to all beneficiaries.  
7       For purposes of this section, the phrase ‘the amount  
8       of income for the taxable year required to be distrib-  
9       uted currently’ includes any amount required to be  
10      paid out of income or corpus to the extent such  
11      amount is paid out of income for such taxable year.

12           “(2) OTHER AMOUNTS DISTRIBUTED.—All  
13      other amounts properly paid, credited, or required to  
14      be distributed to such beneficiary for the taxable  
15      year. If the sum of—

16           “(A) the amount of income for the taxable  
17      year required to be distributed currently to all  
18      beneficiaries, and

19           “(B) all other amounts properly paid, cred-  
20      ited, or required to be distributed to all bene-  
21      ficiaries

22      exceeds the distributable net income of the estate or  
23      trust, then, in lieu of the amount provided in the  
24      preceding sentence, there shall be included in the  
25      gross income of the beneficiary an amount which

1 bears the same ratio to distributable net income (re-  
2 duced by the amounts specified in (A)) as the other  
3 amounts properly paid, credited or required to be  
4 distributed to the beneficiary bear to the other  
5 amounts properly paid, credited, or required to be  
6 distributed to all beneficiaries.

7 “(b) CHARACTER OF AMOUNTS.—The amounts de-  
8 termined under subsection (a) shall have the same char-  
9 acter in the hands of the beneficiary as in the hands of  
10 the estate or trust. For this purpose, the amounts shall  
11 be treated as consisting of the same proportion of each  
12 class of items entering into the computation of distribut-  
13 able net income as the total of each class bears to the  
14 total distributable net income of the estate or trust unless  
15 the terms of the governing instrument specifically allocate  
16 different classes of income to different beneficiaries. In the  
17 application of the preceding sentence, the items of deduc-  
18 tion entering into the computation of distributable net in-  
19 come (including the deduction allowed under section  
20 142(b)) shall be allocated among the items of distributable  
21 net income in accordance with regulations prescribed by  
22 the Secretary. In the application of this subsection to the  
23 amount determined under paragraph (1) of subsection (a),  
24 distributable net income shall be computed without regard

1 to any portion of the deduction under section 142(b) which  
2 is not attributable to income of the taxable year.

3 **“SEC. 148. SPECIAL RULES APPLICABLE TO SECTIONS 146**  
4 **AND 147.**

5 “(a) EXCLUSIONS.—There shall not be included as  
6 amounts falling within section 146(a) or 147(a)—

7 “(1) GIFTS, BEQUESTS, ETC.—Any amount  
8 which, under the terms of the governing instrument,  
9 is properly paid or credited as a gift or bequest of  
10 a specific sum of money or of specific property and  
11 which is paid or credited all at once or in not more  
12 than 3 installments. For this purpose an amount  
13 which can be paid or credited only from the income  
14 of the estate or trust shall not be considered as a  
15 gift or bequest of a specific sum of money.

16 “(2) CHARITABLE, ETC., DISTRIBUTIONS.—Any  
17 amount paid or permanently set aside or otherwise  
18 qualifying for the deduction provided in section  
19 142(b) (computed without regard to sections 508(d),  
20 162, and 4948(c)(4)).

21 “(3) DENIAL OF DOUBLE DEDUCTION.—Any  
22 amount paid, credited, or distributed in the taxable  
23 year, if section 144 or section 146 applied to such  
24 amount for a preceding taxable year of an estate or

1 trust because credited or required to be distributed  
2 in such preceding taxable year.

3 “(b) DISTRIBUTIONS IN FIRST SIXTY-FIVE DAYS OF  
4 TAXABLE YEAR.—

5 “(1) GENERAL RULE.—If within the first 65  
6 days of any taxable year of an estate or a trust, an  
7 amount is properly paid or credited, such amount  
8 shall be considered paid or credited on the last day  
9 of the preceding taxable year.

10 “(2) LIMITATION.—Paragraph (1) shall apply  
11 with respect to any taxable year of an estate or a  
12 trust only if the executor of such estate or the fidu-  
13 ciary of such trust (as the case may be) elects, in  
14 such manner and at such time as the Secretary pre-  
15 scribes by regulations, to have paragraph (1) apply  
16 for such taxable year.

17 “(c) SEPARATE SHARES TREATED AS SEPARATE ES-  
18 TATES OR TRUSTS.—For the sole purpose of determining  
19 the amount of distributable net income in the application  
20 of sections 146 and 147, in the case of a single trust hav-  
21 ing more than one beneficiary, substantially separate and  
22 independent shares of different beneficiaries in the trust  
23 shall be treated as separate trusts. Rules similar to the  
24 rules of the preceding provisions of this subsection shall  
25 apply to treat substantially separate and independent

1 shares of different beneficiaries in an estate having more  
2 than 1 beneficiary as separate estates. The existence of  
3 such substantially separate and independent shares and  
4 the manner of treatment as separate trusts or estates, in-  
5 cluding the application of sections 150 through 152, shall  
6 be determined in accordance with regulations prescribed  
7 by the Secretary.

8 **“SEC. 149. CHARITABLE REMAINDER TRUSTS.**

9       “(a) GENERAL RULE.—Notwithstanding any other  
10 provision of this subchapter, the provisions of this section  
11 shall, in accordance with regulations prescribed by the  
12 Secretary, apply in the case of a charitable remainder an-  
13 nuity trust and a charitable remainder unitrust.

14       “(b) CHARACTER OF DISTRIBUTIONS.—Amounts dis-  
15 tributed by a charitable remainder annuity trust or by a  
16 charitable remainder unitrust shall be considered as hav-  
17 ing the following characteristics in the hands of a bene-  
18 ficiary to whom is paid the annuity described in subsection  
19 (d)(1)(A) or the payment described in subsection  
20 (d)(2)(A):

21               “(1) First, as amounts of income (other than  
22 gains, and amounts treated as gains, from the sale  
23 or other disposition of capital assets) includible in  
24 gross income to the extent of such income of the

1 trust for the year and such undistributed income of  
2 the trust for prior years;

3 “(2) Second, as a capital gain to the extent of  
4 the capital gain of the trust for the year and the un-  
5 distributed capital gain of the trust for prior years;

6 “(3) Third, as other income to the extent of  
7 such income of the trust for the year and such un-  
8 distributed income of the trust for prior years; and

9 “(4) Fourth, as a distribution of trust corpus.

10 For purposes of this section, the trust shall determine the  
11 amount of its undistributed capital gain on a cumulative  
12 net basis.

13 “(c) EXEMPTION FROM INCOME TAXES.—A chari-  
14 table remainder annuity trust and a charitable remainder  
15 unitrust shall, for any taxable year, not be subject to any  
16 tax imposed by this chapter. Any such trust shall be liable  
17 for tax on its unrelated business taxable income (within  
18 the meaning of section 255).

19 “(d) DEFINITIONS.—

20 “(1) CHARITABLE REMAINDER ANNUITY  
21 TRUST.—For purposes of this section, a charitable  
22 remainder annuity trust is a trust—

23 “(A) from which a sum certain (which is  
24 not less than 5 percent nor more than 50 per-  
25 cent of the initial net fair market value of all

1 property placed in trust) is to be paid, not less  
2 often than annually, to one or more persons (at  
3 least one of which is not an organization de-  
4 scribed in section 101(c) and, in the case of in-  
5 dividuals, only to an individual who is living at  
6 the time of the creation of the trust) for a term  
7 of years (not in excess of 20 years) or for the  
8 life or lives of such individual or individuals,

9 “(B) from which no amount other than the  
10 payments described in subparagraph (A) and  
11 other than qualified gratuitous transfers de-  
12 scribed in subparagraph (C) may be paid to or  
13 for the use of any person other than an organi-  
14 zation described in section 101(c),

15 “(C) following the termination of the pay-  
16 ments described in subparagraph (A), the re-  
17 mainder interest in the trust is to be trans-  
18 ferred to, or for the use of, an organization de-  
19 scribed in section 101(c) or is to be retained by  
20 the trust for such a use or, to the extent the  
21 remainder interest is in qualified employer secu-  
22 rities (as defined in subsection (g)(4)), all or  
23 part of such securities are to be transferred to  
24 an employee stock ownership plan (as defined in

1 section 4975(e)(7) in a qualified gratuitous  
2 transfer (as defined by subsection (g)).

3 “(D) the value (determined under section  
4 7520 of such remainder interest is at least 10  
5 percent of the initial net fair market value of all  
6 property placed in the trust.

7 “(2) CHARITABLE REMAINDER UNITRUST.—For  
8 purposes of this section, a charitable remainder  
9 unitrust is a trust—

10 “(A) from which a fixed percentage (which  
11 is not less than 5 percent nor more than 50  
12 percent) of the net fair market value of its as-  
13 sets, valued annually, is to be paid, not less  
14 often than annually, to one or more persons (at  
15 least one of which is not an organization de-  
16 scribed in section 101(c) and, in the case of in-  
17 dividuals, only to an individual who is living at  
18 the time of the creation of the trust) for a term  
19 of years (not in excess of 20 years) or for the  
20 life or lives of such individual or individuals,

21 “(B) from which no amount other than the  
22 payments described in subparagraph (A) and  
23 other than qualified gratuitous transfers de-  
24 scribed in subparagraph (C) may be paid to or

1 for the use of any person other than an organi-  
2 zation described in section 101(c),

3 “(C) following the termination of the pay-  
4 ments described in subparagraph (A), the re-  
5 mainder interest in the trust is to be trans-  
6 ferred to, or for the use of, an organization de-  
7 scribed in section 101(c) or is to be retained by  
8 the trust for such a use or, to the extent the  
9 remainder interest is in qualified employer secu-  
10 rities (as defined in subsection (g)(4)), all or  
11 part of such securities are to be transferred to  
12 an employee stock ownership plan (as defined in  
13 section 4975(e)(7) in a qualified gratuitous  
14 transfer (as defined by subsection (g)).

15 “(D) with respect to each contribution of  
16 property to the trust, the value (determined  
17 under section 7520 of such remainder interest  
18 in such property is at least 10 percent of the  
19 net fair market value of such property as of the  
20 date such property is contributed to the trust.

21 “(3) EXCEPTION.—Notwithstanding the provi-  
22 sions of paragraphs (2)(A) and (B), the trust instru-  
23 ment may provide that the trustee shall pay the in-  
24 come beneficiary for any year—

1           “(A) the amount of the trust income, if  
2           such amount is less than the amount required  
3           to be distributed under paragraph (2)(A), and

4           “(B) any amount of the trust income  
5           which is in excess of the amount required to be  
6           distributed under paragraph (2)(A), to the ex-  
7           tent that (by reason of subparagraph (A)) the  
8           aggregate of the amounts paid in prior years  
9           was less than the aggregate of such required  
10          amounts.

11          “(4) SEVERANCE OF CERTAIN ADDITIONAL  
12          CONTRIBUTIONS.—If—

13               “(A) any contribution is made to a trust  
14               which before the contribution is a charitable re-  
15               mainder unitrust, and

16               “(B) such contribution would (but for this  
17               paragraph) result in such trust ceasing to be a  
18               charitable unitrust by reason of paragraph  
19               (2)(D), such contribution shall be treated as a  
20               transfer to a separate trust under regulations  
21               prescribed by the Secretary.

22          “(e) VALUATION FOR PURPOSES OF CHARITABLE  
23          CONTRIBUTION.—For purposes of determining the  
24          amount of any charitable contribution, the remainder in-  
25          terest of a charitable remainder annuity trust or charitable

1 remainder unitrust shall be computed on the basis that  
2 an amount equal to 5 percent of the net fair market value  
3 of its assets (or a greater amount, if required under the  
4 terms of the trust instrument) is to be distributed each  
5 year.

6 “(f) CERTAIN CONTINGENCIES PERMITTED.—

7 “(1) GENERAL RULE.—If a trust would, but for  
8 a qualified contingency, meet the requirements of  
9 paragraph (1)(A) or (2)(A) of subsection (d), such  
10 trust shall be treated as meeting such requirements.

11 “(2) VALUE DETERMINED WITHOUT REGARD  
12 TO QUALIFIED CONTINGENCY.—For purposes of de-  
13 termining the amount of any charitable contribution  
14 (or the actuarial value of any interest), a qualified  
15 contingency shall not be taken into account.

16 “(3) QUALIFIED CONTINGENCY.—For purposes  
17 of this subsection, the term ‘qualified contingency’  
18 means any provision of a trust which provides that,  
19 upon the happening of a contingency, the payments  
20 described in paragraph (1)(A) or (2)(A) of sub-  
21 section (d) (as the case may be) will terminate not  
22 later than such payments would otherwise terminate  
23 under the trust.

24 “(g) QUALIFIED GRATUITOUS TRANSFER OF QUALI-  
25 FIED EMPLOYER SECURITIES.—

1           “(1) IN GENERAL.—For purposes of this sec-  
2           tion, the term ‘qualified gratuitous transfer’ means  
3           a transfer of qualified employer securities to an em-  
4           ployee stock ownership plan (as defined in section  
5           4975(e)(7) but only to the extent that—

6                   “(A) the securities transferred previously  
7                   passed from a decedent dying before January 1,  
8                   2002, to a trust described in paragraph (1) or  
9                   (2) of subsection (d),

10                   “(B) no deduction under section 404 is al-  
11                   lowable with respect to such transfer,

12                   “(C) such plan contains the provisions re-  
13                   quired by paragraph (3),

14                   “(D) such plan treats such securities as  
15                   being attributable to employer contributions but  
16                   without regard to the limitations otherwise ap-  
17                   plicable to such contributions under section  
18                   404, and

19                   “(E) the employer whose employees are  
20                   covered by the plan described in this paragraph  
21                   files with the Secretary a verified written state-  
22                   ment consenting to the application of sections  
23                   4978 and 4979A with respect to such employer.

24           “(2) EXCEPTION.—The term ‘qualified gratu-  
25           itous transfer’ shall not include a transfer of quali-

1       fied employer securities to an employee stock owner-  
2       ship plan unless—

3               “(A) such plan was in existence on August  
4               1, 1996,

5               “(B) at the time of the transfer, the dece-  
6       dent and members of the decedent’s family  
7       (within the meaning of section 171(a)(6)(D))  
8       own (directly or through constructive ownership  
9       rules) no more than 10 percent of the value of  
10      the stock of the corporation referred to in para-  
11      graph (4), and

12              “(C) immediately after the transfer, such  
13      plan owns (after the application of section  
14      318(a)(4) at least 60 percent of the value of the  
15      outstanding stock of the corporation.

16              “(3) PLAN REQUIREMENTS.—A plan contains  
17      the provisions required by this paragraph if such  
18      plan provides that—

19              “(A) the qualified employer securities so  
20      transferred are allocated to plan participants in  
21      a manner consistent with section 401(a)(4),

22              “(B) plan participants are entitled to di-  
23      rect the plan as to the manner in which such  
24      securities which are entitled to vote and are al-

1 located to the account of such participant are to  
2 be voted,

3 “(C) an independent trustee votes the se-  
4 curities so transferred which are not allocated  
5 to plan participants,

6 “(D) each participant who is entitled to a  
7 distribution from the plan has the rights de-  
8 scribed in subparagraphs (A) and (B) of section  
9 409(h)(1),

10 “(E) such securities are held in a suspense  
11 account under the plan to be allocated each  
12 year, up to the limitations under section 415(c),  
13 after first allocating all other annual additions  
14 for the limitation year, up to the limitations  
15 under sections 415 (c) and (e), and

16 “(F) on termination of the plan, all securi-  
17 ties so transferred which are not allocated to  
18 plan participants as of such termination are to  
19 be transferred to, or for the use of, an organi-  
20 zation described in section 101(c). For purposes  
21 of the preceding sentence, the term ‘inde-  
22 pendent trustee’ means any trustee who is not  
23 a member of the family (within the meaning of  
24 section 171(a)(6)(D)) of the decedent or a 5-  
25 percent shareholder. A plan shall not fail to be

1 treated as meeting the requirements of section  
2 401(a) by reason of meeting the requirements  
3 of this subsection.

4 “(4) QUALIFIED EMPLOYER SECURITIES.—For  
5 purposes of this section, the term ‘qualified employer  
6 securities’ means employer securities (as defined in  
7 section 409(l)) which are issued by a domestic  
8 corporation—

9 “(A) which has no outstanding stock which  
10 is readily tradable on an established securities  
11 market, and

12 “(B) which has only 1 class of stock.

13 “(5) TREATMENT OF SECURITIES ALLOCATED  
14 BY EMPLOYEE STOCK OWNERSHIP PLAN TO PER-  
15 SONS RELATED TO DECEDENT OR 5-PERCENT  
16 SHAREHOLDERS.—

17 “(A) IN GENERAL.—If any portion of the  
18 assets of the plan attributable to securities ac-  
19 quired by the plan in a qualified gratuitous  
20 transfer are allocated to the account of—

21 “(i) any person who is related to the  
22 decedent (within the meaning of section  
23 171(a)(5) or a member of the decedent’s  
24 family (within the meaning of section  
25 171(a)(6)(D), or

1           “(ii) any person who, at the time of  
2           such allocation or at any time during the  
3           1-year period ending on the date of the ac-  
4           quisition of qualified employer securities by  
5           the plan, is a 5-percent shareholder of the  
6           employer maintaining the plan, the plan  
7           shall be treated as having distributed (at  
8           the time of such allocation) to such person  
9           or shareholder the amount so allocated.

10           “(B) 5-PERCENT SHAREHOLDER.—For  
11           purposes of subparagraph (A), the term ‘5-per-  
12           cent shareholder’ means any person who owns  
13           (directly or through the application of construc-  
14           tive ownership rules) more than 5 percent of  
15           the outstanding stock of the corporation which  
16           issued such qualified employer securities or of  
17           any corporation which is a member of the same  
18           controlled group of corporations (within the  
19           meaning of section 409(l)(4)) as such corpora-  
20           tion.

21           “(C) CROSS REFERENCE.—For excise tax  
22           on allocations described in subparagraph (A),  
23           see section 4979A.

24           “(6) TAX ON FAILURE TO TRANSFER  
25           UNALLOCATED SECURITIES TO CHARITY ON TERMI-

1 NATION OF PLAN.—If the requirements of paragraph  
2 (3)(F) are not met with respect to any securities,  
3 there is hereby imposed a tax on the employer main-  
4 taining the plan in an amount equal to the sum of—

5 “(A) the amount of the increase in the tax  
6 which would be imposed by chapter 11 if such  
7 securities were not transferred as described in  
8 paragraph (1), and

9 “(B) interest on such amount at the un-  
10 derpayment rate under section 6621 (and com-  
11 pounded daily) from the due date for filing the  
12 return of the tax imposed by chapter 11.

13 **“SEC. 150. DEFINITIONS APPLICABLE TO EXCESS DISTRIBU-**  
14 **TION RULES.**

15 “(a) **UNDISTRIBUTED NET INCOME.**—For purposes  
16 of sections 150 through 152, the term ‘undistributed net  
17 income’ for any taxable year means the amount by which  
18 the distributable net income of the trust for such taxable  
19 year exceeds the sum of—

20 “(1) the amounts for such taxable year speci-  
21 fied in paragraphs (1) and (2) of section 146(a),  
22 and

23 “(2) the amount of taxes imposed on the trust  
24 attributable to such distributable net income.

1           “(b) ACCUMULATION DISTRIBUTION.—For purposes  
2 of sections 150 through 152, except as provided in sub-  
3 section (c), the term ‘accumulation distribution’ means,  
4 for any taxable year of the trust, the amount by which—

5           “(1) the amounts specified in paragraph (2) of  
6 section 146(a) for such taxable year, exceed

7           “(2) distributable net income for such year re-  
8 duced (but not below zero) by the amounts specified  
9 in paragraph (1) of section 146(a).

10 For purposes of section 152 (other than subsection (c)  
11 thereof, relating to multiple trusts), the amounts specified  
12 in paragraph (2) of section 146(a) shall not include  
13 amounts properly paid, credited, or required to be distrib-  
14 uted to a beneficiary from a trust (other than a foreign  
15 trust) as income accumulated before the birth of such ben-  
16 efiary or before such beneficiary attains the age of 21.  
17 If the amounts properly paid, credited, or required to be  
18 distributed by the trust for the taxable year do not exceed  
19 the income of the trust for such year, there shall be no  
20 accumulation distribution for such year.

21           “(c) EXCEPTION FOR ACCUMULATION DISTRIBUTIONS FROM CERTAIN DOMESTIC TRUSTS.—For purposes  
22 of sections 150 through 152—

24           “(1) IN GENERAL.—In the case of a qualified  
25 trust, any distribution in any taxable year beginning

1 after the date of the enactment of this subsection  
2 shall be computed without regard to any undistrib-  
3 uted net income.

4 “(2) QUALIFIED TRUST.—For purposes of this  
5 subsection, the term ‘qualified trust’ means any  
6 trust other than—

7 “(A) a foreign trust (or, except as provided  
8 in regulations, a domestic trust which at any  
9 time was a foreign trust), or

10 “(B) a trust created before March 1, 1984,  
11 unless it is established that the trust would not  
12 be aggregated with other trusts under section  
13 143(f) if such section applied to such trust.

14 “(d) TAXES IMPOSED ON THE TRUST.—For purposes  
15 of sections 150 through 152—

16 “(1) IN GENERAL.—The term ‘taxes imposed  
17 on the trust’ means the amount of the taxes which  
18 are imposed for any taxable year of the trust under  
19 this chapter (without regard to sections 150 through  
20 152) and which, under regulations prescribed by the  
21 Secretary, are properly allocable to the undistributed  
22 portions of distributable net income and gains in ex-  
23 cess of losses from sales or exchanges of capital as-  
24 sets. The amount determined in the preceding sen-  
25 tence shall be reduced by any amount of such taxes

1 deemed distributed under section 151(b) and (c) to  
2 any beneficiary.

3 “(2) FOREIGN TRUSTS.—In the case of any for-  
4 eign trust, the term ‘taxes imposed on the trust’ in-  
5 cludes the amount, reduced as provided in the last  
6 sentence of paragraph (1), of any income, war prof-  
7 its, and excess profits taxes imposed by any foreign  
8 country or possession of the United States on such  
9 foreign trust which, as determined under paragraph  
10 (1), are so properly allocable. Under rules or regula-  
11 tions prescribed by the Secretary, in the case of any  
12 foreign trust of which the settlor or another person  
13 would be treated as owner of any portion of the  
14 trust but for section 154(f), the term ‘taxes imposed  
15 on the trust’ includes the allocable amount of any  
16 income, war profits, and excess profits taxes imposed  
17 by any foreign country or possession of the United  
18 States on the settlor or such other person in respect  
19 of trust income.

20 **“SEC. 151. ACCUMULATION DISTRIBUTION ALLOCATED TO**  
21 **PRECEDING YEARS.**

22 “(a) AMOUNT ALLOCATED.—In the case of a trust  
23 which is subject to sections 146 through 149, the amount  
24 of the accumulation distribution of such trust for a taxable  
25 year shall be deemed to be an amount within the meaning

1 of paragraph (2) of section 146(a) distributed on the last  
2 day of each of the preceding taxable years, commencing  
3 with the earliest of such years, to the extent that such  
4 amount exceeds the total of any undistributed net income  
5 for all earlier preceding taxable years. The amount deemed  
6 to be distributed in any such preceding taxable year under  
7 the preceding sentence shall not exceed the undistributed  
8 net income for such preceding taxable year. For purposes  
9 of this subsection, undistributed net income for each of  
10 such preceding taxable years shall be computed without  
11 regard to such accumulation distribution and without re-  
12 gard to any accumulation distribution determined for any  
13 succeeding taxable year.

14       “(b) TOTAL TAXES DEEMED DISTRIBUTED.—If any  
15 portion of an accumulation distribution for any taxable  
16 year is deemed under subsection (a) to be an amount with-  
17 in the meaning of paragraph (2) of section 146(a) distrib-  
18 uted on the last day of any preceding taxable year, and  
19 such portion of such distribution is not less than the un-  
20 distributed net income for such preceding taxable year, the  
21 trust shall be deemed to have distributed on the last day  
22 of such preceding taxable year an additional amount with-  
23 in the meaning of paragraph (2) of section 146(a). Such  
24 additional amount shall be equal to the taxes imposed on  
25 the trust for such preceding taxable year attributable to

1 the undistributed net income. For purposes of this sub-  
2 section, the undistributed net income and the taxes im-  
3 posed on the trust for such preceding taxable year attrib-  
4 utable to such undistributed net income shall be computed  
5 without regard to such accumulation distribution and  
6 without regard to any accumulation distribution deter-  
7 mined for any succeeding taxable year.

8       “(c) PRO RATA PORTION OF TAXES DEEMED DIS-  
9 TRIBUTED.—If any portion of an accumulation distribu-  
10 tion for any taxable year is deemed under subsection (a)  
11 to be an amount within the meaning of paragraph (2) of  
12 section 146(a) distributed on the last day of any preceding  
13 taxable year and such portion of the accumulation dis-  
14 tribution is less than the undistributed net income for such  
15 preceding taxable year, the trust shall be deemed to have  
16 distributed on the last day of such preceding taxable year  
17 an additional amount within the meaning of paragraph (2)  
18 of section 146(a). Such additional amount shall be equal  
19 to the taxes imposed on the trust for such taxable year  
20 attributable to the undistributed net income multiplied by  
21 the ratio of the portion of the accumulation distribution  
22 to the undistributed net income of the trust for such year.  
23 For purposes of this subsection, the undistributed net in-  
24 come and the taxes imposed on the trust for such pre-  
25 ceding taxable year attributable to such undistributed net

1 income shall be computed without regard to the accumula-  
2 tion distribution and without regard to any accumulation  
3 distribution determined for any succeeding taxable year.

4       “(d) RULE WHEN INFORMATION IS NOT AVAIL-  
5 ABLE.—If adequate records are not available to determine  
6 the proper application of this subchapter to an amount  
7 distributed by a trust, such amount shall be deemed to  
8 be an accumulation distribution consisting of undistrib-  
9 uted net income earned during the earliest preceding tax-  
10 able year of the trust in which it can be established that  
11 the trust was in existence.

12       “(e) DENIAL OF REFUND TO TRUSTS AND BENE-  
13 FICIARIES.—No refund or credit shall be allowed to a trust  
14 or a beneficiary of such trust for any preceding taxable  
15 year by reason of a distribution deemed to have been made  
16 by such trust in such year under this section.

17 **“SEC. 152. TREATMENT OF AMOUNTS DEEMED DISTRIB-**  
18 **UTED BY TRUST IN PRECEDING YEARS.**

19       “(a) GENERAL RULE.—The total of the amounts  
20 which are treated under section 151 as having been dis-  
21 tributed by a trust in a preceding taxable year shall be  
22 included in the income of a beneficiary of the trust when  
23 paid, credited, or required to be distributed to the extent  
24 that such total would have been included in the income  
25 of such beneficiary under section 147(a)(2) (and, with re-

1 spect to any tax-exempt interest to which section 103 ap-  
2 plies, under section 147(b)) if such total had been paid  
3 to such beneficiary on the last day of such preceding tax-  
4 able year. The tax imposed by this subtitle on a beneficiary  
5 for a taxable year in which any such amount is included  
6 in his income shall be determined only as provided in this  
7 section and shall consist of the sum of—

8           “(1) a partial tax computed on the taxable in-  
9 come reduced by an amount equal to the total of  
10 such amounts, at the rate and in the manner as if  
11 this section had not been enacted,

12           “(2) a partial tax determined as provided in  
13 subsection (b) of this section, and

14           “(3) in the case of a foreign trust, the interest  
15 charge determined as provided in section 152.

16           “(b) TAX ON DISTRIBUTION.—

17           “(1) IN GENERAL.—The partial tax imposed by  
18 subsection (a)(2) shall be determined.

19           “(A) by determining the number of pre-  
20 ceeding taxable years of the trust on the last day  
21 of which an amount is deemed under section  
22 151(a) to have been distributed,

23           “(B) by taking from the 5 taxable years  
24 immediately preceding the year of the accumu-  
25 lation distribution the 1 taxable year for which

1 the beneficiary's taxable income was the highest  
2 and the 1 taxable year for which his taxable in-  
3 come was the lowest,

4 “(C) by adding to the beneficiary's taxable  
5 income for each of the 3 taxable years remain-  
6 ing after the application of subparagraph (B)  
7 an amount determined by dividing the amount  
8 deemed distributed under section 151 and re-  
9 quired to be included in income under sub-  
10 section (a) by the number of preceding taxable  
11 years determined under subparagraph (A), and

12 “(D) by determining the average increase  
13 in tax for the 3 taxable years referred to in sub-  
14 paragraph (C) resulting from the application of  
15 such subparagraph.

16 The partial tax imposed by subsection (a)(2) shall be  
17 the excess (if any) of the average increase in tax de-  
18 termined under subparagraph (D), multiplied by the  
19 number of preceding taxable years determined under  
20 subparagraph (A), over the amount of taxes (other  
21 than the amount of taxes described in section  
22 150(d)(2)) deemed distributed to the beneficiary  
23 under sections 151 (b) and (c).

24 “(2) TREATMENT OF LOSS YEARS.—For pur-  
25 poses of paragraph (1), the taxable income of the

1 beneficiary for any taxable year shall be deemed to  
2 be not less than zero.

3 “(3) CERTAIN PRECEDING TAXABLE YEARS NOT  
4 TAKEN INTO ACCOUNT.—For purposes of paragraph  
5 (1), if the amount of the undistributed net income  
6 deemed distributed in any preceding taxable year of  
7 the trust is less than 25 percent of the amount of  
8 the accumulation distribution divided by the number  
9 of preceding taxable years to which the accumulation  
10 distribution is allocated under section 151(a), the  
11 number of preceding taxable years of the trust with  
12 respect to which an amount is deemed distributed to  
13 a beneficiary under section 151(a) shall be deter-  
14 mined without regard to such year.

15 “(4) EFFECT OF OTHER ACCUMULATION DIS-  
16 TRIBUTIONS.—In computing the partial tax under  
17 paragraph (1) for any beneficiary, the income of  
18 such beneficiary for each of his prior taxable years  
19 shall include amounts previously deemed distributed  
20 to such beneficiary in such year under section 151  
21 as a result of prior accumulation distributions  
22 (whether from the same or another trust).

23 “(5) MULTIPLE DISTRIBUTIONS IN THE SAME  
24 TAXABLE YEAR.—In the case of accumulation dis-  
25 tributions made from more than one trust which are

1 includible in the income of a beneficiary in the same  
2 taxable year, the distributions shall be deemed to  
3 have been made consecutively in whichever order the  
4 beneficiary shall determine. Generation-skipping  
5 transfer bears to the total accumulation distribution.

6 “(c) SPECIAL RULE FOR MULTIPLE TRUSTS.—

7 “(1) IN GENERAL.—If, in the same prior tax-  
8 able year of the beneficiary in which any part of the  
9 accumulation distribution from a trust (hereinafter  
10 in this paragraph referred to as “third trust”) is  
11 deemed under section 151(a) to have been distrib-  
12 uted to such beneficiary, some part of prior distribu-  
13 tions by each of 2 or more other trusts is deemed  
14 under section 151(a) to have been distributed to  
15 such beneficiary, then subsections (b) and (c) of sec-  
16 tion 151 shall not apply with respect to such part  
17 of the accumulation distribution from such third  
18 trust.

19 “(2) ACCUMULATION DISTRIBUTIONS FROM  
20 TRUST NOT TAKEN INTO ACCOUNT UNLESS THEY  
21 EQUAL OR EXCEED \$1,000.—For purposes of para-  
22 graph (1), an accumulation distribution from a trust  
23 to a beneficiary shall be taken into account only if  
24 such distribution, when added to any prior accumu-  
25 lation distributions from such trust which are

1 deemed under section 151(a) to have been distrib-  
2 uted to such beneficiary for the same prior taxable  
3 year of the beneficiary, equals or exceeds \$1,000.

4 **“SEC. 153. TRUST INCOME, DEDUCTIONS, AND CREDITS AT-**  
5 **TRIBUTABLE TO GRANTORS AND OTHERS AS**  
6 **SUBSTANTIAL OWNERS.**

7 “Where it is specified in sections 153 through 161  
8 that the grantor or another person shall be treated as the  
9 owner of any portion of a trust, there shall then be in-  
10 cluded in computing the taxable income and credits of the  
11 grantor or the other person those items of income, deduc-  
12 tions, and credits against tax of the trust which are attrib-  
13 utable to that portion of the trust to the extent that such  
14 items would be taken into account under this chapter in  
15 computing taxable income or credits against the tax of an  
16 individual. Any remaining portion of the trust shall be  
17 subject to sections 140 through 152. No items of a trust  
18 shall be included in computing the taxable income and  
19 credits of the grantor or of any other person solely on the  
20 grounds of his dominion and control over the trust under  
21 section 61 (relating to definition of gross income) or any  
22 other provision of this title, except as specified in this sub-  
23 part.

1 **“SEC. 154. DEFINITIONS AND RULES.**

2       “(a) ADVERSE PARTY.—For purposes of sections 153  
3 through 160, ‘adverse party’ means any person having a  
4 substantial beneficial interest in the trust which would be  
5 adversely affected by the exercise or nonexercise of the  
6 power which he possesses respecting the trust. A person  
7 having a general power of appointment over the trust  
8 property shall be deemed to have a beneficial interest in  
9 the trust.

10       “(b) NONADVERSE PARTY.—For purposes of sections  
11 153 through 160, ‘nonadverse party’ means any person  
12 who is not an adverse party.

13       “(c) RELATED OR SUBORDINATE PARTY.—For pur-  
14 poses of sections 153 through 161, ‘related or subordinate  
15 party’ means any nonadverse party who is—

16               “(1) the grantor’s spouse if living with the  
17 grantor;

18               “(2) any one of the following: The grantor’s fa-  
19 ther, mother, issue, brother or sister; an employee of  
20 the grantor; a corporation or any employee of a cor-  
21 poration in which the stock holdings of the grantor  
22 and the trust are significant from the viewpoint of  
23 voting control; a subordinate employee of a corpora-  
24 tion in which the grantor is an executive.

25 For purposes of subsection (f) and sections 156 and 157,  
26 a related or subordinate party shall be presumed to be

1 subservient to the grantor in respect of the exercise or  
2 nonexercise of the powers conferred on him unless such  
3 party is shown not to be subservient by a preponderance  
4 of the evidence.

5       “(d) RULE WHERE POWER IS SUBJECT TO CONDI-  
6 TION PRECEDENT.—A person shall be considered to have  
7 a power described in sections 153 through 161 even  
8 though the exercise of the power is subject to a precedent  
9 giving of notice or takes effect only on the expiration of  
10 a certain period after the exercise of the power.

11       “(e) GRANTOR TREATED AS HOLDING ANY POWER  
12 OR INTEREST OF GRANTOR’S SPOUSE.—

13               “(1) IN GENERAL.—For purposes of sections  
14 153 through 160, a grantor shall be treated as hold-  
15 ing any power or interest held by—

16                       “(A) any individual who was the spouse of  
17 the grantor at the time of the creation of such  
18 power or interest, or

19                       “(B) any individual who became the spouse  
20 of the grantor after the creation of such power  
21 or interest, but only with respect to periods  
22 after such individual became the spouse of the  
23 grantor.

24               “(2) MARITAL STATUS.—For purposes of para-  
25 graph (1)(A), an individual legally separated from

1 his spouse under a decree of divorce or of separate  
2 maintenance shall not be considered as married.

3 “(f) RULES NOT TO RESULT IN FOREIGN OWNER-  
4 SHIP.—

5 “(1) IN GENERAL.—Notwithstanding any other  
6 provision in sections 153 through 160, sections 153  
7 through 160 shall apply only to the extent such ap-  
8 plication results in an amount (if any) being cur-  
9 rently taken into account (directly or through 1 or  
10 more entities) under this chapter in computing the  
11 income of a citizen or resident of the United States  
12 or a domestic corporation.

13 “(2) EXCEPTIONS.—

14 “(A) CERTAIN REVOCABLE AND IRREV-  
15 OCABLE TRUSTS.—Paragraph (1) shall not  
16 apply to any portion of a trust if—

17 “(i) the power to revest absolutely in  
18 the grantor title to the trust property to  
19 which such portion is attributable is exer-  
20 cisable solely by the grantor without the  
21 approval or consent of any other person or  
22 with the consent of a related or subordi-  
23 nate party who is subservient to the grant-  
24 or, or

1                   “(ii) the only amounts distributable  
2                   from such portion (whether income or cor-  
3                   pus) during the lifetime of the grantor are  
4                   amounts distributable to the grantor or the  
5                   spouse of the grantor.

6                   “(B) COMPENSATORY TRUSTS.—Except as  
7                   provided in regulations, paragraph (1) shall not  
8                   apply to any portion of a trust distributions  
9                   from which are taxable as compensation for  
10                  services rendered.

11                  “(3) SPECIAL RULES.—Except as otherwise  
12                  provided in regulations prescribed by the Secretary,  
13                  a controlled foreign corporation shall be treated as  
14                  a domestic corporation for purposes of paragraph  
15                  (1).

16                  “(4) RECHARACTERIZATION OF PURPORTED  
17                  GIFTS.—In the case of any transfer directly or indi-  
18                  rectly from a partnership or foreign corporation  
19                  which the transferee treats as a gift or bequest, the  
20                  Secretary may recharacterize such transfer in such  
21                  circumstances as the Secretary determines to be ap-  
22                  propriate to prevent the avoidance of the purposes of  
23                  this subsection.

24                  “(5) SPECIAL RULE WHERE GRANTOR IS FOR-  
25                  EIGN PERSON.—If—

1           “(A) but for this subsection, a foreign per-  
2           son would be treated as the owner of any por-  
3           tion of a trust, and

4           “(B) such trust has a beneficiary who is a  
5           United States person,  
6           such beneficiary shall be treated as the grantor of  
7           such portion to the extent such beneficiary has made  
8           (directly or indirectly) transfers of property (other  
9           than in a sale for full and adequate consideration)  
10          to such foreign person.

11          “(6) REGULATIONS.—The Secretary shall pre-  
12          scribe such regulations as may be necessary or ap-  
13          propriate to carry out the purposes of this sub-  
14          section, including regulations providing that para-  
15          graph (1) shall not apply in appropriate cases.

16 **“SEC. 155. REVERSIONARY INTERESTS.**

17          “(a) GENERAL RULE.—The grantor shall be treated  
18          as the owner of any portion of a trust in which he has  
19          a reversionary interest in either the corpus or the income  
20          therefrom, if, as of the inception of that portion of the  
21          trust, the value of such interest exceeds 5 percent of the  
22          value of such portion.

23          “(b) REVERSIONARY INTEREST TAKING EFFECT AT  
24          DEATH OF MINOR LINEAL DESCENDANT BENE-  
25          FICIARY.—In the case of any beneficiary who—

1           “(1) is a lineal descendant of the grantor, and

2           “(2) holds all of the present interests in any

3           portion of a trust,

4           the grantor shall not be treated under subsection (a) as

5           the owner of such portion solely by reason of a rever-

6           sionary interest in such portion which takes effect upon

7           the death of such beneficiary before such beneficiary at-

8           tains age 21.

9           “(c) SPECIAL RULE FOR DETERMINING VALUE OF

10          REVERSIONARY INTEREST.—For purposes of subsection

11          (a), the value of the grantor’s reversionary interest shall

12          be determined by assuming the maximum exercise of dis-

13          cretion in favor of the grantor.

14          “(d) POSTPONEMENT OF DATE SPECIFIED FOR RE-

15          ACQUISITION.—Any postponement of the date specified for

16          the reacquisition of possession or enjoyment of the rever-

17          sionary interest shall be treated as a new transfer in trust

18          commencing with the date on which the postponement is

19          effective and terminating with the date prescribed by the

20          postponement. However, income for any period shall not

21          be included in the income of the grantor by reason of the

22          preceding sentence if such income would not be so includ-

23          ible in the absence of such postponement.

1 **“SEC. 156. POWER TO CONTROL BENEFICIAL ENJOYMENT.**

2       “(a) GENERAL RULE.—The grantor shall be treated  
3 as the owner of any portion of a trust in respect of which  
4 the beneficial enjoyment of the corpus or the income there-  
5 from is subject to a power of disposition, exercisable by  
6 the grantor or a nonadverse party, or both, without the  
7 approval or consent of any adverse party.

8       “(b) EXCEPTIONS FOR CERTAIN POWERS.—Sub-  
9 section (a) shall not apply to the following powers regard-  
10 less of by whom held:

11               “(1) POWER TO APPLY INCOME TO SUPPORT OF  
12 A DEPENDENT.—A power described in section  
13 159(b) to the extent that the grantor would not be  
14 subject to tax under that section.

15               “(2) POWER AFFECTING BENEFICIAL ENJOY-  
16 MENT ONLY AFTER OCCURRENCE OF EVENT.—A  
17 power, the exercise of which can only affect the ben-  
18 efiticial enjoyment of the income for a period com-  
19 mencing after the occurrence of an event such that  
20 a grantor would not be treated as the owner under  
21 section 155 if the power were a reversionary inter-  
22 est; but the grantor may be treated as the owner  
23 after the occurrence of the event unless the power is  
24 relinquished.

25               “(3) POWER EXERCISABLE ONLY BY WILL.—A  
26 power exercisable only by will, other than a power in

1 the grantor to appoint by will the income of the  
2 trust where the income is accumulated for such dis-  
3 position by the grantor or may be so accumulated in  
4 the discretion of the grantor or a nonadverse party,  
5 or both, without the approval or consent of any ad-  
6 verse party.

7 “(4) POWER TO ALLOCATE AMONG CHARITABLE  
8 BENEFICIARIES.—A power to determine the bene-  
9 ficial enjoyment of the corpus or the income there-  
10 from if the corpus or income is irrevocably payable  
11 for a purpose specified in section 101(e) (relating to  
12 definition of charitable contributions) or to an em-  
13 ployee stock ownership plan (as defined in section  
14 4975(e)(7)) in a qualified gratuitous transfer (as de-  
15 fined in section 149(g)(1)).

16 “(5) POWER TO DISTRIBUTE CORPUS.—A  
17 power to distribute corpus either—

18 “(A) to or for a beneficiary or beneficiaries  
19 or to or for a class of beneficiaries (whether or  
20 not income beneficiaries) provided that the  
21 power is limited by a reasonably definite stand-  
22 ard which is set forth in the trust instrument;  
23 or

24 “(B) to or for any current income bene-  
25 ficiary, provided that the distribution of corpus

1           must be chargeable against the proportionate  
2           share of corpus held in trust for the payment  
3           of income to the beneficiary as if the corpus  
4           constituted a separate trust.

5           A power does not fall within the powers described in  
6           this paragraph if any person has a power to add to  
7           the beneficiary or beneficiaries or to a class of bene-  
8           ficiaries designated to receive the income or corpus,  
9           except where such action is to provide for after-born  
10          or after-adopted children.

11           “(6) POWER TO WITHHOLD INCOME TEMPO-  
12          RARILY.—A power to distribute or apply income to  
13          or for any current income beneficiary or to accumu-  
14          late the income for him, provided that any accumu-  
15          lated income must ultimately be payable—

16           “(A) to the beneficiary from whom dis-  
17          tribution or application is withheld, to his es-  
18          tate, or to his appointees (or persons named as  
19          alternate takers in default of appointment) pro-  
20          vided that such beneficiary possesses a power of  
21          appointment which does not exclude from the  
22          class of possible appointees any person other  
23          than the beneficiary, his estate, his creditors, or  
24          the creditors of his estate, or

1           “(B) on termination of the trust, or in con-  
2           junction with a distribution of corpus which is  
3           augmented by such accumulated income, to the  
4           current income beneficiaries in shares which  
5           have been irrevocably specified in the trust in-  
6           strument.

7           Accumulated income shall be considered so payable  
8           although it is provided that if any beneficiary does  
9           not survive a date of distribution which could rea-  
10          sonably have been expected to occur within the bene-  
11          ficiary’s lifetime, the share of the deceased bene-  
12          ficiary is to be paid to his appointees or to one or  
13          more designated alternate takers (other than the  
14          grantor or the grantor’s estate) whose shares have  
15          been irrevocably specified. A power does not fall  
16          within the powers described in this paragraph if any  
17          person has a power to add to the beneficiary or  
18          beneficiaries or to a class of beneficiaries designated  
19          to receive the income or corpus except where such  
20          action is to provide for after-born or after-adopted  
21          children.

22               “(7) POWER TO WITHHOLD INCOME DURING  
23          DISABILITY OF A BENEFICIARY.—A power exer-  
24          cisable only during—

1           “(A) the existence of a legal disability of  
2           any current income beneficiary, or

3           “(B) the period during which any income  
4           beneficiary shall be under the age of 21 years,  
5           to distribute or apply income to or for such bene-  
6           ficiary or to accumulate and add the income to cor-  
7           pus. A power does not fall within the powers de-  
8           scribed in this paragraph if any person has a power  
9           to add to the beneficiary or beneficiaries or to a  
10          class of beneficiaries designated to receive the in-  
11          come or corpus, except where such action is to pro-  
12          vide for after-born or after-adopted children.

13           “(8) POWER TO ALLOCATE BETWEEN CORPUS  
14          AND INCOME.—A power to allocate receipts and dis-  
15          bursements as between corpus and income, even  
16          though expressed in broad language.

17           “(c) EXCEPTION FOR CERTAIN POWERS OF INDE-  
18          PENDENT TRUSTEES.—Subsection (a) shall not apply to  
19          a power solely exercisable (without the approval or consent  
20          of any other person) by a trustee or trustees, none of  
21          whom is the grantor, and no more than half of whom are  
22          related or subordinate parties who are subservient to the  
23          wishes of the grantor—

1           “(1) to distribute, apportion, or accumulate in-  
2           come to or for a beneficiary or beneficiaries, or to,  
3           for, or within a class of beneficiaries; or

4           “(2) to pay out corpus to or for a beneficiary  
5           or beneficiaries or to or for a class of beneficiaries  
6           (whether or not income beneficiaries).

7 A power does not fall within the powers described in this  
8 subsection if any person has a power to add to the bene-  
9 ficiary or beneficiaries or to a class of beneficiaries des-  
10 igned to receive the income or corpus, except where such  
11 action is to provide for after-born or after-adopted chil-  
12 dren. For periods during which an individual is the spouse  
13 of the grantor (within the meaning of section 154(e)(2)),  
14 any reference in this subsection to the grantor shall be  
15 treated as including a reference to such individual.

16           “(d) POWER TO ALLOCATE INCOME IF LIMITED BY  
17 A STANDARD.—Subsection (a) shall not apply to a power  
18 solely exercisable (without the approval or consent of any  
19 other person) by a trustee or trustees, none of whom is  
20 the grantor or spouse living with the grantor, to distribute,  
21 apportion, or accumulate income to or for a beneficiary  
22 or beneficiaries, or to, for, or within a class of bene-  
23 ficiaries, whether or not the conditions of paragraph (6)  
24 or (7) of subsection (b) are satisfied, if such power is lim-  
25 ited by a reasonably definite external standard which is

1 set forth in the trust instrument. A power does not fall  
2 within the powers described in this subsection if any per-  
3 son has a power to add to the beneficiary or beneficiaries  
4 or to a class of beneficiaries designated to receive the in-  
5 come or corpus except where such action is to provide for  
6 after-born or after-adopted children.

7 **“SEC. 157. ADMINISTRATIVE POWERS.**

8 “The grantor shall be treated as the owner of any  
9 portion of a trust in respect of which—

10 “(1) POWER TO DEAL FOR LESS THAN ADE-  
11 QUATE AND FULL CONSIDERATION.—A power exer-  
12 cisable by the grantor or a nonadverse party, or  
13 both, without the approval or consent of any adverse  
14 party enables the grantor or any person to purchase,  
15 exchange, or otherwise deal with or dispose of the  
16 corpus or the income therefrom for less than an ade-  
17 quate consideration in money or money’s worth.

18 “(2) POWER TO BORROW WITHOUT ADEQUATE  
19 INTEREST OR SECURITY.—A power exercisable by  
20 the grantor or a nonadverse party, or both, enables  
21 the grantor to borrow the corpus or income, directly  
22 or indirectly, without adequate interest or without  
23 adequate security except where a trustee (other than  
24 the grantor) is authorized under a general lending

1 power to make loans to any person without regard  
2 to interest or security.

3 “(3) BORROWING OF THE TRUST FUNDS.—The  
4 grantor has directly or indirectly borrowed the cor-  
5 pus or income and has not completely repaid the  
6 loan, including any interest, before the beginning of  
7 the taxable year. The preceding sentence shall not  
8 apply to a loan which provides for adequate interest  
9 and adequate security, if such loan is made by a  
10 trustee other than the grantor and other than a re-  
11 lated or subordinate trustee subservient to the  
12 grantor. For periods during which an individual is  
13 the spouse of the grantor (within the meaning of  
14 section 154(e)(2)), any reference in this paragraph  
15 to the grantor shall be treated as including a ref-  
16 erence to such individual.

17 “(4) GENERAL POWERS OF ADMINISTRATION.—  
18 A power of administration is exercisable in a non-  
19 fiduciary capacity by any person without the ap-  
20 proval or consent of any person in a fiduciary capac-  
21 ity. For purposes of this paragraph, the term ‘power  
22 of administration’ means any one or more of the fol-  
23 lowing powers: (A) a power to vote or direct the vot-  
24 ing of stock or other securities of a corporation in  
25 which the holdings of the grantor and the trust are

1 significant from the viewpoint of voting control; (B)  
2 a power to control the investment of the trust funds  
3 either by directing investments or reinvestments, or  
4 by vetoing proposed investments or reinvestments, to  
5 the extent that the trust funds consist of stocks or  
6 securities of corporations in which the holdings of  
7 the grantor and the trust are significant from the  
8 viewpoint of voting control; or (C) a power to reac-  
9 quire the trust corpus by substituting other property  
10 of an equivalent value.

11 **“SEC. 158. POWER TO REVOKE.**

12 “(a) GENERAL RULE.—The grantor shall be treated  
13 as the owner of any portion of a trust, whether or not  
14 he is treated as such owner under any other provision of  
15 this part, where at any time the power to revert in the  
16 grantor title to such portion is exercisable by the grantor  
17 or a non-adverse party, or both.

18 “(b) POWER AFFECTING BENEFICIAL ENJOYMENT  
19 ONLY AFTER OCCURRENCE OF EVENT.—Subsection (a)  
20 shall not apply to a power the exercise of which can only  
21 affect the beneficial enjoyment of the income for a period  
22 commencing after the occurrence of an event such that  
23 a grantor would not be treated as the owner under section  
24 155 if the power were a reversionary interest. But the

1 grantor may be treated as the owner after the occurrence  
2 of such event unless the power is relinquished.

3 **“SEC. 159. INCOME FOR BENEFIT OF GRANTOR.**

4       “(a) GENERAL RULE.—The grantor shall be treated  
5 as the owner of any portion of a trust, whether or not  
6 he is treated as such owner under section 156, whose in-  
7 come without the approval or consent of any adverse party  
8 is, or, in the discretion of the grantor or a nonadverse  
9 party, or both, may be—

10               “(1) distributed to the grantor or the grantor’s  
11 spouse;

12               “(2) held or accumulated for future distribution  
13 to the grantor or the grantor’s spouse; or

14               “(3) applied to the payment of premiums on  
15 policies of insurance on the life of the grantor or the  
16 grantor’s spouse (except policies of insurance irrev-  
17 ocably payable for a purpose specified in section  
18 101(c) (relating to definition of charitable contribu-  
19 tions)).

20 This subsection shall not apply to a power the exercise  
21 of which can only affect the beneficial enjoyment of the  
22 income for a period commencing after the occurrence of  
23 an event such that the grantor would not be treated as  
24 the owner under section 153 if the power were a rever-  
25 sionary interest; but the grantor may be treated as the

1 owner after the occurrence of the event unless the power  
2 is relinquished.

3 “(b) OBLIGATIONS OF SUPPORT.—Income of a trust  
4 shall not be considered taxable to the grantor under sub-  
5 section (a) or any other provision of this chapter merely  
6 because such income in the discretion of another person,  
7 the trustee, or the grantor acting as trustee or co-trustee,  
8 may be applied or distributed for the support or mainte-  
9 nance of a beneficiary (other than the grantor’s spouse)  
10 whom the grantor is legally obligated to support or main-  
11 tain, except to the extent that such income is so applied  
12 or distributed. In cases where the amounts so applied or  
13 distributed are paid out of corpus or out of other than  
14 income for the taxable year, such amounts shall be consid-  
15 ered to be an amount paid or credited within the meaning  
16 of paragraph (2) of section 146(a) and shall be taxed to  
17 the grantor under section 147.

18 **“SEC. 160. PERSON OTHER THAN GRANTOR TREATED AS**  
19 **SUBSTANTIAL OWNER.**

20 “(a) GENERAL RULE.—A person other than the  
21 grantor shall be treated as the owner of any portion of  
22 a trust with respect to which:

23 “(1) such person has a power exercisable solely  
24 by himself to vest the corpus or the income there-  
25 from in himself, or

1           “(2) such person has previously partially re-  
2           leased or otherwise modified such a power and after  
3           the release or modification retains such control as  
4           would, within the principles of sections 153 to 159,  
5           inclusive, subject a grantor of a trust to treatment  
6           as the owner thereof.

7           “(b) EXCEPTION WHERE GRANTOR IS TAXABLE.—  
8           Subsection (a) shall not apply with respect to a power over  
9           income, as originally granted or thereafter modified, if the  
10          grantor of the trust or a transferor (to whom section 161  
11          applies) is otherwise treated as the owner under sections  
12          153 through 159 or section 161.

13          “(c) OBLIGATIONS OF SUPPORT.—Subsection (a)  
14          shall not apply to a power which enables such person, in  
15          the capacity of trustee or cotrustee, merely to apply the  
16          income of the trust to the support or maintenance of a  
17          person whom the holder of the power is obligated to sup-  
18          port or maintain except to the extent that such income  
19          is so applied. In cases where the amounts so applied or  
20          distributed are paid out of corpus or out of other than  
21          income of the taxable year, such amounts shall be consid-  
22          ered to be an amount paid or credited within the meaning  
23          of paragraph (2) of section 146(a) and shall be taxed to  
24          the holder of the power under section 147.

1       “(d) EFFECT OF RENUNCIATION OR DISCLAIMER.—  
2 Subsection (a) shall not apply with respect to a power  
3 which has been renounced or disclaimed within a reason-  
4 able time after the holder of the power first became aware  
5 of its existence.

6       **“SEC. 161. FOREIGN TRUSTS HAVING ONE OR MORE**  
7                                   **UNITED STATES BENEFICIARIES.**

8       “(a) TRANSFEROR TREATED AS OWNER.—

9               “(1) IN GENERAL.—A United States person  
10 who directly or indirectly transfers property to a for-  
11 eign trust (other than a trust described in section  
12 6048(a)(3)(B)(ii)) shall be treated as the owner for  
13 his taxable year of the portion of such trust attrib-  
14 utable to such property if for such year there is a  
15 United States beneficiary of any portion of such  
16 trust.

17               “(2) EXCEPTIONS.—Paragraph (1) shall not  
18 apply—

19                       “(A) TRANSFERS BY REASON OF DEATH.—  
20 To any transfer by reason of the death of the  
21 transferor.

22                       “(B) TRANSFERS AT FAIR MARKET  
23 VALUE.—To any transfer of property to a trust  
24 in exchange for consideration of at least the fair  
25 market value of the transferred property. For

1 purposes of the preceding sentence, consider-  
2 ation other than cash shall be taken into ac-  
3 count at its fair market value.

4 “(3) CERTAIN OBLIGATIONS NOT TAKEN INTO  
5 ACCOUNT UNDER FAIR MARKET VALUE EXCEP-  
6 TION.—

7 “(A) IN GENERAL.—In determining wheth-  
8 er paragraph (2)(B) applies to any transfer by  
9 a person described in clause (ii) or (iii) of sub-  
10 paragraph (C), there shall not be taken into  
11 account—

12 “(i) except as provided in regulations,  
13 any obligation of a person described in  
14 subparagraph (C), and

15 “(ii) to the extent provided in regula-  
16 tions, any obligation which is guaranteed  
17 by a person described in subparagraph (C).

18 “(B) TREATMENT OF PRINCIPAL PAY-  
19 MENTS ON OBLIGATION.—Principal payments  
20 by the trust on any obligation referred to in  
21 subparagraph (A) shall be taken into account  
22 on and after the date of the payment in deter-  
23 mining the portion of the trust attributable to  
24 the property transferred.

1           “(C) PERSONS DESCRIBED.—The persons  
2 described in this subparagraph are—

3                   “(i) the trust,

4                   “(ii) any grantor, owner, or bene-  
5 ficiary of the trust, and

6                   “(iii) any person who is related (with-  
7 in the meaning of section 143(i)(2)(B) to  
8 any grantor, owner, or beneficiary of the  
9 trust.

10           “(4) SPECIAL RULES APPLICABLE TO FOREIGN  
11 GRANTOR WHO LATER BECOMES A UNITED STATES  
12 PERSON.—

13                   “(A) IN GENERAL.—If a nonresident alien  
14 individual has a residency starting date within  
15 5 years after directly or indirectly transferring  
16 property to a foreign trust, this section and sec-  
17 tion 6048 shall be applied as if such individual  
18 transferred to such trust on the residency start-  
19 ing date an amount equal to the portion of such  
20 trust attributable to the property transferred by  
21 such individual to such trust in such transfer.

22                   “(B) TREATMENT OF UNDISTRIBUTED IN-  
23 COME.—For purposes of this section, undistrib-  
24 uted net income for periods before such individ-  
25 ual’s residency starting date shall be taken into

1 account in determining the portion of the trust  
2 which is attributable to property transferred by  
3 such individual to such trust but shall not oth-  
4 erwise be taken into account.

5 “(C) RESIDENCY STARTING DATE.—For  
6 purposes of this paragraph, an individual’s resi-  
7 dency starting date is the residency starting  
8 date determined under section 7701(b)(2)(A).

9 “(5) OUTBOUND TRUST MIGRATIONS.—If—

10 “(A) an individual who is a citizen or resi-  
11 dent of the United States transferred property  
12 to a trust which was not a foreign trust, and

13 “(B) such trust becomes a foreign trust  
14 while such individual is alive, then this section  
15 and section 6048 shall be applied as if such in-  
16 dividual transferred to such trust on the date  
17 such trust becomes a foreign trust an amount  
18 equal to the portion of such trust attributable  
19 to the property previously transferred by such  
20 individual to such trust. A rule similar to the  
21 rule of paragraph (4)(B) shall apply for pur-  
22 poses of this paragraph.

23 “(b) TRUSTS ACQUIRING UNITED STATES BENE-  
24 FICIARIES.—If—

1           “(1) subsection (a) applies to a trust for the  
2 transferor’s taxable year, and

3           “(2) subsection (a) would have applied to the  
4 trust for his immediately preceding taxable year but  
5 for the fact that for such preceding taxable year  
6 there was no United States beneficiary for any por-  
7 tion of the trust,

8 then, for purposes of this chapter, the transferor shall be  
9 treated as having income for the taxable year (in addition  
10 to his other income for such year) equal to the undistrib-  
11 uted net income (at the close of such immediately pre-  
12 ceding taxable year) attributable to the portion of the  
13 trust referred to in subsection (a).

14           “(c) TRUSTS TREATED AS HAVING A UNITED  
15 STATES BENEFICIARY.—

16           “(1) IN GENERAL.—For purposes of this sec-  
17 tion, a trust shall be treated as having a United  
18 States beneficiary for the taxable year unless—

19                   “(A) under the terms of the trust, no part  
20 of the income or corpus of the trust may be  
21 paid or accumulated during the taxable year to  
22 or for the benefit of a United States person,  
23 and

24                   “(B) if the trust were terminated at any  
25 time during the taxable year, no part of the in-

1           come or corpus of such trust could be paid to  
2           or for the benefit of a United States person.

3           “(2) **ATTRIBUTION OF OWNERSHIP.**—For pur-  
4           poses of paragraph (1), an amount shall be treated  
5           as paid or accumulated to or for the benefit of a  
6           United States person if such amount is paid to or  
7           accumulated for a foreign corporation, foreign part-  
8           nership, or foreign trust or estate, and—

9                   “(A) in the case of a foreign corporation,  
10           such corporation is a controlled foreign corpora-  
11           tion,

12                   “(B) in the case of a foreign partnership,  
13           a United States person is a partner of such  
14           partnership, or

15                   “(C) in the case of a foreign trust or es-  
16           tate, such trust or estate has a United States  
17           beneficiary (within the meaning of paragraph  
18           (1)).

19           “(3) **CERTAIN UNITED STATES BENEFICIARIES**  
20           **DISREGARDED.**—A beneficiary shall not be treated  
21           as a United States person in applying this section  
22           with respect to any transfer of property to foreign  
23           trust if such beneficiary first became a United  
24           States person more than 5 years after the date of  
25           such transfer.



1 a sum which is payable for the support of minor children  
2 of such husband. In case such income is less than the  
3 amount specified in the decree, agreement, or instrument,  
4 for the purpose of applying the preceding sentence, such  
5 income, to the extent of such sum payable for such sup-  
6 port, shall be considered a payment for such support.

7 “(b) WIFE CONSIDERED A BENEFICIARY.—For pur-  
8 poses of computing the taxable income of the estate or  
9 trust and the taxable income of a wife to whom subsection  
10 (a) applies, such wife shall be considered as the bene-  
11 ficiary.

12 “(c) CROSS REFERENCE.—For definitions of ‘hus-  
13 band’ and ‘wife’, as used in this section, see section  
14 7701(a)(17).

15 **“SEC. 164. RECOGNITION OF GAIN ON CERTAIN TRANSFERS**  
16 **TO CERTAIN FOREIGN TRUSTS AND ESTATES.**

17 “(a) IN GENERAL.—Except as provided in regula-  
18 tions, in the case of any transfer of property by a United  
19 States person to a foreign estate or trust, for purposes  
20 of this subtitle, such transfer shall be treated as a sale  
21 or exchange for an amount equal to the fair market value  
22 of the property transferred, and the transferor shall recog-  
23 nize as gain the excess of—

24 “(1) the fair market value of the property so  
25 transferred, over

1           “(2) the adjusted basis (for purposes of deter-  
2           mining gain) of such property in the hands of the  
3           transferor.

4           “(b) EXCEPTION.—Subsection (a) shall not apply to  
5           a transfer to a trust by a United States person to the  
6           extent that any person is treated as the owner of such  
7           trust under section 153.

8           “(c) TREATMENT OF TRUSTS WHICH BECOME FOR-  
9           EIGN TRUSTS.—If a trust which is not a foreign trust be-  
10          comes a foreign trust, such trust shall be treated for pur-  
11          poses of this section as having transferred, immediately  
12          before becoming a foreign trust, all of its assets to a for-  
13          eign trust.

14        **“SEC. 165. TREATMENT OF FUNERAL TRUSTS.**

15          “(a) IN GENERAL.—In the case of a qualified funeral  
16          trust, sections 144 through 161 shall not apply, and no  
17          deduction shall be allowed by section 142(b).

18          “(b) QUALIFIED FUNERAL TRUST.—‘Qualified fu-  
19          neral trust’ means any trust (other than a foreign trust)  
20          if—

21                “(1) the trust arises as a result of a contract  
22                with a person engaged in the trade or business of  
23                providing funeral or burial services or property nec-  
24                essary to provide such services,

1           “(2) the sole purpose of the trust is to hold, in-  
2           vest, and reinvest funds in the trust and to use such  
3           funds solely to make payments for such services or  
4           property for the benefit of the beneficiaries of the  
5           trust,

6           “(3) the only beneficiaries of such trust are in-  
7           dividuals with respect to whom such services or  
8           property are to be provided at their death under  
9           contracts described in paragraph (1),

10           “(4) the only contributions to the trust are con-  
11           tributions by or for the benefit of such beneficiaries,

12           “(5) the trustee elects the application of this  
13           subsection, and

14           “(6) the trust would (but for the election de-  
15           scribed in paragraph (5)) be treated as owned under  
16           sections 153 through 161 by the purchasers of the  
17           contracts described in paragraph (1).

18           “(c) DOLLAR LIMITATION ON CONTRIBUTIONS.—

19           “(1) IN GENERAL.—Any trust which accepts  
20           aggregate contributions by or for the benefit of an  
21           individual in excess of \$7,000 shall not be a quali-  
22           fied funeral trust.

23           “(2) RELATED TRUSTS.—For purposes of para-  
24           graph (1), all trusts having trustees which are re-  
25           lated persons shall be treated as 1 trust. For pur-

1 poses of the preceding sentence, persons are related  
2 if—

3 “(A) the relationship between such persons  
4 is described in section 171(a)(5), or

5 “(B) the Secretary determines that treat-  
6 ing such persons as related is necessary to pre-  
7 vent avoidance of the purposes of this section.

8 “(3) INFLATION ADJUSTMENT.—In the case of  
9 any contract referred to in subsection (b)(1) which  
10 is entered into during any calendar year after 2001,  
11 the dollar amount referred to in paragraph (1) shall  
12 be adjusted for inflation in accordance with section  
13 23.

14 “(d) APPLICATION OF RATE SCHEDULE.—Section  
15 140(b) shall be applied to each qualified funeral trust by  
16 treating each beneficiary’s interest in each such trust as  
17 a separate trust.

18 “(e) TREATMENT OF AMOUNTS REFUNDED TO PUR-  
19 CHASER ON CANCELLATION.—No gain or loss shall be rec-  
20 ognized to a purchaser of a contract described in sub-  
21 section (b)(1) by reason of any payment from such trust  
22 to such purchaser by reason of cancellation of such con-  
23 tract. If any payment referred to in the preceding sentence  
24 consists of property other than money, the basis of such  
25 property in the hands of such purchaser shall be the same

1 as the trust's basis in such property immediately before  
2 the payment.

3 “(f) SIMPLIFIED REPORTING.—The Secretary may  
4 prescribe rules for simplified reporting of all trusts having  
5 a single trustee.

6 **“SEC. 166. INCOME IN RESPECT OF A DECEDENT.**

7 “(a) INCLUSION IN GROSS INCOME.—

8 “(1) GENERAL USE.—The amount of all items  
9 of gross income in respect of a decedent which are  
10 not properly includible in respect of a taxable period  
11 in which falls the date of his death, or a prior pe-  
12 riod, shall be included in gross income, for the tax-  
13 able year when received, of—

14 “(A) the estate of the decedent, if the right  
15 to receive the amount is acquired by the dece-  
16 dent's estate,

17 “(B) the person who, by reason of the  
18 death of the decedent, acquires the right to re-  
19 ceive the amount, if the right to receive the  
20 amount is not acquired by the decedent's estate  
21 from the decedent,

22 “(C) the person who acquires from the de-  
23 cedent the right to receive the amount by be-  
24 quest, devise or inheritance, if the amount is re-



1 posed by section 201 and, to the extent required by  
2 the context, the provisions of chapter 2.

3 “(3) INTERNAL REVENUE CODE OF 1986.—‘In-  
4 ternal Revenue Code of 1986’ means the Internal  
5 Revenue Code of 1986 as in effect immediately be-  
6 fore the enactment of the Simplified USA Tax Act  
7 of 2001.

8 “(4) UNITED STATES.—‘United States’ means  
9 the States and the District of Columbia.

10 “(5) RELATED PARTY.—‘Related party’  
11 means—

12 “(A) Members of a family, as defined in  
13 paragraph (6)(D);

14 “(B) An individual and a business entity  
15 more than 50 percent in value of which is  
16 owned, directly or indirectly, by or for such in-  
17 dividual (applying rules of constructive owner-  
18 ship);

19 “(C) Two business entities that are eligible  
20 to file a consolidated return under chapter 2;

21 “(D) A grantor and a fiduciary of any  
22 trust;

23 “(E) A fiduciary of a trust and a fiduciary  
24 of another trust, if the same person is a grantor  
25 of both trusts;

1           “(F) A fiduciary of a trust and a bene-  
2           ficiary of such trust;

3           “(G) A fiduciary of a trust and a bene-  
4           ficiary of another trust, if the same person is  
5           a grantor of both trusts;

6           “(H) A fiduciary of a trust and a corpora-  
7           tion more than 50 percent in value of the out-  
8           standing stock of which is owned, directly or in-  
9           directly, by or for the trust or by or for a per-  
10          son who is a grantor of the trust;

11          “(I) A person and an organization to  
12          which section 251 (relating to certain edu-  
13          cational and charitable organizations which are  
14          exempt from tax) applies and which is con-  
15          trolled directly or indirectly by such person or  
16          (if such person is an individual) by members of  
17          the family of such individual;

18          “(J) Two business entities if the same per-  
19          sons own more than 50 percent of the value of  
20          each (applying rules of constructive ownership),  
21          with value measured by—

22                  “(i) the value of the outstanding stock  
23                  in the case of a corporation,

24                  “(ii) the capital interest or the profits  
25                  interest, whichever is greater, in the case

1 of a partnership or limited liability com-  
2 pany;

3 “(K) Except in the case of a sale or ex-  
4 change in satisfaction of a pecuniary bequest,  
5 an executor of an estate and a beneficiary of  
6 such estate.

7 “(6) CONSTRUCTIVE OWNERSHIP.—For pur-  
8 poses of determining, in applying paragraph (5), the  
9 ownership of a business entity—

10 “(A) Stock or other equity interest owned,  
11 directly or indirectly, by or for a corporation,  
12 partnership, estate, or trust shall be considered  
13 as being owned proportionately by or for its  
14 shareholders, partners, or beneficiaries;

15 “(B) An individual shall be considered as  
16 owning the stock or other equity interest owned,  
17 directly or indirectly, by or for his family;

18 “(C) An individual owning (otherwise than  
19 by the application of subparagraph (B)) any  
20 stock in a corporation or other equity interest  
21 in another form of business entity shall be con-  
22 sidered as owning the stock owned, directly or  
23 indirectly, by or for his partner;

24 “(D) The family of an individual shall in-  
25 clude only his brothers and sisters (whether by

1 the whole or half blood), spouse, ancestors, and  
2 lineal descendants; and

3 “(E) Stock or other equity interest con-  
4 structively owned by a person by reason of the  
5 application of subparagraph (A) shall, for the  
6 purpose of applying subparagraph (A), (B), or  
7 (C), be treated as actually owned by such per-  
8 son, but stock or other equity interest construc-  
9 tively owned by an individual by reason of the  
10 application of subparagraph (B) or (C) shall  
11 not be treated as owned by him for the purpose  
12 of again applying either of such paragraphs in  
13 order to make another the constructive owner of  
14 such stock or equity interest.

15 “(6) EARNED INCOME.—

16 “(A) IN GENERAL.—‘Earned income’  
17 means—

18 “(i) wages, salaries, tips, and other  
19 employee compensation, plus

20 “(ii) the amount of the taxpayer’s net  
21 earnings from self-employment for the tax-  
22 able year (within the meaning of section  
23 1402(a)).

24 “(B) SPECIAL RULES.—For purposes of  
25 subparagraph (A)—

1           “(i) the earned income of an indi-  
2           vidual shall be computed without regard to  
3           any community property laws,

4           “(ii) no amount received as a pension  
5           or annuity shall be taken into account,

6           “(iii) no income of nonresident alien  
7           individuals not connected with United  
8           States business shall be taken into ac-  
9           count, and

10           “(iv) no amount received for services  
11           provided by an individual while the indi-  
12           vidual is an inmate at a penal institution  
13           shall be taken into account.

14           “(b) TERMS DEFINED IN CHAPTER 1.—If a term  
15           that is used but not defined in this chapter or in section  
16           7701 is defined in chapter 2, the definition in chapter 2  
17           shall apply except if manifestly incompatible with the in-  
18           tent of the provision in which the term is used.

19           **“SEC. 172. RULES OF APPLICATION.**

20           “(a) DEFINITIONS.—Any definition included in this  
21           chapter shall apply for all purposes of this chapter  
22           unless—

23           “(1) such definition is limited to the purposes  
24           of a particular chapter, section, or subsection, or

1           “(2) the definition clearly would not be applica-  
2           ble in a particular context.

3           “(b) INTERPRETATIONS CONSISTENT WITH INTER-  
4           NAL REVENUE CODE OF 1986.—Terms not defined in this  
5           chapter or elsewhere in this title, but defined in the Inter-  
6           nal Revenue Code of 1986, shall be interpreted in a man-  
7           ner consistent with the Internal Revenue Code of 1986,  
8           except to the extent such interpretation would be incon-  
9           sistent with the principles and purposes of this chapter.”

10          (c) EXEMPTION FROM PROHIBITED TRANSACTION  
11          TAX.—Section 4975(g) of the Code is amended by—

12                 (1) striking “or” at the end of paragraph (2),

13                 (2) deleting the period at the end of paragraph

14                 (3) and inserting “; or”,

15                 (3) and inserting the following new paragraph

16                 (4):

17                         “(4) to a Roth IRA in the case of a loan to or  
18                         equity investment in a controlled business entity as  
19                         permitted by section 30(f).”

1 **TITLE III—SIMPLIFIED USA TAX**  
 2 **FOR BUSINESSES**

3 **SEC. 301. REPEAL OF CORPORATE INCOME TAX; NEW TAX**  
 4 **PAID BY CORPORATIONS AND OTHER BUSI-**  
 5 **NESSES.**

6 (a) IN GENERAL.—Chapter 2 of the Internal Rev-  
 7 enue Code is renumbered chapter 3 and following new  
 8 chapter is inserted after chapter 1:

9 **“CHAPTER 2—SIMPLIFIED USA TAX FOR**  
 10 **BUSINESSES**

“Subchapter A. Imposition of tax.

“Subchapter B. Basic rules for business tax.

“Subchapter C. Capital contributions, mergers, acquisitions, and distributions.

“Subchapter D. Accounting methods.

“Subchapter E. Land and rental property.

“Subchapter F. Insurance and financial products.

“Subchapter G. Financial intermediation and financial institutions.

“Subchapter H. Tax-exempt organizations.

“Subchapter I. Cooperatives.

“Subchapter J. Sourcing rules.

“Subchapter K. Business conducted in a possession.

“Subchapter L. Payroll tax credit.

“Subchapter M. Import tax.

“Subchapter N. Transition rules.

“Subchapter O. Rules for administration, consolidated returns.

“Subchapter P. Definitions and rules of applications.

11 **“Subchapter A—Imposition of Tax**

“Sec. 201. Tax imposed.

12 **“SEC. 201. TAX IMPOSED.**

13 “(a) TAXABLE BUSINESS ACTIVITY.—A tax is im-  
 14 posed on the sale of goods and services in the United  
 15 States by a business entity. The amount of the tax equals  
 16 the amount by which—

1 “(1) the business tax exceeds,

2 “(2) the payroll tax credit.

3 “(b) BUSINESS TAX IMPOSED.—

4 “(1) IN GENERAL.—The ‘business tax’ imposed  
5 on a business entity that sells or leases property or  
6 sells services in the United States equals the sum  
7 of—

8 “(A) 8 percent of the portion of the gross  
9 profits of the business entity for the taxable  
10 year that does not exceed \$150,000, and

11 “(B) 12 percent of such portion of the  
12 gross profits of the business entity for the tax-  
13 able year that exceeds \$150,000.

14 “(2) LIMITATION ON APPLICATION OF BENE-  
15 FITS OF GRADUATED RATE SCHEDULE.—The Sec-  
16 retary shall prescribe rules under which the gross  
17 profits of business entities under common control  
18 are aggregated for purposes of applying the benefit  
19 of the lower rate described in subparagraph (A) of  
20 paragraph (1). Such rules shall be similar to rules  
21 applicable under sections 1551 and 1561 of the In-  
22 ternal Revenue Code of 1986.

23 “(c) PAYROLL TAX CREDIT.—The ‘payroll tax credit’  
24 is a credit for the social security, railroad retirement and  
25 hospital insurance taxes paid by an employer, as deter-

1 mined in accordance with subchapter L (sections 281  
2 through 283).

3 “(d) IMPORT TAX.—For rules relating to the import  
4 tax imposed by this chapter, see subchapter M (sections  
5 286 through 288).

## 6 **“Subchapter B—Basic Rules for Business Tax**

“Sec. 202. Gross profits.

“Sec. 203. Taxable receipts.

“Sec. 204. Deductible amounts.

“Sec. 205. Cost of business purchases.

“Sec. 206. Business entity and business activity.

“Sec. 207. Loss carryover deduction.

### 7 **“SEC. 202. GROSS PROFITS.**

8 “‘Gross profits’ means for a taxable year of a busi-  
9 ness entity the amount by which—

10 “(1) the taxable receipts of the business entity  
11 for the taxable year exceed,

12 “(2) the deductible amounts for the business  
13 entity for the taxable year.

### 14 **“SEC. 203. TAXABLE RECEIPTS.**

15 “(a) IN GENERAL.—‘Taxable receipts’ means all re-  
16 ceipts from the sale of property, use of property, and per-  
17 formance of services in the United States.

18 “(b) GAMES OF CHANCE.—Amounts received for  
19 playing games of chance by business entities engaging in  
20 the activity of providing such games shall be treated as  
21 receipts from the sale of property or services.

1       “(c) IN-KIND RECEIPTS.—The taxable receipts at-  
2     tributable to the receipt of property, use of property or  
3     services in whole or partial exchange for property, use of  
4     property or services equal the fair market value of the  
5     services or property received.

6       “(d) TAXES.—Taxable receipts do not include any ex-  
7     cise tax, sales tax, custom duty, or other separately stated  
8     levy imposed by a Federal, State, or local government re-  
9     ceived by a business entity in connection with the sale of  
10    property or services or the use of property.

11       “(e) FINANCIAL RECEIPTS.—

12           “(1) IN GENERAL.—Except as provided in sub-  
13     chapter G (relating to financial intermediation and  
14     financial institutions), taxable receipts do not in-  
15     clude financial receipts.

16           “(2) FINANCIAL RECEIPTS.—‘Financial re-  
17     ceipts’ include—

18                   “(A) interest,

19                   “(B) dividends and other distributions by a  
20     business entity,

21                   “(C) proceeds from the sale of stock, other  
22     ownership interests in business entities, or  
23     other financial instruments (as defined in sec-  
24     tion 242(b)(3)),

25                   “(D) proceeds from life insurance policies,

1           “(E) proceeds from annuities,

2           “(F) proceeds from currency hedging or  
3 exchanges, and

4           “(G) proceeds from other financial trans-  
5 actions.

6       “(f) CROSS REFERENCES.—

7           “(1) FINANCIAL INTERMEDIATION.—See sub-  
8 chapters F and G for rules relating to financial  
9 intermediation.

10          “(2) EXPORTS, SALES IN THE UNITED  
11 STATES.—See subchapter J for the exclusion from  
12 gross receipts for export sales and for rules on sales  
13 of property and services in the United States.

14          “(3) LAND.—See subchapter E for rules relat-  
15 ing to certain sales of land.

16          “(4) INSURANCE PROCEEDS.—See section 237  
17 for rules on the inclusion of certain insurance pro-  
18 ceeds in taxable receipts.

19       **“SEC. 204. DEDUCTIBLE AMOUNTS.**

20       “(a) IN GENERAL.—‘Deductible amounts’ for a busi-  
21 ness entity in a taxable year include—

22           “(1) the cost of business purchases in the tax-  
23 able year (as determined under section 205),

24           “(2) such entity’s loss carryover deduction (as  
25 determined under section 207) , and

1           “(3) the transition basis deduction (as deter-  
2           mined under section 290).

3           “(b) FINANCIAL INTERMEDIATION.—See subchapters  
4 F and G for special rules for business entities engaging  
5 in financial intermediation.

6           **“SEC. 205. COST OF BUSINESS PURCHASES.**

7           “(a) BUSINESS PURCHASES.—

8           “(1) IN GENERAL.—‘Business purchases’ means  
9           the acquisition of—

10                   “(A) property,

11                   “(B) the use of property, or

12                   “(C) services

13           in the United States for use in a business activity.

14           “(2) EXAMPLES.—Business purchases include  
15           (without limitation) the—

16                   “(A) purchase or rental of real property,

17                   “(B) purchase or rental of capital equip-  
18           ment,

19                   “(C) purchase of supplies and inventory,

20                   “(D) purchase of services from inde-  
21           pendent contractors,

22                   “(E) purchase of financial intermediation  
23           services (as determined in accordance with sec-  
24           tion 236),

1           “(F) purchase of a business loss policy (as  
2           determined in accordance with section 237),  
3           and

4           “(G) imports for use in a business activity.

5           “(3) EXCLUSIONS.—Business purchases do not  
6           include—

7           “(A) payments for use of money or capital,  
8           such as interest or dividends (except to the ex-  
9           tent that a portion so paid is a fee for financial  
10          intermediation services),

11          “(B) premiums for life insurance,

12          “(C) the acquisition of savings assets or  
13          other financial instruments (as defined in sec-  
14          tion 242(b)(3)).

15          “(D) property acquired outside the United  
16          States (but such property shall be taken into  
17          account as an import if imported),

18          “(E) services performed outside the United  
19          States (unless treated as imported into the  
20          United States),

21          “(F) compensation expenses for an indi-  
22          vidual (other than amounts paid to an indi-  
23          vidual in his capacity as a business entity), or

24          “(G) taxes (except as provided in sub-  
25          section (b)(2) relating to product taxes).

1           “(4) COMPENSATION EXPENSES.—‘Compensa-  
2           tion expenses’ means—

3                   “(A) wages, salaries or other cash payable  
4                   for services,

5                   “(B) any taxes imposed on the recipient  
6                   that are withheld by the business entity,

7                   “(C) the cost of property purchased to pro-  
8                   vide employees with compensation (other than  
9                   property incidental to the provision of fringe  
10                  benefits that are excluded from income under  
11                  the individual tax),

12                  “(D) the cost of fringe benefits which are  
13                  includible in an employee’s, partner’s, or propri-  
14                  etor’s income under the Simplified USA Income  
15                  Tax (or are excluded solely because they con-  
16                  stitute employee savings), including (without  
17                  limitation)—

18                           “(i) contributions to retirement and  
19                           severance benefit plans,

20                           “(ii) premiums for the cost of life,  
21                           health, accident, disability and other insur-  
22                           ance policies for which the service provider,  
23                           members of his family, or persons des-  
24                           ignated by him or members of his family  
25                           are the beneficiaries,

1           “(iii) rental of parking spaces or park-  
2           ing fees (unless the parking space is used  
3           for a vehicle that is regularly used in a  
4           business activity);

5           “(iv) employer paid educational bene-  
6           fits;

7           “(v) employer paid housing (other  
8           than housing provided for the convenience  
9           of the employer); and

10          “(vi) employer paid meals (other than  
11          meals provided for the convenience of the  
12          employer).

13          “(b) COST OF BUSINESS PURCHASES.—

14           “(1) IN GENERAL.—The ‘cost of a business  
15           purchase’ is the amount paid or to be paid for the  
16           business purchase.

17           “(2) TAXES.—

18           “(A) IN GENERAL.—The ‘cost of business  
19           purchases’ includes any product taxes paid with  
20           respect to the property or services purchased.

21           “(B) PRODUCT TAX.—‘Product tax’ means  
22           any excise tax, sales or use tax, custom duty, or  
23           other separately stated levy imposed by a Fed-  
24           eral, State, or local government on the produc-  
25           tion, severance or consumption of property or

1 on the provision of services, whether or not sep-  
2 arately stated, and including any such taxes  
3 that are technically imposed on the seller of  
4 property or services.

5 “(C) TAXES NOT PRODUCT TAXES.—Prod-  
6 uct taxes do not include—

7 “(i) the import tax,

8 “(ii) state and local property taxes,

9 “(iii) franchise or income taxes,

10 “(iv) payroll taxes and self-employ-  
11 ment taxes, or

12 “(v) the business tax.

13 “(3) IMPORTS.—In the case of an import by a  
14 business entity, the cost of the import is the import  
15 price for purposes of the import tax. The import tax  
16 is not part of the cost of the import.

17 “(c) PROPERTY AND SERVICES ACQUIRED FOR  
18 PROPERTY.—If a business entity receives property or serv-  
19 ices from a business entity in whole or partial exchange  
20 for property or services, the property or services acquired  
21 shall be treated as if they were purchased for an amount  
22 equal to the fair market value of the services or property  
23 received. For purposes of this section, property includes  
24 stock and other equity interests in business other than  
25 stock or an equity interest in the business entity acquiring

1 the property or services. See section 210(b) for rules on  
2 property or services received in exchange for an equity in-  
3 terest in the recipient.

4 “(d) GAMBLING PAYMENTS.—In the case of a busi-  
5 ness involving gambling, lotteries, or other games of  
6 chance, business purchases include amounts paid to win-  
7 ners.

8 “(e) SAVINGS ASSETS.—‘Savings assets’ means  
9 stocks, bonds, securities, certificates of deposits, invest-  
10 ments in partnerships and limited liability companies,  
11 shares of mutual funds, life insurance policies, annuities,  
12 and other similar savings or investment assets.

13 “(f) CROSS REFERENCES.—

14 “(1) FINANCIAL INTERMEDIATION AND INSUR-  
15 ANCE.—For rules relating to fees for financial inter-  
16 mediation services and insurance, see subchapter F.

17 “(2) LAND.—For special rules relating to the  
18 acquisition of land, see subchapter E.

19 “(3) RENTAL REAL ESTATE.—For special rules  
20 relating to the rental of real estate previously occu-  
21 pied by an owner of the real estate, see section 232.

22 “(4) OUTSIDE THE UNITED STATES.—For spe-  
23 cial rules relating to services performed outside the  
24 United States but used inside the United States and  
25 international services, see subchapter J.

1 **“SEC. 206. BUSINESS ENTITY AND BUSINESS ACTIVITY.**

2       “(a) BUSINESS ENTITY.—For purposes of the busi-  
3 ness tax, ‘business entity’ means any corporation, unincor-  
4 porated association, partnership, limited liability company,  
5 proprietorship, independent contractor, individual, or any  
6 other person engaging in business activity in the United  
7 States. An individual shall be considered a business entity  
8 only with respect to the individual’s business activities.

9       “(b) BUSINESS ACTIVITY.—‘Business activity’ means  
10 the sale of property or services, the leasing of property,  
11 the development of property or services for subsequent  
12 sale or use in producing property or services for subse-  
13 quent sale. ‘Business activity’ does not include casual or  
14 occasional sales of property used by an individual (other  
15 than in a business activity), such as the sale by an indi-  
16 vidual of a vehicle used by the individual.

17       “(c) EXCEPTION FOR CERTAIN EMPLOYEES.—

18               “(1) IN GENERAL.—‘Business activity’ does not  
19 include—

20                       “(A) the performance of services by an em-  
21 ployee for an employer that is a business entity  
22 with respect to the activity in which the em-  
23 ployee is engaged, or

24                       “(B) the performance of regular domestic  
25 household services (including babysitting,  
26 housecleaning, and lawn cutting) by an em-

1            ployee of an employer that is an individual or  
2            family.

3            “(2) EMPLOYEE DEFINED.—For purposes of  
4            this subsection, ‘employee’ includes an individual  
5            partner who provides services to a partnership or an  
6            individual member who provides services to a limited  
7            liability company, or a proprietor with respect to  
8            compensation for services from his proprietorship.

9    **“SEC. 207. LOSS CARRYOVER DEDUCTION.**

10          “(a) DEDUCTION.—The ‘loss carryover deduction’ for  
11          a taxable year is the lesser of—

12                  “(1) the business entity’s gross profits for the  
13                  taxable year (determined without the loss carryover  
14                  deduction), or

15                  “(2) the amount of the loss carryover to the  
16                  taxable year.

17          “(b) LOSS CARRYOVER.—

18                  “(1) GENERAL RULE.—A loss for any taxable  
19                  year shall be a loss carryover to each of the 215 tax-  
20                  able years following the taxable year of the loss.

21                  “(2) LOSS CARRYOVERS TO A TAXABLE YEAR.—

22                  The loss carryover to a taxable year is the sum of  
23                  the loss carryovers from all prior taxable years be-  
24                  ginning on or after January 1, 2002, that can be  
25                  carried over to the taxable year.

1           “(3) REDUCTION OF LOSS CARRYOVERS AS A  
2           RESULT OF THE DEDUCTION.—A business entity’s  
3           loss carryovers shall be reduced each year by the  
4           amount of the loss carryover deduction for the year.  
5           Loss carryovers shall be reduced in the order that  
6           they arose.

7           “(c) LOSS FOR TAXABLE YEAR.—A business entity’s  
8           loss (if any) for the taxable year equals the excess (if any)  
9           of—

10           “(1) the sum of—

11                   “(A) the cost of business purchases for the  
12                   taxable year, and

13                   “(B) the transition basis adjustment for  
14                   the taxable year, over

15           “(2) taxable receipts for the taxable year.

16           “(d) SPECIAL RULES.—

17           “(1) CONSOLIDATED RETURNS.—In the case of  
18           a consolidated return, the loss for a taxable year  
19           shall be determined on a consolidated group basis.  
20           In the case of a deconsolidation, the loss carryovers  
21           from the consolidated group shall be allocated in ac-  
22           cordance with rules to be prescribed by the Sec-  
23           retary.

24           “(2) LOSS CARRYOVERS OF ACQUIRED BUSI-  
25           NESS ENTITY.—

1           “(A) IN GENERAL.—If a business entity  
2 acquires another business entity in a trans-  
3 action that is considered the acquisition of a  
4 business entity and the two entities file a con-  
5 solidated return or if two business entities  
6 merge, the loss carryovers will survive and can  
7 be applied against the taxable receipts attrib-  
8 utable to the business activities carried on (or  
9 in the case of a merger formerly carried on) by  
10 either entity.

11           “(B) ASSET ACQUISITION.—If a business  
12 entity acquires all or substantially all of the as-  
13 sets of another entity in a transaction that is  
14 considered an asset acquisition rather than the  
15 acquisition of a business entity, the acquirer  
16 will be treated as if it acquired the loss  
17 carryovers of the selling entity. For purposes of  
18 this rule, the assets of a business entity include  
19 ownership interests in other business entities.

20           “(C) SUBSTANTIALLY ALL.—For purposes  
21 of this paragraph ‘substantially all’ means more  
22 than 80 percent of the fair market value of a  
23 business entity’s net assets. Under rules pre-  
24 scribed by the Secretary, the parties to a trans-  
25 action may elect to treat acquisitions in excess

1 of 70 percent of the fair market value of a busi-  
 2 ness entity's net assets as acquisitions of 'sub-  
 3 stantially all' of a business entity's net assets.

4 **“Subchapter C—Capital Contributions,**  
 5 **Mergers, Acquisitions, and Distributions**

“Sec. 210. Contributions to a business entity.

“Sec. 211. Distributions of property.

“Sec. 212. Asset acquisitions.

“Sec. 213. Mergers and stock acquisitions.

“Sec. 214. Spin-offs, split-off, etc.

“Sec. 215. Allocation of certain tax attributes.

6 **“SEC. 210. CONTRIBUTIONS TO A BUSINESS ENTITY.**

7 “(a) BY BUSINESS ENTITY.—

8 “(1) CASH.—If a business entity contributes  
 9 cash to a business entity of which it is or becomes  
 10 a partial or full owner, the amount contributed is  
 11 not a deductible amount to the contributor or a tax-  
 12 able receipt to the recipient.

13 “(2) PROPERTY OR SERVICES.—If a business  
 14 entity contributes property or services to a business  
 15 entity of which it is or becomes a partial or full  
 16 owner, the transaction will not result in taxable re-  
 17 ceipts to the contributor or a deduction for a busi-  
 18 ness purchase for the recipient and will not con-  
 19 stitute a sale resulting in taxable receipts to the con-  
 20 tributor.

21 “(b) BY INDIVIDUAL.—

1           “(1) CASH.—If an individual contributes cash  
2           to a business entity, the cash received is not a tax-  
3           able receipt.

4           “(2) NEW PROPERTY.—If an individual contrib-  
5           utes to a business entity property that the individual  
6           purchased for the business entity but which was not  
7           used by any person after its purchase, the property  
8           shall be considered purchased by such business enti-  
9           ty from the person from which the individual pur-  
10          chased the property.

11          “(3) PERSONAL USE PROPERTY.—

12                 “(A) IN GENERAL.—If an individual con-  
13                 tributes personal use property to a business en-  
14                 tity in which the individual has an ownership  
15                 interest or for which the individual receives an  
16                 ownership interest, the business entity shall not  
17                 be permitted to deduct the value of the property  
18                 received as a business expense. The business  
19                 entity will have a tax basis in the contributed  
20                 property equal to the contributor’s basis.

21                 “(B) PERSONAL USE PROPERTY.—‘Per-  
22                 sonal use property’ means any property used by  
23                 an individual at any time other than in a busi-  
24                 ness activity.

1           “(4) SERVICES.—If an individual contributes  
2           services to a business entity in which the individual  
3           has an ownership interest or receives an ownership  
4           interest, the business entity shall not be permitted to  
5           deduct the value of the services received (or the  
6           value of the equity interest provided to the services  
7           provider).

8   **“SEC. 211. DISTRIBUTIONS OF PROPERTY.**

9           “(a) DISTRIBUTIONS OTHER THAN TO CONTROL-  
10          LING BUSINESS.—If a business entity distributes all or a  
11          portion of its assets to its owners (other than a controlling  
12          business entity), the business entity will be treated as if  
13          it sold the assets to its owners at fair market value. The  
14          fair market value will be determined by the distributing  
15          corporation and those determinations, unless unreason-  
16          able, will be binding on the recipients.

17          “(b) DISTRIBUTIONS TO A CONTROLLING BUSI-  
18          NESS.—If a business entity distributes all or a portion of  
19          its assets to a controlling business, the controlling busi-  
20          ness will assume the distributing entity’s tax attributes  
21          with respect to the assets and neither entity will have tax-  
22          able receipts or a deduction as a result of the transaction.

23          “(c) DISTRIBUTION OF PERSONAL USE PROP-  
24          ERTY.—If personal use property is distributed to the indi-  
25          vidual who contributed the personal use property to a busi-

1 ness entity, the fair market value of the property for pur-  
2 poses of paragraph (a) shall equal the basis of the prop-  
3 erty plus any enhancement in value of the property attrib-  
4 utable to business purchases with respect to the property.

5 “(d) CONTROLLING BUSINESS ENTITY.—A business  
6 entity is a ‘controlling business entity’ with respect to an-  
7 other business entity if it owns directly or indirectly more  
8 than 50 percent of the profits or capital interest in the  
9 other business entity.

10 “(e) APPLICATION OF THIS SECTION.—This section  
11 applies to both liquidating and nonliquidating distribu-  
12 tions. Property shall be treated as distributed if the prop-  
13 erty is used for a nonbusiness purpose (as defined in sec-  
14 tion 232) for more than an insubstantial period of time  
15 during a taxable year. See section 232 for rules relating  
16 to certain rental property.

17 **“SEC. 212. ASSET ACQUISITIONS.**

18 “(a) IN GENERAL.—If a business entity transfers  
19 some or all of its assets, the consideration received for  
20 such assets shall be allocated among the assets transferred  
21 in the same manner as was required by section 1060 of  
22 the Internal Revenue Code of 1986. If the transferee and  
23 transferor agree in writing on the allocation of any consid-  
24 eration, or as to the fair market value of any of the assets,  
25 such agreement shall be binding on both the transferor

1 and transferee unless the Secretary determines that such  
2 allocation (or fair market value) is not appropriate.

3 “(b) TAX CONSEQUENCES.—The tax consequences of  
4 an asset acquisition shall be determined in accordance  
5 with the rules of this chapter and shall be dependent upon  
6 allocations made under subsection (a). In general, consid-  
7 eration allocable to savings assets, such as stock in an-  
8 other business entity, would not be included in taxable re-  
9 cepts of the transferor and would not be a business pur-  
10 chase of the purchaser, but consideration allocable to the  
11 sale of tangible property and intangible property (other  
12 than savings assets) will constitute taxable receipts of the  
13 seller and a business purchase of the purchaser.

14 “(c) ELECTION TO TREAT ASSET ACQUISITION AS A  
15 STOCK ACQUISITION.—In the case of the sale of substan-  
16 tially all of the assets of a business entity or substantially  
17 all of the assets of a line of business or a separately stand-  
18 ing business of a business entity, the transferee and trans-  
19 feror can jointly elect to treat the acquisition as if it were  
20 an acquisition of the stock of a business entity holding  
21 the assets so transferred. In such case, the rules of section  
22 213 shall apply.

23 “(d) AUTHORITY TO REQUIRE ALLOCATION AGREE-  
24 MENT AND NOTICE TO THE SECRETARY.—If the Sec-  
25 retary determines that certain types of asset acquisitions

1 have significant possibilities of tax avoidance, the Sec-  
2 retary may require—

3 “(1) parties to such types of acquisitions to  
4 enter into agreements allocating consideration,

5 “(2) parties to acquisitions involving certain  
6 kinds of assets to enter into agreements allocating  
7 part of the consideration to those assets, or

8 “(3) parties to certain acquisitions to report in-  
9 formation to the Secretary.

10 “(e) ASSET ACQUISITION RULES DO NOT APPLY IF  
11 CONSIDERATION INCLUDES EQUITY IN PURCHASER.—

12 “(1) IN GENERAL.—If a business entity issues  
13 its own equity or equity in a subsidiary or other con-  
14 trolled entity as part of the consideration for the  
15 transfer of assets to it, the transaction shall not be  
16 treated as an asset acquisition and the rules of sec-  
17 tion 13 shall apply.

18 “(2) EQUITY.—For purposes of this subsection,  
19 equity means—

20 “(A) stock, in the case of a corporation,

21 “(B) partnership or similar interest, in the  
22 case of a partnership or limited liability com-  
23 pany, and

24 “(C) an ownership interest or interest in  
25 profits in the case of any other business entity.

1 **“SEC. 213. MERGERS AND STOCK ACQUISITIONS.**

2 “(a) MERGERS.—A merger of one business entity  
3 into another or two businesses entities into a third busi-  
4 ness entity or any other similar transaction shall have no  
5 direct consequences under the business tax. The surviving  
6 entity shall assume the tax attributes of the merged cor-  
7 porations, including any loss carryovers and credit  
8 carryovers.

9 “(b) STOCK ACQUISITION.—The acquisition of all or  
10 substantially all of the ownership interest in one business  
11 entity either for cash or in exchange for ownership in the  
12 acquiring entity or an entity controlled by the acquired  
13 entity shall have no direct consequences under the busi-  
14 ness tax.

15 **“SEC. 214. SPIN-OFFS, SPLIT-OFFS, ETC.**

16 “A spin-off, split-off or split-up of a business entity  
17 shall have no direct tax consequences under the business  
18 tax.

19 **“SEC. 215. ALLOCATION OF CERTAIN TAX ATTRIBUTES.**

20 “The Secretary shall prescribe rules for allocation of  
21 loss carryovers and payroll tax credit carryovers in cases  
22 of substantial shifts of assets from one business entity to  
23 another business entity. Under such rules, a portion of a  
24 business entity’s carryovers may be deemed transferred  
25 when assets are transferred.

## 1    **“Subchapter D—Accounting Method Rules**

- “Sec. 220. General accounting rules.
- “Sec. 221. Use of the cash method of accounting.
- “Sec. 222. Taxable year.
- “Sec. 223. Long-term contracts.
- “Sec. 224. Post-sale price adjustments and refunds.
- “Sec. 225. Bad debts.
- “Sec. 226. Transition rules.

### 2    **“SEC. 220. GENERAL ACCOUNTING RULES.**

3           “(a) IN GENERAL.—Except as provided in section  
4 221, a business entity shall use an accrual method of ac-  
5 counting for purposes of determining the timing of rec-  
6 ognition of taxable receipts and deduction of business pur-  
7 chases. All business purchases shall be deducted when in-  
8 curred (in the case of a business entity using the accrual  
9 method of accounting) or when paid (in case of a business  
10 entity using the cash method of accounting) without re-  
11 gard to whether the business purchases are for or relate  
12 to—

13                   “(1) inventory,

14                   “(2) assets with a useful life of more than one  
15           year, or

16                   “(3) property that will be used to produce other  
17           property.

18           “(b) ECONOMIC PERFORMANCE.—For purposes of  
19 determining whether an amount has been incurred, the all  
20 events test shall not be treated as met any earlier than  
21 when economic performance with respect to such item oc-  
22 curs.

1       “(c) CONSISTENT ACCOUNTING METHODS.—Except  
2 as otherwise expressly provided in this chapter, a business  
3 entity shall secure the consent of the Secretary before  
4 changing the method of accounting by which it determines  
5 gross profits. This provision shall not apply to changes  
6 required by the adoption of the business tax.

7       **“SEC. 221. USE OF THE CASH METHOD OF ACCOUNTING.**

8       “(a) IN GENERAL.—A business entity that was per-  
9 mitted to use and used the cash method of accounting  
10 under the Internal Revenue Code of 1986 shall be per-  
11 mitted to continue to use the cash method of accounting.

12       “(b) NEW BUSINESS ENTITIES.—A new business en-  
13 tity shall be permitted to use the cash method of account-  
14 ing if permitted to under regulations prescribed by the  
15 Secretary.

16       “(c) CHANGE OR EXPANSION OF BUSINESS.—Sub-  
17 section (a) shall cease to apply to a business entity that  
18 changes or expands its business such that under regula-  
19 tions prescribed by the Secretary it is no longer eligible  
20 to use the cash method of accounting.

21       “(d) REGULATIONS.—

22               “(1) USE OF CASH METHOD.—The Secretary  
23 shall prescribe regulations defining which business  
24 entities may use the cash method of accounting. In  
25 general, those regulations shall be consistent with

1 the rules under sections 447 and 448 of the Internal  
2 Revenue Code of 1986, except that all corporations  
3 shall be treated as C corporations were treated  
4 under those sections. The regulations shall not re-  
5 quire a business entity described in subsection (a) to  
6 convert to the accrual method prior to January 1,  
7 2003.

8 “(2) CHANGE IN ACCOUNTING METHOD.—The  
9 Secretary shall prescribe regulations to prevent dou-  
10 ble counting of taxable receipts and deductible ex-  
11 penses in the case of a change in accounting method.

12 **“SEC. 222. TAXABLE YEAR.**

13 “(a) COMPUTATION OF GROSS PROFITS.—Gross  
14 profits shall be computed on the basis of a business enti-  
15 ty’s taxable year.

16 “(b) TAXABLE YEAR.—‘Taxable year’ means—

17 “(1) the taxpayer’s annual accounting period, if  
18 it is a calendar year or a fiscal year;

19 “(2) the calendar year, if subsection (g) applies;  
20 or

21 “(3) the period for which the return is made if  
22 the return is made for a period of less than 12  
23 months.

1       “(c) ANNUAL ACCOUNTING PERIOD.—‘Annual ac-  
2 counting period’ means the annual period on the basis of  
3 which the business entity regularly keeps its books.

4       “(d) CALENDAR YEAR.—‘Calendar year’ means a pe-  
5 riod of 12 months ending on December 31.

6       “(e) FISCAL YEAR.—‘Fiscal year’ means a period of  
7 12 months ending on the last day of any month other than  
8 December. In the case of any business entity that has  
9 made the election provided by subsection (f), the term  
10 means the annual period (varying from 52 to 53 weeks)  
11 so elected.

12       “(f) ELECTION OF 52–53 WEEK YEAR.—

13               “(1) GENERAL RULE.—A business entity which,  
14 in keeping its books, regularly computes its income  
15 or profits on a basis of an annual period which var-  
16 ies from 52 to 53 weeks and ends always on the  
17 same day of the week and ends always—

18                       “(A) on whatever date such same day of  
19 the week last occurs in a calendar month, or

20                       “(B) on whatever date such same day of  
21 the week falls which is nearest to the last day  
22 of a calendar month,

23 may elect to compute its gross profits on the basis  
24 of such annual period.

1           “(2) REGULATIONS.—The Secretary shall pre-  
2       scribe such regulations as he deems necessary for  
3       the application of this subsection, including regula-  
4       tions relating to the application of effective dates to  
5       taxpayers using a 52–53 week year.

6           “(g) CALENDAR YEAR REQUIRED.—

7           “(1) NO ACCOUNTING PERIOD.—A business en-  
8       tity’s taxable year shall be the calendar year if the  
9       business entity does not have an annual accounting  
10      period or has an annual accounting period that does  
11      not qualify as a fiscal year.

12          “(2) NEW BUSINESS ENTITY.—The taxable  
13      year of a business entity that begins business activ-  
14      ity after December 31, 2001, shall be the calendar  
15      year (or a 52–53 week fiscal year ending in Decem-  
16      ber) unless the business entity can demonstrate a  
17      business reason for selecting an accounting period  
18      other than the calendar year.

19          “(h) TRANSITION RULE FOR BUSINESS ENTITIES  
20      WITH A FISCAL YEAR.—

21          “(1) IN GENERAL.—A business entity with a  
22      taxable year that is not the calendar year shall have  
23      a short taxable year ending on December 31, 2001,  
24      and a subsequent taxable year beginning on January  
25      1, 2002, and ending on the day immediately pre-

1 ceding the beginning of the business entity's next  
2 fiscal year.

3 “(2) BUSINESS ENTITIES WITH 52–53 WEEK  
4 YEAR ENDING IN DECEMBER.—

5 “(A) IN GENERAL.—If a business entity  
6 has a 52–53 week taxable year (under the In-  
7 ternal Revenue Code of 1986) that ends in De-  
8 cember 2001, it may elect to begin its first tax-  
9 able year for the business tax on the first day  
10 immediately following the last day of such tax-  
11 able year.

12 “(B) NO ELECTION.—If a business entity  
13 that has a 52–53 week taxable year that ends  
14 in December 2001, does not make the election  
15 under subparagraph (A) or is prohibited from  
16 making such election by subparagraph (C), the  
17 business entity's taxable year under the Inter-  
18 nal Revenue Code of 1986 that would end in  
19 December 2001 shall end on December 31,  
20 2001.

21 “(C) ANTI-ABUSE RULE.—Subparagraph  
22 (A) shall not apply to any taxpayer that enters  
23 into business transactions in 2001 following the  
24 scheduled end of its fiscal year with business  
25 entities that are not subject to the business tax

1 at the time of such transactions if such trans-  
2 actions deviate from the normal course of busi-  
3 ness in order to achieve some tax benefit.

4 **“SEC. 223. LONG-TERM CONTRACTS.**

5 “(a) IN GENERAL.—In the case of a long-term  
6 contract—

7 “(1) CONTRACTOR EXPENSES.—The contractor  
8 shall be entitled to deduct its business purchases  
9 when paid or incurred.

10 “(2) CONTRACTOR RECEIPTS.—The contractor  
11 shall recognize taxable receipts—

12 “(A) in the case of a project in which the  
13 acquirer has no ownership interest in the  
14 project until delivery—

15 “(i) upon delivery of the project, in  
16 the case of an accrual basis contractor, or

17 “(ii) upon the later of delivery of the  
18 project or the receipt of payment, in the  
19 case of cash-basis contractor.

20 “(B) in the case of a project in which the  
21 acquirer obtains an ownership interest as the  
22 project is constructed—

23 “(i) when the contractor has the right  
24 to payments, in the case of an accrual  
25 basis contractor, or

1                   “(ii) upon the later of when the con-  
2                   tractor receives the cash or has the right  
3                   to payments, in the case of a cash basis  
4                   contractor.

5                   “(3) ACQUIRER EXPENSES.—The acquirer that  
6                   is a business entity shall be entitled to deduct its  
7                   costs of the business purchase—

8                   “(A) in the case of a cash-basis acquirer,  
9                   at such time as a cash basis contractor would  
10                  be required to treat the amounts paid as tax-  
11                  able receipts, or

12                  “(B) in the case of an accrual-basis  
13                  acquirer, at such time as an accrual basis con-  
14                  tractor would be required to treat the amounts  
15                  paid or due as taxable receipts.

16                  “(b) RIGHT TO PAYMENTS.—

17                  “(1) IN GENERAL.—A contractor shall be treat-  
18                  ed as having a right to payments with respect to a  
19                  project at any time to the extent that the contractor  
20                  would not be required to return payments received  
21                  (or would be entitled to collect payments not yet re-  
22                  ceived) if the project were terminated at such time  
23                  by the contractor.

24                  “(2) CONTRACTUAL PROVISIONS.—If a long-  
25                  term contract includes a procedure for paying the

1 contractor as work is completed (for example, by  
2 reason of a draw down from a trust account), the  
3 contractual provisions shall generally govern when a  
4 contractor has a right to payment.

5 “(3) PERCENTAGE COMPLETION METHOD OF  
6 ACCOUNTING.—If a long-term contract does not in-  
7 clude a mechanism for paying the contractor as  
8 work is completed, the percentage-of-completion  
9 method of accounting shall be used to determine the  
10 timing of taxable receipts of the contractor and busi-  
11 ness purchases of the acquirer.

12 “(c) LONG-TERM CONTRACT.—

13 “(1) IN GENERAL.—‘Long-term contract’  
14 means—

15 “(A) any contract that covers service or  
16 production through parts of two different cal-  
17 endar years if the contract includes a formal  
18 deposit and draw-down mechanism, and

19 “(B) any contract for the manufacture,  
20 building, installation, or construction of prop-  
21 erty if such contract is not completed within the  
22 taxable year of the contractor in which such  
23 contract is entered into.

24 “(2) EXCEPTION.—A contract for the manufac-  
25 ture of property shall not be treated as a long-term

1 contract unless such contract involves the manufac-  
2 ture of—

3 “(A) any unique item of a type which is  
4 not normally included in the finished goods in-  
5 ventory of the taxpayer, or

6 “(B) any item which normally requires  
7 more than 12 calendar months to complete.

8 “(d) CONSISTENCY.—The Secretary may require  
9 business entities to file statements containing such infor-  
10 mation with respect to long-term contracts as the Sec-  
11 retary may prescribe to ensure consistency in reporting.

12 “(e) FOREIGN CONTRACTS.—This section shall not  
13 be construed to permit a deduction for a business purchase  
14 for the cost of property produced outside the United  
15 States pursuant to a long-term contract at any time prior  
16 to the import of such property into the United States.

17 **“SEC. 224. POST-SALE PRICE ADJUSTMENTS AND REFUNDS.**

18 “(a) RECEIPT OF PRICE ADJUSTMENT.—In the case  
19 of a post-sale price adjustment attributable to a business  
20 purchase which was taken into account in computing gross  
21 profits for a prior taxable year, the amount of such adjust-  
22 ment shall be treated as a reduction or increase, as the  
23 case may be, in the cost of business purchases for the tax-  
24 able year in which the adjustment is made or incurred.

1       “(b) ISSUANCE OF PRICE ADJUSTMENT.—In the case  
2 of a post-sale price adjustment attributable to a sale the  
3 receipts from which were taken into account in deter-  
4 mining taxable receipts for a prior taxable year, the  
5 amount of such adjustment shall be treated as a reduction  
6 or increase, as the case may be, in taxable receipts for  
7 the taxable year in which the adjustment is made or in-  
8 curred.

9       “(c) POST-SALE PRICE ADJUSTMENT.—‘Post-sale  
10 price adjustment’ means a refund, rebate, or other price  
11 allowance attributable to a sale of property or services or  
12 an upward adjustment in price that was not previously  
13 taken into account under the business entity’s method of  
14 accounting.

15 **“SEC. 225. BAD DEBTS.**

16       “(a) SELLER.—If an amount owed to an accrual  
17 basis business entity for property or services sold—

18               “(1) was taken into account as a taxable receipt  
19               in a prior taxable year, and

20               “(2) becomes wholly or partially uncollectible  
21               during the taxable year, then the seller shall treat  
22               the amount as a reduction in taxable receipts for the  
23               taxable year in which it becomes wholly or partially  
24               uncollectible.

1       “(b) NOTICE REQUIREMENT.—No reduction shall be  
2 allowed under subsection (a) unless the seller notifies the  
3 purchaser of the amount which the seller has treated as  
4 wholly or partially uncollectible.

5       “(c) SUBSEQUENT COLLECTION.—If an amount  
6 which was treated as uncollectible under subsection (a) is  
7 subsequently collected, it shall be treated as a taxable re-  
8 ceipt when collected.

9       “(d) PURCHASER.—If a purchaser receives notice  
10 under subsection (b) from a seller and the purchaser has  
11 treated the amount labeled uncollectible as a business pur-  
12 chase in a prior taxable year, then the purchaser shall  
13 treat such amount as a reduction in the cost of business  
14 purchases in the taxable year to which the notice relates.  
15 If the purchaser subsequently repays such amount, the re-  
16 payment shall constitute the cost of a business purchase.

17 **“SEC. 226. TRANSITION RULES.**

18       “(a) NO DOUBLE DEDUCTIONS.—A business entity  
19 shall not be entitled to treat as a ‘cost of business pur-  
20 chase’ any amount that the business entity deducted in  
21 computing taxable income under the income tax in effect  
22 prior the effective date of the business tax.

23       “(b) NO DOUBLE INCLUSION.—A business entity  
24 shall not be required to include in taxable receipts any  
25 receipt that the business entity took into account in com-

1 putting taxable income under the income tax in effect prior  
2 to the effect date of the business tax.

3 “(c) NO LOSS OF DEDUCTION.—An expense which—

4 “(1) a business entity would have been able to  
5 deduct as a cost of a business purchase in an ac-  
6 counting period before the effective date of the busi-  
7 ness tax if the business tax had been in effect in  
8 such period, and

9 “(2) the business entity would have been able to  
10 deduct as an expense in computing taxable income  
11 in a period after the business tax is effective if the  
12 income tax had continued in effect,

13 shall be treated as a cost of a business purchase incurred  
14 or paid at the time that it would have been paid or in-  
15 curred under the income tax if the income tax had contin-  
16 ued in effect. This subsection shall not apply to any  
17 amount which is to be taken into account under sub-  
18 chapter N (relating to amortization of transition basis, in-  
19 ventory costs, and safe harbor leases), any amounts which  
20 would have been deducted under the income tax through  
21 loss carryover deductions, or any deductions deferred by  
22 the uniform capitalization rules under section 263A of the  
23 Internal Revenue Code of 1986.

24 “(d) ALL TAXABLE RECEIPTS TAXED.—A receipt  
25 which—



1           “(5) use in compensating employees.

2           “(b) FUTURE USE IN BUSINESS ACTIVITY.—Unim-  
3 proved land will not be considered held for ‘indefinite fu-  
4 ture use in a business activity’ if promptly upon acquisi-  
5 tion, the purchaser or the lessee begins construction of im-  
6 provements on the land (other than improvements, such  
7 as paving or sewage lines, intended for indefinite future  
8 development) that will be used in a business activity. Such  
9 improvement must be commensurate with the value of the  
10 land.

11          “(c) UNIMPROVED LAND.—‘Unimproved land’  
12 means—

13           “(1) land with no buildings on it,

14           “(2) land with improvements if the value of the  
15 improvements is relatively small in comparison to  
16 the value of the land and it is anticipated that the  
17 improvements will be demolished and not used,

18           “(3) land in excess of the amount reasonably  
19 needed for the buildings located on it.

20          “(d) CONVERSION TO BUSINESS USE.—If the acqui-  
21 sition of land is not treated as a business purchase by rea-  
22 son of subsection (a) and the land is subsequently used  
23 in a manner for which it could have been treated as a  
24 business purchase, the cost of the land will be treated as  
25 a business purchase when the improvements on the land

1 are placed in service (or in the case of construction for  
2 sale, substantially completed and advertised for sale).

3 **“SEC. 231. TAXABLE RECEIPTS FROM SALE OF LAND HELD**  
4 **FOR NONBUSINESS USE.**

5 “(a) TAX BASIS.—A business entity shall have a tax  
6 basis in land equal to the cost of the land if such cost  
7 is not deductible by reason of section 230(a) and the land  
8 has not been converted to business use for purposes of  
9 section 230(d).

10 “(b) TAXABLE RECEIPTS OF A LAND SALE.—The  
11 taxable receipts from the sale of land (or portion thereof)  
12 in which a business entity has a tax basis by reason of  
13 subsection (a) shall be the amount by which the proceeds  
14 exceed the basis of such land (or portion thereof).

15 **“SEC. 232. CERTAIN RENTAL PROPERTY.**

16 “(a) IN GENERAL.—Except as provided in subsection  
17 (b), the activity of rental of real estate is a business activ-  
18 ity to which the business tax applies.

19 “(b) NOT RENTAL PROPERTY.—Subsection (a) shall  
20 not apply to property described in section 111(b)(1) (relat-  
21 ing to property owned by individuals and used for at least  
22 14 days for a nonbusiness purpose and rented for no more  
23 than 14 days during the taxable year).

24 “(c) RENTAL PROPERTY BECOMES NONRENTAL  
25 PROPERTY.—If property which is considered rental prop-

erty for purposes of subsection (a) in one taxable year ceases to be rental property (by reason of subsection (b)) in the following taxable year, the property (and any associated debt) shall be treated as distributed by the business entity to its owners. Section 211(a) shall apply to such distribution.

## 7           **“Subchapter F—Insurance and** 8                           **Financial Products**

“Sec. 235. General rules.

“Sec. 236. Fees for financial intermediation services.

“Sec. 237. Deductible insurance premiums.

“Sec. 238. Nondeductible insurance premiums.

“Sec. 239. Certain implicit fees for financial intermediate services.

### 9   **“SEC. 235. GENERAL RULES.**

10           “(a) TAXABLE RECEIPTS.—Except in the case of a  
11 financial intermediation business, taxable receipts do not  
12 include financial receipts (as defined in section 203(e)(2)).

13           “(b) BUSINESS PURCHASES.—Except in the case of  
14 a financial intermediation business, business purchases do  
15 not include the cost of financial instruments (as defined  
16 in section 242(b)(3)) or payments for use of money or cap-  
17 ital, other than fees for financial intermediation services.

### 18   **“SEC. 236. FEES FOR FINANCIAL INTERMEDIATION SERV-** 19                           **ICES.**

20           “(a) BUSINESS PURCHASE.—Business purchases in-  
21 clude explicit fees and implicit fees for financial intermedi-  
22 ation services (except to the extent that such fees are for  
23 services treated as performed outside the United States

1 and not imported into the United States or for services  
2 treated as exported.).

3 “(b) FINANCIAL INTERMEDIATION SERVICES.—The  
4 definition of ‘financial intermediation service’ in section  
5 241 applies for purposes of this section.

6 “(c) EXPLICIT FEES.—

7 “(1) IN GENERAL.—‘Explicit fees for financial  
8 intermediation services’ means separately stated fees  
9 for services provided by a business entity in the fi-  
10 nancial intermediation business. Explicit fees do not  
11 include fees for use of money or capital.

12 “(2) EXAMPLES.—Explicit fees for financial  
13 intermediation services include (without limita-  
14 tion)—

15 “(A) separately listed maintenance and  
16 service charges of providers of financial inter-  
17 mediation services,

18 “(B) loan documentation fees,

19 “(C) brokerage fees,

20 “(D) loan origination fees,

21 “(E) underwriting fees,

22 “(F) trustees’ fees, and

23 “(G) fees for credit checks.

24 “(3) EXCLUSIONS.—Explicit fees for financial  
25 intermediation services do not include prepaid inter-

1 est and other fees for use of money or capital even  
2 if such fees are separately stated or are labeled as  
3 service fees.

4 “(d) IMPLICIT FEES.—

5 “(1) IMPLICIT FEES ATTRIBUTABLE TO BOR-  
6 ROWING.—

7 “(A) IN GENERAL.—Implicit fees attrib-  
8 utable to borrowing from banks and other fi-  
9 nancial institutions shall include the portion of  
10 interest payments that the Secretary designates  
11 as constituting service fees.

12 “(B) TIMING.—Implicit fees determined  
13 under this paragraph shall not be deductible in  
14 any taxable year prior to the taxable year in  
15 which the interest is paid. If the amount of the  
16 interest to which implicit fees relate was de-  
17 ducted as original issue discount under the In-  
18 ternal Revenue Code of 1986, the implicit fees  
19 with respect to such interest shall not constitute  
20 a deductible business purchase.

21 “(C) DESIGNATION BY SECRETARY.—

22 “(i) ESTIMATE OF DIFFERENTIAL.—

23 The Secretary shall estimate for each cal-  
24 endar year the difference between the cost  
25 of funds for banks and the rates of interest

1 (including discount points) charged to the  
2 most credit-worthy depositors of banks.  
3 The determinations shall be made sepa-  
4 rately for—

5 “(I) loans with terms of not more  
6 than 3 years,

7 “(II) loans with terms of over 3  
8 but not over 9 years, and

9 “(III) loans with terms of over 9  
10 years.

11 “(ii) DESIGNATION OF IMPLICIT  
12 FEES.—The Secretary shall designate the  
13 differences determined under clause (i) as  
14 the portion of interest expense on loans  
15 from banks and other financial institutions  
16 that constitutes an implicit fee for term  
17 loans originated during the following cal-  
18 endar year for the respective periods listed  
19 in subclauses (I) through (III) of clause  
20 (i). The difference determined for loans de-  
21 scribed in subclause (I) of clause (i) shall  
22 apply to determine the implicit fee portion  
23 of interest on demand loans outstanding  
24 during the following calendar year.

1 “(iii) HISTORICAL DETERMINATION.—

2 The Secretary shall make an historical de-  
3 termination in accordance with the prin-  
4 ciples of this subparagraph to designate  
5 the portion of interest on term loans made  
6 before January 1, 2001, that will con-  
7 stitute implicit fees.

8 “(2) IMPLICIT FEES FOR OTHER FINANCIAL  
9 INTERMEDIATION ACTIVITY.—Implicit fees for finan-  
10 cial intermediation services include the portion of the  
11 fees or other charges paid to a provider of financial  
12 intermediation services (other than lending) as such  
13 provider designates in accordance with section 39.

14 **“SEC. 237. DEDUCTIBLE INSURANCE PREMIUMS.**

15 “(a) IN GENERAL.—The cost of insurance premiums  
16 on business loss policies that insure risks in the United  
17 States constitute costs of business purchases. Proceeds  
18 from such policies constitute taxable receipts.

19 “(b) BUSINESS LOSS POLICY.—A ‘business loss pol-  
20 icy’ is an insurance policy—

21 “(1) owned by a business entity,

22 “(2) the beneficiary of which is the business en-  
23 tity or another business entity doing business with  
24 the owner of the policy,

1           “(3) that has no inside buildup or other savings  
2           component,

3           “(4) that covers losses on a loss incurred or  
4           claims made basis during the term of the policy,

5           “(5) that has a term of not more than 2 years,

6           “(6) that is not a direct or indirect form of  
7           compensation, and

8           “(7) that covers direct losses of the business,  
9           such as—

10           “(A) damage to or theft of property used  
11           in business activity,

12           “(B) tort claims against the business,

13           “(C) loss of use of business premises or  
14           services,

15           “(D) malpractice, or

16           “(E) alleged or actual breach of fiduciary  
17           obligations.

18 **“SEC. 238. NONDEDUCTIBLE INSURANCE PREMIUMS.**

19           “(a) NONDEDUCTIBILITY.—The cost of insurance  
20           policies that are not business loss policies are not deduct-  
21           ible costs of business purchases.

22           “(b) PROCEEDS OF NONDEDUCTIBLE POLICIES.—In-  
23           surance proceeds from policies described in subsection (a)  
24           do not constitute taxable receipts.

1           “(c) APPLICATION OF THIS SECTION TO CERTAIN  
2 INSURANCE.—This section shall apply to life insurance  
3 policies.

4           **“SEC. 239. CERTAIN IMPLICIT FEES FOR FINANCIAL INTER-  
5 MEDIATION SERVICES.**

6           “(a) DEDUCTIBILITY OF FEES.—If a financial inter-  
7 mediation business (as defined in section 241(b)) elects  
8 to determine implicit fees for financial intermediation  
9 services pursuant to this section and notify its business  
10 customers of their share of the implicit fees in accordance  
11 with this section, a business entity which receives such no-  
12 tice may treat the amount reported in the notice as an  
13 implicit fee for financial intermediation services in the cal-  
14 endar year to which such notice relates.

15           “(b) ALLOCATION AND REPORTING.—

16                 “(1) IN GENERAL.—A financial intermediation  
17 business may—

18                         “(A) allocate fees received for services for  
19 which no separately stated fees (or implicit fees  
20 for borrowing determined under section  
21 236(d)(1)) are charged among recipients of  
22 such services on a reasonable and consistent  
23 basis, and

24                         “(B) report to each recipient not later  
25 than February 15th of each year the amount so

1 allocated to it with respect to the immediately  
2 preceding calendar year.

3 “(2) MAXIMUM FEES ALLOCATED.—The max-  
4 imum amount that may be allocated by a financial  
5 intermediation business for a calendar is the excess  
6 of—

7 “(A) the gross profits of the financial  
8 intermediation business for the calendar year  
9 (as reasonably estimated by the financial inter-  
10 mediation business), over

11 “(B) the explicit fees for financial inter-  
12 mediation services received by the financial  
13 intermediation business.

14 “(3) REASONABLE ALLOCATION.—An allocation  
15 will not be considered reasonable unless it takes into  
16 account and allocates fees to—

17 “(A) both services provided to business en-  
18 tities and services provided to individuals (other  
19 than in a business capacity), and

20 “(B) both persons who receive money from  
21 the financial intermediation business and per-  
22 sons who pay money to the financial intermedi-  
23 ation business (even though amounts allocated  
24 to the former do not constitute implicit fees).

1           “(4) REGULATIONS.—The Secretary shall pre-  
2       scribe regulations relating to the allocations under  
3       this subsection, including regulations addressing—

4                   “(A) rules for timing of deductions of im-  
5       plicit fees paid by fiscal year recipients,

6                   “(B) subsequent year adjustments if a fi-  
7       nancial intermediation business allocates too  
8       much in a calendar year,

9                   “(C) rules for advance approval from the  
10      Secretary for allocation procedures, and

11                  “(D) safe-harbor alternatives to the alloca-  
12      tion procedures described in this subsection.

13           “(c) NOT APPLICABLE TO LENDING SERVICES.—  
14   This section shall not apply to lending services.

15       **“Subchapter G—Financial Intermediation**  
16                   **and Financial Institutions**

“Sec. 241. Activities constituting a financial intermediation business.

“Sec. 242. General rule for taxation.

“Sec. 243. Special rule for banks.

“Sec. 244. Insurance companies.

“Sec. 245. Financial pass-through entities.

“Sec. 246. Financial intermediation by other businesses.

17   **“SEC. 241. ACTIVITIES CONSTITUTING A FINANCIAL INTER-**  
18                   **MEDIATION BUSINESS.**

19           “(a) FINANCIAL INTERMEDIATION BUSINESS.—The  
20   providing of financial intermediation services shall be con-  
21   sidered a business activity. The gross profit of a business  
22   entity providing financial intermediation services shall be

1 determined by taking into account the rules of this sub-  
2 chapter.

3       “(b) SEPARATE BUSINESS ACTIVITY.—The provision  
4 of financial intermediation services for unrelated persons  
5 shall be considered a separate business activity and a busi-  
6 ness shall be considered a separate entity with respect to  
7 such activity. An entity engaging in such business is re-  
8 ferred to in this chapter as a ‘financial intermediation  
9 business’.

10       “(c) FINANCIAL INTERMEDIATION BY A BUSINESS.—  
11 Section 246 shall apply to a business that provides finan-  
12 cial intermediation services for itself and related parties  
13 but generally does not provide such services for unrelated  
14 parties.

15       “(d) DEFINITIONS.—

16               “(1) FINANCIAL INTERMEDIATION SERVICES.—

17       ‘Financial intermediation services’ include—

18                       “(A) lending services,

19                       “(B) insurance services,

20                       “(C) market-making and dealer services,

21                       and

22                       “(D) any other service provided as busi-  
23                       ness activity in which a person acts as an inter-  
24                       mediary in—

1                   “(i) the transfer of property, services,  
2                   or financial assets, liabilities, risks or in-  
3                   struments (or income or expense derived  
4                   therefrom) between two or more persons,  
5                   or

6                   “(ii) the pooling of economic risk  
7                   among other persons

8                   and derives all or a portion of such person’s  
9                   gross receipts from streams of income or ex-  
10                  pense, discounts, or other financial flows associ-  
11                  ated with the matter with respect to which such  
12                  person is acting as an intermediary.

13                  “(2) LENDING SERVICES.—‘Lending services’  
14                  means the regular making of loans and providing  
15                  credit to, or taking deposits from customers, but  
16                  does not include an installment or delayed payment  
17                  arrangement provided by a seller of property or serv-  
18                  ices under which additional charges or fees are im-  
19                  posed by the seller for the late payment.

20                  “(3) MARKET-MAKING OR DEALER SERVICES.—  
21                  ‘Market-making or dealer services’ means services  
22                  provided by a person who—

23                         “(A) regularly purchases financial instru-  
24                         ments from or sells financial instruments to

1 customers in the ordinary course of a trade or  
2 business,

3 “(B) regularly offers to enter into, assume,  
4 offset, assign, or otherwise terminate positions  
5 in financial instruments with customers in the  
6 ordinary course of a trade or business.

7 **“SEC. 242. GENERAL RULE FOR TAXATION.**

8 “(a) IN GENERAL.—In the case of a financial inter-  
9 mediation business, gross profits shall be computed by—

10 “(1) substituting financial receipts for taxable  
11 receipts, and

12 “(2) including financial expenses as business  
13 purchases.

14 “(b) DEFINITIONS.—

15 “(1) FINANCIAL RECEIPTS.—‘Financial re-  
16 ceipts’ means all receipts other than amounts re-  
17 ceived as contributions to capital.

18 “(2) FINANCIAL EXPENSES.—‘Financial ex-  
19 penses’ include—

20 “(A) payments for principal and interest  
21 that is properly allocable to the provision of fi-  
22 nancial intermediation services,

23 “(B) the cost of and payments under fi-  
24 nancial instruments (other than financial in-  
25 struments in the person subject to the tax im-

1 posed under this chapter and any person re-  
2 lated to such person),

3 “(C) claims and cash surrender values paid  
4 in connection with insurance or reinsurance  
5 services, and

6 “(D) amounts paid for reinsurance.

7 “(3) FINANCIAL INSTRUMENT.—‘Financial in-  
8 strument’ means any—

9 “(A) share of stock in a corporation,

10 “(B) equity ownership in any widely held  
11 or publicly traded partnership, trust, or other  
12 business entity,

13 “(C) note, bond, debenture, or other evi-  
14 dence of indebtedness,

15 “(D) interest rate, currency, or equity no-  
16 tional principal contract,

17 “(E) evidence or interest in, or a derivative  
18 financial instrument in, any financial instru-  
19 ment described in subparagraph (A), (B), (C),  
20 or (D), or any currency, including any option,  
21 forward contract, short position, and any simi-  
22 lar financial instrument in such a financial in-  
23 strument or currency, and

24 “(F) a position which—

1           “(i) is not a financial instrument de-  
2           scribed in subparagraph (A), (B), (C), (D)  
3           or (E),

4           “(ii) is a hedge with respect to such  
5           a financial instrument, and

6           “(iii) is clearly identified in the deal-  
7           er’s records as being described in this sub-  
8           paragraph before the close of the day on  
9           which it was acquired or entered into.

10          “(c) INTERNATIONAL MATTERS.—For purposes of  
11 this section in the case of a financial intermediation busi-  
12 ness with activity in and outside the United States—

13           “(1) INCLUSION REGARDLESS OF SOURCE.—

14           “(A) Financial receipts shall be determined  
15           without regard to whether they are received for  
16           property or service provided in or outside the  
17           United States, except that financial receipts do  
18           not include amounts that—

19           “(i) are not taxable receipts (as deter-  
20           mined without regard to this section), but

21           “(ii) would have been taxable receipts  
22           (as determined without regard to this sec-  
23           tion) if they had been received for services  
24           or property in the United States.

1           “(B) Financial expenses shall be deter-  
2           mined without regard to whether they are re-  
3           ceived for property or services acquired in or  
4           outside the United States.

5           “(2) ALLOCATION.—Under regulations pre-  
6           scribed by the Secretary, gross profits (as deter-  
7           mined without regard to this paragraph) shall be re-  
8           duced by the amount of financial intermediation  
9           gross profit attributable to financial intermediation  
10          activity provided outside the United States.

11          “(3) GROSS PROFIT ATTRIBUTABLE TO FINAN-  
12          CIAL INTERMEDIATION ACTIVITY.—‘Gross profits at-  
13          tributable to financial intermediation activity’ means  
14          the excess of—

15                 “(A) gross profits as determined under  
16                 this section (but without regard to paragraph  
17                 (2)), over

18                 “(B) gross profits as determined without  
19                 regard to this subchapter.

20   **“SEC. 243. SPECIAL RULES FOR BANKS.**

21          “(a) IN GENERAL.—In the case of a bank, gross prof-  
22          its shall be determined in accordance with section 242, ex-  
23          cept that—

24                 “(1) FINANCIAL RECEIPTS.—Financial receipts  
25                 shall include only—

1           “(A) taxable receipts (as determined with-  
2           out regard to this subchapter),

3           “(B) interest on loans made or acquired by  
4           the bank,

5           “(C) gain on the sale of loans,

6           “(D) discount points received, and

7           “(E) any explicit fees for financial or fidu-  
8           ciary services not included in subparagraphs  
9           (A) through (E).

10          “(2) FINANCIAL EXPENSES.—Financial ex-  
11          penses shall include only—

12                 “(A) interest paid to depositors and on  
13                 other funds borrowed by the bank, and

14                 “(B) reasonable additions to reserves for  
15                 bad debts.

16          “(3) FORECLOSURE PROPERTY.—Gross profits  
17          shall properly take into account proceeds from the  
18          operation or sale of foreclosure property.

19          “(b) BANK.—

20                 “(1) IN GENERAL.—‘Bank’ means a bank or  
21                 trust company incorporated and doing business  
22                 under the laws of the United States, the District of  
23                 Columbia, or any State, a substantial part of the  
24                 business of which consists of receiving deposits and  
25                 making loans and discounts, or of exercising fidu-

1       ciary powers similar to those exercised by national  
2       banks under the authority of the Comptroller of the  
3       Currency, and which is subject by law to supervision  
4       and examination by State or Federal authority hav-  
5       ing supervision over banking institutions or credit  
6       unions. Such term includes domestic building and  
7       loan associations and credit unions.

8               “(2) OTHER ACTIVITIES.—If a bank is engaged  
9       in significant amounts of activities other than those  
10      described in paragraph (1), the bank shall be consid-  
11      ered as a separate business entity with respect to  
12      such other activity.

13   **“SEC. 244. INSURANCE COMPANIES.**

14               “(a) IN GENERAL.—In the case of companies pro-  
15      viding insurance services, gross profits shall be determined  
16      in accordance with section 242, except—

17               “(1) subsection (c) of section 242 (relating to  
18      international operations) shall not apply, and

19               “(2) the rules of subchapter J (sourcing rules)  
20      shall apply to determine financial receipts and finan-  
21      cial expenses.

22               “(b) RESULT INCONSISTENT WITH STATUTORY IN-  
23      TENT.—If an insurance company determines that the ap-  
24      plication of subsection (a) produces results inconsistent  
25      with the territorial approach of the business tax, it may

1 apply to the Secretary for permission to apply section  
2 242(c) in lieu of subsection (a).

3 **“SEC. 245. FINANCIAL PASS-THROUGH ENTITIES.**

4 “(a) IN GENERAL.—In the case of a financial pass-  
5 thru entity, gross profits shall be determined in accord-  
6 ance with section 242, except—

7 “(1) financial receipts shall include contribu-  
8 tions to capital,

9 “(2) financial expenses shall include—

10 “(A) distributions to persons holding inter-  
11 ests in the pass-thru entity,

12 “(B) investments in related entities (in-  
13 cluding wholly owned entities) engaging in real  
14 estate investment.

15 “(b) PASS-THRU ENTITY.—

16 “(1) IN GENERAL.—‘Pass-thru entity’ means a  
17 business entity that is intended to serve as a con-  
18 duit. The Secretary shall prescribe regulations defin-  
19 ing pass-thru entity. Such term shall include—

20 “(A) entities that would qualify as regu-  
21 lated investment companies under the Internal  
22 Revenue Code of 1986,

23 “(B) entities that would qualify as real es-  
24 tate investment trusts under the Internal Rev-  
25 enue Code of 1986,

1           “(C) entities that would qualify as  
2           REMICs under the Internal Revenue Code of  
3           1986, and

4           “(D) partnerships whose purposes are to  
5           invest the funds of the partners in financial in-  
6           struments, distribute or reinvest the income  
7           from such investments, and distribute or rein-  
8           vest the proceeds from the sale of such instru-  
9           ments.

10          “(2) ENGAGEMENT IN BUSINESS ACTIVITY.—

11          An entity will not qualify as a pass-thru entity if it  
12          engages in more than an insubstantial amount of  
13          rental or other business activity (other than invest-  
14          ing in and selling financial instruments). The pre-  
15          ceding sentence will not apply if the business entity  
16          treats the business activity as engaged in by a sepa-  
17          rate business entity (separately subject to tax under  
18          this chapter).

19          **“SEC. 246. FINANCIAL INTERMEDIATION BY OTHER BUSI-  
20                  NESSES.**

21          “(a) IN GENERAL.—If a business entity that is not  
22          regularly in the business of providing financial intermedi-  
23          ation services to unrelated parties engages in significant  
24          financial intermediation activity, its gross profits shall be  
25          increased by its gross profits from financial intermediation

1 activity (determined as if such activity were activity of a  
2 pass-thru entity that paid all costs of such financial inter-  
3 mediation activity including—

4 “(1) compensation for persons engaging in such  
5 activity,

6 “(2) equipment involved in such activity, and

7 “(3) office space for persons involved in such  
8 activity).

9 “(b) PROXY.—A business entity to which subsection  
10 (a) applies will be treated as satisfying the requirements  
11 of that subsection if it increases its gross receipts by the  
12 portion of employee compensation properly allocable to the  
13 provision of financial intermediation services.

14 “(c) SIGNIFICANT FINANCIAL INTERMEDIATION.—A  
15 business will be considered as engaging in substantial fi-  
16 nancial intermediation if—

17 “(1) more than 5 percent of the compensation  
18 paid by the business to its employees is for employ-  
19 ees whose primary activity is the management of the  
20 business’s investments in financial instruments, or

21 “(2) at all times during the taxable year and  
22 the immediately preceding full taxable year, more  
23 than 10 percent of its assets are financial instru-  
24 ments other than—

1           “(A) equity interests in business entities in  
2           which it holds more than 50 percent in value of  
3           the outstanding equity,

4           “(B) equity interests in joint ventures in  
5           which the company is actively participating,

6           “(C) purchase money loans to its cus-  
7           tomers, and

8           “(D) business loans and equity invest-  
9           ments that serve a direct business purpose.

## 10   **“Subchapter H—Tax-Exempt Organizations**

“Sec. 251. Exemption for governmental entities.

“Sec. 252. Taxable activity of governmental entities.

“Sec. 253. Tax-exempt organizations.

“Sec. 254. Special rules for (e)(3) organizations.

“Sec. 255. Tax on unrelated business activity.

“Sec. 256. Unrelated business activity.

### 11   **“SEC. 251. EXEMPTION FOR GOVERNMENTAL ENTITIES.**

12           “(a) STATES.—Except as provided in section 252, a  
13           state, political subdivision thereof and the District of Co-  
14           lumbia shall be exempt from taxation under this chapter  
15           on any gross profits derived from the exercise of any es-  
16           sential governmental function.

17           “(b) POSSESSIONS.—The government of any posses-  
18           sion of the United States shall be exempt from taxation  
19           under this chapter on any gross profits earned by the pos-  
20           session.

1 **“SEC. 252. TAXABLE ACTIVITY OF GOVERNMENTAL ENTI-**  
2 **TIES.**

3 “(a) CERTAIN ACTIVITIES TAXABLE.—A govern-  
4 mental entity shall be considered a business and subject  
5 to tax on any business activity of a type frequently pro-  
6 vided by business entities subject to tax under this chap-  
7 ter.

8 “(b) CERTAIN ACTIVITIES TREATED AS ESSENTIAL  
9 GOVERNMENT FUNCTIONS.—Subsection (a) shall not  
10 apply to the following activities, which shall be treated as  
11 essential government functions:

12 “(1) Provision of mass transportation services.

13 “(2) Provision of public utility services.

14 **“SEC. 253. TAX-EXEMPT ORGANIZATIONS.**

15 “(a) EXEMPTION FROM TAXATION.—An organiza-  
16 tion described in subsection (c) or (d) shall be exempt  
17 from taxation under this chapter.

18 “(b) TAX ON UNRELATED BUSINESS ACTIVITY.—An  
19 organization exempt from taxation under subsection (a)  
20 shall be subject to tax to the extent provided in sections  
21 255 and 256, but shall be considered a tax-exempt organi-  
22 zation for purposes of any law that refers to tax-exempt  
23 organizations.

24 “(c) LIST OF EXEMPT ORGANIZATIONS.—The fol-  
25 lowing organizations are referred to in subsection (a):

1           “(1) INSTRUMENTALITY OF THE UNITED  
2 STATES.—Any corporation organized under Act of  
3 Congress which is an instrumentality of the United  
4 States but only if such corporation—

5           “(A) is exempt from Federal income  
6 taxes—

7           “(i) under such Act as amended and  
8 supplemented before July 18, 1984, or

9           “(ii) under this title without regard to  
10 any provision of law which is not contained  
11 in this title and which is not contained in  
12 a revenue Act, or

13           “(B) is described in subsection (h).

14           “(2) TITLE HOLDING COMPANIES.—Corpora-  
15 tions organized for the exclusive purpose of holding  
16 title to property, collecting income therefrom, and  
17 turning over the entire amount thereof, less ex-  
18 penses, to an organization which itself is exempt  
19 under this section. Rules similar to the rules of sub-  
20 paragraph (G) of paragraph (25) shall apply for  
21 purposes of this paragraph.

22           “(3) CHARITABLE, EDUCATIONAL AND RELI-  
23 GIOUS ORGANIZATIONS.—Corporations, and any  
24 community chest, fund, or foundation, organized and  
25 operated exclusively for religious, charitable, sci-

1       entific, testing for public safety, literary, or edu-  
2       cational purposes, or to foster national or inter-  
3       national amateur sports competition (but only if no  
4       part of its activities involve the provision of athletic  
5       facilities or equipment), or for the prevention of cru-  
6       elty to children or animals, no part of the net earn-  
7       ings of which inures to the benefit of any private  
8       shareholder or individual, no substantial part of the  
9       activities of which is carrying on propaganda, or oth-  
10      erwise attempting, to influence legislation (except as  
11      otherwise provided in subsection (g)), and which  
12      does not participate in, or intervene in (including the  
13      publishing or distributing of statements), any polit-  
14      ical campaign on behalf of (or in opposition to) any  
15      candidate for public office.

16           “(4) SOCIAL WELFARE ORGANIZATIONS, ETC.—

17                   “(A) Civic leagues or organizations not or-  
18                   ganized for profit but operated exclusively for  
19                   the promotion of social welfare, or local associa-  
20                   tions of employees, the membership of which is  
21                   limited to the employees of a designated person  
22                   or persons in a particular municipality, and the  
23                   net earnings of which are devoted exclusively to  
24                   charitable, educational, or recreational pur-  
25                   poses.

1           “(B) Subparagraph (A) shall not apply to  
2           an entity unless no part of the net earnings of  
3           such entity inures to the benefit of any private  
4           shareholder or individual

5           “(5) LABOR AND AGRICULTURAL ORGANIZA-  
6           TIONS.—Labor, agricultural, or horticultural organi-  
7           zations.

8           “(6) TRADE ASSOCIATIONS.—Business leagues,  
9           chambers of commerce, real-estate boards, boards of  
10          trade, or professional football leagues (whether or  
11          not administering a pension fund for football play-  
12          ers) not organized for profit and no part of the net  
13          earnings of which inures to the benefit of any pri-  
14          vate shareholder or individual.

15          “(7) SOCIAL CLUBS.—Clubs organized for  
16          pleasure, recreation, and other nonprofitable pur-  
17          poses, substantially all of the activities of which are  
18          for such purposes and no part of the net earnings  
19          of which inures to the benefit of any private share-  
20          holder.

21          “(8) CERTAIN FRATERNAL SOCIETIES.—Fra-  
22          ternal beneficiary societies, orders, or associations—

23                  “(A) operating under the lodge system or  
24                  for the exclusive benefit of the members of a

1           fraternity itself operating under the lodge sys-  
2           tem, and

3           “(B) providing for the payment of life,  
4           sick, accident, or other benefits to the members  
5           of such society, order, or association or their  
6           dependents.

7           “(9) VEBA’S.—Voluntary employees’ bene-  
8           ficiary associations providing for the payment of life,  
9           sick, accident, or other benefits to the members of  
10          such association or their dependents or designated  
11          beneficiaries, if no part of the net earnings of such  
12          association inures (other than through such pay-  
13          ments) to the benefit of any private shareholder or  
14          individual.

15          “(10) OTHER FRATERNAL ORGANIZATIONS.—  
16          Domestic fraternal societies, orders, or associations,  
17          operating under the lodge system—

18                 “(A) the net earnings of which are devoted  
19                 exclusively to religious, charitable, scientific, lit-  
20                 erary, educational, and fraternal purposes, and

21                 “(B) which do not provide for the payment  
22                 of life, sick, accident, or other benefits.

23          “(11) LOCAL TEACHERS’ RETIREMENT  
24          FUNDS.—Teachers’ retirement fund associations of a  
25          purely local character, if—

1           “(A) no part of their net earnings inures  
2 (other than through payment of retirement ben-  
3 efits) to the benefit of any private shareholder  
4 or individual, and

5           “(B) the income consists solely of amounts  
6 received from public taxation, amounts received  
7 from assessments on the teaching salaries of  
8 members, and income in respect of investments.

9           “(12) CERTAIN COOPERATIVES.—

10           “(A) Benevolent life insurance associations  
11 of a purely local character, mutual ditch or irri-  
12 gation companies, mutual or cooperative tele-  
13 phone companies, or like organizations; but only  
14 if 85 percent or more of the income consists  
15 of amounts collected from members for the sole  
16 purpose of meeting losses and expenses.

17           “(B) In the case of a mutual or coopera-  
18 tive telephone company, subparagraph (A) shall  
19 be applied without taking into account any in-  
20 come received or accrued—

21           “(i) from a nonmember telephone  
22 company for the performance of commu-  
23 nication services which involve members of  
24 the mutual or cooperative telephone com-  
25 pany,

1 “(ii) from qualified pole rentals,

2 “(iii) from the sale of display listings  
3 in a directory furnished to the members of  
4 the mutual or cooperative telephone com-  
5 pany, or

6 “(iv) from the prepayment of a loan  
7 under section 306A, 306B, or 311 of the  
8 Rural Electrification Act of 1936 (as in ef-  
9 fect on January 1, 1987).

10 “(C) In the case of a mutual or cooperative  
11 electric company, subparagraph (A) shall be ap-  
12 plied without taking into account any income  
13 received or accrued—

14 “(i) from qualified pole rentals, or

15 “(ii) from the prepayment of a loan  
16 under section 306A, 306B, or 311 of the  
17 Rural Electrification Act of 1936 (as in ef-  
18 fect on January 1, 1987).

19 “(D) For purposes of this paragraph, the  
20 term ‘qualified pole rental’ means any rental of  
21 a pole (or other structure used to support  
22 wires) if such pole (or other structure)—

23 “(i) is used by the telephone or elec-  
24 tric company to support one or more wires  
25 which are used by such company in pro-

1           viding telephone or electric services to its  
2           members, and

3           “(ii) is used pursuant to the rental to  
4           support one or more wires (in addition to  
5           the wires described in clause (i)) for use in  
6           connection with the transmission by wire  
7           of electricity or of telephone or other com-  
8           munications.

9           For purposes of the preceding sentence, the  
10          term ‘rental’ includes any sale of the right to  
11          use the pole (or other structure).

12          “(13) NONPROFIT CEMETERIES.—Cemetery  
13          companies owned and operated exclusively for the  
14          benefit of their members or which are not operated  
15          for profit; and any corporation chartered solely for  
16          the purpose of the disposal of bodies by burial or  
17          cremation which is not permitted by its charter to  
18          engage in any business not necessarily incident to  
19          that purpose and no part of the net earnings of  
20          which inures to the benefit of any private share-  
21          holder or individual.

22          “(14) GRANDFATHERED MUTUAL FINANCIAL  
23          INSTITUTIONS.—

24                 “(A) Credit unions without capital stock  
25                 organized and operated for mutual purposes

1 and without profit, but only if organized before  
2 July 1, 2001.

3 “(B) Certain corporations or associations  
4 organized before September 1, 1957, and de-  
5 scribed in subparagraphs (B) or (C) of section  
6 501(c)(14) of the Internal Revenue Code of  
7 1986.

8 “(15) GRANDFATHERED SMALL INSURANCE  
9 COMPANIES.—Insurance companies organized before  
10 July 1, 2001, and described in section 501(c)(15) of  
11 the Internal Revenue Code of 1986.

12 “(16) CROP FINANCING ASSOCIATIONS.—Cor-  
13 porations organized by an association subject to part  
14 IV of this subchapter or members thereof, for the  
15 purpose of financing the ordinary crop operations of  
16 such members or other producers, and operated in  
17 conjunction with such association. Exemption shall  
18 not be denied any such corporation because it has  
19 capital stock, if the dividend rate of such stock is  
20 fixed at not to exceed the legal rate of interest in the  
21 State of incorporation or 8 percent per annum,  
22 whichever is greater, on the value of the consider-  
23 ation for which the stock was issued, and if substan-  
24 tially all such stock (other than nonvoting preferred  
25 stock, the owners of which are not entitled or per-

1       mitted to participate, directly or indirectly, in the  
2       profits of the corporation, on dissolution or other-  
3       wise, beyond the fixed dividends) is owned by such  
4       association, or members thereof; nor shall exemption  
5       be denied any such corporation because there is ac-  
6       cumulated and maintained by it a reserve required  
7       by State law or a reasonable reserve for any nec-  
8       essary purpose.

9               “(17) SUPPLEMENTAL EMPLOYMENT BENEFIT  
10       TRUST.—

11               “(A) A trust or trusts forming part of a  
12       plan providing for the payment of supplemental  
13       unemployment compensation benefits, if—

14               “(i) under the plan, it is impossible,  
15       at any time prior to the satisfaction of all  
16       liabilities, with respect to employees under  
17       the plan, for any part of the corpus or in-  
18       come to be (within the taxable year or  
19       thereafter) used for, or diverted to, any  
20       purpose other than the providing of supple-  
21       mental unemployment compensation bene-  
22       fits,

23               “(ii) such benefits are payable to em-  
24       ployees under a classification which is set  
25       forth in the plan and which is found by the

1 Secretary not to be discriminatory in favor  
2 of employees who are highly compensated  
3 employees (within the meaning of section  
4 414(q)), and

5 “(iii) such benefits do not discrimi-  
6 nate in favor of employees who are highly  
7 compensated employees (within the mean-  
8 ing of section 414(q). A plan shall not be  
9 considered discriminatory within the mean-  
10 ing of this clause merely because the bene-  
11 fits received under the plan bear a uniform  
12 relationship to the total compensation, or  
13 the basic or regular rate of compensation,  
14 of the employees covered by the plan.

15 “(B) Rules similar to those contained in  
16 subparagraphs (B) through (E) of section  
17 501(c)(7) of the Internal Revenue Code of 1986  
18 shall apply to subparagraph (A).

19 “(18) GRANDFATHERED TRUSTS.—A trust or  
20 trusts created before June 25, 1959, and described  
21 in section 501(c)(18) of the Internal Revenue Code  
22 of 1986.

23 “(19) CERTAIN VETERANS’ ORGANIZATIONS.—  
24 A post or organization of past or present members  
25 of the Armed Forces of the United States, or an

1 auxiliary unit or society of, or a trust or foundation  
2 for, any such post or organization—

3 “(A) organized in the United States or any  
4 of its possessions,

5 “(B) at least 75 percent of the members of  
6 which are past or present members of the  
7 Armed Forces of the United States and sub-  
8 stantially all of the other members of which are  
9 individuals who are cadets or are spouses, wid-  
10 ows, or widowers of past or present members of  
11 the Armed Forces of the United States or of  
12 cadets, and

13 “(C) no part of the net earnings of which  
14 inures to the benefit of any private shareholder  
15 or individual.

16 “(20) LEGAL SERVICE PLAN TRUSTS.—An or-  
17 ganization or trust created or organized in the  
18 United States, the exclusive function of which is to  
19 form part of a qualified group legal services plan or  
20 plans.

21 “(21) BLACK LUNG ACT TRUSTS.—A trust or  
22 trusts established in writing, created or organized in  
23 the United States, and contributed to by any person  
24 (except an insurance company) if—

1           “(A) the purpose of such trust or trusts is  
2 exclusively—

3           “(i) to satisfy, in whole or in part, the  
4 liability of such person for, or with respect  
5 to, claims for compensation for disability  
6 or death due to pneumoconiosis under  
7 Black Lung Acts,

8           “(ii) to pay premiums for insurance  
9 exclusively covering such liability,

10           “(iii) to pay administrative and other  
11 incidental expenses of such trust in connec-  
12 tion with the operation of the trust and the  
13 processing of claims against such person  
14 under Black Lung Acts, and

15           “(iv) to pay accident or health bene-  
16 fits for retired miners and their spouses  
17 and dependents (including administrative  
18 and other incidental expenses of such trust  
19 in connection therewith) or premiums for  
20 insurance exclusively covering such bene-  
21 fits; and

22           “(B) such trusts meets requirements simi-  
23 lar to those contained in section 501(c)(21) of  
24 the Internal Revenue Code of 1986.

1           “(22) MULTIEmployer ERISA TRUST.—A trust  
2           created or organized in the United States and estab-  
3           lished in writing by the plan sponsors of multiem-  
4           ployer plans if—

5                   “(A) the purpose of such trust is  
6           exclusively—

7                           “(i) to pay any amount described in  
8                           section 4223(c) or (h) of the Employee Re-  
9                           tirement Income Security Act of 1974, and

10                           “(ii) to pay reasonable and necessary  
11                           administrative expenses in connection with  
12                           the establishment and operation of the  
13                           trust and the processing of claims against  
14                           the trust,

15                   “(B) no part of the assets of the trust may  
16           be used for, or diverted to, any purpose other  
17           than—

18                           “(i) the purposes described in sub-  
19                           paragraph (A), or

20                           “(ii) prudent investment in securities,  
21                           obligations, or time or demand deposits,

22                   “(C) such trust meets the requirements of  
23           paragraphs (2), (3), and (4) of section 4223(b),  
24           4223(h), or, if applicable, section 4223(c) of the

1 Employee Retirement Income Security Act of  
2 1974, and

3 “(D) the trust instrument provides that,  
4 on dissolution of the trust, assets of the trust  
5 may not be paid other than to plans which have  
6 participated in the plan or, in the case of a  
7 trust established under section 4223(h) of such  
8 Act, to plans with respect to which employers  
9 have participated in the fund.

10 “(23) GRANDFATHERED VETERANS’ INSURANCE  
11 ORGANIZATION.—Any association organized before  
12 1880 more than 75 percent of the members of which  
13 are present or past members of the Armed Forces  
14 and a principal purpose of which is to provide insur-  
15 ance and other benefits to veterans or their depend-  
16 ents.

17 “(24) ERISA TRUST.—A trust described in sec-  
18 tion 4049 of the Employee Retirement Income Secu-  
19 rity Act of 1974 (as in effect on the date of the en-  
20 actment of the Single-Employer Pension Plan  
21 Amendments Act of 1986).

22 “(25) REAL TITLE HOLDING CORPORATION OR  
23 TRUST.—

24 “(A) Any corporation or trust which—

1                   “(i) has no more than 35 shareholders  
2                   or beneficiaries,

3                   “(ii) has only 1 class of stock or bene-  
4                   ficial interest, and

5                   “(iii) is organized for the exclusive  
6                   purposes of—

7                   “(I) acquiring real property and  
8                   holding title to, and collecting income  
9                   from, such property, and

10                  “(II) remitting the entire amount  
11                  of income from such property (less ex-  
12                  penses) to 1 or more organizations de-  
13                  scribed in subparagraph (C) which are  
14                  shareholders of such corporation or  
15                  beneficiaries of such trust.

16                  “For purposes of clause (iii), the term ‘real  
17                  property’ shall not include any interest as a  
18                  tenant in common (or similar interest) and  
19                  shall not include any indirect interest.

20                  “(B) A corporation or trust shall be de-  
21                  scribed in subparagraph (A) without regard to  
22                  whether the corporation or trust is organized by  
23                  1 or more organizations described in subpara-  
24                  graph (C).

1           “(C) An organization is described in this  
2 subparagraph if such organization is—

3                   “(i) a qualified pension, profit shar-  
4 ing, or stock bonus plan that meets the re-  
5 quirements of section 401(a),

6                   “(ii) a governmental plan (within the  
7 meaning of section 414(d)),

8                   “(iii) the United States, any State or  
9 political subdivision thereof, or any agency  
10 or instrumentality of any of the foregoing,  
11 or

12                   “(iv) any organization described in  
13 paragraph (3).

14           “(D) A corporation or trust shall in no  
15 event be treated as described in subparagraph  
16 (A) unless such corporation or trust permits its  
17 shareholders or beneficiaries—

18                   “(i) to dismiss the corporation’s or  
19 trust’s investment adviser, following rea-  
20 sonable notice, upon a vote of the share-  
21 holders or beneficiaries holding a majority  
22 of interest in the corporation or trust, and

23                   “(ii) to terminate their interest in the  
24 corporation or trust by either, or both, of

1 the following alternatives, as determined by  
2 the corporation or trust:

3 “(I) by selling or exchanging  
4 their stock in the corporation or inter-  
5 est in the trust (subject to any Fed-  
6 eral or State securities law) to any or-  
7 ganization described in subparagraph  
8 (C) so long as the sale or exchange  
9 does not increase the number of  
10 shareholders or beneficiaries in such  
11 corporation or trust above 35, or

12 “(II) by having their stock or in-  
13 terest redeemed by the corporation or  
14 trust after the shareholder or bene-  
15 ficiary has provided 90 days notice to  
16 such corporation or trust.

17 “(E)(i) For purposes of this paragraph—

18 “(I) a corporation which is a qualified  
19 subsidiary shall not be treated as a sepa-  
20 rate corporation, and

21 “(II) all assets, liabilities, and items  
22 of income, deduction, and credit of a quali-  
23 fied subsidiary shall be treated as assets,  
24 liabilities, and such items (as the case may

1           be) of the corporation or trust described in  
2           subparagraph (A).

3           “(ii) For purposes of this subparagraph,  
4           the term ‘qualified subsidiary’ means any cor-  
5           poration if, at all times during the period such  
6           corporation was in existence, 100 percent of the  
7           stock of such corporation is held by the cor-  
8           poration or trust described in subparagraph  
9           (A).

10          “(iii) For purposes of this subtitle, if any  
11          corporation which was a qualified subsidiary  
12          ceases to meet the requirements of clause (ii),  
13          such corporation shall be treated as a new cor-  
14          poration acquiring all of its assets (and assum-  
15          ing all of its liabilities) immediately before such  
16          cessation from the corporation or trust de-  
17          scribed in subparagraph (A) in exchange for its  
18          stock.

19          “(F) For purposes of subparagraph (A),  
20          the term ‘real property’ includes any personal  
21          property which is leased under, or in connection  
22          with, a lease of real property, but only if the  
23          rent attributable to such personal property for  
24          the taxable year does not exceed 15 percent of  
25          the total rent for the taxable year attributable

1 to both the real and personal property leased  
2 under, or in connection with, such lease.

3 “(G)(i) An organization shall not be treat-  
4 ed as failing to be described in this paragraph  
5 merely by reason of the receipt of any otherwise  
6 disqualifying income which is incidentally de-  
7 rived from the holding of real property.

8 “(ii) Clause (i) shall not apply if the  
9 amount of gross income described in such  
10 clause exceeds 10 percent of the organization’s  
11 gross income for the taxable year unless the or-  
12 ganization establishes to the satisfaction of the  
13 Secretary that the receipt of gross income de-  
14 scribed in clause (i) in excess of such limitation  
15 was inadvertent and reasonable steps are being  
16 taken to correct the circumstances giving rise to  
17 such income.

18 “(26) STATE ESTABLISHED MEDICAL CARE IN-  
19 SURER.—Any membership organization if—

20 “(A) such organization is established by a  
21 State exclusively to provide coverage for medical  
22 care on a not-for-profit basis to individuals de-  
23 scribed in subparagraph (B) through—

24 “(i) insurance issued by the organiza-  
25 tion, or

1           “(ii) a health maintenance organiza-  
2           tion under an arrangement with the orga-  
3           nization,

4           “(B) the only individuals receiving such  
5           coverage through the organization are  
6           individuals—

7           “(i) who are residents of such State,  
8           and

9           “(ii) who, by reason of the existence  
10          or history of a medical condition—

11           “(I) are unable to acquire med-  
12           ical care coverage for such condition  
13           through insurance or from a health  
14           maintenance organization, or

15           “(II) are able to acquire such  
16           coverage only at a rate which is sub-  
17           stantially in excess of the rate for  
18           such coverage through the member-  
19           ship organization,

20          “(C) the composition of the membership in  
21          such organization is specified by such State,  
22          and

23          “(D) no part of the net earnings of the or-  
24          ganization inures to the benefit of any private  
25          shareholder or individual. A spouse and any

1           qualifying child) of an individual described in  
2           subparagraph (B) (without regard to this sen-  
3           tence) shall be treated as described in subpara-  
4           graph (B).

5           “(27) GRANDFATHERED WORKERS COMPENSA-  
6           TION ORGANIZATION.—Any membership organiza-  
7           tion established before June 1, 1996, by a State ex-  
8           clusively to reimburse its members for losses arising  
9           under workmen’s compensation acts, and described  
10          in section 501(c)(27) of the Internal Revenue Code  
11          of 1986.

12          “(d) RELIGIOUS AND APOSTOLIC ORGANIZATIONS.—  
13          The following organizations are referred to in subsection  
14          (a): Religious or apostolic associations or corporations, if  
15          such associations or corporations have a common treasury  
16          or community treasury, even if such associations or cor-  
17          porations engage in business for the common benefit of  
18          the members, but only if such activity is treated as unre-  
19          lated business activity.

20          “(e) COOPERATIVE HOSPITAL SERVICE ORGANIZA-  
21          TIONS.—For purposes of this chapter, an organization  
22          shall be treated as an organization organized and operated  
23          exclusively for charitable purposes, if—

24                  “(1) such organization is organized and oper-  
25                  ated solely—

1           “(A) to perform, on a centralized basis,  
2           one or more of the following services which, if  
3           performed on its own behalf by a hospital which  
4           is an organization described in subsection (c)(3)  
5           and exempt from taxation under subsection (a),  
6           would constitute activities in exercising or per-  
7           forming the purpose or function constituting  
8           the basis for its exemption: data processing,  
9           purchasing (including the purchasing of insur-  
10          ance on a group basis), warehousing, billing  
11          and collection, food, clinical, industrial engi-  
12          neering, laboratory, printing, communications,  
13          record center, and personnel (including selec-  
14          tion, testing, training, and education of per-  
15          sonnel) services; and

16          “(B) to perform such services solely for  
17          two or more hospitals each of which is—

18                 “(i) an organization described in sub-  
19                 section (c)(3) which is exempt from tax-  
20                 ation under subsection (a),

21                 “(ii) a constituent part of an organi-  
22                 zation described in subsection (c)(3) which  
23                 is exempt from taxation under subsection  
24                 (a) and which, if organized and operated  
25                 as a separate entity, would constitute an

1 organization described in subsection (c)(3),  
2 or

3 “(iii) owned and operated by the  
4 United States, a State, the District of Co-  
5 lumbia, or a possession of the United  
6 States, or a political subdivision or an  
7 agency or instrumentality of any of the  
8 foregoing;

9 “(2) such organization is organized and oper-  
10 ated on a cooperative basis and allocates or pays,  
11 within 8½ months after the close of its taxable year,  
12 all net earnings to patrons on the basis of services  
13 performed for them; and

14 “(3) if such organization has capital stock, all  
15 of such stock outstanding is owned by its patrons.

16 “For purposes of this title, any organization which, by rea-  
17 son of the preceding sentence, is an organization described  
18 in subsection (c)(3) and exempt from taxation under sub-  
19 section (a), shall be treated as a hospital and as an organi-  
20 zation referred to in section 101(b)(1)(A)(iii).

21 “(f) COOPERATIVE SERVICE ORGANIZATIONS OF OP-  
22 ERATING EDUCATIONAL ORGANIZATIONS.—For purposes  
23 of this chapter, if an organization is—

24 “(1) organized and operated solely to hold,  
25 commingle, and collectively invest and reinvest (in-

1 including arranging for and supervising the perform-  
2 ance by independent contractors of investment serv-  
3 ices related thereto) in stocks and securities, the  
4 moneys contributed thereto by each of the members  
5 of such organization, and to collect income there-  
6 from and turn over the entire amount thereof, less  
7 expenses, to such members,

8 “(2) organized and controlled by one or more  
9 such members, and

10 “(3) comprised solely of members that are orga-  
11 nizations described in clause (ii) or (iv) of section  
12 101(b)(1)(A)—

13 “(A) which are exempt from taxation  
14 under subsection (a), or

15 “(B) the gross profits of which are ex-  
16 cluded from taxation under section 251(a),

17 then such organization shall be treated as an organization  
18 organized and operated exclusively for charitable purposes.

19 “(g) EXPENDITURES BY PUBLIC CHARITIES TO IN-  
20 FLUENCE LEGISLATION.—

21 “(1) GENERAL RULE.—In the case of an orga-  
22 nization to which this subsection applies, exemption  
23 from taxation under subsection (a) shall be denied  
24 because a substantial part of the activities of such  
25 organization consists of carrying on propaganda, or

1 otherwise attempting, to influence legislation, but  
2 only if such organization normally—

3 “(A) makes lobbying expenditures in ex-  
4 cess of the lobbying ceiling amount for such or-  
5 ganization for each taxable year, or

6 “(B) makes grass roots expenditures in ex-  
7 cess of the grass roots ceiling amount for such  
8 organization for each taxable year.

9 “(2) DEFINITIONS.—For purposes of this  
10 subsection—

11 “(A) LOBBYING EXPENDITURES.—‘Lob-  
12 bying expenditures’ means expenditures for the  
13 purpose of influencing legislation (as defined in  
14 section 4911(d)).

15 “(B) LOBBYING CEILING AMOUNT.—The  
16 lobbying ceiling amount for any organization  
17 for any taxable year is 150 percent of the lob-  
18 bying nontaxable amount for such organization  
19 for such taxable year, determined under section  
20 4911.

21 “(C) GRASS ROOTS EXPENDITURES.—  
22 ‘Grass roots expenditures’ means expenditures  
23 for the purpose of influencing legislation (as de-  
24 fined in section 4911(d) without regard to para-  
25 graph (1)(B) thereof).

1           “(D) GRASS ROOTS CEILING AMOUNT.—

2           The grass roots ceiling amount for any organi-  
3           zation for any taxable year is 150 percent of  
4           the grass roots nontaxable amount for such or-  
5           ganization for such taxable year, determined  
6           under section 4911.

7           “(3) ORGANIZATIONS TO WHICH THIS SUB-  
8           SECTION APPLIES.—This subsection shall apply to  
9           any organization which has elected (in such manner  
10          and at such time as the Secretary may prescribe) to  
11          have the provisions of this subsection apply to such  
12          organization and which, for the taxable year which  
13          includes the date the election is made, is described  
14          in subsection (c)(3) and is not described in para-  
15          graph (4) and is not a private foundation.

16          “(4) DISQUALIFIED ORGANIZATIONS.—This  
17          subsection does not apply to—

18                 “(A) a church,

19                 “(B) an integrated auxiliary of a church or  
20                 of a convention or association of churches, or

21                 “(C) a member of an affiliated group of or-  
22                 ganizations (within the meaning of section  
23                 4911(f)(2)) if one or more members of such  
24                 group is described in subparagraph (A) or (B).

1           “(5) YEARS FOR WHICH ELECTION IS EFFEC-  
2           TIVE.—An election by an organization under this  
3           subsection shall be effective for all taxable years of  
4           such organization which—

5                   “(A) end after the date the election is  
6           made, and

7                   “(B) begin before the date the election is  
8           revoked by such organization (under regulations  
9           prescribed by the Secretary).

10           “(6) NO EFFECT ON CERTAIN ORGANIZA-  
11           TIONS.—With respect to any organization for a tax-  
12           able year for which—

13                   “(A) such organization is described in  
14           paragraph (5), or

15                   “(B) an election under this subsection is  
16           not in effect for such organization, nothing in  
17           this subsection or in section 4911 shall be con-  
18           strued to affect the interpretation of the phrase,  
19           ‘no substantial part of the activities of which is  
20           carrying on propaganda, or otherwise attempt-  
21           ing, to influence legislation,’ under subsection  
22           (c)(3).

23           “(h) GOVERNMENT CORPORATIONS EXEMPT UNDER  
24           SUBSECTION (c)(1).—For purposes of subsection (c)(1),

1 the following organizations are described in this sub-  
2 section:

3           “(1) The Central Liquidity Facility established  
4           under title III of the Federal Credit Union Act (12  
5           U.S.C. 1795 et seq.).

6           “(2) The Resolution Trust Corporation estab-  
7           lished under section 21A of the Federal Home Loan  
8           Bank Act.

9           “(3) The Resolution Funding Corporation es-  
10          tablished under section 21B of the Federal Home  
11          Loan Bank Act.

12          “(i) CERTAIN EDUCATIONAL ORGANIZATIONS.—An  
13          organization shall not be eligible for exemption as an edu-  
14          cational organization under subsection (c)(3) if a substan-  
15          tial amount of its activities and funds are devoted to—

16               “(1) conducting seminars and other similar pro-  
17               grams,

18               “(2) conducting research to educate Congress  
19               or the general public about public policy issues,

20               “(3) producing books and pamphlets, or

21               “(4) a combination of the foregoing.

22          **“SEC. 254. SPECIAL RULES FOR (c)(3) ORGANIZATIONS.**

23               “(a) NEW ORGANIZATIONS MUST NOTIFY SEC-  
24          RETARY.—Except as provided in subsection (c), an organi-

1 zation shall not be treated as an organization described  
2 in section 253(c)(3)—

3 “(1) unless that it has given notice to the Sec-  
4 retary, in such manner as the Secretary may pre-  
5 scribe, that it is applying for recognition of such sta-  
6 tus, or

7 “(2) for any period before giving of such notice,  
8 if such notice is given after the time prescribed by  
9 the Secretary by regulations for giving notice under  
10 this subsection.

11 “(b) PRESUMPTION THAT ORGANIZATIONS ARE PRI-  
12 VATE FOUNDATIONS.—Except as provided in subsection  
13 (c), any organization described in section 253(c)(3) and  
14 which does not notify the Secretary, at such time and in  
15 such manner as the Secretary may by regulations pre-  
16 scribe, that it is not a private foundation (as defined in  
17 section 102) shall be presumed to be a private foundation.

18 “(c) EXCEPTIONS.—Subsections (a) and (b) shall not  
19 apply to—

20 “(1) organizations organized before October 10,  
21 1969;

22 “(2) organizations which obtained recognition  
23 of tax-exempt status under section 501(c)(3) of the  
24 Internal Revenue Code of 1986 (in the case of sub-  
25 section (a) only);

1           “(3) organizations which were determined not  
2           to be private foundations under the Internal Rev-  
3           enue Code of 1986;

4           “(4) churches, their integrated auxiliaries, and  
5           conventions and associations of churches;

6           “(5) any organization that is not a private  
7           foundation and the gross receipts of which in each  
8           taxable year are not more than \$25,000, or

9           “(6) such other classes of organizations which  
10          the Secretary may exempt.

11 **“SEC. 255. TAX ON UNRELATED BUSINESS ACTIVITY.**

12          “(a) IN GENERAL.—Each organization described in  
13          subsection (b) shall be subject to the Simplified USA Tax  
14          for businesses under section 201 on its gross profits from  
15          its unrelated business activity.

16          “(b) ORGANIZATIONS SUBJECT TO TAX.—This sec-  
17          tion shall apply to—

18                 “(1) organizations exempt from the business  
19                 tax under section 253(a), other than instrumental-  
20                 ities of the United States described in section  
21                 253(c)(1).

22                 “(2) colleges and universities which are instru-  
23                 mentalities of any government and corporations  
24                 owned by one or more such colleges or universities.

1 **“SEC. 256. UNRELATED BUSINESS ACTIVITY.**

2       “(a) IN GENERAL.—‘Unrelated business activity’  
3 means any trade or business the conduct of which is not  
4 substantially related (aside from the need of such organi-  
5 zation for income or funds or the use it makes of the prof-  
6 its derived) to the exercise or performance by such organi-  
7 zation of its charitable, educational, or other purpose or  
8 function constituting the basis for its exemption under  
9 section 253, except that such term does not include any  
10 trade or business—

11               “(1) in which substantially all the work in car-  
12 rying on such trade or business is performed for the  
13 organization without compensation; or

14               “(2) which is carried on, in the case of an orga-  
15 nization described in section 253(e)(3) or in the case  
16 of a college or university described in section 255(b),  
17 by the organization primarily for the convenience of  
18 its members, students, patients, officers, or employ-  
19 ees, which is the selling by the organization of items  
20 of work-related clothes and equipment and items  
21 normally sold through vending machines, through  
22 food dispensing facilities, or by snack bars, for the  
23 convenience of its members at their usual places of  
24 employment; or

1           “(3) which is the selling of merchandise, sub-  
2           stantially all of which has been received by the orga-  
3           nization as gifts or contributions.

4           “(b) ADVERTISING, ETC., ACTIVITIES.—For pur-  
5           poses of this section, ‘trade or business’ includes any activ-  
6           ity which is carried on for the production of income from  
7           the sale of goods or the performance of services. For pur-  
8           poses of the preceding sentence, an activity does not lose  
9           identity as a trade or business merely because it is carried  
10          on within a larger aggregate of similar activities or within  
11          a larger complex of other endeavors which may, or may  
12          not, be related to the exempt purposes of the organization.  
13          Where an activity carried on for profit constitutes an un-  
14          related trade or business, no part of such trade or business  
15          shall be excluded from such classification merely because  
16          it does not result in profit.

17          “(c) TRADE OR BUSINESS.—

18                 “(1) CERTAIN BUSINESS ACTIVITIES.—An ac-  
19                 tivity shall not be considered a ‘trade or business’  
20                 solely because the activity is a business activity  
21                 (such as certain passive rental activity) that would  
22                 be subject to the business tax if conducted by a busi-  
23                 ness entity other than a tax-exempt organization.

24                 “(2) REGULATIONS.—The Secretary shall pre-  
25                 scribe regulations defining a ‘trade or business.’

1 Such regulations shall be consistent with the provi-  
 2 sions under sections 511 through 513 of the Internal  
 3 Revenue Code of 1986, except to the extent such  
 4 provisions are inconsistent with other principles of  
 5 the business tax. The regulations shall include exclu-  
 6 sions from the definition of ‘trade or business’ simi-  
 7 lar to those contained in section 513 of the Internal  
 8 Revenue Code for—

9 “(A) certain bingo games,

10 “(B) certain hospital services, and

11 “(C) certain public entertainment activity  
 12 at fairs and expositions by an organization  
 13 which regularly conducts, as one of its substan-  
 14 tial exempt purposes, an agricultural or edu-  
 15 cational fair or exhibition.

16 “(3) TRADE SHOWS.—The conduct of trade  
 17 shows and conventions shall not be excluded from  
 18 the definition of trade or business.

### 19 **“Subchapter I—Cooperatives**

Sec. 260. Patronage dividends of cooperatives.

#### 20 **“SEC. 260. PATRONAGE DIVIDENDS OF COOPERATIVES.**

21 “(a) PATRONAGE DIVIDENDS PAID BY SUPPLY CO-  
 22 OPERATIVES.—A qualified patronage dividend paid by a  
 23 supply cooperative to a patron shall be treated as if it is  
 24 a refund of a portion of the amounts paid by the patron

1 for goods, services, or use of capital. In general, if the  
2 supply cooperative included the amount received from the  
3 patron in taxable receipts, the dividend shall reduce tax-  
4 able receipts in the year incurred. If the recipient of the  
5 dividend is a business entity which deducted the cost of  
6 business purchases to which the dividend related, the re-  
7 cipient will reduce its cost of business purchases by the  
8 amount of the dividend in the year the dividend is paid  
9 or incurred.

10       “(b) PATRONAGE DIVIDENDS PAID BY MARKETING  
11 COOPERATIVES.—A qualified patronage dividend paid to  
12 a patron by a marketing cooperative shall be treated as  
13 an upward price adjustment in the amount received by the  
14 patron for its goods marketed by the cooperative. In gen-  
15 eral, the cooperative will increase its cost of business pur-  
16 chases by the amount of the qualified patronage dividend  
17 and the recipient will increase its taxable receipts by the  
18 amount of the qualified patronage dividend.

19       “(c) DIVIDEND TREATMENT.—Only the portion of a  
20 patronage dividend that is not a qualified patronage divi-  
21 dend shall be treated as a dividend under this chapter and  
22 chapter 2.

23       “(d) DEFINITIONS.—

24               “(1) QUALIFIED PATRONAGE DIVIDEND.—A  
25       ‘qualified patronage dividend’ is that part of a pa-

1       tronage dividend that is attributable to the patron’s  
2       allocable share of patronage earnings of a marketing  
3       cooperative or a supply cooperative.

4               “(2) SUPPLY COOPERATIVE.—A ‘supply cooper-  
5       ative’ is a cooperative that sells goods or service to  
6       patrons and provided patronage dividends with re-  
7       spect to the quantity of purchases of the patrons.

8               “(3) MARKETING COOPERATIVE.—A ‘marketing  
9       cooperative’ is a cooperative that sells goods pro-  
10      duced by its members and provides patronage divi-  
11      dends to the members based on the quantities of  
12      goods sold or provided for sale.

13      “(e) SPECIAL RULES.—

14              “(1) NOTICES OF ALLOCATION AND PER-UNIT  
15      RETAIN CERTIFICATES.—Except as provided in  
16      paragraph (2), a notice of allocation, per-unit retain  
17      certificate, or other similar document shall not be  
18      treated as a patronage dividend until it is redeemed  
19      in cash or property.

20              “(2) OPPORTUNITY TO RECEIVE CASH.—If a  
21      patron is given an opportunity to receive a patron-  
22      age dividend in cash, but instead chooses to accept  
23      a per-unit retain certificate or a qualified notice of  
24      allocation, the patron will be treated as receiving

1 cash and simultaneously contributing to the capital  
2 of the cooperative.

3 “(3) APPLICATION LIMITED TO QUALIFIED CO-  
4 OPERATIVES.—Under rules to be prescribed by the  
5 Secretary, this section shall apply only to coopera-  
6 tives to which one of the following provisions of the  
7 Internal Revenue Code of 1986 would have applied:

8 “(A) Section 501(c)(12) (relating to coop-  
9 erative telephone companies and similar organi-  
10 zations).

11 “(B) Section 501(c)(14) (relating to cer-  
12 tain cooperative banks).

13 “(C) Section 521 (relating to farm co-  
14 operatives).

15 “(D) Section 1381 (relating to coopera-  
16 tives generally).

17 “(4) REGULATIONS.—The Secretary shall pre-  
18 scribe regulations for the application of this section.  
19 The regulations shall generally be consistent with  
20 subchapter T of chapter 1 of the Internal Revenue  
21 Code of 1986 except to the extent that such rules  
22 are inconsistent with provisions of this chapter.

### 23 **“Subchapter J—Sourcing Rules**

“Sec. 265. Exports of property or services.

“Sec. 266. Imports of property or services.

“Sec. 267. Import or export of services.

“Sec. 268. International transportation services.

“Sec. 269. International communications.

“Sec. 270. Insurance.

1 **“SEC. 265. EXPORTS OF PROPERTY OR SERVICES.**

2 “(a) GENERAL RULE.—Taxable receipts do not in-  
3 clude amounts received by the exporter thereof for prop-  
4 erty or services exported from the United States for use  
5 or consumption outside the United States.

6 “(b) EXPORT THROUGH NONBUSINESS ENTITY.—  
7 For purposes of subsection (a), if property or services are  
8 sold to a governmental entity or a tax-exempt organization  
9 for export and are exported other than in an activity of  
10 such entity which is subject to the business tax, then the  
11 seller of such property or services is deemed to be the ex-  
12 porter thereof.

13 “(c) EXPORT OF SERVICES.—See section 267 for  
14 rules for determining whether services are exported or im-  
15 ported.

16 **“SEC. 266. IMPORTS OF PROPERTY OR SERVICES.**

17 “(a) IN GENERAL.—The import of property or serv-  
18 ices for consumption in the United States shall constitute  
19 a business purchase if such property or service is to be  
20 used in a business activity in the United States. Property  
21 being held for sale or retail by a business entity that is  
22 in the business of selling goods shall be considered held  
23 for ‘use in a business activity’.

24 “(b) AMOUNT OF BUSINESS PURCHASE.—

1           “(1) IN GENERAL.—The cost of business pur-  
2           chases with respect to the import of property or  
3           services for use or consumption in the United States  
4           is the customs value, price or other amount used for  
5           purposes of determining the import tax under sec-  
6           tion 286 or section 287.

7           “(2) IMPORT TAX.—The cost of business pur-  
8           chases does not include any import tax paid. No de-  
9           duction shall be allowed with respect to property or  
10          service imported by a business entity unless the im-  
11          port tax is paid with respect to such import.

12   **“SEC. 267. IMPORT OR EXPORT OF SERVICES.**

13          “(a) IN GENERAL.—Except as otherwise provided in  
14          this subchapter or in rules prescribed under subchapter  
15          G (relating to financial intermediation business), services  
16          shall not be treated as imported or exported from the loca-  
17          tion in which they are performed.

18          “(b) IMPORT OF SERVICES.—A business entity shall  
19          be treated as importing a service if—

20                  “(1) the entire benefit of the service will be re-  
21                  alized in the United States, and

22                  “(2) the benefit will be realized in connection  
23                  with the United States business activities of the  
24                  business entity.

1       “(c) EXPORT OF SERVICES.—A business will be  
2 treating as exporting a service if—

3           “(1) the entire benefit of the service will be re-  
4 realized outside of the United States, and

5           “(2) the benefit will be realized solely in con-  
6 nection with the activities of the purchaser occurring  
7 outside the United States.

8       “(d) SERVICES ACQUIRED FROM SERVICE PROVIDER  
9 THAT PROVIDES SERVICES IN AND OUTSIDE THE UNITED  
10 STATES.—

11           “(1) IN GENERAL.—If a business entity ac-  
12 quires services from a service provider that provides  
13 services both in and outside the United States and  
14 the service provider shows on the invoice where the  
15 services are provided—

16           “(A) the business entity shall treat the  
17 services as provided where stated on the invoice,  
18 and

19           “(B) the service provider shall treat as tax-  
20 able receipts any services listed as provided in  
21 the United States.

22           “(2) NO INVOICE.—If a business entity acquires  
23 services from a service provider that provides serv-  
24 ices both in and outside the United States and the

1 service provider does not show on an invoice where  
2 such services are provided—

3 “(A) the business entity shall treat the  
4 services as if provided in the location to which  
5 payment is sent, and

6 “(B) the service provider shall treat as tax-  
7 able receipts any payments received in the  
8 United States.

9 “(e) SPECIAL RULES PREVAIL.—See sections 268  
10 and 269 for special rule relating to transportation and  
11 communication services.

12 **“SEC. 268. INTERNATIONAL TRANSPORTATION SERVICES.**

13 “(a) TRANSPORTATION OF PROPERTY.—

14 “(1) TAXABLE RECEIPTS.—

15 “(A) EXPORTS.—Taxable receipts do not  
16 include receipts from the transportation of  
17 property exported from the United States.

18 “(B) IMPORTS.—Taxable receipts include  
19 receipts from transportation of property im-  
20 ported into the United States only if such costs  
21 are not taken into account in determining the  
22 import tax.

23 “(C) PRESUMPTIONS.—The Secretary shall  
24 prescribe regulations describing situations in  
25 which a transporter of property must presume

1 that no import tax has been paid on the cost  
2 of its services.

3 “(2) BUSINESS PURCHASES.—

4 “(A) EXPORTS.—Business purchases do  
5 not include amounts paid or incurred for the  
6 cost of transportation of property exported from  
7 the United States.

8 “(B) IMPORTS.—Amounts paid or incurred  
9 for transportation of goods imported into the  
10 United States, shall constitute a cost of busi-  
11 ness purchase only to the extent that they are  
12 taken into account in determining the customs  
13 value for purposes of section 286(a) (relating  
14 to the import tax).

15 “(b) TRANSPORTATION OF PASSENGERS.—

16 “(1) TAXABLE RECEIPTS.—Taxable receipts—

17 “(A) include receipts from the transpor-  
18 tation of passengers from the United States to  
19 a destination outside the United States, but

20 “(B) do not include receipts from the  
21 transportation of passengers from outside the  
22 United States to a destination in the United  
23 States.

24 “(2) BUSINESS PURCHASES.—Business  
25 purchases—

1           “(A) include amounts paid or incurred in  
2 a business activity for the transportation of  
3 passengers from the United States to a destina-  
4 tion outside the United States, but

5           “(B) do not include amounts paid or in-  
6 curred for transportation of passengers from  
7 outside the United States to a destination in  
8 the United States.

9           “(3) SIMPLIFYING RULES.—The Secretary may  
10 provide rules that simplify this subsection, including  
11 rules under which—

12           “(A) half of receipts attributable to trans-  
13 portation to or from the United States are  
14 treated as taxable receipts,

15           “(B) half of the cost for business trips to  
16 and from the United States are treated as busi-  
17 ness purchases, and

18           “(C) all transportation expenses of a busi-  
19 ness entity that has no regular business outside  
20 the United States are treated as business pur-  
21 chases.

22 **“SEC. 269. INTERNATIONAL COMMUNICATIONS.**

23           “(a) IN GENERAL.—For purposes of section 266,  
24 communications services shall be treated as provided at

1 the point of origin of the communications and shall not  
2 be treated as imported or exported.

3 “(b) COMMUNICATIONS SERVICES.—Communications  
4 services include—

5 “(1) telephone communications services,

6 “(2) courier services (except in the case of  
7 transportation of property that is imported or ex-  
8 ported),

9 “(3) satellite transmission services,

10 “(4) telegraph services,

11 “(5) facsimile transmission services, and

12 “(6) other similar services.

13 **“SEC. 270. INSURANCE.**

14 “(a) IN GENERAL.—Insurance services will be treat-  
15 ed as provided at the location of the insurance company  
16 providing the services. Except as the Secretary may pre-  
17 scribe by regulations, insurance companies will be treated  
18 as providing services at the location to which insurance  
19 payments are made.

20 “(b) INSURED RISKS IN THE UNITED STATES.—If  
21 insurance services are provided outside the United States  
22 and the insured risk is located in the United States—

23 “(1) the insurance service shall be treated as  
24 imported,

1           “(2) the insurance premiums shall be subject to  
2           the import tax, and

3           “(3) payments of insurance benefits shall not be  
4           treated as imported.

5           “(c) INSURED RISK OUTSIDE THE UNITED  
6 STATES.—If insurance services are provided inside the  
7 United States and the insured risk is located outside the  
8 United States—

9           “(1) insurance services shall be treated as ex-  
10          ported,

11          “(2) payments of insurance benefits shall be  
12          treated as payments for services outside the United  
13          States, and shall not be deducted as business pur-  
14          chases.

15          “(d) INSURANCE SERVICES.—Insurance services  
16 means the provision of insurance and services related to  
17 insurance other than insurance that is treated as a savings  
18 asset.

19 **“SEC. 271. BANKING SERVICES.**

20          “The Secretary shall prescribe regulations on the lo-  
21 cation of banking services and the extent to which such  
22 services are to be treated as imported or exported.

23           **“Subchapter K—Business Conducted in a**  
24   **Possession**

“Sec. 276. Treatment of possessions.

1 **“SEC. 276. TREATMENT OF POSSESSIONS.**

2       “(a) IN GENERAL.—For purposes of the business tax  
3 imposed by this chapter, the U.S. possessions shall not  
4 be treated as part of the United States.

5       “(b) EFFECT ON PAYROLL TAX CREDIT.—A busi-  
6 ness entity may not claim a payroll tax credit with respect  
7 to any payroll taxes paid with respect to income of resi-  
8 dents of the U.S. possessions.

9       “(c) POSSESSION.—For purposes of this subchapter,  
10 ‘U.S. possession’ or ‘possession’ means a possession of the  
11 United States and includes the Commonwealth of Puerto  
12 Rico and the Virgin Islands.

13               **“Subchapter L—Payroll Tax Credit**

“Sec. 281. Amount of credit.

“Sec. 282. Current-year payroll tax credit.

“Sec. 283. Credit carryover.

14 **“SEC. 281. AMOUNT OF CREDIT.**

15       “(a) AMOUNT OF CREDIT.—The payroll tax credit for  
16 a business entity for a taxable year is the lesser of—

17               “(1) the sum of—

18                       “(A) the current-year payroll tax credit,

19                       and

20                       “(B) the credit carryovers to the taxable  
21                       year, or

22               “(2) the business entity’s business tax for the  
23               taxable year (determined without regard to the pay-  
24               roll tax credit).

1       “(b) CONSOLIDATED RETURNS.—In the case of busi-  
2       ness entities filing consolidated returns, the amount of the  
3       credit shall be determined using the combined payroll tax  
4       credits and credit carryovers of the business entities and  
5       the combined business tax of the business entities.

6       **“SEC. 282. CURRENT-YEAR PAYROLL TAX CREDIT.**

7       “(a) IN GENERAL.—The ‘current-year payroll tax  
8       credit’ is an amount equal to the sum of—

9               “(1) the employer’s share of the FICA tax im-  
10              posed on wages of its employees during the taxable  
11              year,

12             “(2) the employer’s share of the tier 1 railroad  
13              retirement tax for its employees during the taxable  
14              year,

15             “(3) one-half of the allocable portion of the  
16              SECA tax imposed on individuals (other than inde-  
17              pendent contractors and other business entities) who  
18              provide services to the business entity.

19       “(b) DEFINITIONS.—

20             “(1) EMPLOYER’S SHARE OF THE FICA TAX.—  
21             ‘Employer’s share of the FICA tax’ means the old-  
22             age, survivors, disability and hospital insurance  
23             taxes imposed by section 3111.

1           “(2) EMPLOYER’S SHARE OF THE TIER 1 RAIL-  
2 ROAD RETIREMENT TAX.—‘Employer’s share of the  
3 tier 1 railroad retirement tax’ means—

4                   “(A) the tier 1 railroad retirement tax im-  
5 posed by section 3221(a), and

6                   “(B) the portion of the tax imposed by sec-  
7 tion 3211(a)(1) on employee representatives at-  
8 tributable to the tax imposed by section 3111.

9           “(3) ONE-HALF OF THE ALLOCABLE PORTION  
10 OF THE SECA TAX.—

11                   “(A) SECA TAX.—‘SECA tax’ means the  
12 self-employment tax imposed by section 1401.

13                   “(B) PARTNERSHIPS.—Until such time as  
14 the SECA tax and the Federal Insurance Con-  
15 tributions Acts are amended to treat partners  
16 of partnerships as employees, if a partner des-  
17 ignates a partnership as a principal source of  
18 employment income for the taxable year, one-  
19 half of the partnership’s allocable portion of the  
20 SECA tax of such partner equals the FICA tax  
21 that the employer would have been required to  
22 pay under section 3111 with respect to such  
23 partner if the partner’s self-employment income  
24 as reported by the partnership were wages sub-  
25 ject to the FICA tax. A partner and partner-

1 ship can agree to treat no portion of a partner's  
2 SECA tax as allocable to the partnership.

3 “(C) PROPRIETORSHIP.—In the case of an  
4 individual who is a proprietor or sole owner and  
5 provider of service to a business entity, the indi-  
6 vidual shall allocate the portion of one-half of  
7 his SECA tax not allocated pursuant to sub-  
8 paragraph (B) to his business entities in ac-  
9 cordance with rules prescribed by the Secretary.

10 “(c) SPECIAL RULE.—Under rules prescribed by the  
11 Secretary, an individual subject to the self-employment tax  
12 shall pay half of the self-employment tax on an amount  
13 of self employment income not less than the amount of  
14 the individual's self-employment income taken into ac-  
15 count by partnerships under subparagraph (B) of sub-  
16 section (b)(3).

17 **“SEC. 283. CREDIT CARRYOVER.**

18 “(a) CARRYOVER.—A current-year credit that is not  
19 applied in the taxable year in which earned shall constitute  
20 a credit carryover until applied but for no more than 15  
21 taxable years.

22 “(b) ORDER OF USE.—For purposes of determining  
23 which credits are applied under section 281, if the total  
24 credit allowable in a taxable year is less than the sum of  
25 the current-year payroll credit and the carryover credits,

1 the current-year payroll credit shall be considered applied  
2 first and then credit carryovers shall be considered applied  
3 in the order earned.

#### 4 **“Subchapter M—Import Tax**

“Sec. 286. Imposition of tax on property.

“Sec. 287. Imposition of tax on import of services.

“Sec. 288. General rules for the import tax.

#### 5 **“SEC. 286. IMPOSITION OF TAX ON PROPERTY.**

6 “(a) GENERAL RULE.—There is hereby imposed a  
7 tax equal to 11 percent of the customs value of all prop-  
8 erty entered into the United States for consumption, use  
9 or warehousing.

10 “(b) LIABILITY FOR TAX.—The tax imposed on the  
11 import of property by subsection (a) shall be paid by the  
12 person entering the property into the United States for  
13 consumption, use or warehousing. Such tax shall be due  
14 and payable at the time of import.

15 “(c) IMPORTS OF PREVIOUSLY EXPORTED PROP-  
16 erty.—In the case of any article that is classified under  
17 a heading or subheading of subchapter I or II of chapter  
18 98 of the Tariff Schedules of the United States, the tax  
19 under this section shall be imposed only on that portion  
20 of the customs value of such article that is dutiable under  
21 such heading or subheading.

22 “(d) IMPORTS FOR PERSONAL CONSUMPTION.—The  
23 import tax imposed by this section shall not apply to any  
24 article entered into the United States duty free under sub-

1 chapters I through VII of chapter 98 of the Tariff Sched-  
2 ules of the United States.

3 **“SEC. 287. IMPOSITION OF TAX ON IMPORT OF SERVICES.**

4       “(a) GENERAL RULE.—There is hereby imposed a  
5 tax equal to 11 percent of the cost of all services treated  
6 as imported into the United States during the taxable year  
7 of the service recipient.

8       “(b) LIABILITY FOR THE TAX.—The tax on the im-  
9 port of services imposed by subsection (a) shall be paid  
10 by the person who receives the imported services. The tax  
11 shall be payable as if it were an addition to the business  
12 tax imposed by section 201.

13       “(c) IMPORTED SERVICES.—For purposes of this sec-  
14 tion, services shall be treated as imported if they are treat-  
15 ed as imported under section 267 (general rules on import  
16 of services) or section 270 (related to insurance).

17       “(d) SPECIAL RULE FOR INSURANCE.—The seller of  
18 insurance that is treated as imported under section 270  
19 shall be liable for the collection of the tax imposed by sub-  
20 section (a) on the insurance and for paying such tax to  
21 the Secretary. The first sentence of subsection (b) (relat-  
22 ing to the person liable for the tax) shall apply to insur-  
23 ance only to the extent that the seller of the insurance  
24 services does not collect such tax.

1 **“SEC. 288. GENERAL RULES FOR THE IMPORT TAX.**

2       “(a) IMPORT TAX.—‘Import tax’ means the tax im-  
 3 posed by section 286 on the import of property and the  
 4 tax imposed by section 287 on the import of services.

5       “(b) NO PAYROLL TAX CREDIT.—The payroll tax  
 6 credit shall not be allowed against the import tax.

7               **“Subchapter N—Transition Rules**

- “Sec. 290. Amortization of transition basis.
- “Sec. 291. Sales of transition basis property.
- “Sec. 292. Safe harbor leases.
- “Sec. 293. Carryovers.
- “Sec. 294. Section 481 adjustments.

8 **“SEC. 290. AMORTIZATION OF TRANSITION BASIS.**

9       “(a) TRANSITION BASIS DEDUCTION.—The ‘transi-  
 10 tion basis deduction’ for a taxable year is the sum of the  
 11 amortization allowance determined under this section for  
 12 the taxable year.

13       “(b) AMORTIZATION RULES.—The amortization al-  
 14 lowance for each category of amortizable basis shall be de-  
 15 termined by amortizing the amortizable basis of such cat-  
 16 egory ratably over the amortization period for the category  
 17 beginning January 1, 2002.

18       “(c) AMORTIZATION PERIOD.—The amortization pe-  
 19 riods shall be determined in accordance with the following  
 20 table:

<b>In the case of:</b>	<b>The amortization period is:</b>
Category I basis .....	15 years
Category II basis .....	30 years
Category III basis .....	40 years
Unrecovered inventory costs .....	5 years

1 “(d) CATEGORIES.—

2 “(1) CATEGORY I BASIS.—‘Category I basis’ is  
3 the sum of the unrecovered bases as of January 1,  
4 2002, of all depreciable property placed in service  
5 prior to January 1, 2002, and the unamortized por-  
6 tion of amortizable costs incurred before January 1,  
7 2002, if—

8 “(A) cost recovery or amortization began  
9 before January 1, 2002, and

10 “(B) the remaining recovery period or am-  
11 ortization period as of January 1, 2002, is less  
12 than 15 years.

13 “(2) CATEGORY II BASIS.—‘Category II basis’  
14 is the sum of the unrecovered bases as of January  
15 1, 2002, of all depreciable property placed in service  
16 prior to January 1, 2002, and the unamortized por-  
17 tion of amortizable costs incurred before January 1,  
18 2002, if—

19 “(A) cost recovery or amortization began  
20 before January 1, 2002, and

21 “(B) the remaining recovery period or am-  
22 ortization period as of January 1, 2002, is 15  
23 years or more.

1           “(3) CATEGORY III BASIS.—‘Category III basis’  
2 is the sum of the adjusted basis of each asset satis-  
3 fying the following requirements:

4           “(A) The asset was placed in service prior  
5 to January 1, 2002,

6           “(B) The asset was used in a business ac-  
7 tivity in 2002,

8           “(C) The cost of the asset was capitalized  
9 and not depreciable or otherwise recoverable  
10 under the Internal Revenue Code of 1986, and

11           “(D) The cost of the asset would have con-  
12 stituted deductible expenses under the business  
13 tax if such cost had been incurred after 2001.

14           “(4) UNRECOVERED INVENTORY COSTS.—‘Un-  
15 recovered inventory costs’ means the cost of goods  
16 sold (as determined under the Internal Revenue  
17 Code of 1986) if a business entity sold all of its in-  
18 ventory (including inventory being produced) on the  
19 effective date of the business tax.

20           “(e) RULES OF APPLICATION.—

21           “(1) REMAINING RECOVERY PERIOD.—

22           “(A) TIME OF MEASURE.—The remaining  
23 recovery period shall be determined as of De-  
24 cember 31, 2001, and shall include each taxable  
25 year ending after such date in which a deduc-

1           tion would have been allowed under the Internal  
2           Revenue Code of 1986.

3           “(B) ACCOUNTING METHOD.—The remain-  
4           ing recovery period shall be determined using  
5           the cost recovery method and rules applicable  
6           for determining taxable income under the Inter-  
7           nal Revenue Code of 1986.

8           “(2) DEPLETABLE ASSETS.—Under rules pre-  
9           scribed by the Secretary, this section shall apply to  
10          the remaining cost basis of depletable property and  
11          to other property for which a cost recovery method  
12          other than one based on time is used.

13 **“SEC. 291. SALES OF TRANSITION BASIS PROPERTY.**

14          “(a) IN GENERAL.—Except as provided in subsection  
15 (b), for purposes of determining the tax consequences of  
16 a sale, retirement, casualty or conversion to personal use  
17 of an asset whose basis or cost is taken into account under  
18 section 90, the amount to be amortized shall be treated  
19 as fully deducted upon the adoption of the business tax.

20          “(b) SUBSTANTIAL SALES.—

21                  “(1) IN GENERAL.—In the case of a substantial  
22                  sale of assets to which the amortization rules of sec-  
23                  tion 90 apply, the purchaser and seller may jointly  
24                  elect to have the purchaser assume the amortization

1       deductions attributable to such assets, in which  
2       case—

3               “(A) the seller’s taxable receipts from such  
4               sale shall be reduced by the amount of  
5               unamortized basis or cost assumed by the pur-  
6               chaser,

7               “(B) the purchaser may treat as a cost of  
8               a business purchase only the portion of the pur-  
9               chase price in excess of the amount of  
10              unamortized basis or cost assumed,

11              “(C) the unamortized basis or cost as-  
12              sumed shall continue to be amortized in the  
13              manner amortized by the seller.

14              “(2) SUBSTANTIAL SALE.—A sale of assets by  
15              a business entity to another business entity is a sub-  
16              stantial sale if—

17                      “(A) more than 20 percent (in fair market  
18                      value or in original cost) of the assets of the  
19                      seller are sold,

20                      “(B) the total consideration for the sale  
21                      exceeds \$1 million or 20 percent of the taxable  
22                      receipts of the seller for the taxable year pre-  
23                      ceding the year of the sale, or

1                   “(C) the sale satisfies other criteria estab-  
2                   lished by the Secretary to prevent distortions in  
3                   gross profits resulting from asset sales.

4   **“SEC. 292. SAFE HARBOR LEASES.**

5           “(a) IN GENERAL.—In the case of a safe harbor  
6 lease, rental payments deemed to occur under the lease  
7 and interest payments deemed to be made under the leases  
8 shall constitute costs of business purchases, and rental in-  
9 come and interest income deemed to be earned under the  
10 lease shall constitute taxable receipts. The transition basis  
11 deduction rules shall apply to the lessor’s adjusted basis  
12 in assets subject to a safe harbor lease.

13           “(b) SAFE HARBOR LEASE.—‘Safe harbor lease’  
14 means a sale and leaseback transaction entered into pur-  
15 suant to section 168(f)(8) of the Internal Revenue Code,  
16 as added by the Economic Recovery Tax Act of 1981,  
17 when such provision was in effect but only if such trans-  
18 action would not be treated as a sale and leaseback for  
19 tax purposes but for that provision.

20   **“SEC. 293. CARRYOVERS.**

21           “(a) NO LOSS CARRYOVERS.—No deduction shall be  
22 allowed under the business tax for net operating loss  
23 carryovers, capital loss carryovers, or any other loss  
24 carryovers from the income tax under the Internal Rev-  
25 enue Code of 1986.

1       “(b) NO CREDIT CARRYOVERS.—No credits shall be  
2 allowed under the business tax for business credit  
3 carryovers, minimum tax credit carryovers, or any other  
4 credit carryovers from the income tax under the Internal  
5 Revenue Code of 1986.

6       **“SEC. 294. SECTION 481 ADJUSTMENTS.**

7       “(a) POSITIVE NET SECTION 481 ADJUSTMENT  
8 AMOUNT.—If, as of January 1, 2002, a business entity  
9 has a positive net section 481 adjustment amount, the  
10 amount shall be applied to reduce the transition basis in  
11 accounts (for purposes of section 290) in the following  
12 order:

13               “(1) First, to reduce the category I basis (but  
14 not below zero),

15               “(2) Second, to reduce the category II basis  
16 (but not below zero),

17               “(3) Third, to reduce the unrecovered inventory  
18 costs.

19       “(b) NEGATIVE NET SECTION 481 ADJUSTMENT  
20 AMOUNT.—If, as of January 1, 2002, a business entity  
21 has a negative net section 481 adjustment amount, the  
22 amount shall be applied to increase category I basis for  
23 purposes of section 290.

1       “(c) SECTION 481 ADJUSTMENT.—A business enti-  
2 ty’s net section 481 adjustment is determined by  
3 subtracting—

4           “(1) the sum of all additional deductions to  
5 which a business entity would be entitled by reason  
6 of section 481 of the Internal Revenue Code of 1986  
7 for periods beginning on or after the effective date  
8 of the business tax with respect to changes in ac-  
9 counting methods made before such effective date,  
10 from

11           “(2) the sum of all additional income which a  
12 business entity would recognize by reason of section  
13 481 of the Internal Revenue Code of 1986 for peri-  
14 ods beginning on or after the effective date of the  
15 business tax with respect to changes in accounting  
16 methods made before such effective date,

17 in each case assuming that the income tax under the In-  
18 ternal Revenue Code of 1986 remained in effect.

19       **“Subchapter O—Rules for Administration,**  
20                           **Consolidated Returns**

“Sec. 301. Returns, due dates, etc.

“Sec. 302. Consolidated returns.

21       **“SEC. 301. RETURNS, DUE DATES, ETC.**

22           “(a) IN GENERAL.—Until subtitle F is amended to  
23 reflect the adoption of this chapter, the rules of subtitle

1 F relating to C corporations shall apply to business enti-  
2 ties with respect to—

3 “(1) returns and records;

4 “(2) time and place for paying tax;

5 “(3) assessment of taxes;

6 “(4) collections and liens;

7 “(5) abatements, credits, and refunds;

8 “(6) interest on underpayments and overpay-  
9 ments;

10 “(7) additions to tax and penalties;

11 “(8) closing agreements and compromises;

12 “(9) crimes;

13 “(10) judicial proceedings;

14 “(11) discovery of liability and enforcement;

15 and

16 “(12) estimated taxes.

17 “(b) INDIVIDUALS ENGAGING IN BUSINESS ACTIVI-  
18 TIES.—Under rules prescribed by the Secretary, individ-  
19 uals engaging in business activities on their own or with  
20 their spouses shall be permitted to file their business tax  
21 returns with their individual tax returns and shall be sub-  
22 ject to estimated tax rules for individual income tax re-  
23 turns.

1 **“SEC. 302. CONSOLIDATED RETURNS.**

2 “(a) IN GENERAL.—Business entities may file con-  
 3 solidated returns of business tax if they would have been  
 4 permitted to file consolidated returns under section 1501  
 5 of the Internal Revenue Code and such section were ap-  
 6 plied by treating each business entity as a corporation and  
 7 its owners or partners as shareholders.

8 “(b) FINANCIAL INSTITUTIONS.—Financial inter-  
 9 mediation businesses may be included in consolidated re-  
 10 turns, but each financial intermediation business must  
 11 compute its gross profits separately.

12 “(c) INTERCOMPANY TRANSACTIONS.—In computing  
 13 the gross profits of a consolidated group, intercompany  
 14 transactions can be taken into account, or at the election  
 15 of the filer, be disregarded (except in the case of trans-  
 16 actions with financial intermediation businesses).

17 **“Subchapter P—Definitions and Rules of**  
 18 **Application**

“Sec. 310. Definitions.

“Sec. 311. Rules of application.

19 **“SEC. 310. DEFINITIONS.**

20 “(a) IN GENERAL.—When used in this chapter,  
 21 where not otherwise distinctly expressed or manifestly in-  
 22 compatible with the intent thereof—

1           “(1) USA INCOME TAX.—‘USA Income Tax’  
2           and ‘Simplified USA Tax’ for individuals mean the  
3           tax imposed by chapter 1.

4           “(2) INTERNAL REVENUE CODE OF 1986.—‘In-  
5           ternal Revenue Code of 1986’ means the Internal  
6           Revenue Code of 1986 as in effect immediately be-  
7           fore the enactment of the Simplified USA Tax.

8           “(3) UNITED STATES.—‘United States’ means  
9           the States and the District of Columbia.

10          “(b) TERMS DEFINED IN CHAPTER 2.—If a term  
11          that is used but not defined in this chapter or in section  
12          7701 is defined in chapter 1, the definition in chapter 1  
13          shall apply except if manifestly incompatible with the in-  
14          tent of the provision in which the term is used.

15          **“SEC. 311. RULES OF APPLICATION.**

16          “(a) DEFINITIONS.—Any definition included in this  
17          chapter shall apply for all purposes of this chapter  
18          unless—

19                 “(1) such definition is limited to the purposes  
20                 of a particular chapter, section, or subsection, or

21                 “(2) the definition clearly would not be applica-  
22                 ble in a particular context.

23          “(b) INTERPRETATIONS CONSISTENT WITH INTER-  
24          NAL REVENUE CODE OF 1986.—Terms not defined in this  
25          chapter or elsewhere in this title, but defined in the Inter-

1 nal Revenue Code of 1986, shall be interpreted in a man-  
 2 ner consistent with the Internal Revenue Code of 1986,  
 3 except to the extent such interpretation would be incon-  
 4 sistent with the principles and purposes of this chapter.”

5 (b) The amendments made by this section shall be  
 6 effective on January 1, 2002, except to the extent other-  
 7 wise specifically provided in the text of such amendments.

8 **SEC. 302. REPEAL OF CHAPTER 6.**

9 Chapter 6 of the Code (relating to consolidated re-  
 10 turns) is repealed as of January 1, 2002.

11 **TITLE IV—DEFERRED**  
 12 **COMPENSATION PLANS**

13 **SEC. 401. PROVISIONS SAVED.**

14 (a) IN GENERAL.—Except as otherwise provided in  
 15 this title, the sections contained in subchapter D of chap-  
 16 ter 1 of the Code (relating to deferred compensation, etc.)  
 17 are hereby saved as chapter 3.

18 (b) LIMITATIONS ON CHAPTER 3.—The following  
 19 new section is inserted before section 401 of the Code (as  
 20 saved by subsection (a)):

21 **“SEC. 400. EFFECT OF CHAPTER 3.**

22 “(a) IN GENERAL.—The provisions of chapter 3 (sec-  
 23 tions 401 through 420) are included in this subtitle for  
 24 purposes of cross-reference and for purposes of deter-  
 25 mining whether plans are exempt from the business tax

1 and whether contributions to plans are deductible or ex-  
2 cludable from gross income under chapter 1.

3 “(b) EFFECT ON BUSINESS TAX DEDUCTIONS.—  
4 Notwithstanding any provision to the contrary in this  
5 chapter, no provision of this chapter shall cause any  
6 amount to be treated as a cost of business purchase or  
7 to otherwise be deducted from gross receipts for purposes  
8 of computing the Simplified USA for Tax Businesses  
9 under chapter 2.

10 “(c) NO CREDITS.—Notwithstanding any provision  
11 to the contrary in this chapter, no provision of this chapter  
12 shall result in a tax credit against any tax imposed by  
13 chapter 1 or chapter 2.

14 “(d) EFFECT OF FAILURE TO COMPLY WITH PROVI-  
15 SIONS.—A failure to comply with applicable provisions in  
16 this chapter could cause a plan to lose its exemption from  
17 the business tax and, thereby subject certain business ac-  
18 tivities of the plan to the business tax and/or result in  
19 the constructive distribution of plan assets to plan partici-  
20 pants.”

21 (c) SECTION 408A SUSPERSEDED BY SECTION 30.—  
22 Section 408A is repealed.

23 **SEC. 402. CLERICAL AMENDMENTS.**

24 (a) TABLE OF SECTIONS.—The table of sections for  
25 subpart A of part 1 of chapter 3 of the USA Tax Code

1 (formerly subchapter D of chapter 1 of the Code) is  
2 amended by inserting at the beginning of the table:

3 **“CHAPTER 3—DEFERRED COMPENSATION,**  
4 **ETC.”**

5 (b) RENUMBERING OF CHAPTERS.—

6 (1) RENUMBER CHAPTERS.—Chapters 2 and 3  
7 of the Code are renumbered 4 and 5 respectively.  
8 Such renumbering shall be reflected in all tables and  
9 headings in the Code.

10 (2) CROSS REFERENCES.—Any cross reference  
11 to chapter 2 or 3 of the Code contained in any provi-  
12 sion of the Code that is not amended by this Act or  
13 in any other statute shall be treated as a reference  
14 to such chapter as renumbered by paragraph 1.

15 **TITLE V—REPEAL OF ESTATE**  
16 **AND GIFT TAXES**

17 **SEC. 501. REPEAL OF GRATUITOUS TRANSFER TAXES.**

18 Subtitle B of the Code (relating to estate and gift  
19 taxes) is repealed.

20 **SEC 502. EFFECTIVE DATE.**

21 Section 501 shall apply to—

22 (1) gifts made after December 31, 2001;

23 (2) the estates of decedents dying after Decem-  
24 ber 31, 2001, and

1           (3) generating skipping transfers (within the  
2           meaning of subchapter B of chapter 13 as in effect  
3           before its repeal by this Act) occurring after Decem-  
4           ber 31, 2001.

5 **TITLE VI—TECHNICAL AND AD-**  
6 **MINISTRATIVE CHANGES: EF-**  
7 **FECTIVE DATES**

8 **SEC. 601. USA TAX CODE.**

9           (a) REDESIGNATION OF THE CODE.—The Internal  
10 Revenue Title enacted August 16, 1954, and as heretofore  
11 and hereby amended may be cited as the “USA Tax  
12 Code”. The USA Tax Code, as hereinafter amended, may  
13 be cited as the “USA Tax Code, as amended”.

14           (b) REFERENCES IN LAWS, ETC.—Except where in-  
15 appropriate, any reference in any law, Executive order, or  
16 other document—

17                 (1) to the Internal Revenue Code of 1954 or  
18                 the Internal Revenue Code of 1986 shall include a  
19                 reference to the USA Tax Code or the USA Tax  
20                 Code, as amended,

21                 (2) to the USA Tax Code or the USA Tax  
22                 Code, as amended, shall include a reference, with re-  
23                 spect to periods before January 1, 2002, to the In-  
24                 ternal Revenue Code of 1954 or the Internal Rev-  
25                 enue Code of 1986.

1 **SEC. 602. REVISIONS TO THE CODE.**

2 Not later than January 1, 2003, the Secretary shall  
3 submit to Congress proposed changes in the USA Tax  
4 Code that—

5 (1) eliminate cross-references to the Internal  
6 Revenue Code of 1986 (except with respect to tran-  
7 sition issues) and insert provisions similar to the  
8 cross-referenced sections of the Internal Revenue  
9 Code of 1986,

10 (2) revise subtitles C through J of the USA  
11 Tax Code to fully reflect the amendments to subtitle  
12 A of the Code made by this Act and the repeal of  
13 subtitle B,

14 (3) include statutory definitions or rules in  
15 cases where the Secretary concludes that the defini-  
16 tions or rules cannot or should not be addressed by  
17 regulation,

18 (4) revise chapter 4 of the USA Tax Code (as  
19 renumbered by section 402 of this Act) (relating to  
20 the self-employment tax) to conform to changes  
21 made by this Act, and

22 (5) revise chapter 5 of the USA Tax Code (as  
23 renumbered by section 402 of this Act) (relating to  
24 withholding on nonresident aliens and foreign cor-  
25 porations) to reflect changes made in this Act.

1 **SEC. 603. APPLICATION OF SUBTITLE F.**

2       Until such time as subtitle F of the Code is amended  
3 to reflect the amendments made by this Act, the provisions  
4 of subtitle F shall be treated as generally applying to the  
5 Simplified USA Tax—

6           (1) without regard to specific cross references,

7           (2) without regard to provisions relating to  
8 partnerships, and

9           (3) as if the business tax under chapter 2 were  
10 the corporate income tax and all business entities  
11 were corporations (except for purposes of collection,  
12 in which case the owners of noncorporate entities  
13 shall be obligated for taxes owned by the entities to  
14 the same extent as they would if the entity owed the  
15 tax prior to the amendment of the Code).

16 **SEC. 604. CLERICAL AMENDMENT.**

17       The portion of the table at the beginning of the Code  
18 listing subtitles and chapters of subtitle A is amended to  
19 read as follows:

“Subtitle A. Simplified USA Tax.

“Subtitle B. [deleted].

“Subtitle C. Employment taxes.

“Subtitle D. Miscellaneous excise taxes.

“Subtitle E. Alcohol, tobacco and certain other excise taxes.

“Subtitle F. Procedure and administration.

“Subtitle G. The Joint Committee on Taxation.

“Subtitle H. Financing of presidential election campaigns.

“Subtitle I. Trust Fund Code.

“Subtitle K. Group health plan requirements.

**“Subtitle A—Simplified USA Tax**

“Chapter 1. Simplified USA Tax for individuals.

“Chapter 2. Simplified USA Tax for businesses.

“Chapter 3. Deferred compensation plans.

“Chapter 4. Tax on self-employment income.

“Chapter 5. Withholding of tax on nonresident aliens and foreign corporations.”

1 **SEC. 605. EFFECTIVE DATES.**

2 (a) IN GENERAL.—Except as otherwise provided in  
3 this Act, the amendments made by this Act shall be effec-  
4 tive on January 1, 2002, with respect to tax years begin-  
5 ning on such date.

6 (b) SPECIAL RULES FOR BUSINESSES WITH 52–53  
7 WEEK YEAR.—If a business uses a 52–53 week taxable  
8 year the amendments made by this Act shall apply to the  
9 business with respect to its tax year beginning in the last  
10 week in December except with respect to any transactions  
11 occurring during 2001 that were structured to take advan-  
12 tage of the application of this Act to such business at a  
13 time when this Act did not apply to other businesses or  
14 to individuals.

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