

108TH CONGRESS
1ST SESSION

H. R. 22

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

IN THE HOUSE OF REPRESENTATIVES

JANUARY 7, 2003

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

A BILL

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

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

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

4 (a) **SHORT TITLE.**—This Act may be cited as the
5 “Individual and Small Business Tax Simplification Act of
6 2003”.

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

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

4 (c) TABLE OF CONTENTS.—

Sec. 1. Short title; etc.

TITLE I—INDIVIDUAL INCOME TAX SIMPLIFICATION

Subtitle A—General Provisions

- Sec. 101. Alternative minimum tax reform.
- Sec. 102. Head of household filing status replaced with special personal exemption.
- Sec. 103. Simplification of tax on social security benefits.
- Sec. 104. Simplification of capital gains tax.
- Sec. 105. Repeal of 2-percent floor on miscellaneous itemized deductions.
- Sec. 106. Simplification of deduction for points on home mortgage.
- Sec. 107. Taxation of minor children.
- Sec. 108. Simplification of dependent care tax benefits.
- Sec. 109. Acceleration of phaseout of overall limitation on itemized deductions.
- Sec. 110. Acceleration of repeal of phaseout of personal exemptions.
- Sec. 111. Repeal of personal holding company tax.

Subtitle B—Uniform Definition of Child

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

Subtitle C—Education Tax Incentives

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

TITLE II—SMALL BUSINESS TAX SIMPLIFICATION

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

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

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

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

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

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

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

18 “(4) INFLATION ADJUSTMENT.—

19 “(A) IN GENERAL.—In the case of a tax-
20 able year beginning in a calendar year after
21 2004, each of the dollar amounts contained in
22 subparagraphs (A) and (B) of paragraph (1)
23 shall be increased by an amount equal to—

24 “(i) such dollar amount, multiplied by

1 “(ii) the cost-of-living adjustment de-
2 termined under section 1(f)(3) for the cal-
3 endar year in which the taxable year be-
4 gins, determined by substituting ‘calendar
5 year 2003’ for ‘calendar year 1992’ in sub-
6 paragraph (B) thereof.

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

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

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

16 (d) EFFECTIVE DATE.—The amendments made by
17 this section shall apply to taxable years beginning after
18 December 31, 2003.

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

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

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

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

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

7 “(B) is not a surviving spouse, and

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

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

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

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

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

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

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

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

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

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

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

18 or

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

20 “(4) INFLATION ADJUSTMENT.—

21 “(A) IN GENERAL.—In the case of a tax-
22 able year beginning in a calendar year after
23 2004, the dollar amount contained in paragraph
24 (1) shall be increased by an amount equal to—

25 “(i) such dollar amount, multiplied by

1 “(ii) the cost-of-living adjustment de-
2 termined under section 1(f)(3) for the cal-
3 endar year in which the taxable year be-
4 gins, determined by substituting ‘calendar
5 year 2003’ for ‘calendar year 1992’ in sub-
6 paragraph (B) thereof.

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

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

13 (c) CONFORMING AMENDMENTS.—

14 (1) Section 1(c) is amended—

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

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

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

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

25 (4) Section 63(c)(2) is amended—

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

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

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

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

12 (A) by striking clause (ii),

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

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

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

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

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

23 (B) by striking clause (ii),

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

8 (d) EFFECTIVE DATE.—The amendments made by
9 this section shall apply to taxable years beginning after
10 December 31, 2003.

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

12 **BENEFITS.**

13 (a) REPEAL OF 1993 INCREASE.—

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

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

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

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

1 (2) CONFORMING AMENDMENTS.—

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

20 “(1) the sum of—

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

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

1 “(2) the base amount.”

2 (2) CONFORMING AMENDMENTS.—

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

6 (c) EFFECTIVE DATES.—

7 (1) IN GENERAL.—Except as provided in para-
8 graphs (2) and (3), the amendments made by this
9 section shall apply to taxable years beginning after
10 December 31, 2003.

11 (2) SUBSECTION (a)(2)(B).—The amendment
12 made by subsection (a)(2)(B) shall apply to benefits
13 paid after December 31, 2003.

14 (3) SUBSECTION (a)(2)(C).—The amendments
15 made by subsection (a)(2)(C) shall apply to tax li-
16 abilities for taxable years beginning after December
17 31, 2003.

18 (d) MAINTENANCE OF TRANSFERS TO TRUST
19 FUNDS.—There are hereby appropriated to the trust
20 funds established under the Social Security Act amounts
21 equal to the reduction in revenues to the Treasury by rea-
22 son of the enactment of this section. Amounts appro-
23 priated by the preceding sentence shall be transferred
24 from the general fund at such times and in such manner
25 so as to replicate to the extent possible the transfers which

1 would have occurred to such Trust Funds had this section
2 not been enacted.

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

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

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

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

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

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

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

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

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

25 (c) MINIMUM TAX TREATMENT.—

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

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

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

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

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

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

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

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

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

9 (d) TECHNICAL AND CONFORMING AMENDMENTS.—

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

“Sec. 1203. Capital gains deduction.”.

16 (f) EFFECTIVE DATES.—

17 (1) IN GENERAL.—Except as otherwise pro-
18 vided in this subsection, the amendments made by
19 this section shall apply to taxable years beginning
20 after December 31, 2003.

21 (2) WITHHOLDING.—The amendments made by
22 subsection (d)(16) shall apply only to amounts paid
23 after December 31, 2003.

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

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

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

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

11 (b) **CONFORMING AMENDMENTS.**—

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

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

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

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

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

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

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

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

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

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

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

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

6 (c) EFFECTIVE DATE.—The amendments made by
7 this section shall apply to taxable years beginning after
8 December 31, 2003.

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

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

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

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

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

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

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

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

12 (c) EFFECTIVE DATE.—The amendments made by
13 this section shall apply to taxable years beginning after
14 December 31, 2003.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

11 (d) EFFECTIVE DATE.—The amendments made by
12 this section shall apply to taxable years beginning after
13 December 31, 2003.

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

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

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

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

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

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

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

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

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

16 (c) EFFECTIVE DATE.—The amendments made by
17 this section shall apply to taxable years beginning after
18 December 31, 2003.

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

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

24 (b) CONFORMING AMENDMENTS.—

1 “(A) such dollar amount, multiplied by

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

7 (2) Section 1(f)(6) is amended—

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

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

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

20 (c) EFFECTIVE DATE.—The amendments made by
21 this section shall apply to taxable years beginning after
22 December 31, 2003.

1 **SEC. 111. REPEAL OF PERSONAL HOLDING COMPANY TAX.**

2 (a) IN GENERAL.—Part II of subchapter G of chap-
3 ter 1 (relating to personal holding companies) is hereby
4 repealed.

5 (b) CONFORMING AMENDMENTS.—

6 (1) Section 12(2) is amended to read as follows:

7 “(2) For accumulated earnings tax, see part I
8 of subchapter G (sec. 531 and following).”.

9 (2) Section 26(b)(2) is amended by striking
10 subparagraph (G) and by redesignating the suc-
11 ceeding subparagraphs accordingly.

12 (3) Section 30A(c) is amended by striking para-
13 graph (3) and by redesignating paragraph (4) as
14 paragraph (3).

15 (4) Section 41(e)(7)(E) is amended by adding
16 “and” at the end of clause (i), by striking clause
17 (ii), and by redesignating clause (iii) as clause (ii).

18 (5) Section 56(b)(2) is amended by striking
19 subparagraph (C) and by redesignating subpara-
20 graph (D) as subparagraph (C).

21 (6) Section 170(e)(4)(D) is amended by adding
22 “and” at the end of clause (i), by striking clause
23 (ii), and by redesignating clause (iii) as clause (ii).

24 (7) Section 111(d) is amended to read as fol-
25 lows:

1 “(d) SPECIAL RULES FOR ACCUMULATED EARNINGS
2 TAX.—In applying subsection (a) for the purpose of deter-
3 mining the accumulated earnings tax under section 531—

4 “(1) any excluded amount under subsection (a)
5 allowed for purposes of this subtitle (other than sec-
6 tion 531) shall be allowed whether or not such
7 amount resulted in a reduction of the tax under sec-
8 tion 531 for the prior taxable year, and

9 “(2) where any excluded amount under sub-
10 section (a) was not allowed as a deduction for the
11 prior taxable year for purposes of this subtitle other
12 than section 531 but was allowable for the same tax-
13 able year under section 531, then such excluded
14 amount shall be allowable if it did not result in a re-
15 duction of the tax under section 531.”.

16 (8)(A) Section 316(b) is amended by striking
17 paragraph (2) and by redesignating paragraph (3)
18 as paragraph (2).

19 (B) Section 331(b) is amended by striking
20 “(other than a distribution referred to in paragraph
21 (2)(B) of section 316(b))”.

22 (9) Section 341(d) is amended—

23 (A) by striking “section 544(a)” and in-
24 serting “section 465(f)”, and

1 (B) by inserting before the period at the
2 end of the next to the last sentence “and such
3 paragraph (2) shall be applied by inserting ‘by
4 or for his partner’ after ‘his family’ ”.

5 (10) Section 381(c) is amended by striking
6 paragraphs (14) and (17).

7 (11) Section 443(e) is amended by striking
8 paragraph (2) and by redesignating paragraphs (3),
9 (4), and (5) as paragraphs (2), (3), and (4), respec-
10 tively.

11 (12) Section 447(g)(4)(A) is amended by strik-
12 ing “other than—” and all that follows and insert-
13 ing “other than an S corporation.”

14 (13)(A) Section 465(a)(1)(B) is amended to
15 read as follows:

16 “(B) a C corporation which is closely
17 held,”.

18 (B) Section 465(a)(3) is amended to read as
19 follows:

20 “(3) CLOSELY HELD DETERMINATION.—For
21 purposes of paragraph (1), a corporation is closely
22 held if, at any time during the last half of the tax-
23 able year, more than 50 percent in value of its out-
24 standing stock is owned, directly or indirectly, by or
25 for not more than 5 individuals. For purposes of this

1 paragraph, an organization described in section
2 401(a), 501(c)(17), or 509(a) or a portion of a trust
3 permanently set aside or to be used exclusively for
4 the purposes described in section 642(c) shall be
5 considered an individual.”

6 (C) Section 465 is amended by adding at the
7 end the following new subsection:

8 “(f) CONSTRUCTIVE OWNERSHIP RULES.—For pur-
9 poses of subsection (a)(3)—

10 “(1) STOCK NOT OWNED BY INDIVIDUAL.—
11 Stock owned, directly or indirectly, by or for a cor-
12 poration, partnership, estate, or trust shall be con-
13 sidered as being owned proportionately by its share-
14 holders, partners, or beneficiaries.

15 “(2) FAMILY OWNERSHIP.—An individual shall
16 be considered as owning the stock owned, directly or
17 indirectly, by or for his family. For purposes of this
18 paragraph, the family of an individual includes only
19 his brothers and sisters (whether by the whole or
20 half blood), spouse, ancestors, and lineal descend-
21 ants.

22 “(3) OPTIONS.—If any person has an option to
23 acquire stock, such stock shall be considered as
24 owned by such person. For purposes of this para-
25 graph, an option to acquire such an option, and each

1 one of a series of such options, shall be considered
2 as an option to acquire such stock.

3 “(4) APPLICATION OF FAMILY AND OPTION
4 RULES.—Paragraphs (2) and (3) shall be applied if,
5 but only if, the effect is to make the corporation
6 closely held under subsection (a)(3).

7 “(5) CONSTRUCTIVE OWNERSHIP AS ACTUAL
8 OWNERSHIP.—Stock constructively owned by a per-
9 son by reason of the application of paragraph (1) or
10 (3), shall, for purposes of applying paragraph (1) or
11 (2), be treated as actually owned by such person;
12 but stock constructively owned by an individual by
13 reason of the application of paragraph (2) shall not
14 be treated as owned by him for purposes of again
15 applying such paragraph in order to make another
16 the constructive owner of such stock.

17 “(6) OPTION RULE IN LIEU OF FAMILY
18 RULE.—If stock may be considered as owned by an
19 individual under either paragraph (2) or (3) it shall
20 be considered as owned by him under paragraph (3).

21 “(7) CONVERTIBLE SECURITIES.—Outstanding
22 securities convertible into stock (whether or not con-
23 vertible during the taxable year) shall be considered
24 as outstanding stock if the effect of the inclusion of
25 all such securities is to make the corporation closely

1 held under subsection (a)(3). The requirement under
2 the preceding sentence that all convertible securities
3 must be included if any are to be included shall be
4 subject to the exception that, where some of the out-
5 standing securities are convertible only after a later
6 date than in the case of others, the class having the
7 earlier conversion date may be included although the
8 others are not included, but no convertible securities
9 shall be included unless all outstanding securities
10 having a prior conversion date are also included.”

11 (D) Section 465(c)(7)(B) is amended by strik-
12 ing clause (i) and by redesignating clauses (ii) and
13 (iii) as clauses (i) and (ii), respectively.

14 (E) Section 465(c)(7)(G) is amended to read as
15 follows:

16 “(G) LOSS OF 1 MEMBER OF AFFILIATED
17 GROUP MAY NOT OFFSET INCOME OF PERSONAL
18 SERVICE CORPORATION.—Nothing in this para-
19 graph shall permit any loss of a member of an
20 affiliated group to be used as an offset against
21 the income of any other member of such group
22 which is a personal service corporation (as de-
23 fined in section 269A(b) but determined by sub-
24 stituting ‘5 percent’ for ‘10 percent’ in section
25 269A(b)(2)).”

1 (14) Sections 508(d), 4947, and 4948(c)(4) are
2 each amended by striking “545(b)(2),” each place it
3 appears.

4 (15) Section 532(b) is amended by striking
5 paragraph (1) and by redesignating paragraphs (2),
6 (3), and (4) as paragraphs (1), (2), and (3), respec-
7 tively.

8 (16) Sections 535(b)(1) and 556(b)(1) are each
9 amended by striking “section 541” and inserting
10 “section 541 (as in effect before its repeal)”.

11 (17)(A) Section 553(a)(1) is amended by strik-
12 ing “section 543(d)” and inserting “subsection (c)”.

13 (B) Section 553 is amended by adding at the
14 end the following new subsection:

15 “(c) ACTIVE BUSINESS COMPUTER SOFTWARE ROY-
16 ALTIES.—

17 “(1) IN GENERAL.—For purposes of subsection
18 (a), the term ‘active business computer software roy-
19 alties’ means any royalties—

20 “(A) received by any corporation during
21 the taxable year in connection with the licensing
22 of computer software, and

23 “(B) with respect to which the require-
24 ments of paragraphs (2), (3), (4), and (5) are
25 met.

1 “(2) ROYALTIES MUST BE RECEIVED BY COR-
2 PORATION ACTIVELY ENGAGED IN COMPUTER SOFT-
3 WARE BUSINESS.—The requirements of this para-
4 graph are met if the royalties described in paragraph
5 (1)—

6 “(A) are received by a corporation engaged
7 in the active conduct of the trade or business
8 of developing, manufacturing, or producing
9 computer software, and

10 “(B) are attributable to computer software
11 which—

12 “(i) is developed, manufactured, or
13 produced by such corporation (or its prede-
14 cessor) in connection with the trade or
15 business described in subparagraph (A), or

16 “(ii) is directly related to such trade
17 or business.

18 “(3) ROYALTIES MUST CONSTITUTE AT LEAST
19 50 PERCENT OF INCOME.—The requirements of this
20 paragraph are met if the royalties described in para-
21 graph (1) constitute at least 50 percent of the ordi-
22 nary gross income of the corporation for the taxable
23 year.

1 “(4) DEDUCTIONS UNDER SECTIONS 162 AND
2 174 RELATING TO ROYALTIES MUST EQUAL OR EX-
3 CEED 25 PERCENT OF ORDINARY GROSS INCOME.—

4 “(A) IN GENERAL.—The requirements of
5 this paragraph are met if—

6 “(i) the sum of the deductions allow-
7 able to the corporation under sections 162,
8 174, and 195 for the taxable year which
9 are properly allocable to the trade or busi-
10 ness described in paragraph (2) equals or
11 exceeds 25 percent of the ordinary gross
12 income of such corporation for such tax-
13 able year, or

14 “(ii) the average of such deductions
15 for the 5-taxable year period ending with
16 such taxable year equals or exceeds 25 per-
17 cent of the average ordinary gross income
18 of such corporation for such period.

19 If a corporation has not been in existence dur-
20 ing the 5-taxable year period described in clause
21 (ii), then the period of existence of such cor-
22 poration shall be substituted for such 5-taxable
23 year period.

24 “(B) DEDUCTIONS ALLOWABLE UNDER
25 SECTION 162.—For purposes of subparagraph

1 (A), a deduction shall not be treated as allow-
2 able under section 162 if it is specifically allow-
3 able under another section.

4 “(C) LIMITATION ON ALLOWABLE DEDUC-
5 TIONS.—For purposes of subparagraph (A), no
6 deduction shall be taken into account with re-
7 spect to compensation for personal services ren-
8 dered by the 5 individual shareholders holding
9 the largest percentage (by value) of the out-
10 standing stock of the corporation. For purposes
11 of the preceding sentence individuals holding
12 less than 5 percent (by value) of the stock of
13 such corporation shall not be taken into ac-
14 count.”

15 (18) Section 561(a) is amended by striking
16 paragraph (3), by inserting “and” at the end of
17 paragraph (1), and by striking “, and” at the end
18 of paragraph (2) and inserting a period.

19 (19) Section 562(b) is amended to read as fol-
20 lows:

21 “(b) DISTRIBUTIONS IN LIQUIDATION.—Except in
22 the case of a foreign personal holding company described
23 in section 552—

24 “(1) in the case of amounts distributed in liq-
25 uidation, the part of such distribution which is prop-

1 erly chargeable to earnings and profits accumulated
2 after February 28, 1913, shall be treated as a divi-
3 dend for purposes of computing the dividends paid
4 deduction, and

5 “(2) in the case of a complete liquidation occur-
6 ring within 24 months after the adoption of a plan
7 of liquidation, any distribution within such period
8 pursuant to such plan shall, to the extent of the
9 earnings and profits (computed without regard to
10 capital losses) of the corporation for the taxable year
11 in which such distribution is made, be treated as a
12 dividend for purposes of computing the dividends
13 paid deduction.

14 For purposes of paragraph (1), a liquidation includes a
15 redemption of stock to which section 302 applies. Except
16 to the extent provided in regulations, the preceding sen-
17 tence shall not apply in the case of any mere holding or
18 investment company which is not a regulated investment
19 company.”

20 (20) Section 563 is amended by striking sub-
21 section (b).

22 (21) Section 564 is hereby repealed.

23 (22) Section 631(c) is amended by striking “or
24 section 545(b)(5)”.

1 (23) Section 852(b)(1) is amended by striking
2 “which is a personal holding company (as defined in
3 section 542) or”.

4 (24)(A) Section 856(h)(1) is amended to read
5 as follows:

6 “(1) IN GENERAL.—For purposes of subsection
7 (a)(6), a corporation, trust, or association is closely
8 held if the stock ownership requirement of section
9 465(a)(3) is met.”

10 (B) Section 856(h)(3)(A)(i) is amended by
11 striking “section 542(a)(2)” and inserting “section
12 465(a)(3)”.

13 (C) Paragraph (3) of section 856(h) is amended
14 by striking subparagraph (B) and by redesignating
15 subparagraphs (C) and (D) as subparagraphs (B)
16 and (C), respectively.

17 (D) Subparagraph (C) of section 856(h)(3), as
18 redesignating by the preceding subparagraph, is
19 amended by striking “subparagraph (C)” and insert-
20 ing “subparagraph (B)”.

21 (25) The last sentence of section 882(e)(2) is
22 amended to read as follows:

23 “The preceding sentence shall not be construed to
24 deny the credit provided by section 33 for tax with-

1 held at source or the credit provided by section 34
2 for certain uses of gasoline.”.

3 (26) Section 936(a)(3) is amended by striking
4 subparagraph (C), by inserting “or” at the end of
5 subparagraph (B), and by redesignating subpara-
6 graph (D) as subparagraph (C).

7 (27) Section 992(d) is amended by striking
8 paragraph (2) and by redesignating succeeding para-
9 graphs accordingly.

10 (28) Section 992(e) is amended by striking
11 “and section 541 (relating to personal holding com-
12 pany tax)”.

13 (29) Section 1202(e)(8) is amended by striking
14 “section 543(d)(1)” and inserting “section
15 553(c)(1)”.

16 (30) Section 1362(d)(3)(C)(iii) is amended by
17 adding at the end the following new sentence: “Ref-
18 erences to section 542 in the preceding sentence
19 shall be treated as references to such section as in
20 effect on the day before its repeal.”

21 (31) Section 1504(c)(2)(B) is amended by add-
22 ing “and” at the end of clause (i), by striking clause
23 (ii), and by redesignating clause (iii) as clause (ii).

24 (32) Section 2057(e)(2)(C) is amended by add-
25 ing at the end the following new sentence: “Ref-

1 erences to sections 542 and 543 in the preceding
2 sentence shall be treated as references to such sec-
3 tions as in effect on the day before their repeal.”

4 (33) Sections 6422 is amended by striking
5 paragraph (3) and by redesignating paragraphs (4)
6 through (12) and paragraphs (3) through (11), re-
7 spectively.

8 (34) Section 6501 is amended by striking sub-
9 section (f).

10 (35) Section 6503(k) is amended by striking
11 paragraph (1) and by redesignating paragraphs (2)
12 through (5) as paragraphs (1) through (4), respec-
13 tively.

14 (36) Section 6515 is amended by striking para-
15 graph (1) and by redesignating paragraphs (2)
16 through (6) as paragraphs (1) through (5), respec-
17 tively.

18 (37) Subsections (d)(1)(B) and (e)(2) of section
19 6662 are each amended by striking “or a personal
20 holding company (as defined in section 542)”.

21 (38) Section 6683 is hereby repealed.

22 (c) CLERICAL AMENDMENTS.—

23 (1) The table of parts for subchapter G of
24 chapter 1 is amended by striking the item relating
25 to part II.

1 spect to any taxpayer for any taxable year, an indi-
2 vidual—

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

5 “(B) who has the same principal place of
6 abode as the taxpayer for more than 1/2 of such
7 taxable year, and

8 “(C) who meets the age requirements of
9 paragraph (4).

10 An individual shall not be treated as failing to meet
11 the requirements of subparagraph (B) by reason of
12 time of birth or death or by reason of temporary ab-
13 sences or other circumstances specified in the regu-
14 lations prescribed by the Secretary.

15 “(3) RELATIONSHIP TEST.—

16 “(A) IN GENERAL.—For purposes of para-
17 graph (2)(A), an individual bears a relationship
18 to the taxpayer described in this paragraph if
19 such individual is—

20 “(i) a son, daughter, stepson, or step-
21 daughter of the taxpayer or a descendant
22 of any such relative,

23 “(ii) a brother, sister, stepbrother, or
24 stepsister of the taxpayer or a descendant

1 of any such relative, whom the taxpayer
2 cares for as the taxpayer's own child, or

3 “(iii) an eligible foster child of the
4 taxpayer.

5 “(B) ADOPTED CHILD.—For purposes of
6 subparagraph (A), a child who is legally adopt-
7 ed, or who is placed with the taxpayer by an
8 authorized placement agency for adoption by
9 the taxpayer, shall be treated as a child by
10 blood.

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

14 “(i) who is placed with the taxpayer
15 by an authorized placement agency or by
16 judgment, decree, or other order of any
17 court of competent jurisdiction, and

18 “(ii) whom the taxpayer cares for as
19 the taxpayer's own child.

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

23 “(A) has not attained the age of 19 as of
24 the close of the calendar year in which the tax-
25 able year of the taxpayer begins,

1 “(B) is a student who has not attained the
2 age of 24 as of the close of such calendar year,
3 or

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

7 “(5) SPECIAL RULES.—

8 “(A) MARRIED DEPENDENTS.—An indi-
9 vidual shall not be a qualifying child of a tax-
10 payer if such individual makes a joint return
11 with the individual’s spouse under section 6013
12 for the taxable year beginning in the calendar
13 year in which the taxable year of the taxpayer
14 begins.

15 “(B) INDIVIDUALS WHO SUPPORT THEM-
16 SELVES.—An individual shall not be a quali-
17 fying child of a taxpayer if such individual pro-
18 vides over half of such individual’s own support
19 for the calendar year in which the taxable year
20 of the taxpayer begins.

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

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

3 “(A) IN GENERAL.—Except as provided in
4 paragraph (7), if an individual would (but for
5 this paragraph) be a qualifying child of 2 or
6 more taxpayers for taxable years beginning in
7 the same calendar year, such individual shall be
8 treated as the qualifying child of the taxpayer
9 who is—

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

11 “(ii) if none of such taxpayers is a
12 parent of the individual, the taxpayer with
13 the highest adjusted gross income for such
14 taxable year.

15 “(B) PARENTS NOT FILING JOINT RE-
16 TURNS.—If an individual would (but for this
17 paragraph) be a qualifying child of both parents
18 of such individual and such parents do not file
19 a joint return together, such child shall be
20 treated as the qualifying child of—

21 “(i) the parent with whom the child
22 resided for the longest period during the
23 taxable year, or

24 “(ii) if the child resides with both par-
25 ents for the same length of time during

1 such taxable year, the parent with the
2 highest adjusted gross income.

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

8 “(7) SPECIAL RULE FOR CERTAIN PRE-2005 IN-
9 STRUMENTS.—

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

12 “(i) are divorced or legally separated
13 under a decree of divorce or separate
14 maintenance,

15 “(ii) are separated under a written
16 separation agreement, or

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

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

22 “(B) REQUIREMENTS.—For purposes of
23 subparagraph (A), the requirements of this sub-
24 paragraph are met if—

1 “(i) such child would, but for this
2 paragraph, be the qualifying child of the
3 custodial parent, and

4 “(ii) a qualified pre-2005 instrument
5 between the parents is applicable to such
6 child for the taxable year beginning in such
7 calendar year.

8 In the case of an agreement executed before
9 January 1, 1985, the requirements of this sub-
10 paragraph are met only if, in addition to meet-
11 ing the requirements of clauses (i) and (ii), the
12 noncustodial parent provides at least \$600 for
13 the support of such child during such calendar
14 year.

15 “(C) QUALIFIED PRE-2005 INSTRUMENT.—
16 For purposes of this paragraph, the term
17 ‘qualified pre-2005 instrument’ means any writ-
18 ten declaration referred to in subsection (e)(2)
19 (as in effect on the day before the date of the
20 enactment of the Individual and Small Business
21 Tax Simplification Act of 2003)—

22 “(i) which is executed before January
23 1, 2005, and

24 “(ii) which is not modified on or after
25 such date in a modification which expressly

1 provides that this subsection shall not
2 apply to such declaration.

3 “(D) CUSTODIAL PARENT AND NONCUSTO-
4 DIAL PARENT.—For purposes of this sub-
5 section—

6 “(i) CUSTODIAL PARENT.—The term
7 ‘custodial parent’ means the parent with
8 whom a child shared the same principal
9 place of abode for the greater portion of
10 the calendar year.

11 “(ii) NONCUSTODIAL PARENT.—The
12 term ‘noncustodial parent’ means the par-
13 ent who is not the custodial parent.

14 “(E) SPECIAL RULES FOR SUPPORT.—For
15 purposes of this subsection—

16 “(i) amounts expended for the support
17 of a child or children shall be treated as
18 received from the noncustodial parent to
19 the extent that such parent provided
20 amounts for such support, and

21 “(ii) in the case of the remarriage of
22 a parent, support of a child received from
23 the parent’s spouse shall be treated as re-
24 ceived from the parent.”.

25 (2) CONFORMING AMENDMENTS.—

1 (A) Section 152 is amended by striking
2 subsection (g) (relating to support test in case
3 of child of divorced parents, etc.), as redesign-
4 nated by the preceding sections this Act.

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

9 (C) Paragraph (5) of section 21(e) is
10 amended—

11 (i) by striking “paragraph (2) or (4)
12 of section 152(e)” and inserting “section
13 151(e)(7)”, and

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

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

18 (i) by striking “151(c)” and inserting
19 “151(d)”, and

20 (ii) by striking “151(e)(3)” and in-
21 serting “151(d)(3)”.

22 (E) Sections 25(e)(2)(B), 32(c)(3)(C)(ii),
23 152(d)(2), and 2032A(e)(7)(D) are each
24 amended by striking “151(c)(4)” and inserting
25 “151(d)(4)”.

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

4 (G) Subparagraph (C) of section
5 642(b)(2), as amended by the preceding sec-
6 tions of this Act, is amended by striking
7 “151(e)” and inserting “151(f)”.

8 (H) Paragraph (1) of section 3402(f) is
9 amended by striking “151(e)(2)” and inserting
10 “151(f)(2)”.

11 (I) Subparagraph (B) of section
12 3402(r)(2), as so amended, is amended by
13 striking “151(e)” and inserting “151(f)”.

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

16 (i) by striking “151(e)” and inserting
17 “151(f)”, and

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

20 (K) The last sentence of section
21 6013(b)(3)(A), as so amended is amended by
22 striking “151(e)” and inserting “151(f)”.

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

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

4 (c) APPLICATION OF UNIFORM DEFINITION TO
5 CHILD TAX CREDIT.—Section 24(c)(1) is amended to
6 read as follows:

7 “(1) IN GENERAL.—The term ‘qualifying child’
8 means a qualifying child of the taxpayer (as defined
9 in section 151(c)) who has not attained age 17 as
10 of the close of the calendar year in which the taxable
11 year of the taxpayer begins.”.

12 (d) APPLICATION OF UNIFORM DEFINITION TO
13 EARNED INCOME CREDIT.—

14 (1) IN GENERAL.—Paragraph (3) of section
15 32(c) is amended to read as follows:

16 “(3) QUALIFYING CHILD.—

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

20 “(B) PLACE OF ABODE.—For purposes of
21 subparagraph (A), the requirements of section
22 151(c)(2)(B) shall be met only if the principal
23 place of abode is in the United States.

24 “(C) IDENTIFICATION REQUIREMENTS.—

1 “(i) IN GENERAL—A qualifying child
2 shall not be taken into account under sub-
3 section (b) unless the taxpayer includes the
4 name, age, and TIN of the qualifying child
5 on the return of tax for the taxable year.

6 “(ii) OTHER METHODS.—The Sec-
7 retary may prescribe other methods for
8 providing the information described in
9 clause (i).”.

10 (2) CONFORMING AMENDMENTS.—

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

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

17 (C) Section 32(m) is amended by striking
18 “subsections (c)(1)(F)” and inserting “sub-
19 sections (c)(1)(E)”.

20 **SEC. 122. TREATMENT OF GOVERNMENT BENEFITS IN DE-**
21 **TERMINING SUPPORT AND COST OF MAIN-**
22 **TAINING HOUSEHOLD.**

23 (a) DEPENDENCY EXEMPTION.—Section 152 is
24 amended by adding at the end the following new sub-
25 section:

1 “(f) SPECIAL RULE RELATING TO TREATMENT OF
2 GOVERNMENT BENEFITS IN DETERMINING SUPPORT.—
3 For purposes of this part, any means-tested benefits ob-
4 tained under programs described in section 6103(l)(7) or
5 substantially similar government programs shall not be
6 taken into account for purposes of determining—

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

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

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

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

22 “(c) SPECIAL RULE RELATING TO TREATMENT OF
23 GOVERNMENT BENEFITS IN DETERMINING COST OF
24 MAINTAINING HOUSEHOLD.—For purposes of subsection
25 (b)(2), any means-tested benefits obtained under pro-

1 grams described in section 6103(l)(7) or substantially
2 similar government programs shall not be taken into ac-
3 count for purposes of determining whether over half of the
4 cost of maintaining a household is furnished by the indi-
5 vidual.”.

6 **SEC. 123. EFFECTIVE DATE.**

7 The amendments made by this subtitle shall apply to
8 taxable years beginning after December 31, 2003.

9 **Subtitle C—Education Tax**
10 **Incentives**

11 **SEC. 131. HOPE AND LIFETIME LEARNING CREDITS COM-**
12 **BINED.**

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

16 **“SEC. 25A. EDUCATION CREDIT.**

17 “(a) ALLOWANCE OF CREDIT.—In the case of an in-
18 dividual, there shall be allowed as a credit against the tax
19 imposed by this chapter for the taxable year the amount
20 equal to 50 percent of so much of the qualified expenses
21 paid by the taxpayer during the taxable year (for edu-
22 cation furnished to an individual during any academic pe-
23 riod beginning in such taxable year) as does not exceed
24 \$3,000 for such taxable year with respect to such indi-
25 vidual.

1 “(b) QUALIFIED EXPENSES.—For purposes of sub-
2 section (a), the term ‘qualified expenses’ means the sum
3 of—

4 “(1) qualified higher education expenses, and
5 “(2) the expenses described in subsection (d)(1)
6 with respect to any course of instruction at an eligi-
7 ble educational institution to acquire or improve job
8 skills of the individual.”.

9 (b) CONFORMING AMENDMENTS TO CREDIT.—

10 (1) Section 25A is amended—

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

12 (B) by redesignating subsections (e), (f),
13 (g), and (i) as subsections (c), (d), (e), and (f),
14 respectively.

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

18 (c) OTHER CONFORMING AND CLERICAL AMEND-
19 MENTS.—

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

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

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

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

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

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

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

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

7 (2) Section 221(d) is amended—

8 (A) in paragraph (2) by striking “section
9 25A(f)(2)” and inserting “section 25A(d)(2)”,
10 and

11 (B) by amending paragraph (3) to read as
12 follows:

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

16 “(A) meets the requirements of section
17 484(a)(1) of the Higher Education Act of 1965
18 (20 U.S.C. 1091(a)(1)), as in effect on the date
19 of the enactment of this section, and

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

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

1 (4) The heading of section 529(c)(3)(B)(v) is
2 amended to read as follows: “COORDINATION WITH
3 EDUCATION CREDIT.—”.

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

8 (6) Section 6050S(e) is amended by striking
9 “subsection (g)(2)” and inserting “subsection
10 (e)(2)”.

11 (7) Section 6213(g)(2)(J) is amended by strik-
12 ing “section 25A(g)(1)” and inserting “section
13 25A(e)(1)”.

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

“Sec. 25A. Education Credit.”.

18 (d) EFFECTIVE DATE.—The amendments made by
19 this section shall apply to taxable years beginning after
20 December 31, 2003.

21 **SEC. 132. UNIFORM DEFINITION OF QUALIFYING HIGHER**
22 **EDUCATION EXPENSES.**

23 (a) IN GENERAL.—Paragraph (3) of section 529(e)
24 (relating to other definitions and special rules) is amended
25 to read as follows:

1 “(3) QUALIFIED HIGHER EDUCATION EX-
2 PENSES.—

3 “(A) IN GENERAL.—The term ‘qualified
4 higher education expenses’ means—

5 “(i) tuition, fees, books, supplies, and
6 equipment required for the enrollment or
7 attendance of a designated beneficiary at
8 an eligible educational institution; and

9 “(ii) expenses for special needs serv-
10 ices in the case of a special needs bene-
11 ficiary which are incurred in connection
12 with such enrollment or attendance.

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

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

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

4 “(I) the allowance (applicable to
5 the student) for room and board in-
6 cluded in the cost of attendance (as
7 defined in section 472 of the Higher
8 Education Act of 1965 (20 U.S.C.
9 1087*l*), as in effect on the date of the
10 enactment of the Economic Growth
11 and Tax Relief Reconciliation Act of
12 2001) as determined by the eligible
13 educational institution for such pe-
14 riod, or

15 “(II) if greater, the actual invoice
16 amount the student residing in hous-
17 ing owned or operated by the eligible
18 educational institution is charged by
19 such institution for room and board
20 costs for such period.

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

1 “(I) meets the requirements of
2 section 484(a)(1) of the Higher Edu-
3 cation Act of 1965 (20 U.S.C.
4 1091(a)(1)), as in effect on the date
5 of the enactment of this section, and

6 “(II) is carrying at least $\frac{1}{2}$ the
7 normal full-time work load for the
8 course of study the student is pur-
9 suing.

10 “(C) EXCEPTIONS.—

11 “(i) EXCEPTION FOR EDUCATION IN-
12 VOLVING SPORTS, ETC.—Such term does
13 not include expenses with respect to any
14 course or other education involving sports,
15 games, or hobbies, unless such course or
16 other education is part of the individual’s
17 degree program.

18 “(ii) EXCEPTION FOR NONACADEMIC
19 FEES.—Such term does not include stu-
20 dent activity fees, athletic fees, insurance
21 expenses, or other expenses unrelated to an
22 individual’s academic course of instruc-
23 tion.”.

24 (b) CONFORMING AMENDMENTS.—

1 (1) Section 25A and 6050S are each amended
2 by striking “qualified tuition and related expenses”
3 each place it appears and inserting “qualified higher
4 education expenses”.

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

7 “(1) QUALIFIED HIGHER EDUCATION EX-
8 PENSES.—The term ‘qualified higher education ex-
9 penses’ means the qualified higher education ex-
10 penses (as defined by section 529(e)(3) without re-
11 gard to subparagraph (B) thereof) required for the
12 enrollment or attendance of—

13 “(A) the taxpayer,

14 “(B) the taxpayer’s spouse, or

15 “(C) any dependent of the taxpayer with
16 respect to whom the taxpayer is allowed a de-
17 duction under section 151,

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

20 (3) Section 135(c)(2) is amended—

21 (A) by striking “tuition and fees” and in-
22 serting “the qualified higher education expenses
23 (as defined by section 529(e)(3) without regard
24 to subparagraph (B) thereof)”, and

1 (B) by striking subparagraph (B) and re-
2 designating subparagraph (C) as subparagraph
3 (B).

4 (4) Section 221(d)(2) is amended by striking
5 “the cost of attendance (as defined in section 472 of
6 the Higher Education Act of 1965, 20 U.S.C.
7 1087ll, as in effect on the day before the date of the
8 enactment of this Act)” and inserting “the qualified
9 higher education expenses (as defined by section
10 529(e)(3) without regard to subparagraph (B) there-
11 of) incurred for attendance”.

12 (5)(A) Section 222 is amended by striking
13 “qualified tuition and related expenses” each place
14 it appears and inserting “qualified higher education
15 expenses”.

16 (B) Section 222(d)(1) is amended to read as
17 follows:

18 “(1) QUALIFIED HIGHER EDUCATION EX-
19 PENSES.—The term ‘qualified higher education ex-
20 penses’ has the meaning given such term by section
21 529(e)(3) (without regard to subparagraph (B)
22 thereof). Such expenses shall be reduced in the same
23 manner as under section 25A(g)(2).”.

1 (C) Section 222(d) is amended by redesignating
2 paragraph (6) as paragraph (7) and by inserting
3 after paragraph (5) the following new paragraph:

4 “(6) ROOM AND BOARD INCLUDED FOR STU-
5 DENTS WHO ARE FULL-TIME.—No amount shall be
6 taken into account under this section for an expense
7 described in section 529(e)(3)(B) (relating to room
8 and board included for students who are at least
9 half-time) unless such individual is an eligible stu-
10 dent (as defined in section 25A(b)(3), determined by
11 substituting ‘the normal full-time work load’ in lieu
12 of ‘½ the normal full-time work load’ in subpara-
13 graph (B) thereof.”.

14 (D) The heading for section 222 is amended by
15 striking “**TUITION AND RELATED**” and in-
16 sserting “**HIGHER EDUCATION**”.

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

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

20 (6)(A) Section 6724(d) is amended—

21 (i) in paragraph (1)(B)(x) by striking
22 “qualified tuition and related expenses” and in-
23 sserting “qualified higher education expenses”,
24 and

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

4 (c) EFFECTIVE DATE.—The amendments made by
 5 this section shall apply to amounts paid in taxable years
 6 beginning after December 31, 2003, for education fur-
 7 nished in periods beginning after such date.

8 **TITLE II—SMALL BUSINESS TAX**
 9 **SIMPLIFICATION**

10 **SEC. 201. UNIFIED PASS-THRU ENTITY REGIME.**

11 (a) TERMINATION OF S CORPORATION STATUS.—

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

15 “(3) TERMINATION OF AUTHORITY TO MAKE
 16 ELECTION.—No election may be made under para-
 17 graph (1) for any taxable year beginning after De-
 18 cember 31, 2003.”.

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

22 “(4) TREATMENT AS PARTNERSHIP AFTER
 23 2012.—An election under subsection (a)—

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

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

4 (3) EFFECTIVE DATE.—The amendments made
5 by this subsection shall apply to taxable years begin-
6 ning after December 31, 2003.

7 (b) ELECTION BY CERTAIN CORPORATIONS TO BE
8 TAXED AS PARTNERSHIP.—

9 (1) IN GENERAL.—Paragraph (2) of section
10 7701 (defining partnership and partner) is amended
11 to read as follows:

12 “(2) PARTNERSHIP AND PARTNER.—

13 “(A) IN GENERAL.—The term ‘partner-
14 ship’ includes a syndicate, group, pool, joint
15 venture, or other unincorporated organization,
16 through or by means of which any business, fi-
17 nancial operation, or venture is carried on, and
18 which is not, within the meaning of this title,
19 a trust or estate or a corporation; and the term
20 ‘partner’ includes a member in such a syn-
21 dicate, group, pool, joint venture, or organiza-
22 tion.

23 “(B) ELECTION BY CORPORATION TO BE
24 TAXED AS PARTNERSHIP.—

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

4 “(ii) ELIGIBLE CORPORATION.—For
5 purposes of clause (i), the term ‘eligible
6 corporation’ means an entity—

7 “(I) which, without regard to this
8 subparagraph, is a domestic corpora-
9 tion no stock of which is readily
10 tradable on an established securities
11 market or otherwise, and

12 “(II) which is not an ineligible
13 corporation (as defined by section
14 1361(b)(2)).

15 “(iii) ELECTION AND TERMI-
16 NATION.—For purposes of this subpara-
17 graph, rules similar to the rules of section
18 1362 (other than subsections (a)(3), (d)(3)
19 and (4), and (e) thereof) shall apply.

20 “(iv) EFFECT OF ELECTION.—No
21 gain or loss shall be recognized by the
22 shareholders or the corporation by reason
23 of an election under this subparagraph,
24 and rules similar to the rules of sections
25 1366(f)(2) and 1374 shall apply.

1 “(v) DISTRIBUTIONS, ETC.—Each
2 partner shall include in gross income as a
3 dividend, any amount that would have been
4 so includible had the entity been an S cor-
5 poration during the period the entity was
6 treated as a partnership. Notwithstanding
7 the preceding sentence, the provisions of
8 subchapter K of chapter 1 shall apply to
9 determine the basis of any property dis-
10 tributed and the basis of any interest in
11 the partnership.”.

12 (2) MODIFICATION TO TREATMENT OF SECTION
13 1374 TAX FOR EARNINGS AND PROFITS PURPOSES.—
14 Paragraph (2) of section 1366(f) is amended to read
15 as follows:

16 “(2) TREATMENT OF TAX IMPOSED ON BUILD-
17 IN GAINS.—

18 “(A) IN GENERAL.—The amount of the
19 items of the net recognized built-in-gain taken
20 into account under section 1374(b)(1) (reduced
21 by any deduction allowed under section
22 1374(b)(2)) shall not be taken into account
23 under this section.

24 “(B) EARNINGS AND PROFITS.—The accu-
25 mulated earnings and profits of the corporation

1 shall be increased at the beginning of the tax-
2 able year by the amount not taken into account
3 under this section by reason of subparagraph
4 (A) (determined without regard to section
5 1374(b)(2)) reduced by the tax imposed by sec-
6 tion 1374 (net of credits allowed).”.

7 (3) EFFECTIVE DATE.—The amendments made
8 by this subsection shall apply to taxable years begin-
9 ning after December 31, 2003.

10 (c) STEP TRANSACTION DOCTRINE NOT TO APPLY
11 TO PARTNERSHIP INCORPORATION FOLLOWED BY COR-
12 PORATE REORGANIZATION.—

13 (1) IN GENERAL.—Section 351 is amended by
14 redesignating subsection (h) as subsection (i) and by
15 inserting after subsection (g) the following new sub-
16 section:

17 “(h) SPECIAL RULE FOR PARTNERSHIPS WHICH IN-
18 CORPORATE AND SUBSEQUENTLY REORGANIZE.—The
19 step transaction doctrine and any similar doctrine shall
20 not apply for purposes of determining whether the control
21 requirement of subsection (a) is met in any case in
22 which—

23 “(1) a partnership engaged in an active trade
24 or business transfers substantially all of the property

1 used in carrying on such trade or business to a cor-
2 poration which is not publicly traded, and

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

5 (2) EFFECTIVE DATE.—The amendment made
6 by this subsection shall apply to transactions after
7 December 31, 2003.

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

9 (a) INCREASE IN DOLLAR LIMITATIONS.—

10 (1) IN GENERAL.—Paragraph (1) of section
11 179(b) (relating to dollar limitation) is amended to
12 read as follows:

13 “(1) DOLLAR LIMITATION.—The aggregate cost
14 which may be taken into account under subsection
15 (a) for any taxable year shall not exceed \$25,000
16 (\$40,000 in the case of taxable years beginning after
17 December 31, 2013).”.

18 (2) INCREASE IN PHASEOUT THRESHOLD.—
19 Paragraph (2) of section 179(b) is amended by in-
20 sserting before the period “(\$325,000 in the case of
21 taxable years beginning after December 31, 2013).”.

22 (b) INFLATION ADJUSTMENTS.—

23 (1) IN GENERAL.—Subsection (b) of section
24 179 is amended by redesignating paragraphs (3) and
25 (4) as paragraphs (4) and (5), respectively, and by

1 inserting after paragraph (2) the following new
2 paragraph:

3 “(3) INFLATION ADJUSTMENT.—In the case of
4 any taxable year beginning in a calendar year after
5 2005, the dollar amounts contained in paragraphs
6 (1) and (2) which would (but for this paragraph)
7 apply to such taxable year shall be increased by an
8 amount equal to the product of—

9 “(A) such dollar amount, and

10 “(B) the cost-of-living adjustment deter-
11 mined under section 1(f)(3) for the calendar
12 year in which the taxable year begins, deter-
13 mined by substituting in subparagraph (B)
14 thereof—

15 “(i) ‘calendar year 2004’ for ‘calendar
16 year 1992’ with respect to the \$25,000
17 and \$200,000 amounts, and

18 “(ii) ‘calendar year 2012’ for ‘cal-
19 endar year 1992’ with respect to the
20 \$40,000 and \$325,000 amounts.

21 If any amount after adjustment under the preceding
22 sentence is not a multiple of \$1,000, such amount
23 shall be rounded to the next lowest multiple of
24 \$1,000.”.

1 “(1) SECTION 1031 PROPERTY.—

2 “(A) IN GENERAL.—The term ‘section
3 1031 property’ means any property held for
4 productive use in a trade or business or for in-
5 vestment.

6 “(B) EXCEPTIONS.—The term ‘section
7 1031 property’ shall not include the following:

8 “(i) Stock in trade or other property
9 held primarily for sale.

10 “(ii) Stocks, bonds, or notes.

11 “(iii) Other securities or evidences of
12 indebtedness or interest.

13 “(iv) Interests in a partnership.

14 “(v) Certificates of trust or beneficial
15 interests.

16 “(vi) Choses in action.

17 “(2) REPLACEMENT SECTION 1031 PROP-
18 ERTY.—The term ‘replacement section 1031 prop-
19 erty’ means, with respect to the sale of any section
20 1031 property, other section 1031 property which is
21 of a like kind to the section 1031 property sold.

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

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

3 “(B) the due date (determined with regard
4 to extension) for the taxpayer’s return of the
5 tax imposed by this chapter for the taxable year
6 which includes the date of such sale.

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

15 “(d) SPECIAL RULES FOR TRANSACTIONS BETWEEN
16 RELATED PERSONS.—

17 “(1) SALE BY TAXPAYER.—If—

18 “(A) the taxpayer sells property to a re-
19 lated person,

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

23 “(C) before the date 2 years after the date
24 of such sale the related person disposes of such
25 property,

1 there shall be no nonrecognition of gain under this
2 section to the taxpayer with respect to such sale,
3 and any gain recognized by the taxpayer by reason
4 of this subsection shall be taken into account as of
5 the date on which the disposition referred to in sub-
6 paragraph (C) occurs.

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

9 “(A) purchases property from a related
10 person which is taken into account under sub-
11 section (a)(1) (determined without regard to
12 this subsection), and

13 “(B) disposes of such property before the
14 date 2 years after the date of such purchase,
15 such property shall not be taken into account under
16 subsection (a)(1), and any gain recognized by reason
17 of this subsection shall be taken into account on the
18 date on which the disposition referred to in subpara-
19 graph (B) occurs.

20 “(3) CERTAIN DISPOSITIONS NOT TAKEN INTO
21 ACCOUNT.— For purposes of paragraphs (1)(C) and
22 (2)(B), there shall not be taken into account any
23 disposition—

24 “(A) after the earlier of the death of the
25 taxpayer or the death of the related person,

1 “(B) in a compulsory or involuntary con-
2 version (within the meaning of section 1033) if
3 the transaction occurred before the threat or
4 imminence of such conversion, or

5 “(C) with respect to which it is established
6 to the satisfaction of the Secretary that neither
7 the transaction nor such disposition had as one
8 of its principal purposes the avoidance of Fed-
9 eral income tax.

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

14 “(5) SPECIAL RULE WHERE SUBSTANTIAL DIMI-
15 NUTION OF RISK.—

16 “(A) IN GENERAL.—If subparagraph (B)
17 applies to any property for any period, the run-
18 ning of the period set forth in paragraph (1)(C)
19 with respect to such property shall be sus-
20 pended during such period.

21 “(B) PROPERTY TO WHICH PARAGRAPH
22 APPLIES.—This subparagraph shall apply to
23 any property for any period during which the
24 holder’s risk of loss with respect to the property
25 is substantially diminished by—

1 “(i) the holding of a put with respect
2 to such property,

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

5 “(iii) a short sale or any other trans-
6 action.

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

11 “(e) SPECIAL RULES.—For purposes of this sec-
12 tion—

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

21 “(2) CERTAIN PARTNERSHIPS.—An interest in
22 a partnership which has in effect a valid election
23 under section 761(a) to be excluded from the appli-
24 cation of all of subchapter K shall be treated as an

1 interest in each of the assets of such partnership
2 and not as an interest in a partnership.

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

6 “(4) FOREIGN REAL PROPERTY.—Real property
7 located in the United States and real property lo-
8 cated outside the United States are not property of
9 a like kind.

10 “(5) FOREIGN PERSONAL PROPERTY.—

11 “(A) IN GENERAL.—Personal property
12 used predominantly within the United States
13 and personal property used predominantly out-
14 side the United States are not property of a like
15 kind.

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

20 “(i) in the case of the sale of any
21 property by the taxpayer, the 2-year period
22 ending on the date of such sale, and

23 “(ii) in the case of the purchase of
24 any property by the taxpayer, the 2-year

1 period beginning on the date of such pur-
2 chase.

3 “(C) PROPERTY HELD FOR LESS THAN 2
4 YEARS.—Except in the case of a sale or pur-
5 chase which is part of a transaction (or series
6 of transactions) structured to avoid the pur-
7 poses of this subsection, only the periods the
8 property was held by the taxpayer (or any re-
9 lated person) shall be taken into account under
10 subparagraph (B).

11 “(D) SPECIAL RULE FOR CERTAIN PROP-
12 ERTY.—Property described in any subpara-
13 graph of section 168(g)(4) shall be treated as
14 used predominantly in the United States.”.

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

17 (1) Section 1035 (relating to certain exchanges
18 of insurance policies) is amended—

19 (A) by striking subsection (d),

20 (B) by redesignating subsections (b) and
21 (c) as subsections (e) and (f), respectively, and

22 (C) by inserting after subsection (a) the
23 following new subsections:

24 “(b) GAIN FROM EXCHANGES NOT SOLELY IN
25 KIND.—If an exchange would be within the provisions of

1 subsection (a), of section 1036(a), or of section 1037(a),
2 if it were not for the fact that the property received in
3 exchange consists not only of property permitted by such
4 provisions to be received without the recognition of gain,
5 but also of other property or money, then the gain, if any,
6 to the recipient shall be recognized, but in an amount not
7 in excess of the sum of such money and the fair market
8 value of such other property.

9 “(c) LOSS FROM EXCHANGES NOT SOLELY IN
10 KIND.—If an exchange would be within the provisions of
11 subsection (a), of section 1036(a), or of section 1037(a),
12 if it were not for the fact that the property received in
13 exchange consists not only of property permitted by such
14 provisions to be received without the recognition of gain
15 or loss, but also of other property or money, then no loss
16 from the exchange shall be recognized.

17 “(d) BASIS.—If property was acquired on an ex-
18 change described in subsection (a), section 1036(a), or
19 section 1037(a), then the basis shall be the same as that
20 of the property exchanged, decreased in the amount of any
21 money received by the taxpayer and increased in the
22 amount of gain or decreased in the amount of loss to the
23 taxpayer that was recognized on such exchange. If the
24 property so acquired consisted in part of the type of prop-
25 erty permitted by subsection (a), section 1036(a), or sec-

1 tion 1037(a), to be received without the recognition of
2 gain or loss, and in part of other property, the basis pro-
3 vided in this subsection shall be allocated between the
4 properties (other than money) received, and for the pur-
5 pose of the allocation there shall be assigned to such other
6 property an amount equivalent to its fair market value at
7 the date of the exchange. For purposes of subsection (a)
8 and section 1036(a), where as part of the consideration
9 to the taxpayer another party to the exchange assumed
10 (as determined under section 357(d)) a liability of the tax-
11 payer, such assumption shall be considered as money re-
12 ceived by the taxpayer on the exchange.”.

13 (2) Section 83(g), section 424(b), section
14 424(c)(1)(B), section 454(c)(2), paragraphs (1) and
15 (2) of section 1036(c), and paragraphs (1) and (2)
16 of section 1037(c) are each amended by striking
17 “section 1031” and inserting “section 1035”.

18 (3) Paragraphs (1) and (2) of section 1037(b)
19 are each amended by striking “section 1031(b)” and
20 inserting “section 1035(b)”.

21 (c) CONFORMING AMENDMENTS.—

22 (1) Clause (i) of section 197(f)(2)(B) is amend-
23 ed by inserting “(including any purchase taken into
24 account under subsection (a)(1) thereof)” after
25 “1031”.

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

3 “(6) LIKE-KIND EXCHANGES.—In the case of
4 any sale or exchange to which section 1031 applies,
5 the total contract price, the gross profit from such
6 sale, and the amount of any payment (other than for
7 purposes of subsection (b)(1)) shall be reduced to
8 take into account any amount not recognized by rea-
9 son of section 1031. Similar rules shall apply in the
10 case of an exchange which is described in section
11 356(a) and is not treated as a dividend.”.

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

16 “(1) to any sale or exchange to which section
17 1031 applies, and”.

18 (4) VALUATION OF CERTAIN FARM, ETC., REAL
19 PROPERTY.—

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

22 “(i) QUALIFIED REPLACEMENT PROP-
23 erty.—The term ‘qualified replacement
24 property’ means any real property the ac-
25 quisition of which results in the non-

1 recognition of gain under section 1031 or
2 1033.”.

3 (B) Subclause (I) of section
4 2032A(e)(14)(C)(ii) is amended by inserting
5 “sale or” before “exchange”.

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

8 “(i) REPLACEMENT OF QUALIFIED REAL PROP-
9 erty.—

10 “(1) TREATMENT OF PROPERTY SOLD OR EX-
11 changed.—

12 “(A) SALES AND EXCHANGES WITH NO
13 RECOGNITION OF GAIN.—If an interest in quali-
14 fied real property is sold or exchanged and no
15 gain is recognized under section 1031 by reason
16 of the acquisition of qualified replacement prop-
17 erty, no tax shall be imposed by subsection (c)
18 by reason of such sale or exchange.

19 “(B) SALES AND EXCHANGES WITH PAR-
20 TIAL RECOGNITION OF GAIN.—Except as pro-
21 vided in paragraph (1), if an interest in quali-
22 fied real property is sold or exchanged and a
23 portion of the gain is not recognized under sec-
24 tion 1031 by reason of the acquisition of quali-
25 fied replacement property, the amount of the

1 tax imposed by subsection (c) by reason such
2 sale or exchange shall be the amount of tax
3 which (but for this paragraph) would have been
4 imposed on such sale or exchange under sub-
5 section (c)(1), reduced by an amount which—

6 “(i) bears the same ratio to such tax,
7 as

8 “(ii) the fair market value of the
9 qualified replacement property (determined
10 as of the time or acquisition) bears to the
11 fair market value of the qualified real
12 property sold or exchanged (determined as
13 of the time of disposition).

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

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

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

23 “(C) paragraph (6) of subsection (c) shall
24 be applied by treating material participation
25 with respect to the sold or exchanged property

1 as material participation with respect to the
2 qualified replacement property.

3 “(3) QUALIFIED REPLACEMENT PROPERTY.—

4 For purposes of this subsection, the term ‘qualified
5 replacement property’ means real property which is
6 to be used for the qualified use set forth in subpara-
7 graph (A) or (B) of subsection (b)(2) under which
8 the qualified real property sold in the qualified sale
9 originally qualified under subsection (a).”.

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

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

14 (e) EFFECTIVE DATE.—The amendments made by
15 this section shall apply to transfers made after December
16 31, 2003, in tax years ending after such date.

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

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

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

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

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

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

9 “(I) such corporation is not pro-
10 hibited or limited under State law
11 from participation in the management
12 or business of the partnership.”.

13 (b) PAYMENTS TO RETIRING PARTNERS.—Subpara-
14 graph (B) of section 736(b)(3) (relating to limitation on
15 application of paragraph (2)) is amended to read as fol-
16 lows:

17 “(B) any portion of the retiring or de-
18 ceased partner’s distributive share of partner-
19 ship income was subject to tax under section
20 1401.”.

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

24 “(I) CERTAIN GENERAL PART-
25 NERS.—The interest of a partner in

1 the partnership shall not be treated as
2 failing to meet the 20-percent owner-
3 ship requirements of clause (iii)(I) for
4 any taxable year of the partnership if
5 for the taxable year of the partner in
6 which such partnership taxable year
7 ends—

8 “(aa) the partner is not lim-
9 ited as to participation in the
10 management or activity of the
11 qualified fund, and

12 “(bb) such partner (and
13 each corporation filing a consoli-
14 dated return with such partner)
15 had no ordinary income or loss
16 from a section 988 transaction
17 which is foreign currency gain or
18 loss (as the case may be).”.

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

22 “(ii) in the case of a limited partner-
23 ship, the holding of any interest as a part-
24 ner who is not limited as to participation

1 in management or activity of the partner-
2 ship.”.

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

6 “(7) TAX MATTERS PARTNER.—

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

9 “(i) the partner designated as the tax
10 matters partner as provided in regulations,
11 or

12 “(ii) if there is no partner who has
13 been so designated, the partner having the
14 largest profits interest in the partnership
15 at the close of the taxable year involved
16 (or, where there is more than 1 such part-
17 ner, the 1 of such partners whose name
18 would appear first in an alphabetical list-
19 ing).

20 “(B) SELECTION BY SECRETARY.—If there
21 is no partner designated under subparagraph
22 (A)(i) and the Secretary determines that it is
23 impracticable to apply subparagraph (A)(ii), the
24 partner selected by the Secretary shall be treat-
25 ed as the tax matters partner. The Secretary

1 shall, within 30 days of selecting a tax matters
2 partner under the preceding sentence, notify all
3 partners required to receive notice under sec-
4 tion 6223(a) of the name and address of the
5 person selected.

6 “(C) RESTRICTION ON DESIGNATION OF
7 PARTNER.—A partner may not be designated as
8 a tax matters partner under subparagraph
9 (A)(i) unless such partner is not limited as to
10 participation in management or activity of the
11 partnership.”.

12 (f) EFFECTIVE DATE.—The amendments made by
13 this section shall apply to taxable years beginning after
14 December 31, 2003.

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

16 (a) LIMITED ENTREPRENEUR.—

17 (1) IN GENERAL.—Subparagraph (A) of section
18 464(e)(2) (defining limited entrepreneur) is amend-
19 ed by striking “than as a limited partner”.

20 (2) CONFORMING AMENDMENTS.—

21 (A) Section 464(c) is amended—

22 (i) by striking “limited partners or”
23 in paragraph (1)(B),

24 (ii) by striking “a limited partner or”
25 in paragraph (2).

1 (B) Section 1256 is amended—

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

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

7 (iii) by striking “limited partner or”
8 both places it appears in subsection
9 (e)(4)(A)(i).

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

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

13 (ii) by striking “limited partner’s (or
14 limited entrepreneur’s) in subclause (i) and
15 inserting “limited entrepreneur’s”, and

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

18 (b) PASSIVE LOSS RULES.—

19 (1) Subsection (h) of section 469 is amended by
20 striking paragraph (2) and by redesignating para-
21 graphs (3), (4), and (5) as paragraphs (2), (3), and
22 (4), respectively.

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

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

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

7 “(f) SPECIAL RULES FOR APPLYING PASSIVE LOSS
8 LIMITATIONS.—

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

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

14 “(B) such partner’s distributive share of
15 the partnership items allocable to passive loss
16 limitation activities shall be taken into account
17 separately to the extent necessary to comply
18 with the provisions of section 469.

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

22 “(3) PARTNER DESCRIBED.—For purposes of
23 this subsection, a partner is described in this para-
24 graph if the partner is a person whose participation

1 in the management or business activity of the part-
2 nership is limited under applicable State law.”.

3 (c) EFFECTIVE DATE.—The amendments made by
4 this section shall apply to taxable years beginning after
5 December 31, 2003.

6 **SEC. 207. PARTNERSHIP INCOME ATTRIBUTABLE TO CAP-**
7 **ITAL EXCLUDED FROM NET EARNINGS FROM**
8 **SELF-EMPLOYMENT.**

9 (a) IN GENERAL.—Paragraph (13) of section
10 1402(a) is amended to read as follows:

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

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

17 “(1) PARTNERSHIP INCOME ATTRIBUTABLE TO CAP-
18 ITAL.—

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

22 “(A) the amount, if any, in excess of what
23 would constitute reasonable compensation for
24 services rendered by such partner to the part-
25 nership, and

1 “(B) an amount equal to a reasonable rate
2 of return on unreturned capital of the partner
3 determined as of the beginning of the taxable
4 year.

5 “(2) DEFINITIONS.—For purposes of paragraph
6 (1)—

7 “(A) UNRETURNED CAPITAL.—The term
8 ‘unreturned capital’ means the excess of the ag-
9 gregate amount of money and the fair market
10 value as of the date of contribution of other
11 consideration (net of liabilities) contributed by
12 the partner over the aggregate amount of
13 money and the fair market value as of the date
14 of distribution of other consideration (net of li-
15 abilities) distributed by the partnership to the
16 partner, increased or decreased for the part-
17 ner’s distributive share of all reportable items
18 as determined in section 702. If the partner ac-
19 quires a partnership interest and the partner-
20 ship makes an election under section 754, the
21 partner’s unreturned capital shall take into ac-
22 count appropriate adjustments under section
23 743.

24 “(B) REASONABLE RATE OF RETURN.—A
25 reasonable rate of return on unreturned capital

1 shall equal 150 percent (or such higher rate as
2 is established in regulations) of the highest ap-
3 plicable Federal rate, as determined under sec-
4 tion 1274(d)(1), at the beginning of the part-
5 nership's taxable year.

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

9 (c) EFFECTIVE DATE.—The amendments made by
10 this section shall apply with respect to services performed
11 in taxable years beginning after December 31, 2003.

12 **SEC. 208. REPEAL OF ABILITY TO ELECT LARGE PARTNER-**
13 **SHIP REPORTING RULES.**

14 (a) IN GENERAL.—Paragraph (2) of section 775(a)
15 (relating to election) is amended by adding at the end the
16 following: “No election under this subsection shall be
17 made after December 31, 2003.”.

18 (b) EFFECTIVE DATE.—The amendment made by
19 this section shall apply to partnership taxable years begin-
20 ning after December 31, 2003.

○