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116TH CONGRESS
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HOUSE OF REPRESENTATIVES

REPORT
116–161

PROMOTING RESPECT FOR INDIVIDUALS' DIGNITY AND EQUALITY ACT OF 2019

R E P O R T

OF THE

COMMITTEE ON WAYS AND MEANS HOUSE OF REPRESENTATIVES

ON

H.R. 3299

[Including cost estimate of the Congressional Budget Office]

together with

MINORITY VIEWS

JULY 18, 2019.—Ordered to be printed

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116TH CONGRESS
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HOUSE OF REPRESENTATIVES

REPORT
116–161

PROMOTING RESPECT FOR INDIVIDUALS' DIGNITY AND EQUALITY ACT OF 2019

JULY 18, 2019.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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

R E P O R T

together with

MINORITY VIEWS

[To accompany H.R. 3299]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 3299) to permit legally married same-sex couples to amend their filing status for income tax returns outside the statute of limitations, to amend the Internal Revenue Code of 1986 to clarify that all provisions shall apply to legally married same-sex couples in the same manner as other married couples, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "Promoting Respect for Individuals' Dignity and Equality Act of 2019" or as the "PRIDE Act of 2019".

SEC. 2. EXTENSION OF PERIOD OF LIMITATION FOR CERTAIN LEGALLY MARRIED COUPLES.

(a) IN GENERAL.—In the case of an individual first treated as married for purposes of the Internal Revenue Code of 1986 by the application of the holdings of Revenue Ruling 2013–17—

(1) if such individual filed a return (other than a joint return) for a taxable year ending before September 16, 2013, for which a joint return could have been made by the individual and the individual's spouse but for the fact that such holdings were not effective at the time of filing, such return shall be treated as a separate return within the meaning of section 6013(b) of such Code and

the time prescribed by section 6013(b)(2)(A) of such Code for filing a joint return after filing a separate return shall not expire before the date prescribed by law (including extensions) for filing the return of tax for the taxable year that includes the date of the enactment of this Act, and

(2) in the case of a joint return filed pursuant to paragraph (1)—

(A) the period of limitation prescribed by section 6511(a) of such Code for any such taxable year shall be extended until the date prescribed by law (including extensions) for filing the return of tax for the taxable year that includes the date of the enactment of this Act, and

(B) section 6511(b)(2) of such Code shall not apply to any claim of credit or refund with respect to such return.

(b) AMENDMENTS, ETC. RESTRICTED TO CHANGE IN MARITAL STATUS.—Subsection (a) shall apply only with respect to amendments to the return of tax, and claims for credit or refund, relating to a change in the marital status for purposes of the Internal Revenue Code of 1986 of the individual.

SEC. 3. RULES RELATING TO ALL LEGALLY MARRIED COUPLES.

(a) IN GENERAL.—The Internal Revenue Code of 1986 is amended—

(1) in section 21(d)(2)—

(A) by striking "HIMSELF" in the heading and inserting "SELF"; and

(B) by striking "any husband and wife" and inserting "any married couple";

(2) in section 22(e)(1)—

(A) by striking "husband and wife who live" and inserting "married couple who lives"; and

(B) by striking "the taxpayer and his spouse" and inserting "the taxpayer and the spouse of the taxpayer";

(3) in section 38(c)(6)(A), by striking "husband or wife who files" and inserting "married individual who files";

(4) in section 42(j)(5)(C), by striking clause (i) and inserting the following new clause:

"(i) MARRIED COUPLE TREATED AS 1 PARTNER.—For purposes of subparagraph (B), individuals married to one another (and their estates) shall be treated as 1 partner.";

(5) in section 62(b)(3)—

(A) in subparagraph (A)—

(i) by striking "husband and wife who lived apart" and inserting "married couple who lived apart"; and

(ii) by striking "the taxpayer and his spouse" and inserting "the taxpayer and the spouse of the taxpayer"; and

(B) in subparagraph (D), by striking "husband and wife" and inserting "married couple";

(6) in section 121—

(A) in subsection (b)(2), by striking "husband and wife who make" and inserting "married couple who makes"; and

(B) in subsection (d)(1), by striking "husband and wife make" and inserting "married couple makes";

(7) in section 165(h)(4)(B), by striking "husband and wife" and inserting "married couple";

(8) in section 179(b)(4), by striking "a husband and wife filing" and inserting "individuals married to one another who file";

(9) in section 213(d)(8), by striking "status as husband and wife" and inserting "marital status";

(10) in section 219(g)(4), in the matter preceding subparagraph (A), by striking "A husband and wife" and inserting "Married individuals";

(11) in section 274(b)(2)(B), by striking "husband and wife" and inserting "married couple";

(12) in section 643(f), by striking "husband and wife" in the second sentence and inserting "married couple";

(13) in section 761(f)—

(A) in paragraph (1), by striking "husband and wife" and inserting "married couple"; and

(B) in paragraph (2)(A), by striking "husband and wife" and inserting "married couple";

(14) in section 911—

(A) in subsection (b)(2), by striking subparagraph (C) and inserting the following new subparagraph:

"(C) TREATMENT OF COMMUNITY INCOME.—In applying subparagraph (A) with respect to amounts received from services performed by a married in-

dividual which are community income under community property laws applicable to such income, the aggregate amount which may be excludable from the gross income of such individual and such individual's spouse under subsection (a)(1) for any taxable year shall equal the amount which would be so excludable if such amounts did not constitute community income."; and

(B) in subsection (d)(9)(A), by striking "where a husband and wife each have" and inserting "where both spouses have";

(15) in section 1244(b)(2), by striking "a husband and wife filing";

(16) in section 1272(a)(2)(D), by striking clause (iii) and inserting the following new clause:

"(iii) TREATMENT OF A MARRIED COUPLE.—For purposes of this subparagraph, a married couple shall be treated as 1 person. The preceding sentence shall not apply where the spouses lived apart at all times during the taxable year in which the loan is made.";

(17) in section 1313(c)(1), by striking "husband and wife" and inserting "spouses";

(18) in section 1361(c)(1)(A)(i), by striking "a husband and wife" and inserting "a married couple";

(19) in section 2040(b), by striking "CERTAIN JOINT INTERESTS OF HUSBAND AND WIFE" in the heading and inserting "CERTAIN JOINT INTERESTS OF MARRIED COUPLE";

(20) in section 2513—

(A) by striking "gift by husband or wife to third party" in the heading and inserting "gift by spouse to third party"; and

(B) by striking paragraph (1) of subsection (a) and inserting the following new paragraph:

"(1) IN GENERAL.—A gift made by one individual to any person other than such individual's spouse shall, for the purposes of this chapter, be considered as made one-half by the individual and one-half by such individual's spouse, but only if at the time of the gift each spouse is a citizen or resident of the United States. This paragraph shall not apply with respect to a gift by an individual of an interest in property if such individual creates in the individual's spouse a general power of appointment, as defined in section 2514(c), over such interest. For purposes of this section, an individual shall be considered as the spouse of another only if the individual is married to the individual's spouse at the time of the gift and does not remarry during the remainder of the calendar year.";

(21) in section 2516—

(A) by striking "Where a husband and wife enter" and inserting the following:

"(a) IN GENERAL.—Where a married couple enters"; and

(B) by adding at the end the following new subsection:

"(b) SPOUSE.—For purposes of this section, if the spouses referred to are divorced, wherever appropriate to the meaning of this section, the term 'spouse' shall read 'former spouse'.";

(22) in section 5733(d)(2), by striking "husband or wife" and inserting "married individual";

(23) in section 6013—

(A) by striking "joint returns of income tax by husband and wife" in the heading and inserting "joint returns of income tax by a married couple";

(B) in subsection (a), in the matter preceding paragraph (1), by striking "husband and wife" and inserting "married couple";

(C) in subsection (a)(1), by striking "either the husband or wife" and inserting "either spouse";

(D) in subsection (a)(2)—

(i) by striking "husband and wife" and inserting "spouses"; and

(ii) by striking "his taxable year" and inserting "such spouse's taxable year";

(E) in subsection (a)(3)—

(i) by striking "his executor or administrator" and inserting "the decedent's executor or administrator";

(ii) by striking "with respect to both himself and the decedent" and inserting "with respect to both the surviving spouse and the decedent"; and

(iii) by striking "constitute his separate return" and inserting "constitute the survivor's separate return";

(F) in subsection (b), by striking paragraph (1) and inserting the following new paragraph:

"(1) IN GENERAL.—Except as provided in paragraph (2), if an individual has filed a separate return for a taxable year for which a joint return could have been made by the individual and the individual's spouse under subsection (a) and the time prescribed by law for filing the return for such taxable year has expired, such individual and such spouse may nevertheless make a joint return for such taxable year. A joint return filed under this subsection shall constitute the return of the individual and the individual's spouse for such taxable year, and all payments, credits, refunds, or other repayments made or allowed with respect to the separate return of either spouse for such taxable year shall be taken into account in determining the extent to which the tax based upon the joint return has been paid. If a joint return is made under this subsection, any election (other than the election to file a separate return) made by either spouse in a separate return for such taxable year with respect to the treatment of any income, deduction, or credit of such spouse shall not be changed in the making of the joint return where such election would have been irrevocable if the joint return had not been made. If a joint return is made under this subsection after the death of either spouse, such return with respect to the decedent can be made only by the decedent's executor or administrator.";

(G) in subsection (c), by striking "husband and wife" and inserting "spouses";

(H) in subsection (d)(1), by striking "status as husband and wife" and inserting "the marital status with respect to each other";

(I) in subsection (d)(2), by striking "his spouse" and inserting "the spouse of the individual";

(J) in subsection (f)(2)(B), by striking "such individual, his spouse, and his estate shall be determined as if he were alive" and inserting "such individual, the individual's spouse, and the individual's estate shall be determined as if the individual were alive"; and

(K) in subsection (f)(3)—

(i) in subparagraph (A), by striking "for which he is entitled" and inserting "for which such member is entitled"; and

(ii) in subparagraph (B), by striking "for which he is entitled" and inserting "for which such employee is entitled";

(24) in section 6014(b), by striking "husband and wife" in the second sentence and inserting "a married couple";

(25) in section 6017, by striking "husband and wife" and inserting "married couple";

(26) in section 6096(a), by striking "of husband and wife having" and inserting "reporting";

(27) in section 6166(b)(2), by striking subparagraph (B) and inserting the following new subparagraph:

"(B) CERTAIN INTERESTS HELD BY MARRIED COUPLE.—Stock or a partnership interest which—

"(i) is community property of a married couple (or the income from which is community income) under the applicable community property law of a State, or

"(ii) is held by a married couple as joint tenants, tenants by the entirety, or tenants in common,

shall be treated as owned by 1 shareholder or 1 partner, as the case may be.";

(28) in section 6212(b)(2)—

(A) by striking "return filed by husband and wife" and inserting "return"; and

(B) by striking "his last known address" and inserting "the last known address of such spouse";

(29) in section 7428(c)(2)(A), by striking "husband and wife" and inserting "married couple";

(30) in section 7701(a)—

(A) by striking paragraph (17); and

(B) in paragraph (38), by striking "husband and wife" and inserting "married couple"; and

(31) in section 7872(f), by striking paragraph (7) and inserting the following new paragraph:

"(7) MARRIED COUPLE TREATED AS 1 PERSON.—A married couple shall be treated as 1 person.".

(b) CONFORMING AMENDMENTS.—

(1) The table of sections for subchapter B of chapter 12 of the Internal Revenue Code of 1986 is amended by striking the item relating to section 2513 and inserting the following new item:

"Sec. 2513. Gift by spouse to third party.".

(2) The table of sections for subpart B of part II of subchapter A of chapter 61 of such Code is amended by striking the item relating to section 6013 and inserting the following new item:

"Sec. 6013. Joint returns of income tax by a married couple.".

SEC. 4. RULES RELATING TO THE GENDER OF SPOUSES, ETC.

(a) IN GENERAL.—The following provisions of the Internal Revenue Code of 1986 are each amended by striking "his spouse" each place it appears and inserting "the individual's spouse":

(1) Subsections (a)(1) and (d) of section 1.
(2) Section 2(b)(2)(A).
(3) Subsections (d)(1)(B) and (e)(3) of section 21.
(4) Section 36(c)(5).
(5) Section 179(d)(2)(A).
(6) Section 318(a)(1)(A)(i).
(7) Section 408(d)(6).
(8) Section 469(i)(5)(B)(ii).
(9) Section 507(d)(2)(B)(iii).
(10) Clauses (ii) and (iii) of section 613A(c)(8)(D).
(11) Section 672(e)(2).
(12) Section 704(e)(2).
(13) Subparagraphs (A) and (B)(ii) of section 911(c)(3).
(14) Section 1235(c)(2).
(15) Section 1563(e)(5).
(16) Section 3121(b)(3)(B).
(17) Section 4946(d).
(18) Section 4975(e)(6).
(19) Subparagraphs (A)(iv) and (B) of section 6012(a)(1).
(20) Section 7703(a).

(b) CONFORMING AMENDMENTS.—

(1) The following provisions of the Internal Revenue Code of 1986 are each amended by striking "his spouse" each place it appears and inserting "the taxpayer's spouse":

(A) Section 2(a)(2)(B).
(B) Subparagraphs (B) and (C) of section 2(b)(2).
(C) Paragraphs (2) and (6)(A) of section 21(e).
(D) Section 36B(e)(1).
(E) Section 63(e)(3)(B).
(F) Section 86(c)(1)(C)(ii).
(G) Section 105(c)(1).
(H) Section 135(d)(3).
(I) Section 151(b).
(J) Subsections (a) and (d)(7) of section 213.
(K) Section 1233(e)(2)(C).
(L) Section 1239(b)(2).
(M) Section 6504(2).

(2) The following provisions of the Internal Revenue Code of 1986 are each amended by striking "his spouse" each place it appears and inserting "the employee's spouse":

(A) Section 132(m)(1).
(B) Section 401(h)(6).
(C) Section 3402(l)(3).

(3) The following provisions of the Internal Revenue Code of 1986 are each amended by striking "his taxable year" each place it appears and inserting "the individual's taxable year":

(A) Section 2(b)(1).
(B) Section 7703(a)(1).

(4) The following provisions of the Internal Revenue Code of 1986 are each amended by striking "his taxable year" each place it appears and inserting "the taxpayer's taxable year":

(A) Subparagraphs (B) and (C) of section 2(b)(2) (as amended by paragraph (1)(B)).
(B) Section 63(f)(1)(A).

(5) The following provisions of the Internal Revenue Code of 1986 are each amended by striking "his home" and inserting "the individual's home":

(A) Section 2(b)(1)(A).

(B) Section 21(e)(4)(A)(i).

(C) Section 7703(b)(1).

(6) The Internal Revenue Code of 1986, as amended by this section, is amended—

(A) in section 2(a)(1)(A), by striking "his two taxable years" and inserting "the taxpayer's two taxable years";

(B) in section 2(a)(1)(B), by striking "his home" and inserting "the taxpayer's home";

(C) in paragraphs (1)(A) and (2)(A) of section 63(f), by striking "for himself if he" both places it appears and inserting "for the taxpayer if the taxpayer";

(D) in section 63(f)(4), by striking "his" both places it appears and inserting "the individual's";

(E) in section 105(b)—

(i) by striking "his spouse, his dependents" and inserting "the taxpayer's spouse, the taxpayer's dependents"; and

(ii) by striking "by him";

(F) in the heading of section 119(a), by striking ", HIS SPOUSE, AND HIS DEPENDENTS" and inserting "AND THE EMPLOYEE'S SPOUSE AND DEPENDENTS";

(G) in section 119(a), by striking "him, his spouse, or any of his dependents by or on behalf of his employer" and inserting "the employee or the employee's spouse or dependents by or on behalf of the employer of the employee";

(H) in section 119(a)(2), by striking "his" both places it appears and inserting "the employee's";

(I) in section 119(d)(3)(B), by striking "his spouse, and any of his dependents" and inserting "the employee's spouse, and any of the employee's dependents";

(J) in section 129(b)(2), by striking "himself" and inserting "the spouse's self";

(K) in section 170(b)(1)(F)(iii)—

(i) by striking "his spouse" and inserting "the spouse of such donor"; and

(ii) by striking "his death or after the death of his surviving spouse if she" and inserting "the death of the donor or after the death of the donor's surviving spouse if such surviving spouse";

(L) in section 213(c)(1)—

(i) by striking "his estate" and inserting "the estate of the taxpayer"; and

(ii) by striking "his death" and inserting "the death of the taxpayer";

(M) in section 213(d)(7), by striking "he" and inserting "the taxpayer";

(N) in section 217(g)—

(i) by striking ", his spouse, or his dependents" in paragraph (2) and inserting "or the spouse or dependents of such member";

(ii) by striking "his dependents" in paragraph (3) and inserting "dependents"; and

(iii) by striking "his spouse" each place it appears in paragraph (3) and inserting "the member's spouse";

(O) in section 217(i)(3)(A), by striking "his";

(P) in section 267(c), by striking "his" each place it appears and inserting "the individual's";

(Q) in section 318(a)(1)(A)(ii), by striking "his" and inserting "the individual's";

(R) in section 402(l)(4)(D), by striking ", his spouse, and dependents" and inserting "and the spouse and dependents of such officer";

(S) in section 415(l)(2)(B), by striking ", his spouse, or his dependents" and inserting "or the participant's spouse or dependents";

(T) in section 420(f)(6)(A), by striking "his covered spouse and dependents" each place it appears and inserting "the covered spouse and dependents of such retiree";

(U) in section 424(d)(1), by striking "his" and inserting "the individual's";

(V) in section 544(a)(2), by striking "his" each place it appears and inserting "the individual's";

(W) in section 911(c)(3), by striking "him" each place it appears in subparagraphs (A) and (B)(ii) and inserting "the individual";

(X) in section 1015(d)(3), by striking "his spouse" and inserting "the donor's spouse";

(Y) in section 1563(e)—

(i) by striking "his children" both places it appears in paragraphs (5)(D) and (6)(A) and inserting "the individual's children"; and

(ii) by striking "his parents" both places it appears in subparagraphs (A) and (B) of paragraph (6) and inserting "the individual's parents";

(Z) in section 1563(f)(2)(B), by striking "him" and inserting "the individual";

(AA) in section 2012(c), by striking "his spouse" and inserting "the decedent's spouse";

(BB) in section 2032A(e)(10), by striking "his surviving spouse" and inserting "the decedent's surviving spouse";

(CC) in section 2035(b)—

(i) by striking "his estate" and inserting "the decedent's estate"; and

(ii) by striking "his spouse" and inserting "the decedent's spouse";

(DD) in subsections (a) and (b)(5) of section 2056, by striking "his";

(EE) in section 2523(b)—

(i) by striking "(or his heirs or assigns) or such person (or his heirs or assigns)" in paragraph (1) and inserting "(or the donor's heirs or assigns) or such person (or such person's heirs or assigns)";

(ii) by striking "himself" in paragraph (1) and inserting "the donor's self";

(iii) by striking "he" in paragraph (2) and inserting "the donor"; and

(iv) by striking "him" each place it appears in the matter following paragraph (2) and inserting "the donor";

(FF) in section 2523(d), by striking "himself" and inserting "the donor's self";

(GG) in section 2523(e), by striking "his spouse" and inserting "the donor's spouse";

(HH) in section 3121(b)(3)—

(i) by striking "his father" in subparagraph (A) and inserting "the child's father";

(ii) by striking "his father" in subparagraph (B) and inserting "the individual's father"; and

(iii) by striking "his son" in subparagraph (B) and inserting "the individual's son";

(II) in section 3306(c)(5)—

(i) by striking "his son" and inserting "the individual's son"; and

(ii) by striking "his father" and inserting "the child's father";

(JJ) in section 3402(l)—

(i) by striking "he" each place it appears in paragraphs (2) and (3)(A) and inserting "the employee"; and

(ii) by striking "his taxable year" both places it appears in paragraph (3)(B) and inserting "the employee's taxable year";

(KK) in section 4905(a), by striking "his spouse" and inserting "such person's spouse";

(LL) in section 6046(c), by striking "his" both places it appears and inserting "the individual's";

(MM) in section 6103(e)(1)(A)(ii), by striking "him" and inserting "the individual";

(NN) in section 7448(a)(8), by striking "his death" and inserting "the individual's death";

(OO) in subsections (d), (m), and (n) of section 7448, by striking "his" each place it appears and inserting "the individual's";

(PP) in subsection (m) of section 7448, as so amended, by striking "he" each place it appears and inserting "such judge or special trial judge"; and

(QQ) in section 7448(q)—

(i) by striking "his" both places it appears and inserting "such judge's"; and

(ii) by striking "to bring himself" and inserting "to come".

I. SUMMARY AND BACKGROUND

A. Purpose and Summary

The bill H.R. 3999, the Promoting Respect for Individuals' Dignity and Equality (PRIDE) Act of 2019, as ordered reported by the

Committee on Ways and Means on June 20, 2019, amends the Internal Revenue Code of 1986 so as to provide lawfully married same-sex couples with the ability to file claims for credits and refunds related to a change in marital status back to their year of marriage, and to amend such code so that provisions that apply to married couples use gender-neutral language.

B. Background and Need for Legislation

The Promoting Respect for Individuals' Dignity and Equality (PRIDE) Act of 2019 makes long-overdue changes to the tax code for same-sex married couples. June 28, 2019 is the 50th anniversary of the Stonewall riots. To commemorate that moment in the LGBTQ+ movement, the PRIDE Act scrubs the tax code of any gendered language related to married couples.

Additionally, the legislation resolves a problem related to the mismatched timing of IRS guidance changes and state-level same-sex marriage legalization. Specifically, after the 2013 Supreme Court ruling in *United States v. Windsor*, 570 U.S. 744 (2013), the IRS updated its procedures to allow same-sex couples to amend old returns from 2010 onwards to reflect their marital status and claim overpayment credits for years they were married but unable to file jointly. H.R. 3299 allows same-sex couples to file federal income tax adjustments back to the date of marriage providing additional relief for those couples who were lawfully married under state law before 2010.

C. Legislative History

Background

H.R. 3299, the "Promoting Respect for Individuals' Dignity and Equality Act of 2019," was introduced on June 18, 2019, and was referred to the Committee on Ways and Means.

Committee action

The Committee on Ways and Means marked up H.R. 3299 on June 20, 2019, and ordered the bill, as amended, favorably reported (with a quorum being present).

Committee hearings

The Committee on Ways and Means heard testimony from Rep. Andy Levin on June 4, 2019 regarding H.R. 1244, the Equal Dignity for Married Taxpayers Act of 2019. Additionally, on June 4, 2019, the Committee heard testimony from Rep. Judy Chu regarding H.R. 3294, the Refund Equality Act of 2019. Provisions substantially similar to both H.R. 1244 and H.R. 3294 are included in H.R. 3299.

II. EXPLANATION OF THE BILL

A. Extension of Period of Limitation for Certain Legally Married Couples (Sec. 2 of the Bill and Sec. 6511 of the Code)

PRESENT LAW

Statute of limitations on credit or refund

In general, a taxpayer must file a claim for credit or refund within three years of the filing of the tax return or within two years of the payment of the tax, whichever expires later (if no tax return is filed, the two-year limit applies).[1] A claim for credit or refund that is not filed within these time periods is rejected as untimely. In addition, the amount of credit or refund is limited to the portion of tax paid within the three-year period (plus any filing extension) or the two-year period, as applicable, immediately preceding the filing of the claim.[2]

Limitation on filing a joint return after filing a separate return

An individual filing a separate return for a tax year for which the individual and the individual's spouse could have filed a joint return may file a joint return amending the prior separate return for the tax year after the due date for filing the return has passed.[3] However, an individual cannot elect to file a joint return after having filed a separate return more than three years after the due date of the return (without regard to any extensions) for the applicable tax year.[4]

Federal tax treatment of same-sex marriage

Prior to the Supreme Court's decision in *United States v. Windsor*,[5] section 3 of the Defense of Marriage Act (DOMA)[6] prohibited the IRS from recognizing same-sex marriages for purposes of the provisions of the Code that refer to the marital status of the taxpayer and convey benefits upon such status. In *Windsor*, the Supreme Court held that section 3 of DOMA was unconstitutional because it violated principles of equal protection.

Following the *Windsor* decision, the IRS issued Revenue Ruling 2013–17[7] (the "Revenue Ruling"), which provided guidance on the effect of the *Windsor* decision on the IRS's interpretation of the provisions of the Code that refer to a taxpayer's marital status. In the Revenue Ruling, the IRS recognized the validity of same-sex marriages that were lawful in the State where they occurred. In particular, the Revenue Ruling made three specific holdings for Federal tax purposes:

> 1. The terms "spouse," "husband and wife," "husband," and "wife" include an individual married to a person of the same sex if the individuals are lawfully married under State law, and the term "marriage" includes such a marriage between individuals of the same sex.

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[1] Sec. 6511(a).
[2] Sec. 6511(b)(2).
[3] Sec. 6013(b)(1).
[4] Sec. 6013(b)(2).
[5] 570 U.S. 744 (2013).
[6] 1 U.S.C. sec. 7.
[7] 2013–38 I.R.B. 201.

2. The IRS adopts a general rule recognizing a marriage of same-sex individuals that was validly entered into in a State whose laws authorize the marriage of two individuals of the same sex even if the married couple is domiciled in a State that does not recognize the validity of same-sex marriages.

3. The terms "spouse," "husband and wife," "husband," and "wife" do not include individuals (whether of the opposite sex or the same sex) who have entered into a registered domestic partnership, civil union, or other similar formal relationship recognized under State law that is not denominated as a marriage under the laws of that State, and the term "marriage" does not include such formal relationships.

The holdings of Revenue Ruling 2013–17 were applied prospectively as of September 16, 2013. The Revenue Ruling allowed affected taxpayers to rely on the ruling for purposes of filing original returns, amended returns, adjusted returns, or claims for credit or refund resulting from its holdings but only if the applicable limitations period for filing such claims had not expired. Thus, taxpayers lawfully married under State law during tax years for which the statute of limitations was closed as of September 16, 2013, could not claim the tax benefits of Federal recognition of same-sex marriage. Among those that were affected were residents of Massachusetts and several other States that recognized same-sex marriage during years for which the statute of limitations generally was closed as of September 16, 2013.[8] Accordingly, some lawfully married same-sex couples were not able to claim Federal tax benefits associated with their marital status for all tax years for which they were lawfully married.

REASONS FOR CHANGE

The Committee believes that lawfully married same-sex couples should be entitled to the Federal tax benefits of their marital status for all years for which their marriages are recognized under State law. Although the Revenue Ruling provided limited relief for married same-sex couples, the IRS does not have the authority to allow claims for years for which the statute of limitations was closed. This provision provides full relief to married same-sex couples and ensures equal Federal tax treatment between same-sex married couples and other married couples for all applicable years.

EXPLANATION OF PROVISION

Under the provision, lawfully married same-sex couples may file an amended return (including a joint return after filing a return other than a joint return[9]) and a claim for credit or refund relating to a change in marital status as a result of the holdings in Revenue Ruling 2013–17 for taxable years ending before September 16, 2013. The period for filing an amended return or claim for refund under the provision expires on the filing date (including extensions) of the return for the tax year that includes the date of enactment

[8] The States that recognized same-sex marriage prior to 2010 (the years for which the statute of limitations would generally be closed for taxpayers amending their returns in calendar year 2013) are Massachusetts, California (during a portion of 2008), Connecticut, Iowa and Vermont.

[9] Because this legislation involves the novel situation of a retroactive change in the marital status of an individual for purpose of the Code, the provision clarifies that in applying section 6013(b) in this situation, the term "separate return" means any return other than a joint return. No inference is intended as the application of section 6013(b) in any other situation.

of the provision. In addition, the limitation on the dollar amounts recoverable is made inapplicable for newly-filed joint returns.

EFFECTIVE DATE

The provision is effective on the date of enactment.

B. Rules Relating to All Legally Married Couples, and Rules Relating to the Gender of Spouses, Etc. (Secs. 3 and 4 of the Bill)

PRESENT LAW

The Code contains a number of provisions that apply to married couples. While these provisions apply to both opposite-sex and same-sex married couples,[10] they generally refer to "husband and wife" or otherwise use gendered language in describing the couple or one or both spouses.

For example, the Code allows taxpayers to claim a nonrefundable child and dependent care credit, for which the allowable credit is an applicable percentage of employment-related expenses. For purposes of this credit, qualifying expenses are limited by the earned income of the taxpayer. A special rule applies in the case of married couples:

> Section 21(d)(2). Special rule for spouse who is a student or incapable of caring for himself. In the case of a spouse who is a student or a qualifying individual described in subsection (b)(1)(C), for purposes of the paragraph (1), such spouse shall be deemed for each month during which such spouse is a full-time student at an educational institution, or is such a qualifying individual, to be gainfully employed and to have earned income of not less than—
>
> (A) $250 if subsection (c)(1) applies for the taxable year, or
>
> (B) $500 if subsection (c)(2) applies for the taxable year.
>
> In the case of any husband and wife, this paragraph shall apply with respect to only one spouse for any one month.

REASONS FOR CHANGE

The Committee believes that the Code should be modernized to remove outdated references relating to marriage and replace them with gender-neutral terms. This provision ensures equal dignity for all taxpayers.

EXPLANATION OF PROVISIONS

The provisions amend the Code so that provisions that apply to married couples use gender-neutral language, by changing terms such as "husband and wife" or other gendered language.

For example, with respect to section 21(d)(2), quoted above, the provisions change "himself" to "self" and "husband and wife" to "any married couple."

[10] Rev. Rul. 2013–17. For a full description of Revenue Ruling 2013–17, see discussion above.

EFFECTIVE DATE

The provisions are effective on the date of enactment.

III. VOTES OF THE COMMITTEE

Pursuant to clause 3(b) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 3299, the "Promoting Respect for Individuals' Dignity and Equality Act of 2019" on June 20, 2019.

The amendment in the nature of a substitute was agreed to by voice vote (with a quorum being present).

The bill, H.R. 3299, as amended, was ordered favorably reported to the House of Representatives by voice vote (with a quorum being present).

IV. BUDGET EFFECTS OF THE BILL

A. Committee Estimate of Budgetary Effects

In compliance with clause 3(d) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the effects on the budget of the bill, H.R. 3299, as ordered reported.

The bill is estimated to decrease Federal fiscal year budget receipts by $57 million dollars for the period 2019 through 2029.

ESTIMATED BUDGET EFFECTS OF H.R. 3299, THE ''PROMPTING RESPECT FOR INDIVIDUALS' DIGNITY AND EQUALITY ACT OF 2019,'' AS REPORTED BY THE COMMITTEE ON WAYS AND MEANS—Fiscal Years 2019–2029

[Millions of Dollars]

Provision	Effective	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2019–24	2019–29
1. Extension of period of limitation for certain legally married couples.	DOE	[1]	−57	[1]	– – –	– – –	– – –	– – –	– – –	– – –	– – –	– – –	−57	−57
2. Rules relating to all legally married couples	DOE							*No Revenue Effect*						
3. Rules relating to the gender of spouses, etc.								*No Revenue Effect*						
NET TOTAL		[1]	−57	[1]	[2]	[2]	[2]	[2]	[2]	[2]	[2]	[2]	−57	−57

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column: DOE = date of enactment

[1] Loss of less than $500,000.

[2] No revenue effect.

B. Statement Regarding New Budget Authority and Tax Expenditures Budget Authority

Pursuant to clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee states that the bill involves no new or increased budget authority. The Committee further states that the bill involves no new tax expenditure.

C. Cost Estimate Prepared by the Congressional Budget Office

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, requiring a cost estimate prepared by CBO, the following statement by CBO is provided.

U.S. Congress,
Congressional Budget Office,
Washington, DC, June 25, 2019.

Hon. Richard Neal,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 3299, the Promoting Respect for Individuals' Dignity and Equality Act of 2019.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Shannon Mok.

Sincerely,

Mark P. Hadley
(For Phillip L. Swagel, Director).

Enclosure.

At a Glance

H.R. 3299, Promoting Respect for Individuals' Dignity and Equality Act of 2019

As ordered reported by the House Committee on Ways and Means on June 20, 2019

By Fiscal Year, Millions of Dollars	2019	2019-2024	2019-2029
Direct Spending (Outlays)	0	0	0
Revenues	*	-57	-57
Deficit Effect	*	57	57
Spending Subject to Appropriation (Outlays)	0	0	0

Statutory pay-as-you-go procedures apply?	Yes	**Mandate Effects**	
Increases on-budget deficits in any of the four consecutive 10-year periods beginning in 2030?	No	Contains intergovernmental mandate?	No
		Contains private-sector mandate?	No

* = between -$500,000 and $500,000.

The bill would

- Extend the statute of limitations for certain lawfully married same-sex couples to file amended tax returns and claims for credit or refund

- Amend the Internal Revenue Code to use gender-neutral language

Estimated budgetary effects would primarily stem from

- A reduction in tax liability from filing a joint return

The Congressional Budget Act of 1974, as amended, stipulates that revenue estimates provided by the staff of the Joint Committee on Taxation (JCT) are the official estimates for all tax legislation considered by the Congress. CBO therefore incorporates such estimates into its cost estimates of the effects of legislation. All of the estimates for the provisions of H.R. 3299 were provided by JCT.

Bill summary: H.R. 3299 would extend the statute of limitations for filing amended returns or claims for credit or refund for same-sex couples who were married prior to the federal recognition of same-sex marriage and for whom the statute of limitations had closed as of September 16, 2013. The extended statute of limitations would expire on the filing date (including extensions) of the return for the tax year in which the proposal is enacted. In addition, it would amend the Internal Revenue Code to use gender-neutral language in describing couples and spouses.

Estimated Federal cost: The estimated budgetary effect of H.R. 3299 is shown in Table 1.

TABLE 1.—ESTIMATED BUDGETARY EFFECTS OF H.R. 3299

	By fiscal year, millions of dollars—												
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2019–2024	2019–2029
	Decreases (−) in Revenues												
Estimated Revenues	*	−57	*	0	0	0	0	0	0	0	0	−57	−57
	Increases in the Deficit From Changes in Revenues												
Effect on the Deficit	*	57	*	0	0	0	0	0	0	0	0	57	57

Source: Staff of the Joint Committee on Taxation.
Components may not sum to totals because of rounding; * = between −$500,000 and $500,000.

Basis of estimate: The Congressional Budget Act of 1974, as amended, stipulates that revenue estimates provided by the staff of the Joint Committee on Taxation (JCT) are the official estimates for all tax legislation considered by the Congress. CBO therefore incorporates such estimates into its cost estimates of the effects of legislation. All of the estimates for the provisions of H.R. 3299 were provided by JCT.[1]

Revenues: On net, JCT estimates, enacting the bill would decrease revenues by $57 million over the 2019–2029 period.

V. OTHER MATTERS TO BE DISCUSSED UNDER THE RULES OF THE HOUSE

A. Committee Oversight Findings and Recommendations

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee advises that the findings and recommendations of the Committee, based on oversight activities

[1] For JCT's estimates of the provisions, which include detail beyond the summary presented below, see Joint Committee on Taxation, *Estimated Revenue Effects of H.R. 3299, The "Promoting Respect for Individuals' Dignity and Equality Act of 2019,"* JCX–27–19 (June 18, 2019) https://go.usa.gov/xyCgv

under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated into the explanations of the provisions in this report.

B. Statement of General Performance Goals and Objectives

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee states that, because the bill contains no measure that authorizes funding, no statement of general performance goals and objectives is required.

C. Information Relating to Unfunded Mandates

Pursuant to section 423 of Public Law 104–4, the Unfunded Mandates Reform Act of 1995, the Committee has determined that the bill does not contain Federal mandates on the private sector. Further, the Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

D. Applicability of House Rule XXI, Clause 5(b)

Clause 5(b) of rule XXI of the Rules of the House of Representatives provides, in part, that "It shall not be in order to consider a bill, joint resolution, amendment, or conference report carrying a retroactive Federal income tax rate increase." The Committee, after careful review, states that the bill does not involve any retroactive Federal income tax rate increase within the meaning of the rule.

E. Tax Complexity Analysis

Section 4022(b) of Public Law 105–206, the Internal Revenue Service Restructuring and Reform Act of 1998 (the "RRA"), requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Treasury Department) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code of 1986 and has widespread applicability to individuals or small businesses.

Pursuant to clause 3(h)(1) of rule XIII of the Rules of the House of Representatives, the staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the RRA because the bill contains no provision that amends the Internal Revenue Code of 1986 and has "widespread applicability" to individuals or small businesses within the meaning of the rule.

F. Congressional Earmarks, Limited Tax Benefits, and Limited Tariff Benefits

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee, after careful review, states that no provision of the bill contains any congressional earmark, limited tax benefit, or limited tariff benefit within the meaning of the rule.

G. Duplication of Federal Programs

Pursuant to clause 3(c)(5) of rule XIII of the Rules of the House of Representatives, the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program, (2) a program included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139, or (3) a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to section 6104 of title 31, United States Code.

H. Hearings

In compliance with Sec. 103(i) of H. Res. 6 (116th Congress) the following hearing was used to develop or consider H.R. 3299: House Ways and Means Committee Member Day Hearing held on June 4, 2019 during which Representative Andy Levin (D–MI) and Representative Judy Chu (D–CA) testified regarding legislation that is incorporated into H.R. 3299.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL

A. Changes in Existing Law Proposed by the Bill

Pursuant to clause 3(e)(1)(B) of rule XIII of the Rules of the House of Representatives, changes in existing law proposed by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman):

Changes in Existing Law Made by the Bill, as Reported

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, and existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1986

* * * * * * *

Subtitle A—Income Taxes

* * * * * * *

CHAPTER 1—NORMAL TAXES AND SURTAXES

* * * * * * *

Subchapter A—DETERMINATION OF TAX LIABILITY

* * * * * * *

PART I—TAX ON INDIVIDUALS

* * * * * * *

SEC. 1. TAX IMPOSED.

(a) MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES.—There is hereby imposed on the taxable income of—

(1) every married individual (as defined in section 7703) who makes a single return jointly with [his spouse] *the individual's spouse* under section 6013, and

(2) every surviving spouse (as defined in section 2(a)),

a tax determined in accordance with the following table:

(b) HEADS OF HOUSEHOLDS.—There is hereby imposed on the taxable income of every head of a household (as defined in section 2(b)) a tax determined in accordance with the following table:

(c) UNMARRIED INDIVIDUALS (OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS).—There is hereby imposed on the taxable income of every individual (other than a surviving spouse as defined in section 2(a) or the head of a household as defined in section 2(b)) who is not a married individual (as defined in section 7703) a tax determined in accordance with the following table:

(d) MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—There is hereby imposed on the taxable income of every married individual (as defined in section 7703) who does not make a single return jointly with [his spouse] *the individual's spouse* under section 6013, a tax determined in accordance with the following table:

(e) ESTATES AND TRUSTS.—There is hereby imposed on the taxable income of—

(1) every estate, and

(2) every trust,

taxable under this subsection a tax determined in accordance with the following table:

(f) PHASEOUT OF MARRIAGE PENALTY IN 15-PERCENT BRACKET; ADJUSTMENTS IN TAX TABLES SO THAT INFLATION WILL NOT RESULT IN TAX INCREASES.—

(1) IN GENERAL.—Not later than December 15 of 1993, and each subsequent calendar year, the Secretary shall prescribe tables which shall apply in lieu of the tables contained in subsections (a), (b), (c), (d), and (e) with respect to taxable years beginning in the succeeding calendar year.

(2) METHOD OF PRESCRIBING TABLES.—The table which under paragraph (1) is to apply in lieu of the table contained in subsection (a), (b), (c), (d), or (e), as the case may be, with respect to taxable years beginning in any calendar year shall be prescribed—

(A) except as provided in paragraph (8), by increasing the minimum and maximum dollar amounts for each bracket for which a tax is imposed under such table by the cost-of-living adjustment for such calendar year, determined—

(i) except as provided in clause (ii), by substituting "1992" for "2016" in paragraph (3)(A)(ii), and

(ii) in the case of adjustments to the dollar amounts at which the 36 percent rate bracket begins or at which the 39.6 percent rate bracket begins, by substituting "1993" for "2016" in paragraph (3)(A)(ii),

(B) by not changing the rate applicable to any rate bracket as adjusted under subparagraph (A), and

(C) by adjusting the amounts setting forth the tax to the extent necessary to reflect the adjustments in the rate brackets.

(3) COST-OF-LIVING ADJUSTMENT.—For purposes of this subsection—

(A) IN GENERAL.—The cost-of-living adjustment for any calendar year is the percentage (if any) by which—

(i) the C-CPI-U for the preceding calendar year, exceeds

(ii) the CPI for calendar year 2016, multiplied by the amount determined under subparagraph (B).

(B) AMOUNT DETERMINED.—The amount determined under this clause is the amount obtained by dividing—

(i) the C-CPI-U for calendar year 2016, by

(ii) the CPI for calendar year 2016.

(C) SPECIAL RULE FOR ADJUSTMENTS WITH A BASE YEAR AFTER 2016.—For purposes of any provision of this title which provides for the substitution of a year after 2016 for "2016" in subparagraph (A)(ii), subparagraph (A) shall be applied by substituting "the C-CPI-U for calendar year 2016" for "the CPI for calendar year 2016" and all that follows in clause (ii) thereof.

(4) CPI FOR ANY CALENDAR YEAR.—For purposes of paragraph (3), the CPI for any calendar year is the average of the Consumer Price Index as of the close of the 12-month period ending on August 31 of such calendar year.

(5) CONSUMER PRICE INDEX.—For purposes of paragraph (4), the term "Consumer Price Index" means the last Consumer Price Index for all-urban consumers published by the Department of Labor. For purposes of the preceding sentence, the revision of the Consumer Price Index which is most consistent with the Consumer Price Index for calendar year 1986 shall be used.

(6) C-CPI-U.—For purposes of this subsection—

(A) IN GENERAL.—The term "C-CPI-U" means the Chained Consumer Price Index for All Urban Consumers (as published by the Bureau of Labor Statistics of the Department of Labor). The values of the Chained Consumer Price Index for All Urban Consumers taken into account for purposes of determining the cost-of-living adjustment for any calendar year under this subsection shall be the latest values so published as of the date on which such Bureau publishes the initial value of the Chained Consumer Price Index for All Urban Consumers for the month of August for the preceding calendar year.

(B) DETERMINATION FOR CALENDAR YEAR.—The C-CPI-U for any calendar year is the average of the C-CPI-U as of the close of the 12-month period ending on August 31 of such calendar year.

(7) ROUNDING.—

(A) IN GENERAL.—If any increase determined under paragraph (2)(A), section 63(c)(4), section 68(b)(2) or sec-

tion 151(d)(4) is not a multiple of $50, such increase shall be rounded to the next lowest multiple of $50.

(B) TABLE FOR MARRIED INDIVIDUALS FILING SEPARATELY.—In the case of a married individual filing a separate return, subparagraph (A) (other than with respect to sections 63(c)(4) and 151(d)(4)(A)) shall be applied by substituting "$25" for "$50" each place it appears.

(8) ELIMINATION OF MARRIAGE PENALTY IN 15-PERCENT BRACKET.—With respect to taxable years beginning after December 31, 2003, in prescribing the tables under paragraph (1)—

(A) the maximum taxable income in the 15-percent rate bracket in the table contained in subsection (a) (and the minimum taxable income in the next higher taxable income bracket in such table) shall be 200 percent of the maximum taxable income in the 15-percent rate bracket in the table contained in subsection (c) (after any other adjustment under this subsection), and

(B) the comparable taxable income amounts in the table contained in subsection (d) shall be 1/2 of the amounts determined under subparagraph (A).

(g) CERTAIN UNEARNED INCOME OF CHILDREN TAXED AS IF PARENT'S INCOME.—

(1) IN GENERAL.—In the case of any child to whom this subsection applies, the tax imposed by this section shall be equal to the greater of—

(A) the tax imposed by this section without regard to this subsection, or

(B) the sum of—

(i) the tax which would be imposed by this section if the taxable income of such child for the taxable year were reduced by the net unearned income of such child, plus

(ii) such child's share of the allocable parental tax.

(2) CHILD TO WHOM SUBSECTION APPLIES.—This subsection shall apply to any child for any taxable year if—

(A) such child—

(i) has not attained age 18 before the close of the taxable year, or

(ii)(I) has attained age 18 before the close of the taxable year and meets the age requirements of section 152(c)(3) (determined without regard to subparagraph (B) thereof), and

(II) whose earned income (as defined in section 911(d)(2)) for such taxable year does not exceed one-half of the amount of the individual's support (within the meaning of section 152(c)(1)(D) after the application of section 152(f)(5) (without regard to subparagraph (A) thereof)) for such taxable year,

(B) either parent of such child is alive at the close of the taxable year, and

(C) such child does not file a joint return for the taxable year.

(3) ALLOCABLE PARENTAL TAX.—For purposes of this subsection—

(A) IN GENERAL.—The term "allocable parental tax" means the excess of—

(i) the tax which would be imposed by this section on the parent's taxable income if such income included the net unearned income of all children of the parent to whom this subsection applies, over

(ii) the tax imposed by this section on the parent without regard to this subsection.

For purposes of clause (i), net unearned income of all children of the parent shall not be taken into account in computing any exclusion, deduction, or credit of the parent.

(B) CHILD'S SHARE.—A child's share of any allocable parental tax of a parent shall be equal to an amount which bears the same ratio to the total allocable parental tax as the child's net unearned income bears to the aggregate net unearned income of all children of such parent to whom this subsection applies.

(C) SPECIAL RULE WHERE PARENT HAS DIFFERENT TAXABLE YEAR.—Except as provided in regulations, if the parent does not have the same taxable year as the child, the allocable parental tax shall be determined on the basis of the taxable year of the parent ending in the child's taxable year.

(4) NET UNEARNED INCOME.—For purposes of this subsection—

(A) IN GENERAL.—The term "net unearned income" means the excess of—

(i) the portion of the adjusted gross income for the taxable year which is not attributable to earned income (as defined in section 911(d)(2)), over

(ii) the sum of—

(I) the amount in effect for the taxable year under section 63(c)(5)(A) (relating to limitation on standard deduction in the case of certain dependents), plus

(II) the greater of the amount described in subclause (I) or, if the child itemizes his deductions for the taxable year, the amount of the itemized deductions allowed by this chapter for the taxable year which are directly connected with the production of the portion of adjusted gross income referred to in clause (i).

(B) LIMITATION BASED ON TAXABLE INCOME.—The amount of the net unearned income for any taxable year shall not exceed the individual's taxable income for such taxable year.

(C) TREATMENT OF DISTRIBUTIONS FROM QUALIFIED DISABILITY TRUSTS.—For purposes of this subsection, in the case of any child who is a beneficiary of a qualified disability trust (as defined in section 642(b)(2)(C)(ii)), any amount included in the income of such child under sections 652 and 662 during a taxable year shall be considered earned income of such child for such taxable year.

(5) SPECIAL RULES FOR DETERMINING PARENT TO WHOM SUBSECTION APPLIES.—For purposes of this subsection, the parent whose taxable income shall be taken into account shall be—

(A) in the case of parents who are not married (within the meaning of section 7703), the custodial parent (within the meaning of section 152(e)) of the child, and

(B) in the case of married individuals filing separately, the individual with the greater taxable income.

(6) PROVIDING OF PARENT'S TIN.—The parent of any child to whom this subsection applies for any taxable year shall provide the TIN of such parent to such child and such child shall include such TIN on the child's return of tax imposed by this section for such taxable year.

(7) ELECTION TO CLAIM CERTAIN UNEARNED INCOME OF CHILD ON PARENT'S RETURN.—

(A) IN GENERAL.—If—

(i) any child to whom this subsection applies has gross income for the taxable year only from interest and dividends (including Alaska Permanent Fund dividends),

(ii) such gross income is more than the amount described in paragraph (4)(A)(ii)(I) and less than 10 times the amount so described,

(iii) no estimated tax payments for such year are made in the name and TIN of such child, and no amount has been deducted and withheld under section 3406, and

(iv) the parent of such child (as determined under paragraph (5)) elects the application of subparagraph (B),

such child shall be treated (other than for purposes of this paragraph) as having no gross income for such year and shall not be required to file a return under section 6012.

(B) INCOME INCLUDED ON PARENT'S RETURN.—In the case of a parent making the election under this paragraph—

(i) the gross income of each child to whom such election applies (to the extent the gross income of such child exceeds twice the amount described in paragraph (4)(A)(ii)(I)) shall be included in such parent's gross income for the taxable year,

(ii) the tax imposed by this section for such year with respect to such parent shall be the amount equal to the sum of—

(I) the amount determined under this section after the application of clause (i), plus

(II) for each such child, 10 percent of the lesser of the amount described in paragraph (4)(A)(ii)(I) or the excess of the gross income of such child over the amount so described, and

(iii) any interest which is an item of tax preference under section 57(a)(5) of the child shall be treated as an item of tax preference of such parent (and not of such child).

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

(h) MAXIMUM CAPITAL GAINS RATE.—

(1) IN GENERAL.—If a taxpayer has a net capital gain for any taxable year, the tax imposed by this section for such taxable year shall not exceed the sum of—

(A) a tax computed at the rates and in the same manner as if this subsection had not been enacted on the greater of—

(i) taxable income reduced by the net capital gain; or

(ii) the lesser of—

(I) the amount of taxable income taxed at a rate below 25 percent; or

(II) taxable income reduced by the adjusted net capital gain;

(B) 0 percent of so much of the adjusted net capital gain (or, if less, taxable income) as does not exceed the excess (if any) of—

(i) the amount of taxable income which would (without regard to this paragraph) be taxed at a rate below 25 percent, over

(ii) the taxable income reduced by the adjusted net capital gain;

(C) 15 percent of the lesser of—

(i) so much of the adjusted net capital gain (or, if less, taxable income) as exceeds the amount on which a tax is determined under subparagraph (B), or

(ii) the excess of—

(I) the amount of taxable income which would (without regard to this paragraph) be taxed at a rate below 39.6 percent, over

(II) the sum of the amounts on which a tax is determined under subparagraphs (A) and (B),

(D) 20 percent of the adjusted net capital gain (or, if less, taxable income) in excess of the sum of the amounts on which tax is determined under subparagraphs (B) and (C),

(E) 25 percent of the excess (if any) of—

(i) the unrecaptured section 1250 gain (or, if less, the net capital gain (determined without regard to paragraph (11))), over

(ii) the excess (if any) of—

(I) the sum of the amount on which tax is determined under subparagraph (A) plus the net capital gain, over

(II) taxable income; and

(F) 28 percent of the amount of taxable income in excess of the sum of the amounts on which tax is determined under the preceding subparagraphs of this paragraph.

(2) NET CAPITAL GAIN TAKEN INTO ACCOUNT AS INVESTMENT INCOME.—For purposes of this subsection, the net capital gain for any taxable year shall be reduced (but not below zero) by the amount which the taxpayer takes into account as investment income under section 163(d)(4)(B)(iii).

(3) ADJUSTED NET CAPITAL GAIN.—For purposes of this subsection, the term "adjusted net capital gain" means the sum of—

(A) net capital gain (determined without regard to paragraph (11)) reduced (but not below zero) by the sum of—

(i) unrecaptured section 1250 gain, and

(ii) 28-percent rate gain, plus

(B) qualified dividend income (as defined in paragraph (11)).

(4) 28-PERCENT RATE GAIN.—For purposes of this subsection, the term "28-percent rate gain" means the excess (if any) of—

(A) the sum of—

(i) collectibles gain; and

(ii) section 1202 gain, over

(B) the sum of—

(i) collectibles loss;

(ii) the net short-term capital loss; and

(iii) the amount of long-term capital loss carried under section 1212(b)(1)(B) to the taxable year.

(5) COLLECTIBLES GAIN AND LOSS.—For purposes of this subsection—

(A) IN GENERAL.—The terms "collectibles gain" and "collectibles loss" mean gain or loss (respectively) from the sale or exchange of a collectible (as defined in section 408(m) without regard to paragraph (3) thereof) which is a capital asset held for more than 1 year but only to the extent such gain is taken into account in computing gross income and such loss is taken into account in computing taxable income.

(B) PARTNERSHIPS, ETC..—For purposes of subparagraph (A), any gain from the sale of an interest in a partnership, S corporation, or trust which is attributable to unrealized appreciation in the value of collectibles shall be treated as gain from the sale or exchange of a collectible. Rules similar to the rules of section 751 shall apply for purposes of the preceding sentence.

(6) UNRECAPTURED SECTION 1250 GAIN.—For purposes of this subsection—

(A) IN GENERAL.—The term "unrecaptured section 1250 gain" means the excess (if any) of—

(i) the amount of long-term capital gain (not otherwise treated as ordinary income) which would be treated as ordinary income if section 1250(b)(1) included all depreciation and the applicable percentage under section 1250(a) were 100 percent, over

(ii) the excess (if any) of—

(I) the amount described in paragraph (4)(B); over

(II) the amount described in paragraph (4)(A).

(B) LIMITATION WITH RESPECT TO SECTION 1231 PROPERTY.—The amount described in subparagraph (A)(i) from sales, exchanges, and conversions described in section 1231(a)(3)(A) for any taxable year shall not exceed the net section 1231 gain (as defined in section 1231(c)(3)) for such year.

(7) SECTION 1202 GAIN.—For purposes of this subsection, the term "section 1202 gain" means the excess of—

(A) the gain which would be excluded from gross income under section 1202 but for the percentage limitation in section 1202(a), over

(B) the gain excluded from gross income under section 1202.

(8) COORDINATION WITH RECAPTURE OF NET ORDINARY LOSSES UNDER SECTION 1231.—If any amount is treated as ordinary income under section 1231(c), such amount shall be allocated among the separate categories of net section 1231 gain (as defined in section 1231(c)(3)) in such manner as the Secretary may by forms or regulations prescribe.

(9) REGULATIONS.—The Secretary may prescribe such regulations as are appropriate (including regulations requiring reporting) to apply this subsection in the case of sales and exchanges by pass-thru entities and of interests in such entities.

(10) PASS-THRU ENTITY DEFINED.—For purposes of this subsection, the term "pass-thru entity" means—

(A) a regulated investment company;

(B) a real estate investment trust;

(C) an S corporation;

(D) a partnership;

(E) an estate or trust;

(F) a common trust fund; and

(G) a qualified electing fund (as defined in section 1295).

(11) DIVIDENDS TAXED AS NET CAPITAL GAIN.—

(A) IN GENERAL.—For purposes of this subsection, the term "net capital gain" means net capital gain (determined without regard to this paragraph) increased by qualified dividend income.

(B) QUALIFIED DIVIDEND INCOME.—For purposes of this paragraph—

(i) IN GENERAL.—The term "qualified dividend income" means dividends received during the taxable year from—

(I) domestic corporations, and

(II) qualified foreign corporations.

(ii) CERTAIN DIVIDENDS EXCLUDED.—Such term shall not include—

(I) any dividend from a corporation which for the taxable year of the corporation in which the distribution is made, or the preceding taxable year, is a corporation exempt from tax under section 501 or 521,

(II) any amount allowed as a deduction under section 591 (relating to deduction for dividends paid by mutual savings banks, etc.), and

(III) any dividend described in section 404(k).

(iii) COORDINATION WITH SECTION 246(C).—Such term shall not include any dividend on any share of stock—

(I) with respect to which the holding period requirements of section 246(c) are not met (determined by substituting in section 246(c) "60 days"

for "45 days" each place it appears and by substituting "121-day period" for "91-day period"), or

(II) to the extent that the taxpayer is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

(C) QUALIFIED FOREIGN CORPORATIONS.—

(i) IN GENERAL.—Except as otherwise provided in this paragraph, the term "qualified foreign corporation" means any foreign corporation if—

(I) such corporation is incorporated in a possession of the United States, or

(II) such corporation is eligible for benefits of a comprehensive income tax treaty with the United States which the Secretary determines is satisfactory for purposes of this paragraph and which includes an exchange of information program.

(ii) DIVIDENDS ON STOCK READILY TRADABLE ON UNITED STATES SECURITIES MARKET.—A foreign corporation not otherwise treated as a qualified foreign corporation under clause (i) shall be so treated with respect to any dividend paid by such corporation if the stock with respect to which such dividend is paid is readily tradable on an established securities market in the United States.

(iii) EXCLUSION OF DIVIDENDS OF CERTAIN FOREIGN CORPORATIONS.—Such term shall not include—

(I) any foreign corporation which for the taxable year of the corporation in which the dividend was paid, or the preceding taxable year, is a passive foreign investment company (as defined in section 1297), and

(II) any corporation which first becomes a surrogate foreign corporation (as defined in section 7874(a)(2)(B)) after the date of the enactment of this subclause, other than a foreign corporation which is treated as a domestic corporation under section 7874(b).

(iv) COORDINATION WITH FOREIGN TAX CREDIT LIMITATION.—Rules similar to the rules of section 904(b)(2)(B) shall apply with respect to the dividend rate differential under this paragraph.

(D) SPECIAL RULES.—

(i) AMOUNTS TAKEN INTO ACCOUNT AS INVESTMENT INCOME.—Qualified dividend income shall not include any amount which the taxpayer takes into account as investment income under section 163(d)(4)(B).

(ii) EXTRAORDINARY DIVIDENDS.—If a taxpayer to whom this section applies receives, with respect to any share of stock, qualified dividend income from 1 or more dividends which are extraordinary dividends (within the meaning of section 1059(c)), any loss on the sale or exchange of such share shall, to the extent of such dividends, be treated as long-term capital loss.

(iii) TREATMENT OF DIVIDENDS FROM REGULATED INVESTMENT COMPANIES AND REAL ESTATE INVESTMENT TRUSTS.—A dividend received from a regulated investment company or a real estate investment trust shall be subject to the limitations prescribed in sections 854 and 857.

(i) RATE REDUCTIONS AFTER 2000.—

(1) 10-PERCENT RATE BRACKET.—

(A) IN GENERAL.—In the case of taxable years beginning after December 31, 2000—

(i) the rate of tax under subsections (a), (b), (c), and (d) on taxable income not over the initial bracket amount shall be 10 percent, and

(ii) the 15 percent rate of tax shall apply only to taxable income over the initial bracket amount but not over the maximum dollar amount for the 15-percent rate bracket.

(B) INITIAL BRACKET AMOUNT.—For purposes of this paragraph, the initial bracket amount is—

(i) $14,000 in the case of subsection (a),

(ii) $10,000 in the case of subsection (b), and

(iii) 1/2 the amount applicable under clause (i) (after adjustment, if any, under subparagraph (C)) in the case of subsections (c) and (d).

(C) INFLATION ADJUSTMENT.—In prescribing the tables under subsection (f) which apply with respect to taxable years beginning in calendar years after 2003—

(i) the cost-of-living adjustment shall be determined under subsection (f)(3) by substituting "2002" for "2016" in subparagraph (A)(ii) thereof, and

(ii) the adjustments under clause (i) shall not apply to the amount referred to in subparagraph (B)(iii).

If any amount after adjustment under the preceding sentence is not a multiple of $50, such amount shall be rounded to the next lowest multiple of $50.

(2) 25-, 28-, AND 33-PERCENT RATE BRACKETS.—The tables under subsections (a), (b), (c), (d), and (e) shall be applied—

(A) by substituting "25%" for "28%" each place it appears (before the application of subparagraph (B)),

(B) by substituting "28%" for "31%" each place it appears, and

(C) by substituting "33%" for "36%" each place it appears.

(3) MODIFICATIONS TO INCOME TAX BRACKETS FOR HIGH-INCOME TAXPAYERS.—

(A) 35-PERCENT RATE BRACKET.—In the case of taxable years beginning after December 31, 2012—

(i) the rate of tax under subsections (a), (b), (c), and (d) on a taxpayer's taxable income in the highest rate bracket shall be 35 percent to the extent such income does not exceed an amount equal to the excess of—

(I) the applicable threshold, over

(II) the dollar amount at which such bracket begins, and

(ii) the 39.6 percent rate of tax under such subsections shall apply only to the taxpayer's taxable income in such bracket in excess of the amount to which clause (i) applies.

(B) APPLICABLE THRESHOLD.—For purposes of this paragraph, the term "applicable threshold" means—

(i) $450,000 in the case of subsection (a),

(ii) $425,000 in the case of subsection (b),

(iii) $400,000 in the case of subsection (c), and

(iv) 1/2 the amount applicable under clause (i) (after adjustment, if any, under subparagraph (C)) in the case of subsection (d).

(C) INFLATION ADJUSTMENT.—For purposes of this paragraph, with respect to taxable years beginning in calendar years after 2013, each of the dollar amounts under clauses (i), (ii), and (iii) of subparagraph (B) shall be adjusted in the same manner as under paragraph (1)(C)(i), except that subsection (f)(3)(A)(ii) shall be applied by substituting "2012" for "2016".

(4) ADJUSTMENT OF TABLES.—The Secretary shall adjust the tables prescribed under subsection (f) to carry out this subsection.

(j) MODIFICATIONS FOR TAXABLE YEARS 2018 THROUGH 2025.—

(1) IN GENERAL.—In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026—

(A) subsection (i) shall not apply, and

(B) this section (other than subsection (i)) shall be applied as provided in paragraphs (2) through (6).

(2) RATE TABLES.—

(A) MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES.—The following table shall be applied in lieu of the table contained in subsection (a):

(B) HEADS OF HOUSEHOLDS.—The following table shall be applied in lieu of the table contained in subsection (b):

(C) UNMARRIED INDIVIDUALS OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS.—The following table shall be applied in lieu of the table contained in subsection (c):

(D) MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—The following table shall be applied in lieu of the table contained in subsection (d):

(E) ESTATES AND TRUSTS.—The following table shall be applied in lieu of the table contained in subsection (e):

(F) REFERENCES TO RATE TABLES.—Any reference in this title to a rate of tax under subsection (c) shall be treated as a reference to the corresponding rate bracket under subparagraph (C) of this paragraph, except that the reference in section 3402(q)(1) to the third lowest rate of tax applicable under subsection (c) shall be treated as a reference to the fourth lowest rate of tax under subparagraph (C).

(3) ADJUSTMENTS.—

(A) NO ADJUSTMENT IN 2018.—The tables contained in paragraph (2) shall apply without adjustment for taxable years beginning after December 31, 2017, and before January 1, 2019.

(B) SUBSEQUENT YEARS.—For taxable years beginning after December 31, 2018, the Secretary shall prescribe tables which shall apply in lieu of the tables contained in paragraph (2) in the same manner as under paragraphs (1) and (2) of subsection (f) (applied without regard to clauses (i) and (ii) of subsection (f)(2)(A)), except that in prescribing such tables—

(i) subsection (f)(3) shall be applied by substituting "calendar year 2017" for "calendar year 2016" in subparagraph (A)(ii) thereof,

(ii) subsection (f)(7)(B) shall apply to any unmarried individual other than a surviving spouse or head of household, and

(iii) subsection (f)(8) shall not apply.

(4) SPECIAL RULES FOR CERTAIN CHILDREN WITH UNEARNED INCOME.—

(A) IN GENERAL.—In the case of a child to whom subsection (g) applies for the taxable year, the rules of subparagraphs (B) and (C) shall apply in lieu of the rule under subsection (g)(1).

(B) MODIFICATIONS TO APPLICABLE RATE BRACKETS.—In determining the amount of tax imposed by this section for the taxable year on a child described in subparagraph (A), the income tax table otherwise applicable under this subsection to the child shall be applied with the following modifications:

(i) 24-PERCENT BRACKET.—The maximum taxable income which is taxed at a rate below 24 percent shall not be more than the sum of—

(I) the earned taxable income of such child, plus

(II) the minimum taxable income for the 24-percent bracket in the table under paragraph (2)(E) (as adjusted under paragraph (3)) for the taxable year.

(ii) 35-PERCENT BRACKET.—The maximum taxable income which is taxed at a rate below 35 percent shall not be more than the sum of—

(I) the earned taxable income of such child, plus

(II) the minimum taxable income for the 35-percent bracket in the table under paragraph (2)(E) (as adjusted under paragraph (3)) for the taxable year.

(iii) 37-PERCENT BRACKET.—The maximum taxable income which is taxed at a rate below 37 percent shall not be more than the sum of—

(I) the earned taxable income of such child, plus

(II) the minimum taxable income for the 37-percent bracket in the table under paragraph (2)(E) (as adjusted under paragraph (3)) for the taxable year.

(C) COORDINATION WITH CAPITAL GAINS RATES.—For purposes of applying section 1(h) (after the modifications under paragraph (5)(A))—

(i) the maximum zero rate amount shall not be more than the sum of—

(I) the earned taxable income of such child, plus

(II) the amount in effect under paragraph (5)(B)(i)(IV) for the taxable year, and

(ii) the maximum 15-percent rate amount shall not be more than the sum of—

(I) the earned taxable income of such child, plus

(II) the amount in effect under paragraph (5)(B)(ii)(IV) for the taxable year.

(D) EARNED TAXABLE INCOME.—For purposes of this paragraph, the term "earned taxable income" means, with respect to any child for any taxable year, the taxable income of such child reduced (but not below zero) by the net unearned income (as defined in subsection (g)(4)) of such child.

(5) APPLICATION OF CURRENT INCOME TAX BRACKETS TO CAPITAL GAINS BRACKETS.—

(A) IN GENERAL.—Section 1(h)(1) shall be applied—

(i) by substituting "below the maximum zero rate amount" for "which would (without regard to this paragraph) be taxed at a rate below 25 percent" in subparagraph (B)(i), and

(ii) by substituting "below the maximum 15-percent rate amount" for "which would (without regard to this paragraph) be taxed at a rate below 39.6 percent" in subparagraph (C)(ii)(I).

(B) MAXIMUM AMOUNTS DEFINED.—For purposes of applying section 1(h) with the modifications described in subparagraph (A)—

(i) MAXIMUM ZERO RATE AMOUNT.—The maximum zero rate amount shall be—

(I) in the case of a joint return or surviving spouse, $77,200,

(II) in the case of an individual who is a head of household (as defined in section 2(b)), $51,700,

(III) in the case of any other individual (other than an estate or trust), an amount equal to 1/2 of the amount in effect for the taxable year under subclause (I), and

(IV) in the case of an estate or trust, $2,600.

(ii) MAXIMUM 15-PERCENT RATE AMOUNT.—The maximum 15-percent rate amount shall be—

(I) in the case of a joint return or surviving spouse, $479,000 (1/2 such amount in the case of a married individual filing a separate return),

(II) in the case of an individual who is the head of a household (as defined in section 2(b)), $452,400,

(III) in the case of any other individual (other than an estate or trust), $425,800, and

(IV) in the case of an estate or trust, $12,700.

(C) INFLATION ADJUSTMENT.—In the case of any taxable year beginning after 2018, each of the dollar amounts in clauses (i) and (ii) of subparagraph (B) shall be increased by an amount equal to—

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under subsection (f)(3) for the calendar year in which the taxable year begins, determined by substituting "calendar year 2017" for "calendar year 2016" in subparagraph (A)(ii) thereof.

If any increase under this subparagraph is not a multiple of $50, such increase shall be rounded to the next lowest multiple of $50.

(6) SECTION 15 NOT TO APPLY.—Section 15 shall not apply to any change in a rate of tax by reason of this subsection.

SEC. 2. DEFINITIONS AND SPECIAL RULES.

(a) DEFINITION OF SURVIVING SPOUSE.—

(1) IN GENERAL.—For purposes of section 1, the term "surviving spouse" means a taxpayer—

(A) whose spouse died during either of [his two taxable years] *the taxpayer's two taxable years* immediately preceding the taxable year, and

(B) who maintains as [his home] *the taxpayer's home* a household which constitutes for the taxable year the principal place of abode (as a member of such household) of a dependent (i) who (within the meaning of section 152, determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B) thereof) is a son, stepson, daughter, or stepdaughter of the taxpayer, and (ii) with respect to whom the taxpayer is entitled to a deduction for the taxable year under section 151.

For purposes of this paragraph, an individual shall be considered as maintaining a household only if over half of the cost of maintaining the household during the taxable year is furnished by such individual.

(2) LIMITATIONS.—Notwithstanding paragraph (1), for purposes of section 1 a taxpayer shall not be considered to be a surviving spouse—

(A) if the taxpayer has remarried at any time before the close of the taxable year, or

(B) unless, for the taxpayer's taxable year during which [his spouse] *the taxpayer's spouse* died, a joint return could have been made under the provisions of section 6013 (without regard to subsection (a)(3) thereof).

(3) SPECIAL RULE WHERE DECEASED SPOUSE WAS IN MISSING STATUS.—If an individual was in a missing status (within the meaning of section 6013(f)(3)) as a result of service in a combat zone (as determined for purposes of section 112) and if such individual remains in such status until the date referred to in subparagraph (A) or (B), then, for purposes of paragraph (1)(A), the date on which such individual died shall be treated as the earlier of the date determined under subparagraph (A) or the date determined under subparagraph (B):

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

(B) except in the case of the combat zone designated for purposes of the Vietnam conflict, the date which is 2 years

after the date designated under section 112 as the date of termination of combatant activities in that zone.

(b) DEFINITION OF HEAD OF HOUSEHOLD.—

(1) IN GENERAL.—For purposes of this subtitle, an individual shall be considered a head of a household if, and only if, such individual is not married at the close of his taxable year, is not a surviving spouse (as defined in subsection (a)), and either—

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

(i) a qualifying child of the individual (as defined in section 152(c), determined without regard to section 152(e)), but not if such child—

(I) is married at the close of the taxpayer's taxable year, and

(II) is not a dependent of such individual by reason of section 152(b)(2) or 152(b)(3), or both, or

(ii) any other person who is a dependent of the taxpayer, if the taxpayer is entitled to a deduction for the taxable year for such person under section 151, or

(B) maintains a household which constitutes for such taxable year the principal place of abode of the father or mother of the taxpayer, if the taxpayer is entitled to a deduction for the taxable year for such father or mother under section 151.

For purposes of this paragraph, an individual shall be considered as maintaining a household only if over half of the cost of maintaining the household during the taxable year is furnished by such individual.

(2) DETERMINATION OF STATUS.—For purposes of this subsection—

(A) an individual who is legally separated from [his spouse] *the individual's spouse* under a decree of divorce or of separate maintenance shall not be considered as married;

(B) a taxpayer shall be considered as not married at the close of [his taxable year] *the taxpayer's taxable year* if at any time during the taxable year [his spouse] *the taxpayer's spouse* is a nonresident alien; and

(C) a taxpayer shall be considered as married at the close of [his taxable year] *the taxpayer's taxable year* if [his spouse] *the taxpayer's spouse* (other than a spouse described in subparagraph (B)) died during the taxable year.

(3) LIMITATIONS.—Notwithstanding paragraph (1), for purposes of this subtitle a taxpayer shall not be considered to be a head of a household—

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

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

(i) subparagraph (H) of section 152(d)(2), or

(ii) paragraph (3) of section 152(d).

(c) CERTAIN MARRIED INDIVIDUALS LIVING APART.—For purposes of this part, an individual shall be treated as not married at the

close of the taxable year if such individual is so treated under the provisions of section 7703(b).

(d) NONRESIDENT ALIENS.—In the case of a nonresident alien individual, the taxes imposed by sections 1 and 55 shall apply only as provided by section 871 or 877.

(e) CROSS REFERENCE.—For definition of taxable income, see section 63.

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PART IV—CREDITS AGAINST TAX

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Subpart A—NONREFUNDABLE PERSONAL CREDITS

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SEC. 21. EXPENSES FOR HOUSEHOLD AND DEPENDENT CARE SERVICES NECESSARY FOR GAINFUL EMPLOYMENT.

(a) ALLOWANCE OF CREDIT.—

(1) IN GENERAL.—In the case of an individual for which there are 1 or more qualifying individuals (as defined in subsection (b)(1)) with respect to such individual, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the applicable percentage of the employment-related expenses (as defined in subsection (b)(2)) paid by such individual during the taxable year.

(2) APPLICABLE PERCENTAGE DEFINED.—For purposes of paragraph (1), the term "applicable percentage" means 35 percent reduced (but not below 20 percent) by 1 percentage point for each $2,000 (or fraction thereof) by which the taxpayer's adjusted gross income for the taxable year exceeds $15,000.

(b) DEFINITIONS OF QUALIFYING INDIVIDUAL AND EMPLOYMENT-RELATED EXPENSES.—For purposes of this section—

(1) QUALIFYING INDIVIDUAL.—The term "qualifying individual" means—

(A) a dependent of the taxpayer (as defined in section 152(a)(1)) who has not attained age 13,

(B) a dependent of the taxpayer (as defined in section 152, determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B)) who is physically or mentally incapable of caring for himself or herself and who has the same principal place of abode as the taxpayer for more than one-half of such taxable year, or

(C) the spouse of the taxpayer, if the spouse is physically or mentally incapable of caring for himself or herself and who has the same principal place of abode as the taxpayer for more than one-half of such taxable year.

(2) EMPLOYMENT-RELATED EXPENSES.—

(A) IN GENERAL.—The term "employment-related expenses" means amounts paid for the following expenses, but only if such expenses are incurred to enable the taxpayer to be gainfully employed for any period for which there are 1 or more qualifying individuals with respect to the taxpayer:

(i) expenses for household services, and

(ii) expenses for the care of a qualifying individual.

Such term shall not include any amount paid for services outside the taxpayer's household at a camp where the qualifying individual stays overnight.

(B) EXCEPTION.—Employment-related expenses described in subparagraph (A) which are incurred for services outside the taxpayer's household shall be taken into account only if incurred for the care of—

(i) a qualifying individual described in paragraph (1)(A), or

(ii) a qualifying individual (not described in paragraph (1)(A)) who regularly spends at least 8 hours each day in the taxpayer's household.

(C) DEPENDENT CARE CENTERS.—Employment-related expenses described in subparagraph (A) which are incurred for services provided outside the taxpayer's household by a dependent care center (as defined in subparagraph (D)) shall be taken into account only if—

(i) such center complies with all applicable laws and regulations of a State or unit of local government, and

(ii) the requirements of subparagraph (B) are met.

(D) DEPENDENT CARE CENTER DEFINED.—For purposes of this paragraph, the term "dependent care center" means any facility which—

(i) provides care for more than six individuals (other than individuals who reside at the facility), and

(ii) receives a fee, payment, or grant for providing services for any of the individuals (regardless of whether such facility is operated for profit).

(c) DOLLAR LIMIT ON AMOUNT CREDITABLE.—The amount of the employment-related expenses incurred during any taxable year which may be taken into account under subsection (a) shall not exceed—

(1) $3,000 if there is 1 qualifying individual with respect to the taxpayer for such taxable year, or

(2) $6,000 if there are 2 or more qualifying individuals with respect to the taxpayer for such taxable year.

The amount determined under paragraph (1) or (2) (whichever is applicable) shall be reduced by the aggregate amount excludable from gross income under section 129 for the taxable year.

(d) EARNED INCOME LIMITATION.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amount of the employment-related expenses incurred during any taxable year which may be taken into account under subsection (a) shall not exceed—

(A) in the case of an individual who is not married at the close of such year, such individual's earned income for such year, or

(B) in the case of an individual who is married at the close of such year, the lesser of such individual's earned income or the earned income of [his spouse] *the individual's spouse* for such year.

(2) SPECIAL RULE FOR SPOUSE WHO IS A STUDENT OR INCAPABLE OF CARING FOR [HIMSELF] *SELF*.—In the case of a spouse who is a student or a qualifying individual described in subsection (b)(1)(C), for purposes of paragraph (1), such spouse

shall be deemed for each month during which such spouse is a full-time student at an educational institution, or is such a qualifying individual, to be gainfully employed and to have earned income of not less than—

(A) $250 if subsection (c)(1) applies for the taxable year, or

(B) $500 if subsection (c)(2) applies for the taxable year.

In the case of [any husband and wife] *any married couple*, this paragraph shall apply with respect to only one spouse for any one month.

(e) SPECIAL RULES.—For purposes of this section—

(1) PLACE OF ABODE.—An individual shall not be treated as having the same principal place of abode of the taxpayer if at any time during the taxable year of the taxpayer the relationship between the individual and the taxpayer is in violation of local law.

(2) MARRIED COUPLES MUST FILE JOINT RETURN.—If the taxpayer is married at the close of the taxable year, the credit shall be allowed under subsection (a) only if the taxpayer and [his spouse] *the taxpayer's spouse* file a joint return for the taxable year.

(3) MARITAL STATUS.—An individual legally separated from [his spouse] *the individual's spouse* under a decree of divorce or of separate maintenance shall not be considered as married.

(4) CERTAIN MARRIED INDIVIDUALS LIVING APART.—If—

(A) an individual who is married and who files a separate return—

(i) maintains as [his home] *the individual's home* a household which constitutes for more than one-half of the taxable year the principal place of abode of a qualifying individual, and

(ii) furnishes over half of the cost of maintaining such household during the taxable year, and

(B) during the last 6 months of such taxable year such individual's spouse is not a member of such household,

such individual shall not be considered as married.

(5) SPECIAL DEPENDENCY TEST IN CASE OF DIVORCED PARENTS, ETC..—If—

(A) section 152(e) applies to any child with respect to any calendar year, and

(B) such child is under the age of 13 or is physically or mentally incapable of caring for himself,

in the case of any taxable year beginning in such calendar year, such child shall be treated as a qualifying individual described in subparagraph (A) or (B) of subsection (b)(1) (whichever is appropriate) with respect to the custodial parent (as defined in section 152(e)(4)(A)), and shall not be treated as a qualifying individual with respect to the noncustodial parent.

(6) PAYMENTS TO RELATED INDIVIDUALS.—No credit shall be allowed under subsection (a) for any amount paid by the taxpayer to an individual—

(A) with respect to whom, for the taxable year, a deduction under section 151(c) (relating to deduction for personal exemptions for dependents) is allowable either to the taxpayer or [his spouse] *the taxpayer's spouse*, or

(B) who is a child of the taxpayer (within the meaning of section 152(f)(1)) who has not attained the age of 19 at the close of the taxable year.

For purposes of this paragraph, the term "taxable year" means the taxable year of the taxpayer in which the service is performed.

(7) STUDENT.—The term "student" means an individual who during each of 5 calendar months during the taxable year is a full-time student at an educational organization.

(8) EDUCATIONAL ORGANIZATION.—The term "educational organization" means an educational organization described in section 170(b)(1)(A)(ii).

(9) IDENTIFYING INFORMATION REQUIRED WITH RESPECT TO SERVICE PROVIDER.—No credit shall be allowed under subsection (a) for any amount paid to any person unless—

(A) the name, address, and taxpayer identification number of such person are included on the return claiming the credit, or

(B) if such person is an organization described in section 501(c)(3) and exempt from tax under section 501(a), the name and address of such person are included on the return claiming the credit.

In the case of a failure to provide the information required under the preceding sentence, the preceding sentence shall not apply if it is shown that the taxpayer exercised due diligence in attempting to provide the information so required.

(10) IDENTIFYING INFORMATION REQUIRED WITH RESPECT TO QUALIFYING INDIVIDUALS.—No credit shall be allowed under this section with respect to any qualifying individual unless the TIN of such individual is included on the return claiming the credit.

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

SEC. 22. CREDIT FOR THE ELDERLY AND THE PERMANENTLY AND TOTALLY DISABLED.

(a) GENERAL RULE.—In the case of a qualified individual, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to 15 percent of such individual's section 22 amount for such taxable year.

(b) QUALIFIED INDIVIDUAL.—For purposes of this section, the term "qualified individual" means any individual—

(1) who has attained age 65 before the close of the taxable year, or

(2) who retired on disability before the close of the taxable year and who, when he retired, was permanently and totally disabled.

(c) SECTION 22 AMOUNT.—For purposes of subsection (a)—

(1) IN GENERAL.—An individual's section 22 amount for the taxable year shall be the applicable initial amount determined under paragraph (2), reduced as provided in paragraph (3) and in subsection (d).

(2) INITIAL AMOUNT.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the initial amount shall be—

(i) $5,000 in the case of a single individual, or a joint return where only one spouse is a qualified individual,

(ii) $7,500 in the case of a joint return where both spouses are qualified individuals, or

(iii) $3,750 in the case of a married individual filing a separate return.

(B) LIMITATION IN CASE OF INDIVIDUALS WHO HAVE NOT ATTAINED AGE 65.—

(i) IN GENERAL.—In the case of a qualified individual who has not attained age 65 before the close of the taxable year, except as provided in clause (ii), the initial amount shall not exceed the disability income for the taxable year.

(ii) SPECIAL RULES IN CASE OF JOINT RETURN.—In the case of a joint return where both spouses are qualified individuals and at least one spouse has not attained age 65 before the close of the taxable year—

(I) if both spouses have not attained age 65 before the close of the taxable year, the initial amount shall not exceed the sum of such spouses' disability income, or

(II) if one spouse has attained age 65 before the close of the taxable year, the initial amount shall not exceed the sum of $5,000 plus the disability income for the taxable year of the spouse who has not attained age 65 before the close of the taxable year.

(iii) DISABILITY INCOME.—For purposes of this subparagraph, the term "disability income" means the aggregate amount includable in the gross income of the individual for the taxable year under section 72 or 105(a) to the extent such amount constitutes wages (or payments in lieu of wages) for the period during which the individual is absent from work on account of permanent and total disability.

(3) REDUCTION.—

(A) IN GENERAL.—The reduction under this paragraph is an amount equal to the sum of the amounts received by the individual (or, in the case of a joint return, by either spouse) as a pension or annuity or as a disability benefit—

(i) which is excluded from gross income and payable under—

(I) title II of the Social Security Act,

(II) the Railroad Retirement Act of 1974, or

(III) a law administered by the Department of Veterans Affairs, or

(ii) which is excluded from gross income under any provision of law not contained in this title.

No reduction shall be made under clause (i)(III) for any amount described in section 104(a)(4).

(B) TREATMENT OF CERTAIN WORKMEN'S COMPENSATION BENEFITS.—For purposes of subparagraph (A), any amount treated as a social security benefit under section 86(d)(3) shall be treated as a disability benefit received under title II of the Social Security Act.

(d) ADJUSTED GROSS INCOME LIMITATION.—If the adjusted gross income of the taxpayer exceeds—

(1) $7,500 in the case of a single individual,

(2) $10,000 in the case of a joint return, or

(3) $5,000 in the case of a married individual filing a separate return,

the section 22 amount shall be reduced by one-half of the excess of the adjusted gross income over $7,500, $10,000, or $5,000, as the case may be.

(e) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) MARRIED COUPLE MUST FILE JOINT RETURN.—Except in the case of a [husband and wife who live] *married couple who lives* apart at all times during the taxable year, if the taxpayer is married at the close of the taxable year, the credit provided by this section shall be allowed only if [the taxpayer and his spouse] *the taxpayer and the spouse of the taxpayer* file a joint return for the taxable year.

(2) MARITAL STATUS.—Marital status shall be determined under section 7703.

(3) PERMANENT AND TOTAL DISABILITY DEFINED.—An individual is permanently and totally disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months. An individual shall not be considered to be permanently and totally disabled unless he furnishes proof of the existence thereof in such form and manner, and at such times, as the Secretary may require.

(f) NONRESIDENT ALIEN INELIGIBLE FOR CREDIT.—No credit shall be allowed under this section to any nonresident alien.

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Subpart C—REFUNDABLE CREDITS

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SEC. 36. FIRST-TIME HOMEBUYER CREDIT.

(a) ALLOWANCE OF CREDIT.—In the case of an individual who is a first-time homebuyer of a principal residence in the United States during a taxable year, there shall be allowed as a credit against the tax imposed by this subtitle for such taxable year an amount equal to 10 percent of the purchase price of the residence.

(b) LIMITATIONS.—

(1) DOLLAR LIMITATION.—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, the credit allowed under subsection (a) shall not exceed $8,000.

(B) MARRIED INDIVIDUALS FILING SEPARATELY.—In the case of a married individual filing a separate return, subparagraph (A) shall be applied by substituting "$4,000" for "$8,000".

(C) OTHER INDIVIDUALS.—If two or more individuals who are not married purchase a principal residence, the amount of the credit allowed under subsection (a) shall be

allocated among such individuals in such manner as the Secretary may prescribe, except that the total amount of the credits allowed to all such individuals shall not exceed $8,000.

(D) SPECIAL RULE FOR LONG-TIME RESIDENTS OF SAME PRINCIPAL RESIDENCE.—In the case of a taxpayer to whom a credit under subsection (a) is allowed by reason of subsection (c)(6), subparagraphs (A), (B), and (C) shall be applied by substituting "$6,500" for "$8,000" and "$3,250" for "$4,000".

(2) LIMITATION BASED ON MODIFIED ADJUSTED GROSS INCOME.—

(A) IN GENERAL.—The amount allowable as a credit under subsection (a) (determined without regard to this paragraph) for the taxable year shall be reduced (but not below zero) by the amount which bears the same ratio to the amount which is so allowable as—

(i) the excess (if any) of—

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

(II) $125,000 ($225,000 in the case of a joint return), bears to

(ii) $20,000.

(B) MODIFIED ADJUSTED GROSS INCOME.—For purposes of subparagraph (A), the term "modified adjusted gross income" means the adjusted gross income of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911, 931, or 933.

(3) LIMITATION BASED ON PURCHASE PRICE.—No credit shall be allowed under subsection (a) for the purchase of any residence if the purchase price of such residence exceeds $800,000.

(4) AGE LIMITATION.—No credit shall be allowed under subsection (a) with respect to the purchase of any residence unless the taxpayer has attained age 18 as of the date of such purchase. In the case of any taxpayer who is married (within the meaning of section 7703), the taxpayer shall be treated as meeting the age requirement of the preceding sentence if the taxpayer or the taxpayer's spouse meets such age requirement.

(c) DEFINITIONS.—For purposes of this section—

(1) FIRST-TIME HOMEBUYER.—The term "first-time homebuyer" means any individual if such individual (and if married, such individual's spouse) had no present ownership interest in a principal residence during the 3-year period ending on the date of the purchase of the principal residence to which this section applies.

(2) PRINCIPAL RESIDENCE.—The term "principal residence" has the same meaning as when used in section 121.

(3) PURCHASE.—

(A) IN GENERAL.—The term "purchase" means any acquisition, but only if—

(i) the property is not acquired from a person related to the person acquiring such property (or, if married, such individual's spouse), and

(ii) the basis of the property in the hands of the person acquiring such property is not determined—

(I) in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or

(II) under section 1014(a) (relating to property acquired from a decedent).

(B) CONSTRUCTION.—A residence which is constructed by the taxpayer shall be treated as purchased by the taxpayer on the date the taxpayer first occupies such residence.

(4) PURCHASE PRICE.—The term "purchase price" means the adjusted basis of the principal residence on the date such residence is purchased.

(5) RELATED PERSONS.—A person shall be treated as related to another person if the relationship between such persons would result in the disallowance of losses under section 267 or 707(b) (but, in applying section 267(b) and (c) for purposes of this section, paragraph (4) of section 267(c) shall be treated as providing that the family of an individual shall include only [his spouse] *the individual's spouse* , ancestors, and lineal descendants).

(6) EXCEPTION FOR LONG-TIME RESIDENTS OF SAME PRINCIPAL RESIDENCE.—In the case of an individual (and, if married, such individual's spouse) who has owned and used the same residence as such individual's principal residence for any 5-consecutive-year period during the 8-year period ending on the date of the purchase of a subsequent principal residence, such individual shall be treated as a first-time homebuyer for purposes of this section with respect to the purchase of such subsequent residence.

(d) EXCEPTIONS.—No credit under subsection (a) shall be allowed to any taxpayer for any taxable year with respect to the purchase of a residence if—

(1) the taxpayer is a nonresident alien,

(2) the taxpayer disposes of such residence (or such residence ceases to be the principal residence of the taxpayer (and, if married, the taxpayer's spouse)) before the close of such taxable year,

(3) a deduction under section 151 with respect to such taxpayer is allowable to another taxpayer for such taxable year, or

(4) the taxpayer fails to attach to the return of tax for such taxable year a properly executed copy of the settlement statement used to complete such purchase.

(e) REPORTING.—If the Secretary requires information reporting under section 6045 by a person described in subsection (e)(2) thereof to verify the eligibility of taxpayers for the credit allowable by this section, the exception provided by section 6045(e) shall not apply.

(f) RECAPTURE OF CREDIT.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, if a credit under subsection (a) is allowed to a taxpayer, the tax imposed by this chapter shall be increased by 62/3 percent of the amount of such credit for each taxable year in the recapture period.

(2) ACCELERATION OF RECAPTURE.—If a taxpayer disposes of the principal residence with respect to which a credit was al-

lowed under subsection (a) (or such residence ceases to be the principal residence of the taxpayer (and, if married, the taxpayer's spouse)) before the end of the recapture period—

(A) the tax imposed by this chapter for the taxable year of such disposition or cessation shall be increased by the excess of the amount of the credit allowed over the amounts of tax imposed by paragraph (1) for preceding taxable years, and

(B) paragraph (1) shall not apply with respect to such credit for such taxable year or any subsequent taxable year.

(3) LIMITATION BASED ON GAIN.—In the case of the sale of the principal residence to a person who is not related to the taxpayer, the increase in tax determined under paragraph (2) shall not exceed the amount of gain (if any) on such sale. Solely for purposes of the preceding sentence, the adjusted basis of such residence shall be reduced by the amount of the credit allowed under subsection (a) to the extent not previously recaptured under paragraph (1).

(4) EXCEPTIONS.—

(A) DEATH OF TAXPAYER.—Paragraphs (1) and (2) shall not apply to any taxable year ending after the date of the taxpayer's death.

(B) INVOLUNTARY CONVERSION.—Paragraph (2) shall not apply in the case of a residence which is compulsorily or involuntarily converted (within the meaning of section 1033(a)) if the taxpayer acquires a new principal residence during the 2-year period beginning on the date of the disposition or cessation referred to in paragraph (2). Paragraph (2) shall apply to such new principal residence during the recapture period in the same manner as if such new principal residence were the converted residence.

(C) TRANSFERS BETWEEN SPOUSES OR INCIDENT TO DIVORCE.—In the case of a transfer of a residence to which section 1041(a) applies—

(i) paragraph (2) shall not apply to such transfer, and

(ii) in the case of taxable years ending after such transfer, paragraphs (1) and (2) shall apply to the transferee in the same manner as if such transferee were the transferor (and shall not apply to the transferor).

(D) WAIVER OF RECAPTURE FOR PURCHASES IN 2009 AND 2010.—In the case of any credit allowed with respect to the purchase of a principal residence after December 31, 2008—

(i) paragraph (1) shall not apply, and

(ii) paragraph (2) shall apply only if the disposition or cessation described in paragraph (2) with respect to such residence occurs during the 36-month period beginning on the date of the purchase of such residence by the taxpayer.

(E) SPECIAL RULE FOR MEMBERS OF THE ARMED FORCES, ETC..—

(i) IN GENERAL.—In the case of the disposition of a principal residence by an individual (or a cessation referred to in paragraph (2)) after December 31, 2008, in connection with Government orders received by such individual, or such individual's spouse, for qualified official extended duty service—

(I) paragraph (2) and subsection (d)(2) shall not apply to such disposition (or cessation), and

(II) if such residence was acquired before January 1, 2009, paragraph (1) shall not apply to the taxable year in which such disposition (or cessation) occurs or any subsequent taxable year.

(ii) QUALIFIED OFFICIAL EXTENDED DUTY SERVICE.—For purposes of this section, the term "qualified official extended duty service" means service on qualified official extended duty as—

(I) a member of the uniformed services,

(II) a member of the Foreign Service of the United States, or

(III) an employee of the intelligence community.

(iii) DEFINITIONS.—Any term used in this subparagraph which is also used in paragraph (9) of section 121(d) shall have the same meaning as when used in such paragraph.

(5) JOINT RETURNS.—In the case of a credit allowed under subsection (a) with respect to a joint return, half of such credit shall be treated as having been allowed to each individual filing such return for purposes of this subsection.

(6) RETURN REQUIREMENT.—If the tax imposed by this chapter for the taxable year is increased under this subsection, the taxpayer shall, notwithstanding section 6012, be required to file a return with respect to the taxes imposed under this subtitle.

(7) RECAPTURE PERIOD.—For purposes of this subsection, the term "recapture period" means the 15 taxable years beginning with the second taxable year following the taxable year in which the purchase of the principal residence for which a credit is allowed under subsection (a) was made.

(g) ELECTION TO TREAT PURCHASE IN PRIOR YEAR.—In the case of a purchase of a principal residence after December 31, 2008, a taxpayer may elect to treat such purchase as made on December 31 of the calendar year preceding such purchase for purposes of this section (other than subsections (b)(4), (c), (f)(4)(D), and (h)).

(h) APPLICATION OF SECTION.—

(1) IN GENERAL.—This section shall only apply to a principal residence purchased by the taxpayer on or after April 9, 2008, and before May 1, 2010.

(2) EXCEPTION IN CASE OF BINDING CONTRACT.—In the case of any taxpayer who enters into a written binding contract before May 1, 2010, to close on the purchase of a principal residence before July 1, 2010, and who purchases such residence before October 1, 2010, paragraph (1) shall be applied by substituting "October 1, 2010" for "May 1, 2010".

(3) SPECIAL RULE FOR INDIVIDUALS ON QUALIFIED OFFICIAL EXTENDED DUTY OUTSIDE THE UNITED STATES.—In the case of

any individual who serves on qualified official extended duty service (as defined in section 121(d)(9)(C)(i)) outside the United States for at least 90 days during the period beginning after December 31, 2008, and ending before May 1, 2010, and, if married, such individual's spouse—

(A) paragraphs (1) and (2) shall each be applied by substituting "May 1, 2011" for "May 1, 2010", and

(B) paragraph (2) shall be applied by substituting "July 1, 2011" for "July 1, 2010", and for "October 1, 2010".

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SEC. 36B. REFUNDABLE CREDIT FOR COVERAGE UNDER A QUALIFIED HEALTH PLAN.

(a) IN GENERAL.—In the case of an applicable taxpayer, there shall be allowed as a credit against the tax imposed by this subtitle for any taxable year an amount equal to the premium assistance credit amount of the taxpayer for the taxable year.

(b) PREMIUM ASSISTANCE CREDIT AMOUNT.—For purposes of this section—

(1) IN GENERAL.—The term "premium assistance credit amount" means, with respect to any taxable year, the sum of the premium assistance amounts determined under paragraph (2) with respect to all coverage months of the taxpayer occurring during the taxable year.

(2) PREMIUM ASSISTANCE AMOUNT.—The premium assistance amount determined under this subsection with respect to any coverage month is the amount equal to the lesser of—

(A) the monthly premiums for such month for 1 or more qualified health plans offered in the individual market within a State which cover the taxpayer, the taxpayer's spouse, or any dependent (as defined in section 152) of the taxpayer and which were enrolled in through an Exchange established by the State under 1311 of the Patient Protection and Affordable Care Act, or

(B) the excess (if any) of—

(i) the adjusted monthly premium for such month for the applicable second lowest cost silver plan with respect to the taxpayer, over

(ii) an amount equal to 1/12 of the product of the applicable percentage and the taxpayer's household income for the taxable year.

(3) OTHER TERMS AND RULES RELATING TO PREMIUM ASSISTANCE AMOUNTS.—For purposes of paragraph (2)—

(A) APPLICABLE PERCENTAGE.—

(i) IN GENERAL.—Except as provided in clause (ii), the applicable percentage for any taxable year shall be the percentage such that the applicable percentage for any taxpayer whose household income is within an income tier specified in the following table shall increase, on a sliding scale in a linear manner, from the initial premium percentage to the final premium percentage specified in such table for such income tier:

(ii) INDEXING.—

(I) IN GENERAL.—Subject to subclause (II), in the case of taxable years beginning in any cal-

endar year after 2014, the initial and final applicable percentages under clause (i) (as in effect for the preceding calendar year after application of this clause) shall be adjusted to reflect the excess of the rate of premium growth for the preceding calendar year over the rate of income growth for the preceding calendar year.

(II) ADDITIONAL ADJUSTMENT.—Except as provided in subclause (III), in the case of any calendar year after 2018, the percentages described in subclause (I) shall, in addition to the adjustment under subclause (I), be adjusted to reflect the excess (if any) of the rate of premium growth estimated under subclause (I) for the preceding calendar year over the rate of growth in the consumer price index for the preceding calendar year.

(III) FAILSAFE.—Subclause (II) shall apply for any calendar year only if the aggregate amount of premium tax credits under this section and cost-sharing reductions under section 1402 of the Patient Protection and Affordable Care Act for the preceding calendar year exceeds an amount equal to 0.504 percent of the gross domestic product for the preceding calendar year.

(B) APPLICABLE SECOND LOWEST COST SILVER PLAN.—The applicable second lowest cost silver plan with respect to any applicable taxpayer is the second lowest cost silver plan of the individual market in the rating area in which the taxpayer resides which—

(i) is offered through the same Exchange through which the qualified health plans taken into account under paragraph (2)(A) were offered, and

(ii) provides—

(I) self-only coverage in the case of an applicable taxpayer—

(aa) whose tax for the taxable year is determined under section 1(c) (relating to unmarried individuals other than surviving spouses and heads of households) and who is not allowed a deduction under section 151 for the taxable year with respect to a dependent, or

(bb) who is not described in item (aa) but who purchases only self-only coverage, and

(II) family coverage in the case of any other applicable taxpayer.

If a taxpayer files a joint return and no credit is allowed under this section with respect to 1 of the spouses by reason of subsection (e), the taxpayer shall be treated as described in clause (ii)(I) unless a deduction is allowed under section 151 for the taxable year with respect to a dependent other than either spouse and subsection (e) does not apply to the dependent.

(C) ADJUSTED MONTHLY PREMIUM.—The adjusted monthly premium for an applicable second lowest cost silver plan is the monthly premium which would have been charged

(for the rating area with respect to which the premiums under paragraph (2)(A) were determined) for the plan if each individual covered under a qualified health plan taken into account under paragraph (2)(A) were covered by such silver plan and the premium was adjusted only for the age of each such individual in the manner allowed under section 2701 of the Public Health Service Act. In the case of a State participating in the wellness discount demonstration project under section 2705(d) of the Public Health Service Act, the adjusted monthly premium shall be determined without regard to any premium discount or rebate under such project.

(D) ADDITIONAL BENEFITS.—If—

(i) a qualified health plan under section 1302(b)(5) of the Patient Protection and Affordable Care Act offers benefits in addition to the essential health benefits required to be provided by the plan, or

(ii) a State requires a qualified health plan under section 1311(d)(3)(B) of such Act to cover benefits in addition to the essential health benefits required to be provided by the plan,

the portion of the premium for the plan properly allocable (under rules prescribed by the Secretary of Health and Human Services) to such additional benefits shall not be taken into account in determining either the monthly premium or the adjusted monthly premium under paragraph (2).

(E) SPECIAL RULE FOR PEDIATRIC DENTAL COVERAGE.—For purposes of determining the amount of any monthly premium, if an individual enrolls in both a qualified health plan and a plan described in section 1311(d)(2)(B)(ii)(I) of the Patient Protection and Affordable Care Act for any plan year, the portion of the premium for the plan described in such section that (under regulations prescribed by the Secretary) is properly allocable to pediatric dental benefits which are included in the essential health benefits required to be provided by a qualified health plan under section 1302(b)(1)(J) of such Act shall be treated as a premium payable for a qualified health plan.

(c) DEFINITION AND RULES RELATING TO APPLICABLE TAXPAYERS, COVERAGE MONTHS, AND QUALIFIED HEALTH PLAN.—For purposes of this section—

(1) APPLICABLE TAXPAYER.—

(A) IN GENERAL.—The term "applicable taxpayer" means, with respect to any taxable year, a taxpayer whose household income for the taxable year equals or exceeds 100 percent but does not exceed 400 percent of an amount equal to the poverty line for a family of the size involved.

(B) SPECIAL RULE FOR CERTAIN INDIVIDUALS LAWFULLY PRESENT IN THE UNITED STATES.—If—

(i) a taxpayer has a household income which is not greater than 100 percent of an amount equal to the poverty line for a family of the size involved, and

(ii) the taxpayer is an alien lawfully present in the United States, but is not eligible for the medicaid pro-

gram under title XIX of the Social Security Act by reason of such alien status,

the taxpayer shall, for purposes of the credit under this section, be treated as an applicable taxpayer with a household income which is equal to 100 percent of the poverty line for a family of the size involved.

(C) MARRIED COUPLES MUST FILE JOINT RETURN.—If the taxpayer is married (within the meaning of section 7703) at the close of the taxable year, the taxpayer shall be treated as an applicable taxpayer only if the taxpayer and the taxpayer's spouse file a joint return for the taxable year.

(D) DENIAL OF CREDIT TO DEPENDENTS.—No credit shall be allowed under this section to any individual with respect to whom a deduction under section 151 is allowable to another taxpayer for a taxable year beginning in the calendar year in which such individual's taxable year begins.

(2) COVERAGE MONTH.—For purposes of this subsection—

(A) IN GENERAL.—The term "coverage month" means, with respect to an applicable taxpayer, any month if—

(i) as of the first day of such month the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer is covered by a qualified health plan described in subsection (b)(2)(A) that was enrolled in through an Exchange established by the State under section 1311 of the Patient Protection and Affordable Care Act, and

(ii) the premium for coverage under such plan for such month is paid by the taxpayer (or through advance payment of the credit under subsection (a) under section 1412 of the Patient Protection and Affordable Care Act).

(B) EXCEPTION FOR MINIMUM ESSENTIAL COVERAGE.—

(i) IN GENERAL.—The term "coverage month" shall not include any month with respect to an individual if for such month the individual is eligible for minimum essential coverage other than eligibility for coverage described in section 5000A(f)(1)(C) (relating to coverage in the individual market).

(ii) MINIMUM ESSENTIAL COVERAGE.—The term "minimum essential coverage" has the meaning given such term by section 5000A(f).

(C) SPECIAL RULE FOR EMPLOYER-SPONSORED MINIMUM ESSENTIAL COVERAGE.—For purposes of subparagraph (B)—

(i) COVERAGE MUST BE AFFORDABLE.—Except as provided in clause (iii), an employee shall not be treated as eligible for minimum essential coverage if such coverage—

(I) consists of an eligible employer-sponsored plan (as defined in section 5000A(f)(2)), and

(II) the employee's required contribution (within the meaning of section 5000A(e)(1)(B)) with respect to the plan exceeds 9.5 percent of the applicable taxpayer's household income.

This clause shall also apply to an individual who is eligible to enroll in the plan by reason of a relationship the individual bears to the employee.

(ii) COVERAGE MUST PROVIDE MINIMUM VALUE.—Except as provided in clause (iii), an employee shall not be treated as eligible for minimum essential coverage if such coverage consists of an eligible employer-sponsored plan (as defined in section 5000A(f)(2)) and the plan's share of the total allowed costs of benefits provided under the plan is less than 60 percent of such costs.

(iii) EMPLOYEE OR FAMILY MUST NOT BE COVERED UNDER EMPLOYER PLAN.—Clauses (i) and (ii) shall not apply if the employee (or any individual described in the last sentence of clause (i)) is covered under the eligible employer-sponsored plan or the grandfathered health plan.

(iv) INDEXING.—In the case of plan years beginning in any calendar year after 2014, the Secretary shall adjust the 9.5 percent under clause (i)(II) in the same manner as the percentages are adjusted under subsection (b)(3)(A)(ii).

(3) DEFINITIONS AND OTHER RULES.—

(A) QUALIFIED HEALTH PLAN.—The term "qualified health plan" has the meaning given such term by section 1301(a) of the Patient Protection and Affordable Care Act, except that such term shall not include a qualified health plan which is a catastrophic plan described in section 1302(e) of such Act.

(B) GRANDFATHERED HEALTH PLAN.—The term "grandfathered health plan" has the meaning given such term by section 1251 of the Patient Protection and Affordable Care Act.

(4) SPECIAL RULES FOR QUALIFIED SMALL EMPLOYER HEALTH REIMBURSEMENT ARRANGEMENTS.—

(A) IN GENERAL.—The term "coverage month" shall not include any month with respect to an employee (or any spouse or dependent of such employee) if for such month the employee is provided a qualified small employer health reimbursement arrangement which constitutes affordable coverage.

(B) DENIAL OF DOUBLE BENEFIT.—In the case of any employee who is provided a qualified small employer health reimbursement arrangement for any coverage month (determined without regard to subparagraph (A)), the credit otherwise allowable under subsection (a) to the taxpayer for such month shall be reduced (but not below zero) by the amount described in subparagraph (C)(i)(II) for such month.

(C) AFFORDABLE COVERAGE.—For purposes of subparagraph (A), a qualified small employer health reimbursement arrangement shall be treated as constituting affordable coverage for a month if—

(i) the excess of—

(I) the amount that would be paid by the employee as the premium for such month for self-only coverage under the second lowest cost silver plan offered in the relevant individual health insurance market, over

(II) $^{1}/_{12}$ of the employee's permitted benefit (as defined in section 9831(d)(3)(C)) under such arrangement, does not exceed—

(ii) $^{1}/_{12}$ of 9.5 percent of the employee's household income.

(D) QUALIFIED SMALL EMPLOYER HEALTH REIMBURSEMENT ARRANGEMENT.—For purposes of this paragraph, the term "qualified small employer health reimbursement arrangement" has the meaning given such term by section 9831(d)(2).

(E) COVERAGE FOR LESS THAN ENTIRE YEAR.—In the case of an employee who is provided a qualified small employer health reimbursement arrangement for less than an entire year, subparagraph (C)(i)(II) shall be applied by substituting "the number of months during the year for which such arrangement was provided" for "12".

(F) INDEXING.—In the case of plan years beginning in any calendar year after 2014, the Secretary shall adjust the 9.5 percent amount under subparagraph (C)(ii) in the same manner as the percentages are adjusted under subsection (b)(3)(A)(ii).

(d) TERMS RELATING TO INCOME AND FAMILIES.—For purposes of this section—

(1) FAMILY SIZE.—The family size involved with respect to any taxpayer shall be equal to the number of individuals for whom the taxpayer is allowed a deduction under section 151 (relating to allowance of deduction for personal exemptions) for the taxable year.

(2) HOUSEHOLD INCOME.—

(A) HOUSEHOLD INCOME.—The term "household income" means, with respect to any taxpayer, an amount equal to the sum of—

(i) the modified adjusted gross income of the taxpayer, plus

(ii) the aggregate modified adjusted gross incomes of all other individuals who—

(I) were taken into account in determining the taxpayer's family size under paragraph (1), and

(II) were required to file a return of tax imposed by section 1 for the taxable year.

(B) MODIFIED ADJUSTED GROSS INCOME.—The term "modified adjusted gross income" means adjusted gross income increased by—

(i) any amount excluded from gross income under section 911,

(ii) any amount of interest received or accrued by the taxpayer during the taxable year which is exempt from tax, and

(iii) an amount equal to the portion of the taxpayer's social security benefits (as defined in section 86(d))

which is not included in gross income under section 86 for the taxable year.

(3) POVERTY LINE.—

(A) IN GENERAL.—The term "poverty line" has the meaning given that term in section 2110(c)(5) of the Social Security Act (42 U.S.C. 1397jj(c)(5)).

(B) POVERTY LINE USED.—In the case of any qualified health plan offered through an Exchange for coverage during a taxable year beginning in a calendar year, the poverty line used shall be the most recently published poverty line as of the 1st day of the regular enrollment period for coverage during such calendar year.

(e) RULES FOR INDIVIDUALS NOT LAWFULLY PRESENT.—

(1) IN GENERAL.—If 1 or more individuals for whom a taxpayer is allowed a deduction under section 151 (relating to allowance of deduction for personal exemptions) for the taxable year (including the taxpayer or [his spouse] *the taxpayer's spouse*) are individuals who are not lawfully present—

(A) the aggregate amount of premiums otherwise taken into account under clauses (i) and (ii) of subsection (b)(2)(A) shall be reduced by the portion (if any) of such premiums which is attributable to such individuals, and

(B) for purposes of applying this section, the determination as to what percentage a taxpayer's household income bears to the poverty level for a family of the size involved shall be made under one of the following methods:

(i) A method under which—

(I) the taxpayer's family size is determined by not taking such individuals into account, and

(II) the taxpayer's household income is equal to the product of the taxpayer's household income (determined without regard to this subsection) and a fraction—

(aa) the numerator of which is the poverty line for the taxpayer's family size determined after application of subclause (I), and

(bb) the denominator of which is the poverty line for the taxpayer's family size determined without regard to subclause (I).

(ii) A comparable method reaching the same result as the method under clause (i).

(2) LAWFULLY PRESENT.—For purposes of this section, an individual shall be treated as lawfully present only if the individual is, and is reasonably expected to be for the entire period of enrollment for which the credit under this section is being claimed, a citizen or national of the United States or an alien lawfully present in the United States.

(3) SECRETARIAL AUTHORITY.—The Secretary of Health and Human Services, in consultation with the Secretary, shall prescribe rules setting forth the methods by which calculations of family size and household income are made for purposes of this subsection. Such rules shall be designed to ensure that the least burden is placed on individuals enrolling in qualified health plans through an Exchange and taxpayers eligible for the credit allowable under this section.

(f) RECONCILIATION OF CREDIT AND ADVANCE CREDIT.—

(1) IN GENERAL.—The amount of the credit allowed under this section for any taxable year shall be reduced (but not below zero) by the amount of any advance payment of such credit under section 1412 of the Patient Protection and Affordable Care Act.

(2) EXCESS ADVANCE PAYMENTS.—

(A) IN GENERAL.—If the advance payments to a taxpayer under section 1412 of the Patient Protection and Affordable Care Act for a taxable year exceed the credit allowed by this section (determined without regard to paragraph (1)), the tax imposed by this chapter for the taxable year shall be increased by the amount of such excess.

(B) LIMITATION ON INCREASE.—

(i) IN GENERAL.—In the case of a taxpayer whose household income is less than 400 percent of the poverty line for the size of the family involved for the taxable year, the amount of the increase under subparagraph (A) shall in no event exceed the applicable dollar amount determined in accordance with the following table (one-half of such amount in the case of a taxpayer whose tax is determined under section 1(c) for the taxable year):

(ii) INDEXING OF AMOUNT.—In the case of any calendar year beginning after 2014, each of the dollar amounts in the table contained under clause (i) shall be increased by an amount equal to—

(I) such dollar amount, multiplied by

(II) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year, determined by substituting "calendar year 2013" for "calendar year 2016" in subparagraph (A)(ii) thereof.

If the amount of any increase under clause (i) is not a multiple of $50, such increase shall be rounded to the next lowest multiple of $50.

(3) INFORMATION REQUIREMENT.—Each Exchange (or any person carrying out 1 or more responsibilities of an Exchange under section 1311(f)(3) or 1321(c) of the Patient Protection and Affordable Care Act) shall provide the following information to the Secretary and to the taxpayer with respect to any health plan provided through the Exchange:

(A) The level of coverage described in section 1302(d) of the Patient Protection and Affordable Care Act and the period such coverage was in effect.

(B) The total premium for the coverage without regard to the credit under this section or cost-sharing reductions under section 1402 of such Act.

(C) The aggregate amount of any advance payment of such credit or reductions under section 1412 of such Act.

(D) The name, address, and TIN of the primary insured and the name and TIN of each other individual obtaining coverage under the policy.

(E) Any information provided to the Exchange, including any change of circumstances, necessary to determine eligibility for, and the amount of, such credit.

(F) Information necessary to determine whether a taxpayer has received excess advance payments.

(g) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the provisions of this section, including regulations which provide for—

(1) the coordination of the credit allowed under this section with the program for advance payment of the credit under section 1412 of the Patient Protection and Affordable Care Act, and

(2) the application of subsection (f) where the filing status of the taxpayer for a taxable year is different from such status used for determining the advance payment of the credit.

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Subpart D—BUSINESS RELATED CREDITS

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SEC. 38. GENERAL BUSINESS CREDIT.

(a) ALLOWANCE OF CREDIT.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the sum of—

(1) the business credit carryforwards carried to such taxable year,

(2) the amount of the current year business credit, plus

(3) the business credit carrybacks carried to such taxable year.

(b) CURRENT YEAR BUSINESS CREDIT.—For purposes of this subpart, the amount of the current year business credit is the sum of the following credits determined for the taxable year:

(1) the investment credit determined under section 46,

(2) the work opportunity credit determined under section 51(a),

(3) the alcohol fuels credit determined under section 40(a),

(4) the research credit determined under section 41(a),

(5) the low-income housing credit determined under section 42(a),

(6) the enhanced oil recovery credit under section 43(a),

(7) in the case of an eligible small business (as defined in section 44(b)), the disabled access credit determined under section 44(a),

(8) the renewable electricity production credit under section 45(a),

(9) the empowerment zone employment credit determined under section 1396(a),

(10) the Indian employment credit as determined under section 45A(a),

(11) the employer social security credit determined under section 45B(a),

(12) the orphan drug credit determined under section 45C(a),

(13) the new markets tax credit determined under section 45D(a),

(14) in the case of an eligible employer (as defined in section 45E(c)), the small employer pension plan startup cost credit determined under section 45E(a),

(15) the employer-provided child care credit determined under section 45F(a),

(16) the railroad track maintenance credit determined under section 45G(a),

(17) the biodiesel fuels credit determined under section 40A(a),

(18) the low sulfur diesel fuel production credit determined under section 45H(a),

(19) the marginal oil and gas well production credit determined under section 45I(a),

(20) the distilled spirits credit determined under section 5011(a),

(21) the advanced nuclear power facility production credit determined under section 45J(a),

(22) the nonconventional source production credit determined under section 45K(a),

(23) the new energy efficient home credit determined under section 45L(a),

(24) the portion of the alternative motor vehicle credit to which section 30B(g)(1) applies,

(25) the portion of the alternative fuel vehicle refueling property credit to which section 30C(d)(1) applies,

(26) the mine rescue team training credit determined under section 45N(a),

(27) in the case of an eligible agricultural business (as defined in section 45O(e)), the agricultural chemicals security credit determined under section 45O(a),

(28) the differential wage payment credit determined under section 45P(a),

(29) the carbon dioxide sequestration credit determined under section 45Q(a),

(30) the portion of the new qualified plug-in electric drive motor vehicle credit to which section 30D(c)(1) applies,

(31) the small employer health insurance credit determined under section 45R, plus

(32) in the case of an eligible employer (as defined in section 45S(c)), the paid family and medical leave credit determined under section 45S(a).

(c) LIMITATION BASED ON AMOUNT OF TAX.—

(1) IN GENERAL.—The credit allowed under subsection (a) for any taxable year shall not exceed the excess (if any) of the taxpayer's net income tax over the greater of—

(A) the tentative minimum tax for the taxable year, or

(B) 25 percent of so much of the taxpayer's net regular tax liability as exceeds $25,000.

For purposes of the preceding sentence, the term "net income tax" means the sum of the regular tax liability and the tax imposed by section 55, reduced by the credits allowable under subparts A and B of this part, and the term "net regular tax liability" means the regular tax liability reduced by the sum of the credits allowable under subparts A and B of this part.

(2) EMPOWERMENT ZONE EMPLOYMENT CREDIT MAY OFFSET 25 PERCENT OF MINIMUM TAX.—

(A) IN GENERAL.—In the case of the empowerment zone employment credit—

(i) this section and section 39 shall be applied separately with respect to such credit, and

(ii) for purposes of applying paragraph (1) to such credit—

(I) 75 percent of the tentative minimum tax shall be substituted for the tentative minimum tax under subparagraph (A) thereof, and

(II) the limitation under paragraph (1) (as modified by subclause (I)) shall be reduced by the credit allowed under subsection (a) for the taxable year (other than the empowerment zone employment credit and the specified credits).

(B) EMPOWERMENT ZONE EMPLOYMENT CREDIT.—For purposes of this paragraph, the term "empowerment zone employment credit" means the portion of the credit under subsection (a) which is attributable to the credit determined under section 1396 (relating to empowerment zone employment credit).

(4) SPECIAL RULES FOR SPECIFIED CREDITS.—

(A) IN GENERAL.—In the case of specified credits—

(i) this section and section 39 shall be applied separately with respect to such credits, and

(ii) in applying paragraph (1) to such credits—

(I) the tentative minimum tax shall be treated as being zero, and

(II) the limitation under paragraph (1) (as modified by subclause (I)) shall be reduced by the credit allowed under subsection (a) for the taxable year (other than the specified credits).

(B) SPECIFIED CREDITS.—For purposes of this subsection, the term "specified credits" means—

(i) for taxable years beginning after December 31, 2004, the credit determined under section 40,

(ii) the credit determined under section 41 for the taxable year with respect to an eligible small business (as defined in paragraph (5)(A) after application of the rules of paragraph (5)(B)),

(iii) the credit determined under section 42 to the extent attributable to buildings placed in service after December 31, 2007,

(iv) the credit determined under section 45 to the extent that such credit is attributable to electricity or refined coal produced—

(I) at a facility which is originally placed in service after the date of the enactment of this paragraph, and

(II) during the 4-year period beginning on the date that such facility was originally placed in service,

(v) the credit determined under section 45 to the extent that such credit is attributable to section 45(e)(10) (relating to Indian coal production facilities),

(vi) the credit determined under section 45B,

(vii) the credit determined under section 45G,

(viii) the credit determined under section 45R,

(ix) the credit determined under section 45S,

(x) the credit determined under section 46 to the extent that such credit is attributable to the energy credit determined under section 48,

(xi) the credit determined under section 46 to the extent that such credit is attributable to the rehabilitation credit under section 47, but only with respect to qualified rehabilitation expenditures properly taken into account for periods after December 31, 2007, and

(xii) the credit determined under section 51.

(5) RULES RELATED TO ELIGIBLE SMALL BUSINESSES.—

(A) ELIGIBLE SMALL BUSINESS.—For purposes of this subsection, the term "eligible small business" means, with respect to any taxable year—

(i) a corporation the stock of which is not publicly traded,

(ii) a partnership, or

(iii) a sole proprietorship,

if the average annual gross receipts of such corporation, partnership, or sole proprietorship for the 3-taxable-year period preceding such taxable year does not exceed $50,000,000. For purposes of applying the test under the preceding sentence, rules similar to the rules of paragraphs (2) and (3) of section 448(c) shall apply.

(B) TREATMENT OF PARTNERS AND S CORPORATION SHAREHOLDERS.—For purposes of paragraph (4)(B)(ii), any credit determined under section 41 with respect to a partnership or S corporation shall not be treated as a specified credit by any partner or shareholder unless such partner or shareholder meets the gross receipts test under subparagraph (A) for the taxable year in which such credit is treated as a current year business credit.

(6) SPECIAL RULES.—

(A) MARRIED INDIVIDUALS.—In the case of a [husband or wife who files] *married individual who files* a separate return, the amount specified under subparagraph (B) of paragraph (1) shall be $12,500 in lieu of $25,000. This subparagraph shall not apply if the spouse of the taxpayer has no business credit carryforward or carryback to, and has no current year business credit for, the taxable year of such spouse which ends within or with the taxpayer's taxable year.

(B) CONTROLLED GROUPS.—In the case of a controlled group, the $25,000 amount specified under subparagraph (B) of paragraph (1) shall be reduced for each component member of such group by apportioning $25,000 among the component members of such group in such manner as the Secretary shall by regulations prescribe. For purposes of

the preceding sentence, the term "controlled group" has the meaning given to such term by section 1563(a).

(C) LIMITATIONS WITH RESPECT TO CERTAIN PERSONS.—In the case of a person described in subparagraph (A) or (B) of section 46(e)(1) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990), the $25,000 amount specified under subparagraph (B) of paragraph (1) shall equal such person's ratable share (as determined under section 46(e)(2) (as so in effect) of such amount.

(D) ESTATES AND TRUSTS.—In the case of an estate or trust, the $25,000 amount specified under subparagraph (B) of paragraph (1) shall be reduced to an amount which bears the same ratio to $25,000 as the portion of the income of the estate or trust which is not allocated to beneficiaries bears to the total income of the estate or trust.

(E) CORPORATIONS.—In the case of a corporation, this subsection shall be applied by treating the corporation as having a tentative minimum tax of zero.

(d) ORDERING RULES.—For purposes of any provision of this title where it is necessary to ascertain the extent to which the credits determined under any section referred to in subsection (b) are used in a taxable year or as a carryback or carryforward—

(1) IN GENERAL.—The order in which such credits are used shall be determined on the basis of the order in which they are listed in subsection (b) as of the close of the taxable year in which the credit is used.

(2) COMPONENTS OF INVESTMENT CREDIT.—The order in which the credits listed in section 46 are used shall be determined on the basis of the order in which such credits are listed in section 46 as of the close of the taxable year in which the credit is used.

* * * * * * *

SEC. 42. LOW-INCOME HOUSING CREDIT.

(a) IN GENERAL.—For purposes of section 38, the amount of the low-income housing credit determined under this section for any taxable year in the credit period shall be an amount equal to—

(1) the applicable percentage of

(2) the qualified basis of each qualified low-income building.

(b) APPLICABLE PERCENTAGE: 70 PERCENT PRESENT VALUE CREDIT FOR CERTAIN NEW BUILDINGS; 30 PERCENT PRESENT VALUE CREDIT FOR CERTAIN OTHER BUILDINGS.—

(1) DETERMINATION OF APPLICABLE PERCENTAGE.—For purposes of this section—

(A) IN GENERAL.—The term "applicable percentage" means, with respect to any building, the appropriate percentage prescribed by the Secretary for the earlier of—

(i) the month in which such building is placed in service, or

(ii) at the election of the taxpayer—

(I) the month in which the taxpayer and the housing credit agency enter into an agreement with respect to such building (which is binding on such agency, the taxpayer, and all successors in

interest) as to the housing credit dollar amount to be allocated to such building, or

(II) in the case of any building to which subsection (h)(4)(B) applies, the month in which the tax-exempt obligations are issued.

A month may be elected under clause (ii) only if the election is made not later than the 5th day after the close of such month. Such an election, once made, shall be irrevocable.

(B) METHOD OF PRESCRIBING PERCENTAGES.—The percentages prescribed by the Secretary for any month shall be percentages which will yield over a 10-year period amounts of credit under subsection (a) which have a present value equal to—

(i) 70 percent of the qualified basis of a new building which is not federally subsidized for the taxable year, and

(ii) 30 percent of the qualified basis of a building not described in clause (i).

(C) METHOD OF DISCOUNTING.—The present value under subparagraph (B) shall be determined—

(i) as of the last day of the 1st year of the 10-year period referred to in subparagraph (B),

(ii) by using a discount rate equal to 72 percent of the average of the annual Federal mid-term rate and the annual Federal long-term rate applicable under section 1274(d)(1) to the month applicable under clause (i) or (ii) of subparagraph (A) and compounded annually, and

(iii) by assuming that the credit allowable under this section for any year is received on the last day of such year.

(2) MINIMUM CREDIT RATE FOR NON-FEDERALLY SUBSIDIZED NEW BUILDINGS.—In the case of any new building—

(A) which is placed in service by the taxpayer after the date of the enactment of this paragraph, and

(B) which is not federally subsidized for the taxable year,

the applicable percentage shall not be less than 9 percent.

(3) CROSS REFERENCES.—

(A) For treatment of certain rehabilitation expenditures as separate new buildings, see subsection (e).

(B) For determination of applicable percentage for increases in qualified basis after the 1st year of the credit period, see subsection (f)(3).

(C) For authority of housing credit agency to limit applicable percentage and qualified basis which may be taken into account under this section with respect to any building, see subsection (h)(7).

(c) QUALIFIED BASIS; QUALIFIED LOW-INCOME BUILDING.—For purposes of this section—

(1) QUALIFIED BASIS.—

(A) DETERMINATION.—The qualified basis of any qualified low-income building for any taxable year is an amount equal to—

(i) the applicable fraction (determined as of the close of such taxable year) of

(ii) the eligible basis of such building (determined under subsection (d)(5)).

(B) APPLICABLE FRACTION.—For purposes of subparagraph (A), the term "applicable fraction" means the smaller of the unit fraction or the floor space fraction.

(C) UNIT FRACTION.—For purposes of subparagraph (B), the term "unit fraction" means the fraction—

(i) the numerator of which is the number of low-income units in the building, and

(ii) the denominator of which is the number of residential rental units (whether or not occupied) in such building.

(D) FLOOR SPACE FRACTION.—For purposes of subparagraph (B), the term "floor space fraction" means the fraction—

(i) the numerator of which is the total floor space of the low-income units in such building, and

(ii) the denominator of which is the total floor space of the residential rental units (whether or not occupied) in such building.

(E) QUALIFIED BASIS TO INCLUDE PORTION OF BUILDING USED TO PROVIDE SUPPORTIVE SERVICES FOR HOMELESS.—In the case of a qualified low-income building described in subsection (i)(3)(B)(iii), the qualified basis of such building for any taxable year shall be increased by the lesser of—

(i) so much of the eligible basis of such building as is used throughout the year to provide supportive services designed to assist tenants in locating and retaining permanent housing, or

(ii) 20 percent of the qualified basis of such building (determined without regard to this subparagraph).

(2) QUALIFIED LOW-INCOME BUILDING.—The term "qualified low-income building" means any building—

(A) which is part of a qualified low-income housing project at all times during the period—

(i) beginning on the 1st day in the compliance period on which such building is part of such a project, and

(ii) ending on the last day of the compliance period with respect to such building, and

(B) to which the amendments made by section 201(a) of the Tax Reform Act of 1986 apply.

(d) ELIGIBLE BASIS.—For purposes of this section—

(1) NEW BUILDINGS.—The eligible basis of a new building is its adjusted basis as of the close of the 1st taxable year of the credit period.

(2) EXISTING BUILDINGS.—

(A) IN GENERAL.—The eligible basis of an existing building is—

(i) in the case of a building which meets the requirements of subparagraph (B), its adjusted basis as of the close of the 1st taxable year of the credit period, and

(ii) zero in any other case.

(B) REQUIREMENTS.—A building meets the requirements of this subparagraph if—

(i) the building is acquired by purchase (as defined in section 179(d)(2)),

(ii) there is a period of at least 10 years between the date of its acquisition by the taxpayer and the date the building was last placed in service,

(iii) the building was not previously placed in service by the taxpayer or by any person who was a related person with respect to the taxpayer as of the time previously placed in service, and

(iv) except as provided in subsection (f)(5), a credit is allowable under subsection (a) by reason of subsection (e) with respect to the building.

(C) ADJUSTED BASIS.—For purposes of subparagraph (A), the adjusted basis of any building shall not include so much of the basis of such building as is determined by reference to the basis of other property held at any time by the person acquiring the building.

(D) SPECIAL RULES FOR SUBPARAGRAPH (B).—

(i) SPECIAL RULES FOR CERTAIN TRANSFERS.—For purposes of determining under subparagraph (B)(ii) when a building was last placed in service, there shall not be taken into account any placement in service—

(I) in connection with the acquisition of the building in a transaction in which the basis of the building in the hands of the person acquiring it is determined in whole or in part by reference to the adjusted basis of such building in the hands of the person from whom acquired,

(II) by a person whose basis in such building is determined under section 1014(a) (relating to property acquired from a decedent),

(III) by any governmental unit or qualified nonprofit organization (as defined in subsection (h)(5)) if the requirements of subparagraph (B)(ii) are met with respect to the placement in service by such unit or organization and all the income from such property is exempt from Federal income taxation,

(IV) by any person who acquired such building by foreclosure (or by instrument in lieu of foreclosure) of any purchase-money security interest held by such person if the requirements of subparagraph (B)(ii) are met with respect to the placement in service by such person and such building is resold within 12 months after the date such building is placed in service by such person after such foreclosure, or

(V) of a single-family residence by any individual who owned and used such residence for no other purpose than as his principal residence.

(ii) RELATED PERSON.—For purposes of subparagraph (B)(iii), a person (hereinafter in this subclause referred to as the "related person") is related to any

person if the related person bears a relationship to such person specified in section 267(b) or 707(b)(1), or the related person and such person are engaged in trades or businesses under common control (within the meaning of subsections (a) and (b) of section 52).

(3) ELIGIBLE BASIS REDUCED WHERE DISPROPORTIONATE STANDARDS FOR UNITS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the eligible basis of any building shall be reduced by an amount equal to the portion of the adjusted basis of the building which is attributable to residential rental units in the building which are not low-income units and which are above the average quality standard of the low-income units in the building.

(B) EXCEPTION WHERE TAXPAYER ELECTS TO EXCLUDE EXCESS COSTS.—

(i) IN GENERAL.—Subparagraph (A) shall not apply with respect to a residential rental unit in a building which is not a low-income unit if—

(I) the excess described in clause (ii) with respect to such unit is not greater than 15 percent of the cost described in clause (ii)(II), and

(II) the taxpayer elects to exclude from the eligible basis of such building the excess described in clause (ii) with respect to such unit.

(ii) EXCESS.—The excess described in this clause with respect to any unit is the excess of—

(I) the cost of such unit, over

(II) the amount which would be the cost of such unit if the average cost per square foot of low-income units in the building were substituted for the cost per square foot of such unit.

The Secretary may by regulation provide for the determination of the excess under this clause on a basis other than square foot costs.

(4) SPECIAL RULES RELATING TO DETERMINATION OF ADJUSTED BASIS.—For purposes of this subsection—

(A) IN GENERAL.—Except as provided in subparagraphs (B) and (C), the adjusted basis of any building shall be determined without regard to the adjusted basis of any property which is not residential rental property.

(B) BASIS OF PROPERTY IN COMMON AREAS, ETC., INCLUDED.—The adjusted basis of any building shall be determined by taking into account the adjusted basis of property (of a character subject to the allowance for depreciation) used in common areas or provided as comparable amenities to all residential rental units in such building.

(C) INCLUSION OF BASIS OF PROPERTY USED TO PROVIDE SERVICES FOR CERTAIN NONTENANTS.—

(i) IN GENERAL.—The adjusted basis of any building located in a qualified census tract (as defined in paragraph (5)(B)(ii)) shall be determined by taking into account the adjusted basis of property (of a character subject to the allowance for depreciation and not oth-

erwise taken into account) used throughout the taxable year in providing any community service facility.

(ii) LIMITATION.—The increase in the adjusted basis of any building which is taken into account by reason of clause (i) shall not exceed the sum of—

(I) 25 percent of so much of the eligible basis of the qualified low-income housing project of which it is a part as does not exceed $15,000,000, plus

(II) 10 percent of so much of the eligible basis of such project as is not taken into account under subclause (I).

For purposes of the preceding sentence, all community service facilities which are part of the same qualified low-income housing project shall be treated as one facility.

(iii) COMMUNITY SERVICE FACILITY.—For purposes of this subparagraph, the term "community service facility" means any facility designed to serve primarily individuals whose income is 60 percent or less of area median income (within the meaning of subsection (g)(1)(B)).

(D) NO REDUCTION FOR DEPRECIATION.—The adjusted basis of any building shall be determined without regard to paragraphs (2) and (3) of section 1016(a).

(5) SPECIAL RULES FOR DETERMINING ELIGIBLE BASIS.—

(A) FEDERAL GRANTS NOT TAKEN INTO ACCOUNT IN DETERMINING ELIGIBLE BASIS.—The eligible basis of a building shall not include any costs financed with the proceeds of a federally funded grant.

(B) INCREASE IN CREDIT FOR BUILDINGS IN HIGH COST AREAS.—

(i) IN GENERAL.—In the case of any building located in a qualified census tract or difficult development area which is designated for purposes of this subparagraph—

(I) in the case of a new building, the eligible basis of such building shall be 130 percent of such basis determined without regard to this subparagraph, and

(II) in the case of an existing building, the rehabilitation expenditures taken into account under subsection (e) shall be 130 percent of such expenditures determined without regard to this subparagraph.

(ii) QUALIFIED CENSUS TRACT.—

(I) IN GENERAL.—The term "qualified census tract" means any census tract which is designated by the Secretary of Housing and Urban Development and, for the most recent year for which census data are available on household income in such tract, either in which 50 percent or more of the households have an income which is less than 60 percent of the area median gross income for such year or which has a poverty rate of at least 25 percent. If the Secretary of Housing and Urban Development determines that sufficient data for

any period are not available to apply this clause on the basis of census tracts, such Secretary shall apply this clause for such period on the basis of enumeration districts.

(II) LIMIT ON MSA'S DESIGNATED.—The portion of a metropolitan statistical area which may be designated for purposes of this subparagraph shall not exceed an area having 20 percent of the population of such metropolitan statistical area.

(III) DETERMINATION OF AREAS.—For purposes of this clause, each metropolitan statistical area shall be treated as a separate area and all nonmetropolitan areas in a State shall be treated as 1 area.

(iii) DIFFICULT DEVELOPMENT AREAS.—

(I) IN GENERAL.—The term "difficult development areas" means any area designated by the Secretary of Housing and Urban Development as an area which has high construction, land, and utility costs relative to area median gross income.

(II) LIMIT ON AREAS DESIGNATED.—The portions of metropolitan statistical areas which may be designated for purposes of this subparagraph shall not exceed an aggregate area having 20 percent of the population of such metropolitan statistical areas. A comparable rule shall apply to nonmetropolitan areas.

(iv) SPECIAL RULES AND DEFINITIONS.—For purposes of this subparagraph—

(I) population shall be determined on the basis of the most recent decennial census for which data are available,

(II) area median gross income shall be determined in accordance with subsection (g)(4),

(III) the term "metropolitan statistical area" has the same meaning as when used in section 143(k)(2)(B), and

(IV) the term "nonmetropolitan area" means any county (or portion thereof) which is not within a metropolitan statistical area.

(v) BUILDINGS DESIGNATED BY STATE HOUSING CREDIT AGENCY.—Any building which is designated by the State housing credit agency as requiring the increase in credit under this subparagraph in order for such building to be financially feasible as part of a qualified low-income housing project shall be treated for purposes of this subparagraph as located in a difficult development area which is designated for purposes of this subparagraph. The preceding sentence shall not apply to any building if paragraph (1) of subsection (h) does not apply to any portion of the eligible basis of such building by reason of paragraph (4) of such subsection.

(6) CREDIT ALLOWABLE FOR CERTAIN BUILDINGS ACQUIRED DURING 10-YEAR PERIOD DESCRIBED IN PARAGRAPH (2)(B)(II).—

(A) IN GENERAL.—Paragraph (2)(B)(ii) shall not apply to any federally- or State-assisted building.

(B) BUILDINGS ACQUIRED FROM INSURED DEPOSITORY INSTITUTIONS IN DEFAULT.—On application by the taxpayer, the Secretary may waive paragraph (2)(B)(ii) with respect to any building acquired from an insured depository institution in default (as defined in section 3 of the Federal Deposit Insurance Act) or from a receiver or conservator of such an institution.

(C) FEDERALLY- OR STATE-ASSISTED BUILDING.—For purposes of this paragraph—

(i) FEDERALLY-ASSISTED BUILDING.—The term "federally-assisted building" means any building which is substantially assisted, financed, or operated under section 8 of the United States Housing Act of 1937, section 221(d)(3), 221(d)(4), or 236 of the National Housing Act, section 515 of the Housing Act of 1949, or any other housing program administered by the Department of Housing and Urban Development or by the Rural Housing Service of the Department of Agriculture.

(ii) STATE-ASSISTED BUILDING.—The term "State-assisted building" means any building which is substantially assisted, financed, or operated under any State law similar in purposes to any of the laws referred to in clause (i).

(7) ACQUISITION OF BUILDING BEFORE END OF PRIOR COMPLIANCE PERIOD.—

(A) IN GENERAL.—Under regulations prescribed by the Secretary, in the case of a building described in subparagraph (B) (or interest therein) which is acquired by the taxpayer—

(i) paragraph (2)(B) shall not apply, but

(ii) the credit allowable by reason of subsection (a) to the taxpayer for any period after such acquisition shall be equal to the amount of credit which would have been allowable under subsection (a) for such period to the prior owner referred to in subparagraph (B) had such owner not disposed of the building.

(B) DESCRIPTION OF BUILDING.—A building is described in this subparagraph if—

(i) a credit was allowed by reason of subsection (a) to any prior owner of such building, and

(ii) the taxpayer acquired such building before the end of the compliance period for such building with respect to such prior owner (determined without regard to any disposition by such prior owner).

(e) REHABILITATION EXPENDITURES TREATED AS SEPARATE NEW BUILDING.—

(1) IN GENERAL.—Rehabilitation expenditures paid or incurred by the taxpayer with respect to any building shall be treated for purposes of this section as a separate new building.

(2) REHABILITATION EXPENDITURES.—For purposes of paragraph (1)—

(A) IN GENERAL.—The term "rehabilitation expenditures" means amounts chargeable to capital account and incurred for property (or additions or improvements to property) of a character subject to the allowance for depreciation in connection with the rehabilitation of a building.

(B) COST OF ACQUISITION, ETC., NOT INCLUDED.—Such term does not include the cost of acquiring any building (or interest therein) or any amount not permitted to be taken into account under paragraph (3) or (4) of subsection (d).

(3) MINIMUM EXPENDITURES TO QUALIFY.—

(A) IN GENERAL.—Paragraph (1) shall apply to rehabilitation expenditures with respect to any building only if—

(i) the expenditures are allocable to 1 or more low-income units or substantially benefit such units, and

(ii) the amount of such expenditures during any 24-month period meets the requirements of whichever of the following subclauses requires the greater amount of such expenditures:

(I) The requirement of this subclause is met if such amount is not less than 20 percent of the adjusted basis of the building (determined as of the 1st day of such period and without regard to paragraphs (2) and (3) of section 1016(a)).

(II) The requirement of this subclause is met if the qualified basis attributable to such amount, when divided by the number of low-income units in the building, is $6,000 or more.

(B) EXCEPTION FROM 10 PERCENT REHABILITATION.—In the case of a building acquired by the taxpayer from a governmental unit, at the election of the taxpayer, subparagraph (A)(ii)(I) shall not apply and the credit under this section for such rehabilitation expenditures shall be determined using the percentage applicable under subsection (b)(2)(B)(ii).

(C) DATE OF DETERMINATION.—The determination under subparagraph (A) shall be made as of the close of the 1st taxable year in the credit period with respect to such expenditures.

(D) INFLATION ADJUSTMENT.—In the case of any expenditures which are treated under paragraph (4) as placed in service during any calendar year after 2009, the $6,000 amount in subparagraph (A)(ii)(II) shall be increased by an amount equal to—

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar year 2008" for "calendar year 2016" in subparagraph (A)(ii) thereof.

Any increase under the preceding sentence which is not a multiple of $100 shall be rounded to the nearest multiple of $100.

(4) SPECIAL RULES.—For purposes of applying this section with respect to expenditures which are treated as a separate building by reason of this subsection—

(A) such expenditures shall be treated as placed in service at the close of the 24-month period referred to in paragraph (3)(A), and

(B) the applicable fraction under subsection (c)(1) shall be the applicable fraction for the building (without regard to paragraph (1)) with respect to which the expenditures were incurred.

Nothing in subsection (d)(2) shall prevent a credit from being allowed by reason of this subsection.

(5) NO DOUBLE COUNTING.—Rehabilitation expenditures may, at the election of the taxpayer, be taken into account under this subsection or subsection (d)(2)(A)(i) but not under both such subsections.

(6) REGULATIONS TO APPLY SUBSECTION WITH RESPECT TO GROUP OF UNITS IN BUILDING.—The Secretary may prescribe regulations, consistent with the purposes of this subsection, treating a group of units with respect to which rehabilitation expenditures are incurred as a separate new building.

(f) DEFINITION AND SPECIAL RULES RELATING TO CREDIT PERIOD.—

(1) CREDIT PERIOD DEFINED.—For purposes of this section, the term "credit period" means, with respect to any building, the period of 10 taxable years beginning with—

(A) the taxable year in which the building is placed in service, or

(B) at the election of the taxpayer, the succeeding taxable year,

but only if the building is a qualified low-income building as of the close of the 1st year of such period. The election under subparagraph (B), once made, shall be irrevocable.

(2) SPECIAL RULE FOR 1ST YEAR OF CREDIT PERIOD.—

(A) IN GENERAL.—The credit allowable under subsection (a) with respect to any building for the 1st taxable year of the credit period shall be determined by substituting for the applicable fraction under subsection (c)(1) the fraction—

(i) the numerator of which is the sum of the applicable fractions determined under subsection (c)(1) as of the close of each full month of such year during which such building was in service, and

(ii) the denominator of which is 12.

(B) DISALLOWED 1ST YEAR CREDIT ALLOWED IN 11TH YEAR.—Any reduction by reason of subparagraph (A) in the credit allowable (without regard to subparagraph (A)) for the 1st taxable year of the credit period shall be allowable under subsection (a) for the 1st taxable year following the credit period.

(3) DETERMINATION OF APPLICABLE PERCENTAGE WITH RESPECT TO INCREASES IN QUALIFIED BASIS AFTER 1ST YEAR OF CREDIT PERIOD.—

(A) IN GENERAL.—In the case of any building which was a qualified low-income building as of the close of the 1st year of the credit period, if—

(i) as of the close of any taxable year in the compliance period (after the 1st year of the credit period) the qualified basis of such building exceeds

(ii) the qualified basis of such building as of the close of the 1st year of the credit period,

the applicable percentage which shall apply under subsection (a) for the taxable year to such excess shall be the percentage equal to 2/3 of the applicable percentage which (after the application of subsection (h)) would but for this paragraph apply to such basis.

(B) 1ST YEAR COMPUTATION APPLIES.—A rule similar to the rule of paragraph (2)(A) shall apply to any increase in qualified basis to which subparagraph (A) applies for the 1st year of such increase.

(4) DISPOSITIONS OF PROPERTY.—If a building (or an interest therein) is disposed of during any year for which credit is allowable under subsection (a), such credit shall be allocated between the parties on the basis of the number of days during such year the building (or interest) was held by each. In any such case, proper adjustments shall be made in the application of subsection (j).

(5) CREDIT PERIOD FOR EXISTING BUILDINGS NOT TO BEGIN BEFORE REHABILITATION CREDIT ALLOWED.—

(A) IN GENERAL.—The credit period for an existing building shall not begin before the 1st taxable year of the credit period for rehabilitation expenditures with respect to the building.

(B) ACQUISITION CREDIT ALLOWED FOR CERTAIN BUILDINGS NOT ALLOWED A REHABILITATION CREDIT.—

(i) IN GENERAL.—In the case of a building described in clause (ii)—

(I) subsection (d)(2)(B)(iv) shall not apply, and

(II) the credit period for such building shall not begin before the taxable year which would be the 1st taxable year of the credit period for rehabilitation expenditures with respect to the building under the modifications described in clause (ii)(II).

(ii) BUILDING DESCRIBED.—A building is described in this clause if—

(I) a waiver is granted under subsection (d)(6)(B) with respect to the acquisition of the building, and

(II) a credit would be allowed for rehabilitation expenditures with respect to such building if subsection (e)(3)(A)(ii)(I) did not apply and if the dollar amount in effect under subsection (e)(3)(A)(ii)(II) were two-thirds of such amount.

(g) QUALIFIED LOW-INCOME HOUSING PROJECT.—For purposes of this section—

(1) IN GENERAL.—The term "qualified low-income housing project" means any project for residential rental property if the project meets the requirements of subparagraph (A), (B), or (C) whichever is elected by the taxpayer:

(A) 20–50 TEST.—The project meets the requirements of this subparagraph if 20 percent or more of the residential

units in such project are both rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income.

(B) 40–60 TEST.—The project meets the requirements of this subparagraph if 40 percent or more of the residential units in such project are both rent-restricted and occupied by individuals whose income is 60 percent or less of area median gross income.

(C) AVERAGE INCOME TEST.—

(i) IN GENERAL.—The project meets the minimum requirements of this subparagraph if 40 percent or more (25 percent or more in the case of a project described in section 142(d)(6)) of the residential units in such project are both rent-restricted and occupied by individuals whose income does not exceed the imputed income limitation designated by the taxpayer with respect to the respective unit.

(ii) SPECIAL RULES RELATING TO INCOME LIMITATION.—For purposes of clause (i)—

(I) DESIGNATION.—The taxpayer shall designate the imputed income limitation of each unit taken into account under such clause.

(II) AVERAGE TEST.—The average of the imputed income limitations designated under subclause (I) shall not exceed 60 percent of area median gross income.

(III) 10-PERCENT INCREMENTS.—The designated imputed income limitation of any unit under subclause (I) shall be 20 percent, 30 percent, 40 percent, 50 percent, 60 percent, 70 percent, or 80 percent of area median gross income.

Any election under this paragraph, once made, shall be irrevocable. For purposes of this paragraph, any property shall not be treated as failing to be residential rental property merely because part of the building in which such property is located is used for purposes other than residential rental purposes.

(2) RENT-RESTRICTED UNITS.—

(A) IN GENERAL.—For purposes of paragraph (1), a residential unit is rent-restricted if the gross rent with respect to such unit does not exceed 30 percent of the imputed income limitation applicable to such unit. For purposes of the preceding sentence, the amount of the income limitation under paragraph (1) applicable for any period shall not be less than such limitation applicable for the earliest period the building (which contains the unit) was included in the determination of whether the project is a qualified low-income housing project.

(B) GROSS RENT.—For purposes of subparagraph (A), gross rent—

(i) does not include any payment under section 8 of the United States Housing Act of 1937 or any comparable rental assistance program (with respect to such unit or occupants thereof),

(ii) includes any utility allowance determined by the Secretary after taking into account such determina-

tions under section 8 of the United States Housing Act of 1937,

(iii) does not include any fee for a supportive service which is paid to the owner of the unit (on the basis of the low-income status of the tenant of the unit) by any governmental program of assistance (or by an organization described in section 501(c)(3) and exempt from tax under section 501(a)) if such program (or organization) provides assistance for rent and the amount of assistance provided for rent is not separable from the amount of assistance provided for supportive services, and

(iv) does not include any rental payment to the owner of the unit to the extent such owner pays an equivalent amount to the Farmers' Home Administration under section 515 of the Housing Act of 1949.

For purposes of clause (iii), the term "supportive service" means any service provided under a planned program of services designed to enable residents of a residential rental property to remain independent and avoid placement in a hospital, nursing home, or intermediate care facility for the mentally or physically handicapped. In the case of a single-room occupancy unit or a building described in subsection (i)(3)(B)(iii), such term includes any service provided to assist tenants in locating and retaining permanent housing.

(C) IMPUTED INCOME LIMITATION APPLICABLE TO UNIT.—For purposes of this paragraph, the imputed income limitation applicable to a unit is the income limitation which would apply under paragraph (1) to individuals occupying the unit if the number of individuals occupying the unit were as follows:

(i) In the case of a unit which does not have a separate bedroom, 1 individual.

(ii) In the case of a unit which has 1 or more separate bedrooms, 1.5 individuals for each separate bedroom.

In the case of a project with respect to which a credit is allowable by reason of this section and for which financing is provided by a bond described in section 142(a)(7), the imputed income limitation shall apply in lieu of the otherwise applicable income limitation for purposes of applying section 142(d)(4)(B)(ii).

(D) TREATMENT OF UNITS OCCUPIED BY INDIVIDUALS WHOSE INCOMES RISE ABOVE LIMIT.—

(i) IN GENERAL.—Except as provided in clauses (ii), (iii), and (iv), notwithstanding an increase in the income of the occupants of a low-income unit above the income limitation applicable under paragraph (1), such unit shall continue to be treated as a low-income unit if the income of such occupants initially met such income limitation and such unit continues to be rent-restricted.

(ii) RENTAL OF NEXT AVAILABLE UNIT IN CASE OF 20–50 OR 40–60 TEST.—In the case of a project with respect

to which the taxpayer elects the requirements of subparagraph (A) or (B) of paragraph (1), if the income of the occupants of the unit increases above 140 percent of the income limitation applicable under paragraph (1), clause (i) shall cease to apply to such unit if any residential rental unit in the building (of a size comparable to, or smaller than, such unit) is occupied by a new resident whose income exceeds such income limitation.

(iii) RENTAL OF NEXT AVAILABLE UNIT IN CASE OF AVERAGE INCOME TEST.—In the case of a project with respect to which the taxpayer elects the requirements of subparagraph (C) of paragraph (1), if the income of the occupants of the unit increases above 140 percent of the greater of—

(I) 60 percent of area median gross income, or

(II) the imputed income limitation designated with respect to the unit under paragraph (1)(C)(ii)(I),

clause (i) shall cease to apply to any such unit if any residential rental unit in the building (of a size comparable to, or smaller than, such unit) is occupied by a new resident whose income exceeds the limitation described in clause (v).

(iv) DEEP RENT SKEWED PROJECTS.—In the case of a project described in section 142(d)(4)(B), clause (ii) or (iii), whichever is applicable, shall be applied by substituting "170 percent" for "140 percent", and—

(I) in the case of clause (ii), by substituting "any low-income unit in the building is occupied by a new resident whose income exceeds 40 percent of area median gross income" for "any residential rental unit" and all that follows in such clause, and

(II) in the case of clause (iii), by substituting "any low-income unit in the building is occupied by a new resident whose income exceeds the lesser of 40 percent of area median gross income or the imputed income limitation designated with respect to such unit under paragraph (1)(C)(ii)(I)" for "any residential rental unit" and all that follows in such clause.

(v) LIMITATION DESCRIBED.—For purposes of clause (iii), the limitation described in this clause with respect to any unit is—

(I) the imputed income limitation designated with respect to such unit under paragraph (1)(C)(ii)(I), in the case of a unit which was taken into account as a low-income unit prior to becoming vacant, and

(II) the imputed income limitation which would have to be designated with respect to such unit under such paragraph in order for the project to continue to meet the requirements of paragraph (1)(C)(ii)(II), in the case of any other unit.

(E) UNITS WHERE FEDERAL RENTAL ASSISTANCE IS REDUCED AS TENANT'S INCOME INCREASES.—If the gross rent with respect to a residential unit exceeds the limitation under subparagraph (A) by reason of the fact that the income of the occupants thereof exceeds the income limitation applicable under paragraph (1), such unit shall, nevertheless, be treated as a rent-restricted unit for purposes of paragraph (1) if—

(i) a Federal rental assistance payment described in subparagraph (B)(i) is made with respect to such unit or its occupants, and

(ii) the sum of such payment and the gross rent with respect to such unit does not exceed the sum of the amount of such payment which would be made and the gross rent which would be payable with respect to such unit if—

(I) the income of the occupants thereof did not exceed the income limitation applicable under paragraph (1), and

(II) such units were rent-restricted within the meaning of subparagraph (A).

The preceding sentence shall apply to any unit only if the result described in clause (ii) is required by Federal statute as of the date of the enactment of this subparagraph and as of the date the Federal rental assistance payment is made.

(3) DATE FOR MEETING REQUIREMENTS.—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, a building shall be treated as a qualified low-income building only if the project (of which such building is a part) meets the requirements of paragraph (1) not later than the close of the 1st year of the credit period for such building.

(B) BUILDINGS WHICH RELY ON LATER BUILDINGS FOR QUALIFICATION.—

(i) IN GENERAL.—In determining whether a building (hereinafter in this subparagraph referred to as the "prior building") is a qualified low-income building, the taxpayer may take into account 1 or more additional buildings placed in service during the 12-month period described in subparagraph (A) with respect to the prior building only if the taxpayer elects to apply clause (ii) with respect to each additional building taken into account.

(ii) TREATMENT OF ELECTED BUILDINGS.—In the case of a building which the taxpayer elects to take into account under clause (i), the period under subparagraph (A) for such building shall end at the close of the 12-month period applicable to the prior building.

(iii) DATE PRIOR BUILDING IS TREATED AS PLACED IN SERVICE.—For purposes of determining the credit period and the compliance period for the prior building, the prior building shall be treated for purposes of this section as placed in service on the most recent date

any additional building elected by the taxpayer (with respect to such prior building) was placed in service.

(C) SPECIAL RULE.—A building—

(i) other than the 1st building placed in service as part of a project, and

(ii) other than a building which is placed in service during the 12-month period described in subparagraph (A) with respect to a prior building which becomes a qualified low-income building,

shall in no event be treated as a qualified low-income building unless the project is a qualified low-income housing project (without regard to such building) on the date such building is placed in service.

(D) PROJECTS WITH MORE THAN 1 BUILDING MUST BE IDENTIFIED.—For purposes of this section, a project shall be treated as consisting of only 1 building unless, before the close of the 1st calendar year in the project period (as defined in subsection (h)(1)(F)(ii)), each building which is (or will be) part of such project is identified in such form and manner as the Secretary may provide.

(4) CERTAIN RULES MADE APPLICABLE.—Paragraphs (2) (other than subparagraph (A) thereof), (3), (4), (5), (6), and (7) of section 142(d), and section 6652(j), shall apply for purposes of determining whether any project is a qualified low-income housing project and whether any unit is a low-income unit; except that, in applying such provisions for such purposes, the term "gross rent" shall have the meaning given such term by paragraph (2)(B) of this subsection.

(5) ELECTION TO TREAT BUILDING AFTER COMPLIANCE PERIOD AS NOT PART OF A PROJECT.—For purposes of this section, the taxpayer may elect to treat any building as not part of a qualified low-income housing project for any period beginning after the compliance period for such building.

(6) SPECIAL RULE WHERE DE MINIMIS EQUITY CONTRIBUTION.—Property shall not be treated as failing to be residential rental property for purposes of this section merely because the occupant of a residential unit in the project pays (on a voluntary basis) to the lessor a de minimis amount to be held toward the purchase by such occupant of a residential unit in such project if—

(A) all amounts so paid are refunded to the occupant on the cessation of his occupancy of a unit in the project, and

(B) the purchase of the unit is not permitted until after the close of the compliance period with respect to the building in which the unit is located.

Any amount paid to the lessor as described in the preceding sentence shall be included in gross rent under paragraph (2) for purposes of determining whether the unit is rent-restricted.

(7) SCATTERED SITE PROJECTS.—Buildings which would (but for their lack of proximity) be treated as a project for purposes of this section shall be so treated if all of the dwelling units in each of the buildings are rent-restricted (within the meaning of paragraph (2)) residential rental units.

(8) WAIVER OF CERTAIN DE MINIMIS ERRORS AND RECERTIFICATIONS.—On application by the taxpayer, the Secretary may waive—

(A) any recapture under subsection (j) in the case of any de minimis error in complying with paragraph (1), or

(B) any annual recertification of tenant income for purposes of this subsection, if the entire building is occupied by low-income tenants.

(9) CLARIFICATION OF GENERAL PUBLIC USE REQUIREMENT.—A project does not fail to meet the general public use requirement solely because of occupancy restrictions or preferences that favor tenants—

(A) with special needs,

(B) who are members of a specified group under a Federal program or State program or policy that supports housing for such a specified group, or

(C) who are involved in artistic or literary activities.

(h) LIMITATION ON AGGREGATE CREDIT ALLOWABLE WITH RESPECT TO PROJECTS LOCATED IN A STATE.—

(1) CREDIT MAY NOT EXCEED CREDIT AMOUNT ALLOCATED TO BUILDING.—

(A) IN GENERAL.—The amount of the credit determined under this section for any taxable year with respect to any building shall not exceed the housing credit dollar amount allocated to such building under this subsection.

(B) TIME FOR MAKING ALLOCATION.—Except in the case of an allocation which meets the requirements of subparagraph (C), (D), (E), or (F), an allocation shall be taken into account under subparagraph (A) only if it is made not later than the close of the calendar year in which the building is placed in service.

(C) EXCEPTION WHERE BINDING COMMITMENT.—An allocation meets the requirements of this subparagraph if there is a binding commitment (not later than the close of the calendar year in which the building is placed in service) by the housing credit agency to allocate a specified housing credit dollar amount to such building beginning in a specified later taxable year.

(D) EXCEPTION WHERE INCREASE IN QUALIFIED BASIS.—

(i) IN GENERAL.—An allocation meets the requirements of this subparagraph if such allocation is made not later than the close of the calendar year in which ends the taxable year to which it will 1st apply but only to the extent the amount of such allocation does not exceed the limitation under clause (ii).

(ii) LIMITATION.—The limitation under this clause is the amount of credit allowable under this section (without regard to this subsection) for a taxable year with respect to an increase in the qualified basis of the building equal to the excess of—

(I) the qualified basis of such building as of the close of the 1st taxable year to which such allocation will apply, over

(II) the qualified basis of such building as of the close of the 1st taxable year to which the most re-

cent prior housing credit allocation with respect to such building applied.

(iii) HOUSING CREDIT DOLLAR AMOUNT REDUCED BY FULL ALLOCATION.—Notwithstanding clause (i), the full amount of the allocation shall be taken into account under paragraph (2).

(E) EXCEPTION WHERE 10 PERCENT OF COST INCURRED.—

(i) IN GENERAL.—An allocation meets the requirements of this subparagraph if such allocation is made with respect to a qualified building which is placed in service not later than the close of the second calendar year following the calendar year in which the allocation is made.

(ii) QUALIFIED BUILDING.—For purposes of clause (i), the term "qualified building" means any building which is part of a project if the taxpayer's basis in such project (as of the date which is 1 year after the date that the allocation was made) is more than 10 percent of the taxpayer's reasonably expected basis in such project (as of the close of the second calendar year referred to in clause (i)). Such term does not include any existing building unless a credit is allowable under subsection (e) for rehabilitation expenditures paid or incurred by the taxpayer with respect to such building for a taxable year ending during the second calendar year referred to in clause (i) or the prior taxable year.

(F) ALLOCATION OF CREDIT ON A PROJECT BASIS.—

(i) IN GENERAL.—In the case of a project which includes (or will include) more than 1 building, an allocation meets the requirements of this subparagraph if—

(I) the allocation is made to the project for a calendar year during the project period,

(II) the allocation only applies to buildings placed in service during or after the calendar year for which the allocation is made, and

(III) the portion of such allocation which is allocated to any building in such project is specified not later than the close of the calendar year in which the building is placed in service.

(ii) PROJECT PERIOD.—For purposes of clause (i), the term "project period" means the period—

(I) beginning with the 1st calendar year for which an allocation may be made for the 1st building placed in service as part of such project, and

(II) ending with the calendar year the last building is placed in service as part of such project.

(2) ALLOCATED CREDIT AMOUNT TO APPLY TO ALL TAXABLE YEARS ENDING DURING OR AFTER CREDIT ALLOCATION YEAR.—Any housing credit dollar amount allocated to any building for any calendar year—

(A) shall apply to such building for all taxable years in the compliance period ending during or after such calendar year, and

(B) shall reduce the aggregate housing credit dollar amount of the allocating agency only for such calendar year.

(3) HOUSING CREDIT DOLLAR AMOUNT FOR AGENCIES.—

(A) IN GENERAL.—The aggregate housing credit dollar amount which a housing credit agency may allocate for any calendar year is the portion of the State housing credit ceiling allocated under this paragraph for such calendar year to such agency.

(B) STATE CEILING INITIALLY ALLOCATED TO STATE HOUSING CREDIT AGENCIES.—Except as provided in subparagraphs (D) and (E), the State housing credit ceiling for each calendar year shall be allocated to the housing credit agency of such State. If there is more than 1 housing credit agency of a State, all such agencies shall be treated as a single agency.

(C) STATE HOUSING CREDIT CEILING.—The State housing credit ceiling applicable to any State for any calendar year shall be an amount equal to the sum of—

(i) the unused State housing credit ceiling (if any) of such State for the preceding calendar year,

(ii) the greater of—

(I) $1.75 multiplied by the State population, or

(II) $2,000,000,

(iii) the amount of State housing credit ceiling returned in the calendar year, plus

(iv) the amount (if any) allocated under subparagraph (D) to such State by the Secretary.

For purposes of clause (i), the unused State housing credit ceiling for any calendar year is the excess (if any) of the sum of the amounts described in clauses (ii) through (iv) over the aggregate housing credit dollar amount allocated for such year. For purposes of clause (iii), the amount of State housing credit ceiling returned in the calendar year equals the housing credit dollar amount previously allocated within the State to any project which fails to meet the 10 percent test under paragraph (1)(E)(ii) on a date after the close of the calendar year in which the allocation was made or which does not become a qualified low-income housing project within the period required by this section or the terms of the allocation or to any project with respect to which an allocation is cancelled by mutual consent of the housing credit agency and the allocation recipient.

(D) UNUSED HOUSING CREDIT CARRYOVERS ALLOCATED AMONG CERTAIN STATES.—

(i) IN GENERAL.—The unused housing credit carryover of a State for any calendar year shall be assigned to the Secretary for allocation among qualified States for the succeeding calendar year.

(ii) UNUSED HOUSING CREDIT CARRYOVER.—For purposes of this subparagraph, the unused housing credit

carryover of a State for any calendar year is the excess (if any) of—

(I) the unused State housing credit ceiling for the year preceding such year, over

(II) the aggregate housing credit dollar amount allocated for such year.

(iii) FORMULA FOR ALLOCATION OF UNUSED HOUSING CREDIT CARRYOVERS AMONG QUALIFIED STATES.—The amount allocated under this subparagraph to a qualified State for any calendar year shall be the amount determined by the Secretary to bear the same ratio to the aggregate unused housing credit carryovers of all States for the preceding calendar year as such State's population for the calendar year bears to the population of all qualified States for the calendar year. For purposes of the preceding sentence, population shall be determined in accordance with section 146(j).

(iv) QUALIFIED STATE.—For purposes of this subparagraph, the term "qualified State" means, with respect to a calendar year, any State—

(I) which allocated its entire State housing credit ceiling for the preceding calendar year, and

(II) for which a request is made (not later than May 1 of the calendar year) to receive an allocation under clause (iii).

(E) SPECIAL RULE FOR STATES WITH CONSTITUTIONAL HOME RULE CITIES.—For purposes of this subsection—

(i) IN GENERAL.—The aggregate housing credit dollar amount for any constitutional home rule city for any calendar year shall be an amount which bears the same ratio to the State housing credit ceiling for such calendar year as—

(I) the population of such city, bears to

(II) the population of the entire State.

(ii) COORDINATION WITH OTHER ALLOCATIONS.—In the case of any State which contains 1 or more constitutional home rule cities, for purposes of applying this paragraph with respect to housing credit agencies in such State other than constitutional home rule cities, the State housing credit ceiling for any calendar year shall be reduced by the aggregate housing credit dollar amounts determined for such year for all constitutional home rule cities in such State.

(iii) CONSTITUTIONAL HOME RULE CITY.—For purposes of this paragraph, the term "constitutional home rule city" has the meaning given such term by section 146(d)(3)(C).

(F) STATE MAY PROVIDE FOR DIFFERENT ALLOCATION.—Rules similar to the rules of section 146(e) (other than paragraph (2)(B) thereof) shall apply for purposes of this paragraph.

(G) POPULATION.—For purposes of this paragraph, population shall be determined in accordance with section 146(j).

(H) COST-OF-LIVING ADJUSTMENT.—

(i) IN GENERAL.—In the case of a calendar year after 2002, the $2,000,000 and $1.75 amounts in subparagraph (C) shall each be increased by an amount equal to—

(I) such dollar amount, multiplied by

(II) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar year 2001" for "calendar year 2016" in subparagraph (A)(ii) thereof.

(ii) ROUNDING.—(I) In the case of the $2,000,000 amount, any increase under clause (i) which is not a multiple of $5,000 shall be rounded to the next lowest multiple of $5,000.

(II) In the case of the $1.75 amount, any increase under clause (i) which is not a multiple of 5 cents shall be rounded to the next lowest multiple of 5 cents.

(I) INCREASE IN STATE HOUSING CREDIT CEILING FOR 2018, 2019, 2020, AND 2021.—In the case of calendar years 2018, 2019, 2020, and 2021, each of the dollar amounts in effect under clauses (I) and (II) of subparagraph (C)(ii) for any calendar year (after any increase under subparagraph (H)) shall be increased by multiplying such dollar amount by 1.125.

(4) CREDIT FOR BUILDINGS FINANCED BY TAX-EXEMPT BONDS SUBJECT TO VOLUME CAP NOT TAKEN INTO ACCOUNT.—

(A) IN GENERAL.—Paragraph (1) shall not apply to the portion of any credit allowable under subsection (a) which is attributable to eligible basis financed by any obligation the interest on which is exempt from tax under section 103 if—

(i) such obligation is taken into account under section 146, and

(ii) principal payments on such financing are applied within a reasonable period to redeem obligations the proceeds of which were used to provide such financing or such financing is refunded as described in section 146(i)(6).

(B) SPECIAL RULE WHERE 50 PERCENT OR MORE OF BUILDING IS FINANCED WITH TAX-EXEMPT BONDS SUBJECT TO VOLUME CAP.—For purposes of subparagraph (A), if 50 percent or more of the aggregate basis of any building and the land on which the building is located is financed by any obligation described in subparagraph (A), paragraph (1) shall not apply to any portion of the credit allowable under subsection (a) with respect to such building.

(5) PORTION OF STATE CEILING SET-ASIDE FOR CERTAIN PROJECTS INVOLVING QUALIFIED NONPROFIT ORGANIZATIONS.—

(A) IN GENERAL.—Not more than 90 percent of the State housing credit ceiling for any State for any calendar year shall be allocated to projects other than qualified low-income housing projects described in subparagraph (B).

(B) PROJECTS INVOLVING QUALIFIED NONPROFIT ORGANIZATIONS.—For purposes of subparagraph (A), a qualified low-income housing project is described in this subparagraph if a qualified nonprofit organization is to own an in-

terest in the project (directly or through a partnership) and materially participate (within the meaning of section 469(h)) in the development and operation of the project throughout the compliance period.

(C) QUALIFIED NONPROFIT ORGANIZATION.—For purposes of this paragraph, the term "qualified nonprofit organization" means any organization if—

(i) such organization is described in paragraph (3) or (4) of section 501(c) and is exempt from tax under section 501(a),

(ii) such organization is determined by the State housing credit agency not to be affiliated with or controlled by a for-profit organization, and

(iii) 1 of the exempt purposes of such organization includes the fostering of low-income housing.

(D) TREATMENT OF CERTAIN SUBSIDIARIES.—

(i) IN GENERAL.—For purposes of this paragraph, a qualified nonprofit organization shall be treated as satisfying the ownership and material participation test of subparagraph (B) if any qualified corporation in which such organization holds stock satisfies such test.

(ii) QUALIFIED CORPORATION.—For purposes of clause (i), the term "qualified corporation" means any corporation if 100 percent of the stock of such corporation is held by 1 or more qualified nonprofit organizations at all times during the period such corporation is in existence.

(E) STATE MAY NOT OVERRIDE SET-ASIDE.—Nothing in subparagraph (F) of paragraph (3) shall be construed to permit a State not to comply with subparagraph (A) of this paragraph.

(6) BUILDINGS ELIGIBLE FOR CREDIT ONLY IF MINIMUM LONG-TERM COMMITMENT TO LOW-INCOME HOUSING.—

(A) IN GENERAL.—No credit shall be allowed by reason of this section with respect to any building for the taxable year unless an extended low-income housing commitment is in effect as of the end of such taxable year.

(B) EXTENDED LOW-INCOME HOUSING COMMITMENT.—For purposes of this paragraph, the term "extended low-income housing commitment" means any agreement between the taxpayer and the housing credit agency—

(i) which requires that the applicable fraction (as defined in subsection (c)(1)) for the building for each taxable year in the extended use period will not be less than the applicable fraction specified in such agreement and which prohibits the actions described in subclauses (I) and (II) of subparagraph (E)(ii),

(ii) which allows individuals who meet the income limitation applicable to the building under subsection (g) (whether prospective, present, or former occupants of the building) the right to enforce in any State court the requirement and prohibitions of clause (i),

(iii) which prohibits the disposition to any person of any portion of the building to which such agreement

applies unless all of the building to which such agreement applies is disposed of to such person,

(iv) which prohibits the refusal to lease to a holder of a voucher or certificate of eligibility under section 8 of the United States Housing Act of 1937 because of the status of the prospective tenant as such a holder,

(v) which is binding on all successors of the taxpayer, and

(vi) which, with respect to the property, is recorded pursuant to State law as a restrictive covenant.

(C) ALLOCATION OF CREDIT MAY NOT EXCEED AMOUNT NECESSARY TO SUPPORT COMMITMENT.—

(i) IN GENERAL.—The housing credit dollar amount allocated to any building may not exceed the amount necessary to support the applicable fraction specified in the extended low-income housing commitment for such building, including any increase in such fraction pursuant to the application of subsection (f)(3) if such increase is reflected in an amended low-income housing commitment.

(ii) BUILDINGS FINANCED BY TAX-EXEMPT BONDS.—If paragraph (4) applies to any building the amount of credit allowed in any taxable year may not exceed the amount necessary to support the applicable fraction specified in the extended low-income housing commitment for such building. Such commitment may be amended to increase such fraction.

(D) EXTENDED USE PERIOD.—For purposes of this paragraph, the term "extended use period" means the period—

(i) beginning on the 1st day in the compliance period on which such building is part of a qualified low-income housing project, and

(ii) ending on the later of—

(I) the date specified by such agency in such agreement, or

(II) the date which is 15 years after the close of the compliance period.

(E) EXCEPTIONS IF FORECLOSURE OR IF NO BUYER WILLING TO MAINTAIN LOW-INCOME STATUS.—

(i) IN GENERAL.—The extended use period for any building shall terminate—

(I) on the date the building is acquired by foreclosure (or instrument in lieu of foreclosure) unless the Secretary determines that such acquisition is part of an arrangement with the taxpayer a purpose of which is to terminate such period, or

(II) on the last day of the period specified in subparagraph (I) if the housing credit agency is unable to present during such period a qualified contract for the acquisition of the low-income portion of the building by any person who will continue to operate such portion as a qualified low-income building.

Subclause (II) shall not apply to the extent more stringent requirements are provided in the agreement or in State law.

(ii) EVICTION, ETC. OF EXISTING LOW-INCOME TENANTS NOT PERMITTED.—The termination of an extended use period under clause (i) shall not be construed to permit before the close of the 3-year period following such termination—

(I) the eviction or the termination of tenancy (other than for good cause) of an existing tenant of any low-income unit, or

(II) any increase in the gross rent with respect to such unit not otherwise permitted under this section.

(F) QUALIFIED CONTRACT.—For purposes of subparagraph (E), the term "qualified contract" means a bona fide contract to acquire (within a reasonable period after the contract is entered into) the nonlow-income portion of the building for fair market value and the low-income portion of the building for an amount not less than the applicable fraction (specified in the extended low-income housing commitment) of—

(i) the sum of—

(I) the outstanding indebtedness secured by, or with respect to, the building,

(II) the adjusted investor equity in the building, plus

(III) other capital contributions not reflected in the amounts described in subclause (I) or (II), reduced by

(ii) cash distributions from (or available for distribution from) the project.

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this paragraph, including regulations to prevent the manipulation of the amount determined under the preceding sentence.

(G) ADJUSTED INVESTOR EQUITY.—

(i) IN GENERAL.—For purposes of subparagraph (E), the term "adjusted investor equity" means, with respect to any calendar year, the aggregate amount of cash taxpayers invested with respect to the project increased by the amount equal to—

(I) such amount, multiplied by

(II) the cost-of-living adjustment for such calendar year, determined under section 1(f)(3) by substituting the base calendar year for "calendar year 2016" in subparagraph (A)(ii) thereof.

An amount shall be taken into account as an investment in the project only to the extent there was an obligation to invest such amount as of the beginning of the credit period and to the extent such amount is reflected in the adjusted basis of the project.

(ii) COST-OF-LIVING INCREASES IN EXCESS OF 5 PERCENT NOT TAKEN INTO ACCOUNT.—Under regulations prescribed by the Secretary, if the C-CPI-U for any

calendar year (as defined in section 1(f)(6)) exceeds the C-CPI-U for the preceding calendar year by more than 5 percent, the C-CPI-U for the base calendar year shall be increased such that such excess shall never be taken into account under clause (i). In the case of a base calendar year before 2017, the C-CPI-U for such year shall be determined by multiplying the CPI for such year by the amount determined under section 1(f)(3)(B).

(iii) BASE CALENDAR YEAR.—For purposes of this subparagraph, the term "base calendar year" means the calendar year with or within which the 1st taxable year of the credit period ends.

(H) LOW-INCOME PORTION.—For purposes of this paragraph, the low-income portion of a building is the portion of such building equal to the applicable fraction specified in the extended low-income housing commitment for the building.

(I) PERIOD FOR FINDING BUYER.—The period referred to in this subparagraph is the 1-year period beginning on the date (after the 14th year of the compliance period) the taxpayer submits a written request to the housing credit agency to find a person to acquire the taxpayer's interest in the low-income portion of the building.

(J) EFFECT OF NONCOMPLIANCE.—If, during a taxable year, there is a determination that an extended low-income housing agreement was not in effect as of the beginning of such year, such determination shall not apply to any period before such year and subparagraph (A) shall be applied without regard to such determination if the failure is corrected within 1 year from the date of the determination.

(K) PROJECTS WHICH CONSIST OF MORE THAN 1 BUILDING.—The application of this paragraph to projects which consist of more than 1 building shall be made under regulations prescribed by the Secretary.

(7) SPECIAL RULES.—

(A) BUILDING MUST BE LOCATED WITHIN JURISDICTION OF CREDIT AGENCY.—A housing credit agency may allocate its aggregate housing credit dollar amount only to buildings located in the jurisdiction of the governmental unit of which such agency is a part.

(B) AGENCY ALLOCATIONS IN EXCESS OF LIMIT.—If the aggregate housing credit dollar amounts allocated by a housing credit agency for any calendar year exceed the portion of the State housing credit ceiling allocated to such agency for such calendar year, the housing credit dollar amounts so allocated shall be reduced (to the extent of such excess) for buildings in the reverse of the order in which the allocations of such amounts were made.

(C) CREDIT REDUCED IF ALLOCATED CREDIT DOLLAR AMOUNT IS LESS THAN CREDIT WHICH WOULD BE ALLOWABLE WITHOUT REGARD TO PLACED IN SERVICE CONVENTION, ETC..—

(i) IN GENERAL.—The amount of the credit determined under this section with respect to any building shall not exceed the clause (ii) percentage of the amount of the credit which would (but for this subparagraph) be determined under this section with respect to such building.

(ii) DETERMINATION OF PERCENTAGE.—For purposes of clause (i), the clause (ii) percentage with respect to any building is the percentage which—

(I) the housing credit dollar amount allocated to such building bears to

(II) the credit amount determined in accordance with clause (iii).

(iii) DETERMINATION OF CREDIT AMOUNT.—The credit amount determined in accordance with this clause is the amount of the credit which would (but for this subparagraph) be determined under this section with respect to the building if—

(I) this section were applied without regard to paragraphs (2)(A) and (3)(B) of subsection (f), and

(II) subsection (f)(3)(A) were applied without regard to "the percentage equal to 2/3 of".

(D) HOUSING CREDIT AGENCY TO SPECIFY APPLICABLE PERCENTAGE AND MAXIMUM QUALIFIED BASIS.—In allocating a housing credit dollar amount to any building, the housing credit agency shall specify the applicable percentage and the maximum qualified basis which may be taken into account under this section with respect to such building. The applicable percentage and maximum qualified basis so specified shall not exceed the applicable percentage and qualified basis determined under this section without regard to this subsection.

(8) OTHER DEFINITIONS.—For purposes of this subsection—

(A) HOUSING CREDIT AGENCY.—The term "housing credit agency" means any agency authorized to carry out this subsection.

(B) POSSESSIONS TREATED AS STATES.—The term "State" includes a possession of the United States.

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

(1) COMPLIANCE PERIOD.—The term "compliance period" means, with respect to any building, the period of 15 taxable years beginning with the 1st taxable year of the credit period with respect thereto.

(2) DETERMINATION OF WHETHER BUILDING IS FEDERALLY SUBSIDIZED.—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, for purposes of subsection (b)(1), a new building shall be treated as federally subsidized for any taxable year if, at any time during such taxable year or any prior taxable year, there is or was outstanding any obligation the interest on which is exempt from tax under section 103 the proceeds of which are or were used (directly or indirectly) with respect to such building or the operation thereof.

(B) ELECTION TO REDUCE ELIGIBLE BASIS BY PROCEEDS OF OBLIGATIONS.—A tax-exempt obligation shall not be taken into account under subparagraph (A) if the taxpayer elects to exclude from the eligible basis of the building for purposes of subsection (d) the proceeds of such obligation.

(C) SPECIAL RULE FOR SUBSIDIZED CONSTRUCTION FINANCING.—Subparagraph (A) shall not apply to any tax-exempt obligation used to provide construction financing for any building if—

(i) such obligation (when issued) identified the building for which the proceeds of such obligation would be used, and

(ii) such obligation is redeemed before such building is placed in service.

(3) LOW-INCOME UNIT.—

(A) IN GENERAL.—The term "low-income unit" means any unit in a building if—

(i) such unit is rent-restricted (as defined in subsection (g)(2)), and

(ii) the individuals occupying such unit meet the income limitation applicable under subsection (g)(1) to the project of which such building is a part.

(B) EXCEPTIONS.—

(i) IN GENERAL.—A unit shall not be treated as a low-income unit unless the unit is suitable for occupancy and used other than on a transient basis.

(ii) SUITABILITY FOR OCCUPANCY.—For purposes of clause (i), the suitability of a unit for occupancy shall be determined under regulations prescribed by the Secretary taking into account local health, safety, and building codes.

(iii) TRANSITIONAL HOUSING FOR HOMELESS.—For purposes of clause (i), a unit shall be considered to be used other than on a transient basis if the unit contains sleeping accommodations and kitchen and bathroom facilities and is located in a building—

(I) which is used exclusively to facilitate the transition of homeless individuals (within the meaning of section 103 of the McKinney-Vento Homeless Assistance Act (42 U.S.C. 11302), as in effect on the date of the enactment of this clause) to independent living within 24 months, and

(II) in which a governmental entity or qualified nonprofit organization (as defined in subsection (h)(5)) provides such individuals with temporary housing and supportive services designed to assist such individuals in locating and retaining permanent housing.

(iv) SINGLE-ROOM OCCUPANCY UNITS.—For purposes of clause (i), a single-room occupancy unit shall not be treated as used on a transient basis merely because it is rented on a month-by-month basis.

(C) SPECIAL RULE FOR BUILDINGS HAVING 4 OR FEWER UNITS.—In the case of any building which has 4 or fewer residential rental units, no unit in such building shall be

treated as a low-income unit if the units in such building are owned by—

(i) any individual who occupies a residential unit in such building, or

(ii) any person who is related (as defined in subsection (d)(2)(D)(iii)) to such individual.

(D) CERTAIN STUDENTS NOT TO DISQUALIFY UNIT.—A unit shall not fail to be treated as a low-income unit merely because it is occupied—

(i) by an individual who is—

(I) a student and receiving assistance under title IV of the Social Security Act,

(II) a student who was previously under the care and placement responsibility of the State agency responsible for administering a plan under part B or part E of title IV of the Social Security Act, or

(III) enrolled in a job training program receiving assistance under the Job Training Partnership Act or under other similar Federal, State, or local laws, or

(ii) entirely by full-time students if such students are—

(I) single parents and their children and such parents are not dependents (as defined in section 152, determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B) thereof) of another individual and such children are not dependents (as so defined) of another individual other than a parent of such children, or

(II) married and file a joint return.

(E) OWNER-OCCUPIED BUILDINGS HAVING 4 OR FEWER UNITS ELIGIBLE FOR CREDIT WHERE DEVELOPMENT PLAN.—

(i) IN GENERAL.—Subparagraph (C) shall not apply to the acquisition or rehabilitation of a building pursuant to a development plan of action sponsored by a State or local government or a qualified nonprofit organization (as defined in subsection (h)(5)(C)).

(ii) LIMITATION ON CREDIT.—In the case of a building to which clause (i) applies, the applicable fraction shall not exceed 80 percent of the unit fraction.

(iii) CERTAIN UNRENTED UNITS TREATED AS OWNER-OCCUPIED.—In the case of a building to which clause (i) applies, any unit which is not rented for 90 days or more shall be treated as occupied by the owner of the building as of the 1st day it is not rented.

(4) NEW BUILDING.—The term "new building" means a building the original use of which begins with the taxpayer.

(5) EXISTING BUILDING.—The term "existing building" means any building which is not a new building.

(6) APPLICATION TO ESTATES AND TRUSTS.—In the case of an estate or trust, the amount of the credit determined under subsection (a) and any increase in tax under subsection (j) shall be apportioned between the estate or trust and the bene-

ficiaries on the basis of the income of the estate or trust allocable to each.

(7) IMPACT OF TENANT'S RIGHT OF 1ST REFUSAL TO ACQUIRE PROPERTY.—

(A) IN GENERAL.—No Federal income tax benefit shall fail to be allowable to the taxpayer with respect to any qualified low-income building merely by reason of a right of 1st refusal held by the tenants (in cooperative form or otherwise) or resident management corporation of such building or by a qualified nonprofit organization (as defined in subsection (h)(5)(C)) or government agency to purchase the property after the close of the compliance period for a price which is not less than the minimum purchase price determined under subparagraph (B).

(B) MINIMUM PURCHASE PRICE.—For purposes of subparagraph (A), the minimum purchase price under this subparagraph is an amount equal to the sum of—

(i) the principal amount of outstanding indebtedness secured by the building (other than indebtedness incurred within the 5-year period ending on the date of the sale to the tenants), and

(ii) all Federal, State, and local taxes attributable to such sale.

Except in the case of Federal income taxes, there shall not be taken into account under clause (ii) any additional tax attributable to the application of clause (ii).

(8) TREATMENT OF RURAL PROJECTS.—For purposes of this section, in the case of any project for residential rental property located in a rural area (as defined in section 520 of the Housing Act of 1949), any income limitation measured by reference to area median gross income shall be measured by reference to the greater of area median gross income or national non-metropolitan median income. The preceding sentence shall not apply with respect to any building if paragraph (1) of section 42(h) does not apply by reason of paragraph (4) thereof to any portion of the credit determined under this section with respect to such building.

(9) COORDINATION WITH LOW-INCOME HOUSING GRANTS.—

(A) REDUCTION IN STATE HOUSING CREDIT CEILING FOR LOW-INCOME HOUSING GRANTS RECEIVED IN 2009.—For purposes of this section, the amounts described in clauses (i) through (iv) of subsection (h)(3)(C) with respect to any State for 2009 shall each be reduced by so much of such amount as is taken into account in determining the amount of any grant to such State under section 1602 of the American Recovery and Reinvestment Tax Act of 2009.

(B) SPECIAL RULE FOR BASIS.—Basis of a qualified low-income building shall not be reduced by the amount of any grant described in subparagraph (A).

(j) RECAPTURE OF CREDIT.—

(1) IN GENERAL.—If—

(A) as of the close of any taxable year in the compliance period, the amount of the qualified basis of any building with respect to the taxpayer is less than

(B) the amount of such basis as of the close of the preceding taxable year,

then the taxpayer's tax under this chapter for the taxable year shall be increased by the credit recapture amount.

(2) CREDIT RECAPTURE AMOUNT.—For purposes of paragraph (1), the credit recapture amount is an amount equal to the sum of—

(A) the aggregate decrease in the credits allowed to the taxpayer under section 38 for all prior taxable years which would have resulted if the accelerated portion of the credit allowable by reason of this section were not allowed for all prior taxable years with respect to the excess of the amount described in paragraph (1)(B) over the amount described in paragraph (1)(A), plus

(B) interest at the overpayment rate established under section 6621 on the amount determined under subparagraph (A) for each prior taxable year for the period beginning on the due date for filing the return for the prior taxable year involved.

No deduction shall be allowed under this chapter for interest described in subparagraph (B).

(3) ACCELERATED PORTION OF CREDIT.—For purposes of paragraph (2), the accelerated portion of the credit for the prior taxable years with respect to any amount of basis is the excess of—

(A) the aggregate credit allowed by reason of this section (without regard to this subsection) for such years with respect to such basis, over

(B) the aggregate credit which would be allowable by reason of this section for such years with respect to such basis if the aggregate credit which would (but for this subsection) have been allowable for the entire compliance period were allowable ratably over 15 years.

(4) SPECIAL RULES.—

(A) TAX BENEFIT RULE.—The tax for the taxable year shall be increased under paragraph (1) only with respect to credits allowed by reason of this section which were used to reduce tax liability. In the case of credits not so used to reduce tax liability, the carryforwards and carrybacks under section 39 shall be appropriately adjusted.

(B) ONLY BASIS FOR WHICH CREDIT ALLOWED TAKEN INTO ACCOUNT.—Qualified basis shall be taken into account under paragraph (1)(B) only to the extent such basis was taken into account in determining the credit under subsection (a) for the preceding taxable year referred to in such paragraph.

(C) NO RECAPTURE OF ADDITIONAL CREDIT ALLOWABLE BY REASON OF SUBSECTION (F)(3).—Paragraph (1) shall apply to a decrease in qualified basis only to the extent such decrease exceeds the amount of qualified basis with respect to which a credit was allowable for the taxable year referred to in paragraph (1)(B) by reason of subsection (f)(3).

(D) NO CREDITS AGAINST TAX.—Any increase in tax under this subsection shall not be treated as a tax imposed

by this chapter for purposes of determining the amount of any credit under this chapter.

(E) NO RECAPTURE BY REASON OF CASUALTY LOSS.—The increase in tax under this subsection shall not apply to a reduction in qualified basis by reason of a casualty loss to the extent such loss is restored by reconstruction or replacement within a reasonable period established by the Secretary.

(F) NO RECAPTURE WHERE DE MINIMIS CHANGES IN FLOOR SPACE.—The Secretary may provide that the increase in tax under this subsection shall not apply with respect to any building if—

(i) such increase results from a de minimis change in the floor space fraction under subsection (c)(1), and

(ii) the building is a qualified low-income building after such change.

(5) CERTAIN PARTNERSHIPS TREATED AS THE TAXPAYER.—

(A) IN GENERAL.—For purposes of applying this subsection to a partnership to which this paragraph applies—

(i) such partnership shall be treated as the taxpayer to which the credit allowable under subsection (a) was allowed,

(ii) the amount of such credit allowed shall be treated as the amount which would have been allowed to the partnership were such credit allowable to such partnership,

(iii) paragraph (4)(A) shall not apply, and

(iv) the amount of the increase in tax under this subsection for any taxable year shall be allocated among the partners of such partnership in the same manner as such partnership's taxable income for such year is allocated among such partners.

(B) PARTNERSHIPS TO WHICH PARAGRAPH APPLIES.—This paragraph shall apply to any partnership which has 35 or more partners unless the partnership elects not to have this paragraph apply.

(C) SPECIAL RULES.—

[(i) HUSBAND AND WIFE TREATED AS 1 PARTNER.—For purposes of subparagraph (B)(i), a husband and wife (and their estates) shall be treated as 1 partner.]

(i) MARRIED COUPLE TREATED AS 1 PARTNER.—For purposes of subparagraph (B), individuals married to one another (and their estates) shall be treated as 1 partner.

(ii) ELECTION IRREVOCABLE.—Any election under subparagraph (B), once made, shall be irrevocable.

(6) NO RECAPTURE ON DISPOSITION OF BUILDING WHICH CONTINUES IN QUALIFIED USE.—

(A) IN GENERAL.—The increase in tax under this subsection shall not apply solely by reason of the disposition of a building (or an interest therein) if it is reasonably expected that such building will continue to be operated as a qualified low-income building for the remaining compliance period with respect to such building.

(B) STATUTE OF LIMITATIONS.—If a building (or an interest therein) is disposed of during any taxable year and there is any reduction in the qualified basis of such building which results in an increase in tax under this subsection for such taxable or any subsequent taxable year, then—

(i) the statutory period for the assessment of any deficiency with respect to such increase in tax shall not expire before the expiration of 3 years from the date the Secretary is notified by the taxpayer (in such manner as the Secretary may prescribe) of such reduction in qualified basis, and

(ii) such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

(k) APPLICATION OF AT-RISK RULES.—For purposes of this section—

(1) IN GENERAL.—Except as otherwise provided in this subsection, rules similar to the rules of section 49(a)(1) (other than subparagraphs (D)(ii)(II) and (D)(iv)(I) thereof), section 49(a)(2), and section 49(b)(1) shall apply in determining the qualified basis of any building in the same manner as such sections apply in determining the credit base of property.

(2) SPECIAL RULES FOR DETERMINING QUALIFIED PERSON.—For purposes of paragraph (1)—

(A) IN GENERAL.—If the requirements of subparagraphs (B), (C), and (D) are met with respect to any financing borrowed from a qualified nonprofit organization (as defined in subsection (h)(5)), the determination of whether such financing is qualified commercial financing with respect to any qualified low-income building shall be made without regard to whether such organization—

(i) is actively and regularly engaged in the business of lending money, or

(ii) is a person described in section 49(a)(1)(D)(iv)(II).

(B) FINANCING SECURED BY PROPERTY.—The requirements of this subparagraph are met with respect to any financing if such financing is secured by the qualified low-income building, except that this subparagraph shall not apply in the case of a federally assisted building described in subsection (d)(6)(C) if—

(i) a security interest in such building is not permitted by a Federal agency holding or insuring the mortgage secured by such building, and

(ii) the proceeds from the financing (if any) are applied to acquire or improve such building.

(C) PORTION OF BUILDING ATTRIBUTABLE TO FINANCING.—The requirements of this subparagraph are met with respect to any financing for any taxable year in the compliance period if, as of the close of such taxable year, not more than 60 percent of the eligible basis of the qualified low-income building is attributable to such financing (reduced by the principal and interest of any governmental fi-

nancing which is part of a wrap-around mortgage involving such financing).

(D) REPAYMENT OF PRINCIPAL AND INTEREST.—The requirements of this subparagraph are met with respect to any financing if such financing is fully repaid on or before the earliest of—

(i) the date on which such financing matures,

(ii) the 90th day after the close of the compliance period with respect to the qualified low-income building, or

(iii) the date of its refinancing or the sale of the building to which such financing relates.

In the case of a qualified nonprofit organization which is not described in section 49(a)(1)(D)(iv)(II) with respect to a building, clause (ii) of this subparagraph shall be applied as if the date described therein were the 90th day after the earlier of the date the building ceases to be a qualified low-income building or the date which is 15 years after the close of a compliance period with respect thereto.

(3) PRESENT VALUE OF FINANCING.—If the rate of interest on any financing described in paragraph (2)(A) is less than the rate which is 1 percentage point below the applicable Federal rate as of the time such financing is incurred, then the qualified basis (to which such financing relates) of the qualified low-income building shall be the present value of the amount of such financing, using as the discount rate such applicable Federal rate. For purposes of the preceding sentence, the rate of interest on any financing shall be determined by treating interest to the extent of government subsidies as not payable.

(4) FAILURE TO FULLY REPAY.—

(A) IN GENERAL.—To the extent that the requirements of paragraph (2)(D) are not met, then the taxpayer's tax under this chapter for the taxable year in which such failure occurs shall be increased by an amount equal to the applicable portion of the credit under this section with respect to such building, increased by an amount of interest for the period—

(i) beginning with the due date for the filing of the return of tax imposed by chapter 1 for the 1st taxable year for which such credit was allowable, and

(ii) ending with the due date for the taxable year in which such failure occurs,

determined by using the underpayment rate and method under section 6621.

(B) APPLICABLE PORTION.—For purposes of subparagraph (A), the term "applicable portion" means the aggregate decrease in the credits allowed to a taxpayer under section 38 for all prior taxable years which would have resulted if the eligible basis of the building were reduced by the amount of financing which does not meet requirements of paragraph (2)(D).

(C) CERTAIN RULES TO APPLY.—Rules similar to the rules of subparagraphs (A) and (D) of subsection (j)(4) shall apply for purposes of this subsection.

(l) CERTIFICATIONS AND OTHER REPORTS TO SECRETARY.—

(1) CERTIFICATION WITH RESPECT TO 1ST YEAR OF CREDIT PERIOD.—Following the close of the 1st taxable year in the credit period with respect to any qualified low-income building, the taxpayer shall certify to the Secretary (at such time and in such form and in such manner as the Secretary prescribes)—

(A) the taxable year, and calendar year, in which such building was placed in service,

(B) the adjusted basis and eligible basis of such building as of the close of the 1st year of the credit period,

(C) the maximum applicable percentage and qualified basis permitted to be taken into account by the appropriate housing credit agency under subsection (h),

(D) the election made under subsection (g) with respect to the qualified low-income housing project of which such building is a part, and

(E) such other information as the Secretary may require.

In the case of a failure to make the certification required by the preceding sentence on the date prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, no credit shall be allowable by reason of subsection (a) with respect to such building for any taxable year ending before such certification is made.

(2) ANNUAL REPORTS TO THE SECRETARY.—The Secretary may require taxpayers to submit an information return (at such time and in such form and manner as the Secretary prescribes) for each taxable year setting forth—

(A) the qualified basis for the taxable year of each qualified low-income building of the taxpayer,

(B) the information described in paragraph (1)(C) for the taxable year, and

(C) such other information as the Secretary may require.

The penalty under section 6652(j) shall apply to any failure to submit the return required by the Secretary under the preceding sentence on the date prescribed therefor.

(3) ANNUAL REPORTS FROM HOUSING CREDIT AGENCIES.—Each agency which allocates any housing credit amount to any building for any calendar year shall submit to the Secretary (at such time and in such manner as the Secretary shall prescribe) an annual report specifying—

(A) the amount of housing credit amount allocated to each building for such year,

(B) sufficient information to identify each such building and the taxpayer with respect thereto, and

(C) such other information as the Secretary may require.

The penalty under section 6652(j) shall apply to any failure to submit the report required by the preceding sentence on the date prescribed therefor.

(m) RESPONSIBILITIES OF HOUSING CREDIT AGENCIES.—

(1) PLANS FOR ALLOCATION OF CREDIT AMONG PROJECTS.—

(A) IN GENERAL.—Notwithstanding any other provision of this section, the housing credit dollar amount with respect to any building shall be zero unless—

(i) such amount was allocated pursuant to a qualified allocation plan of the housing credit agency which is approved by the governmental unit (in accordance

with rules similar to the rules of section 147(f)(2) (other than subparagraph (B)(ii) thereof)) of which such agency is a part,

(ii) such agency notifies the chief executive officer (or the equivalent) of the local jurisdiction within which the building is located of such project and provides such individual a reasonable opportunity to comment on the project,

(iii) a comprehensive market study of the housing needs of low-income individuals in the area to be served by the project is conducted before the credit allocation is made and at the developer's expense by a disinterested party who is approved by such agency, and

(iv) a written explanation is available to the general public for any allocation of a housing credit dollar amount which is not made in accordance with established priorities and selection criteria of the housing credit agency.

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

(i) which sets forth selection criteria to be used to determine housing priorities of the housing credit agency which are appropriate to local conditions,

(ii) which also gives preference in allocating housing credit dollar amounts among selected projects to—

(I) projects serving the lowest income tenants,

(II) projects obligated to serve qualified tenants for the longest periods, and

(III) projects which are located in qualified census tracts (as defined in subsection (d)(5)(B)(ii)) and the development of which contributes to a concerted community revitalization plan, and

(iii) which provides a procedure that the agency (or an agent or other private contractor of such agency) will follow in monitoring for noncompliance with the provisions of this section and in notifying the Internal Revenue Service of such noncompliance which such agency becomes aware of and in monitoring for noncompliance with habitability standards through regular site visits.

(C) CERTAIN SELECTION CRITERIA MUST BE USED.—The selection criteria set forth in a qualified allocation plan must include

(i) project location,

(ii) housing needs characteristics,

(iii) project characteristics, including whether the project includes the use of existing housing as part of a community revitalization plan,

(iv) sponsor characteristics,

(v) tenant populations with special housing needs,

(vi) public housing waiting lists,

(vii) tenant populations of individuals with children,

(viii) projects intended for eventual tenant ownership,

(ix) the energy efficiency of the project, and

(x) the historic nature of the project.

(D) APPLICATION TO BOND FINANCED PROJECTS.—Subsection (h)(4) shall not apply to any project unless the project satisfies the requirements for allocation of a housing credit dollar amount under the qualified allocation plan applicable to the area in which the project is located.

(2) CREDIT ALLOCATED TO BUILDING NOT TO EXCEED AMOUNT NECESSARY TO ASSURE PROJECT FEASIBILITY.—

(A) IN GENERAL.—The housing credit dollar amount allocated to a project shall not exceed the amount the housing credit agency determines is necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period.

(B) AGENCY EVALUATION.—In making the determination under subparagraph (A), the housing credit agency shall consider—

(i) the sources and uses of funds and the total financing planned for the project,

(ii) any proceeds or receipts expected to be generated by reason of tax benefits,

(iii) the percentage of the housing credit dollar amount used for project costs other than the cost of intermediaries, and

(iv) the reasonableness of the developmental and operational costs of the project.

Clause (iii) shall not be applied so as to impede the development of projects in hard-to-develop areas. Such a determination shall not be construed to be a representation or warranty as to the feasibility or viability of the project.

(C) DETERMINATION MADE WHEN CREDIT AMOUNT APPLIED FOR AND WHEN BUILDING PLACED IN SERVICE.—

(i) IN GENERAL.—A determination under subparagraph (A) shall be made as of each of the following times:

(I) The application for the housing credit dollar amount.

(II) The allocation of the housing credit dollar amount.

(III) The date the building is placed in service.

(ii) CERTIFICATION AS TO AMOUNT OF OTHER SUBSIDIES.—Prior to each determination under clause (i), the taxpayer shall certify to the housing credit agency the full extent of all Federal, State, and local subsidies which apply (or which the taxpayer expects to apply) with respect to the building.

(D) APPLICATION TO BOND FINANCED PROJECTS.—Subsection (h)(4) shall not apply to any project unless the governmental unit which issued the bonds (or on behalf of which the bonds were issued) makes a determination under rules similar to the rules of subparagraphs (A) and (B).

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

(1) dealing with—

(A) projects which include more than 1 building or only a portion of a building,

(B) buildings which are placed in service in portions,

(2) providing for the application of this section to short taxable years,

(3) preventing the avoidance of the rules of this section, and

(4) providing the opportunity for housing credit agencies to correct administrative errors and omissions with respect to allocations and record keeping within a reasonable period after their discovery, taking into account the availability of regulations and other administrative guidance from the Secretary.

Subchapter B—COMPUTATION OF TAXABLE INCOME

* * * * * * *

PART I—DEFINITION OF GROSS INCOME, ADJUSTED GROSS INCOME, TAXABLE INCOME, ETC.

* * * * * * *

SEC. 62. ADJUSTED GROSS INCOME DEFINED.

(a) GENERAL RULE.—For purposes of this subtitle, the term "adjusted gross income" means, in the case of an individual, gross income minus the following deductions:

(1) TRADE AND BUSINESS DEDUCTIONS.—The deductions allowed by this chapter (other than by part VII of this subchapter) which are attributable to a trade or business carried on by the taxpayer, if such trade or business does not consist of the performance of services by the taxpayer as an employee.

(2) CERTAIN TRADE AND BUSINESS DEDUCTIONS OF EMPLOYEES.—

(A) REIMBURSED EXPENSES OF EMPLOYEES.—The deductions allowed by part VI (section 161 and following) which consist of expenses paid or incurred by the taxpayer, in connection with the performance by him of services as an employee, under a reimbursement or other expense allowance arrangement with his employer. The fact that the reimbursement may be provided by a third party shall not be determinative of whether or not the preceding sentence applies.

(B) CERTAIN EXPENSES OF PERFORMING ARTISTS.—The deductions allowed by section 162 which consist of expenses paid or incurred by a qualified performing artist in connection with the performances by him of services in the performing arts as an employee.

(C) CERTAIN EXPENSES OF OFFICIALS.—The deductions allowed by section 162 which consist of expenses paid or incurred with respect to services performed by an official as an employee of a State or a political subdivision thereof in a position compensated in whole or in part on a fee basis.

(D) CERTAIN EXPENSES OF ELEMENTARY AND SECONDARY SCHOOL TEACHERS.—The deductions allowed by section 162 which consist of expenses, not in excess of $250, paid or incurred by an eligible educator—

(i) by reason of the participation of the educator in professional development courses related to the curriculum in which the educator provides instruction or to the students for which the educator provides instruction, and

(ii) in connection with books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services) and other equipment, and supplementary materials used by the eligible educator in the classroom.

(E) CERTAIN EXPENSES OF MEMBERS OF RESERVE COMPONENTS OF THE ARMED FORCES OF THE UNITED STATES.—The deductions allowed by section 162 which consist of expenses, determined at a rate not in excess of the rates for travel expenses (including per diem in lieu of subsistence) authorized for employees of agencies under subchapter I of chapter 57 of title 5, United States Code, paid or incurred by the taxpayer in connection with the performance of services by such taxpayer as a member of a reserve component of the Armed Forces of the United States for any period during which such individual is more than 100 miles away from home in connection with such services.

(3) LOSSES FROM SALE OR EXCHANGE OF PROPERTY.—The deductions allowed by part VI (sec. 161 and following) as losses from the sale or exchange of property.

(4) DEDUCTIONS ATTRIBUTABLE TO RENTS AND ROYALTIES.—The deductions allowed by part VI (sec. 161 and following), by section 212 (relating to expenses for production of income), and by section 611 (relating to depletion) which are attributable to property held for the production of rents or royalties.

(5) CERTAIN DEDUCTIONS OF LIFE TENANTS AND INCOME BENEFICIARIES OF PROPERTY.—In the case of a life tenant of property, or an income beneficiary of property held in trust, or an heir, legatee, or devisee of an estate, the deduction for depreciation allowed by section 167 and the deduction allowed by section 611.

(6) PENSION, PROFIT-SHARING, AND ANNUITY PLANS OF SELF-EMPLOYED INDIVIDUALS.—In the case of an individual who is an employee within the meaning of section 401(c)(1), the deduction allowed by section 404.

(7) RETIREMENT SAVINGS.—The deduction allowed by section 219 (relating to deduction of certain retirement savings).

(9) PENALTIES FORFEITED BECAUSE OF PREMATURE WITHDRAWAL OF FUNDS FROM TIME SAVINGS ACCOUNTS OR DEPOSITS.—The deductions allowed by section 165 for losses incurred in any transaction entered into for profit, though not connected with a trade or business, to the extent that such losses include amounts forfeited to a bank, mutual savings bank, savings and loan association, building and loan association, cooperative bank or homestead association as a penalty for premature

withdrawal of funds from a time savings account, certificate of deposit, or similar class of deposit.

(11) REFORESTATION EXPENSES.—The deduction allowed by section 194.

(12) CERTAIN REQUIRED REPAYMENTS OF SUPPLEMENTAL UNEMPLOYMENT COMPENSATION BENEFITS.—The deduction allowed by section 165 for the repayment to a trust described in paragraph (9) or (17) of section 501(c) of supplemental unemployment compensation benefits received from such trust if such repayment is required because of the receipt of trade readjustment allowances under section 231 or 232 of the Trade Act of 1974 (19 U.S.C. 2291 and 2292).

(13) JURY DUTY PAY REMITTED TO EMPLOYER.—Any deduction allowable under this chapter by reason of an individual remitting any portion of any jury pay to such individual's employer in exchange for payment by the employer of compensation for the period such individual was performing jury duty. For purposes of the preceding sentence, the term "jury pay" means any payment received by the individual for the discharge of jury duty.

(15) MOVING EXPENSES.—The deduction allowed by section 217.

(16) ARCHER MSAS.—The deduction allowed by section 220.

(17) INTEREST ON EDUCATION LOANS.—The deduction allowed by section 221.

(18) HIGHER EDUCATION EXPENSES.—The deduction allowed by section 222.

(19) HEALTH SAVINGS ACCOUNTS.—The deduction allowed by section 223.

(20) COSTS INVOLVING DISCRIMINATION SUITS, ETC..—Any deduction allowable under this chapter for attorney fees and court costs paid by, or on behalf of, the taxpayer in connection with any action involving a claim of unlawful discrimination (as defined in subsection (e)) or a claim of a violation of subchapter III of chapter 37 of title 31, United States Code, or a claim made under section 1862(b)(3)(A) of the Social Security Act (42 U.S.C. 1395y(b)(3)(A)). The preceding sentence shall not apply to any deduction in excess of the amount includible in the taxpayer's gross income for the taxable year on account of a judgment or settlement (whether by suit or agreement and whether as lump sum or periodic payments) resulting from such claim.

(21) ATTORNEYS' FEES RELATING TO AWARDS TO WHISTLEBLOWERS.—

(A) IN GENERAL.—Any deduction allowable under this chapter for attorney fees and court costs paid by, or on behalf of, the taxpayer in connection with any award under—

(i) section 7623(b), or

(ii) in the case of taxable years beginning after December 31, 2017, any action brought under—

(I) section 21F of the Securities Exchange Act of 1934 (15 U.S.C. 78u–6),

(II) a State false claims act, including a State false claims act with qui tam provisions, or

(III) section 23 of the Commodity Exchange Act (7 U.S.C. 26).

(B) MAY NOT EXCEED AWARD.—Subparagraph (A) shall not apply to any deduction in excess of the amount includible in the taxpayer's gross income for the taxable year on account of such award.

Nothing in this section shall permit the same item to be deducted more than once. Any deduction allowed by section 199A shall not be treated as a deduction described in any of the preceding paragraphs of this subsection.

(b) QUALIFIED PERFORMING ARTIST.—

(1) IN GENERAL.—For purposes of subsection (a)(2)(B), the term "qualified performing artist" means, with respect to any taxable year, any individual if—

(A) such individual performed services in the performing arts as an employee during the taxable year for at least 2 employers,

(B) the aggregate amount allowable as a deduction under section 162 in connection with the performance of such services exceeds 10 percent of such individual's gross income attributable to the performance of such services, and

(C) the adjusted gross income of such individual for the taxable year (determined without regard to subsection (a)(2)(B)) does not exceed $16,000.

(2) NOMINAL EMPLOYER NOT TAKEN INTO ACCOUNT.—An individual shall not be treated as performing services in the performing arts as an employee for any employer during any taxable year unless the amount received by such individual from such employer for the performance of such services during the taxable year equals or exceeds $200.

(3) SPECIAL RULES FOR MARRIED COUPLES.—

(A) IN GENERAL.—Except in the case of a [husband and wife who lived apart] *married couple who lived apart* at all times during the taxable year, if the taxpayer is married at the close of the taxable year, subsection (a)(2)(B) shall apply only if [the taxpayer and his spouse] *the taxpayer and the spouse of the taxpayer* file a joint return for the taxable year.

(B) APPLICATION OF PARAGRAPH (1).—In the case of a joint return—

(i) paragraph (1) (other than subparagraph (C) thereof) shall be applied separately with respect to each spouse, but

(ii) paragraph (1)(C) shall be applied with respect to their combined adjusted gross income.

(C) DETERMINATION OF MARITAL STATUS.—For purposes of this subsection, marital status shall be determined under section 7703(a).

(D) JOINT RETURN.—For purposes of this subsection, the term "joint return" means the joint return of a [husband and wife] *married couple* made under section 6013.

(c) CERTAIN ARRANGEMENTS NOT TREATED AS REIMBURSEMENT ARRANGEMENTS.—For purposes of subsection (a)(2)(A), an arrange-

ment shall in no event be treated as a reimbursement or other expense allowance arrangement if—

(1) such arrangement does not require the employee to substantiate the expenses covered by the arrangement to the person providing the reimbursement, or

(2) such arrangement provides the employee the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

The substantiation requirements of the preceding sentence shall not apply to any expense to the extent that substantiation is not required under section 274(d) for such expense by reason of the regulations prescribed under the 2nd sentence thereof.

(d) DEFINITION; SPECIAL RULES.—

(1) ELIGIBLE EDUCATOR.—

(A) IN GENERAL.—For purposes of subsection (a)(2)(D), the term "eligible educator" means, with respect to any taxable year, an individual who is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide in a school for at least 900 hours during a school year.

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

(2) COORDINATION WITH EXCLUSIONS.—A deduction shall be allowed under subsection (a)(2)(D) for expenses only to the extent the amount of such expenses exceeds the amount excludable under section 135, 529(c)(1), or 530(d)(2) for the taxable year.

(3) INFLATION ADJUSTMENT.—In the case of any taxable year beginning after 2015, the $250 amount in subsection (a)(2)(D) shall be increased by an amount equal to—

(A) such dollar amount, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting "calendar year 2014" for "calendar year 2016" in subparagraph (A)(ii) thereof.

Any increase determined under the preceding sentence shall be rounded to the nearest multiple of $50.

(e) UNLAWFUL DISCRIMINATION DEFINED.—For purposes of subsection (a)(20), the term "unlawful discrimination" means an act that is unlawful under any of the following:

(1) Section 302 of the Civil Rights Act of 1991 (42 U.S.C. 2000e–16b).

(2) Section 201, 202, 203, 204, 205, 206, or 207 of the Congressional Accountability Act of 1995 (2 U.S.C. 1311, 1312, 1313, 1314, 1315, 1316, or 1317).

(3) The National Labor Relations Act (29 U.S.C. 151 et seq.).

(4) The Fair Labor Standards Act of 1938 (29 U.S.C. 201 et seq.).

(5) Section 4 or 15 of the Age Discrimination in Employment Act of 1967 (29 U.S.C. 623 or 633a).

(6) Section 501 or 504 of the Rehabilitation Act of 1973 (29 U.S.C. 791 or 794).

(7) Section 510 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1140).

(8) Title IX of the Education Amendments of 1972 (20 U.S.C. 1681 et seq.).

(9) The Employee Polygraph Protection Act of 1988 (29 U.S.C. 2001 et seq.).

(10) The Worker Adjustment and Retraining Notification Act (29 U.S.C. 2102 et seq.).

(11) Section 105 of the Family and Medical Leave Act of 1993 (29 U.S.C. 2615).

(12) Chapter 43 of title 38, United States Code (relating to employment and reemployment rights of members of the uniformed services).

(13) Section 1977, 1979, or 1980 of the Revised Statutes (42 U.S.C. 1981, 1983, or 1985).

(14) Section 703, 704, or 717 of the Civil Rights Act of 1964 (42 U.S.C. 2000e–2, 2000e–3, or 2000e–16).

(15) Section 804, 805, 806, 808, or 818 of the Fair Housing Act (42 U.S.C. 3604, 3605, 3606, 3608, or 3617).

(16) Section 102, 202, 302, or 503 of the Americans with Disabilities Act of 1990 (42 U.S.C. 12112, 12132, 12182, or 12203).

(17) Any provision of Federal law (popularly known as whistleblower protection provisions) prohibiting the discharge of an employee, the discrimination against an employee, or any other form of retaliation or reprisal against an employee for asserting rights or taking other actions permitted under Federal law.

(18) Any provision of Federal, State, or local law, or common law claims permitted under Federal, State, or local law—

(i) providing for the enforcement of civil rights, or

(ii) regulating any aspect of the employment relationship, including claims for wages, compensation, or benefits, or prohibiting the discharge of an employee, the discrimination against an employee, or any other form of retaliation or reprisal against an employee for asserting rights or taking other actions permitted by law.

SEC. 63. TAXABLE INCOME DEFINED.

(a) IN GENERAL.—Except as provided in subsection (b), for purposes of this subtitle, the term "taxable income" means gross income minus the deductions allowed by this chapter (other than the standard deduction).

(b) INDIVIDUALS WHO DO NOT ITEMIZE THEIR DEDUCTIONS.—In the case of an individual who does not elect to itemize his deductions for the taxable year, for purposes of this subtitle, the term "taxable income" means adjusted gross income, minus—

(1) the standard deduction,

(2) the deduction for personal exemptions provided in section 151, and

(3) any deduction provided in section 199A.

(c) STANDARD DEDUCTION.—For purposes of this subtitle—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the term "standard deduction" means the sum of—

(A) the basic standard deduction, and

(B) the additional standard deduction.

(2) BASIC STANDARD DEDUCTION.—For purposes of paragraph (1), the basic standard deduction is—

(A) 200 percent of the dollar amount in effect under subparagraph (C) for the taxable year in the case of—

(i) a joint return, or

(ii) a surviving spouse (as defined in section 2(a)),

(B) $4,400 in the case of a head of household (as defined in section 2(b)), or

(C) $3,000 in any other case.

(3) ADDITIONAL STANDARD DEDUCTION FOR AGED AND BLIND.—For purposes of paragraph (1), the additional standard deduction is the sum of each additional amount to which the taxpayer is entitled under subsection (f).

(4) ADJUSTMENTS FOR INFLATION.—In the case of any taxable year beginning in a calendar year after 1988, each dollar amount contained in paragraph (2)(B), (2)(C), or (5) or subsection (f) shall be increased by an amount equal to—

(A) such dollar amount, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting for "calendar year 2016" in subparagraph (A)(ii) thereof—

(i) "calendar year 1987" in the case of the dollar amounts contained in paragraph (2)(B), (2)(C), or (5)(A) or subsection (f), and

(ii) "calendar year 1997" in the case of the dollar amount contained in paragraph (5)(B).

(5) LIMITATION ON BASIC STANDARD DEDUCTION IN THE CASE OF CERTAIN DEPENDENTS.—In the case of an individual with respect to whom a deduction under section 151 is allowable to another taxpayer for a taxable year beginning in the calendar year in which the individual's taxable year begins, the basic standard deduction applicable to such individual for such individual's taxable year shall not exceed the greater of—

(A) $500, or

(B) the sum of $250 and such individual's earned income.

(6) CERTAIN INDIVIDUALS, ETC., NOT ELIGIBLE FOR STANDARD DEDUCTION.—In the case of—

(A) a married individual filing a separate return where either spouse itemizes deductions,

(B) a nonresident alien individual,

(C) an individual making a return under section 443(a)(1) for a period of less than 12 months on account of a change in his annual accounting period, or

(D) an estate or trust, common trust fund, or partnership,

the standard deduction shall be zero.

(7) SPECIAL RULES FOR TAXABLE YEARS 2018 THROUGH 2025.—In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026—

(A) INCREASE IN STANDARD DEDUCTION.—Paragraph (2) shall be applied—

(i) by substituting "$18,000" for "$4,400" in subparagraph (B), and

(ii) by substituting "$12,000" for "$3,000" in subparagraph (C).

(B) ADJUSTMENT FOR INFLATION.—

(i) IN GENERAL.—Paragraph (4) shall not apply to the dollar amounts contained in paragraphs (2)(B) and (2)(C).

(ii) ADJUSTMENT OF INCREASED AMOUNTS.—In the case of a taxable year beginning after 2018, the $18,000 and $12,000 amounts in subparagraph (A) shall each be increased by an amount equal to—

(I) such dollar amount, multiplied by

(II) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting "2017" for "2016" in subparagraph (A)(ii) thereof.

If any increase under this clause is not a multiple of $50, such increase shall be rounded to the next lowest multiple of $50.

(d) ITEMIZED DEDUCTIONS.—For purposes of this subtitle, the term "itemized deductions" means the deductions allowable under this chapter other than—

(1) the deductions allowable in arriving at adjusted gross income,

(2) the deduction for personal exemptions provided by section 151, and

(3) any deduction provided in section 199A.

(e) ELECTION TO ITEMIZE.—

(1) IN GENERAL.—Unless an individual makes an election under this subsection for the taxable year, no itemized deduction shall be allowed for the taxable year. For purposes of this subtitle, the determination of whether a deduction is allowable under this chapter shall be made without regard to the preceding sentence.

(2) TIME AND MANNER OF ELECTION.—Any election under this subsection shall be made on the taxpayer's return, and the Secretary shall prescribe the manner of signifying such election on the return.

(3) CHANGE OF ELECTION.—Under regulations prescribed by the Secretary, a change of election with respect to itemized deductions for any taxable year may be made after the filing of the return for such year. If the spouse of the taxpayer filed a separate return for any taxable year corresponding to the taxable year of the taxpayer, the change shall not be allowed unless, in accordance with such regulations—

(A) the spouse makes a change of election with respect to itemized deductions, for the taxable year covered in such separate return, consistent with the change of treatment sought by the taxpayer, and

(B) the taxpayer and [his spouse] *the taxpayer's spouse* consent in writing to the assessment (within such period as may be agreed on with the Secretary) of any deficiency, to the extent attributable to such change of election, even though at the time of the filing of such consent the assessment of such deficiency would otherwise be prevented by the operation of any law or rule of law.

This paragraph shall not apply if the tax liability of the taxpayer's spouse for the taxable year corresponding to the taxable year of the taxpayer has been compromised under section 7122.

(f) AGED OR BLIND ADDITIONAL AMOUNTS.—

(1) ADDITIONAL AMOUNTS FOR THE AGED.—The taxpayer shall be entitled to an additional amount of $600—

(A) [for himself if he] *for the taxpayer if the taxpayer* has attained age 65 before the close of [his taxable year] *the taxpayer's taxable year* , and

(B) for the spouse of the taxpayer if the spouse has attained age 65 before the close of the taxable year and an additional exemption is allowable to the taxpayer for such spouse under section 151(b).

(2) ADDITIONAL AMOUNT FOR BLIND.—The taxpayer shall be entitled to an additional amount of $600—

(A) [for himself if he] *for the taxpayer if the taxpayer* is blind at the close of the taxable year, and

(B) for the spouse of the taxpayer if the spouse is blind as of the close of the taxable year and an additional exemption is allowable to the taxpayer for such spouse under section 151(b).

For purposes of subparagraph (B), if the spouse dies during the taxable year the determination of whether such spouse is blind shall be made as of the time of such death.

(3) HIGHER AMOUNT FOR CERTAIN UNMARRIED INDIVIDUALS.—In the case of an individual who is not married and is not a surviving spouse, paragraphs (1) and (2) shall be applied by substituting "$750" for "$600".

(4) BLINDNESS DEFINED.—For purposes of this subsection, an individual is blind only if [his] *the individual's* central visual acuity does not exceed 20/200 in the better eye with correcting lenses, or if [his] *the individual's* visual acuity is greater than 20/200 but is accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees.

(g) MARITAL STATUS.—For purposes of this section, marital status shall be determined under section 7703.

* * * * * * *

PART II—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

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SEC. 86. SOCIAL SECURITY AND TIER 1 RAILROAD RETIREMENT BENEFITS.

(a) IN GENERAL.—

(1) IN GENERAL.—Except as provided in paragraph (2), gross income for the taxable year of any taxpayer described in subsection (b) (notwithstanding section 207 of the Social Security Act) includes social security benefits in an amount equal to the lesser of—

(A) one-half of the social security benefits received during the taxable year, or

(B) one-half of the excess described in subsection (b)(1).

(2) ADDITIONAL AMOUNT.—In the case of a taxpayer with respect to whom the amount determined under subsection (b)(1)(A) exceeds the adjusted base amount, the amount included in gross income under this section shall be equal to the lesser of—

(A) the sum of—

(i) 85 percent of such excess, plus

(ii) the lesser of the amount determined under paragraph (1) or an amount equal to one-half of the difference between the adjusted base amount and the base amount of the taxpayer, or

(B) 85 percent of the social security benefits received during the taxable year.

(b) TAXPAYERS TO WHOM SUBSECTION (A) APPLIES.—

(1) IN GENERAL.—A taxpayer is described in this subsection if—

(A) the sum of—

(i) the modified adjusted gross income of the taxpayer for the taxable year, plus

(ii) one-half of the social security benefits received during the taxable year, exceeds

(B) the base amount.

(2) MODIFIED ADJUSTED GROSS INCOME.—For purposes of this subsection, the term "modified adjusted gross income" means adjusted gross income—

(A) determined without regard to this section and sections 135, 137, 221, 222, 911, 931, and 933, and

(B) increased by the amount of interest received or accrued by the taxpayer during the taxable year which is exempt from tax.

(c) BASE AMOUNT AND ADJUSTED BASE AMOUNT.—For purposes of this section—

(1) BASE AMOUNT.—The term "base amount" means—

(A) except as otherwise provided in this paragraph, $25,000,

(B) $32,000 in the case of a joint return, and

(C) zero in the case of a taxpayer who—

(i) is married as of the close of the taxable year (within the meaning of section 7703) but does not file a joint return for such year, and

(ii) does not live apart from [his spouse] *the taxpayer's spouse* at all times during the taxable year.

(2) ADJUSTED BASE AMOUNT.—The term "adjusted base amount" means—

(A) except as otherwise provided in this paragraph, $34,000,

(B) $44,000 in the case of a joint return, and

(C) zero in the case of a taxpayer described in paragraph (1)(C).

(d) SOCIAL SECURITY BENEFIT.—

(1) IN GENERAL.—For purposes of this section, the term "social security benefit" means any amount received by the taxpayer by reason of entitlement to—

(A) a monthly benefit under title II of the Social Security Act, or

(B) a tier 1 railroad retirement benefit.

(2) ADJUSTMENT FOR REPAYMENTS DURING YEAR.—

(A) IN GENERAL.—For purposes of this section, the amount of social security benefits received during any taxable year shall be reduced by any repayment made by the taxpayer during the taxable year of a social security benefit previously received by the taxpayer (whether or not such benefit was received during the taxable year).

(B) DENIAL OF DEDUCTION.—If (but for this subparagraph) any portion of the repayments referred to in subparagraph (A) would have been allowable as a deduction for the taxable year under section 165, such portion shall be allowable as a deduction only to the extent it exceeds the social security benefits received by the taxpayer during the taxable year (and not repaid during such taxable year).

(3) WORKMEN'S COMPENSATION BENEFITS SUBSTITUTED FOR SOCIAL SECURITY BENEFITS.—For purposes of this section, if, by reason of section 224 of the Social Security Act (or by reason of section 3(a)(1) of the Railroad Retirement Act of 1974), any social security benefit is reduced by reason of the receipt of a benefit under a workmen's compensation act, the term "social security benefit" includes that portion of such benefit received under the workmen's compensation act which equals such reduction.

(4) TIER 1 RAILROAD RETIREMENT BENEFIT.—For purposes of paragraph (1), the term "tier 1 railroad retirement benefit" means—

(A) the amount of the annuity under the Railroad Retirement Act of 1974 equal to the amount of the benefit to which the taxpayer would have been entitled under the Social Security Act if all of the service after December 31, 1936, of the employee (on whose employment record the annuity is being paid) had been included in the term "employment" as defined in the Social Security Act, and

(B) a monthly annuity amount under section 3(f)(3) of the Railroad Retirement Act of 1974.

(5) EFFECT OF EARLY DELIVERY OF BENEFIT CHECKS.—For purposes of subsection (a), in any case where section 708 of the Social Security Act causes social security benefit checks to be delivered before the end of the calendar month for which they are issued, the benefits involved shall be deemed to have been received in the succeeding calendar month.

(e) LIMITATION ON AMOUNT INCLUDED WHERE TAXPAYER RECEIVES LUMP-SUM PAYMENT.—

(1) LIMITATION.—If—

(A) any portion of a lump-sum payment of social security benefits received during the taxable year is attributable to prior taxable years, and

(B) the taxpayer makes an election under this subsection for the taxable year,

then the amount included in gross income under this section for the taxable year by reason of the receipt of such portion shall not exceed the sum of the increases in gross income under this chapter for prior taxable years which would result

solely from taking into account such portion in the taxable years to which it is attributable.

(2) SPECIAL RULES.—

(A) YEAR TO WHICH BENEFIT ATTRIBUTABLE.—For purposes of this subsection, a social security benefit is attributable to a taxable year if the generally applicable payment date for such benefit occurred during such taxable year.

(B) ELECTION.—An election under this subsection shall be made at such time and in such manner as the Secretary shall by regulations prescribe. Such election, once made, may be revoked only with the consent of the Secretary.

(f) TREATMENT AS PENSION OR ANNUITY FOR CERTAIN PURPOSES.—For purposes of—

(1) section 22(c)(3)(A) (relating to reduction for amounts received as pension or annuity),

(2) section 32(c)(2) (defining earned income),

(3) section 219(f)(1) (defining compensation), and

(4) section 911(b)(1) (defining foreign earned income),

any social security benefit shall be treated as an amount received as a pension or annuity.

* * * * * * *

PART III—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

* * * * * * *

SEC. 105. AMOUNTS RECEIVED UNDER ACCIDENT AND HEALTH PLANS.

(a) AMOUNTS ATTRIBUTABLE TO EMPLOYER CONTRIBUTIONS.—Except as otherwise provided in this section, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.

(b) AMOUNTS EXPENDED FOR MEDICAL CARE.—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include amounts referred to in subsection (a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred [by him] for the medical care (as defined in section 213(d)) of the taxpayer, [his spouse, his dependents] *the taxpayer's spouse, the taxpayer's dependents* (as defined in section 152, determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B) thereof), and any child (as defined in section 152(f)(1)) of the taxpayer who as of the end of the taxable year has not attained age 27. Any child to whom section 152(e) applies shall be treated as a dependent of both parents for purposes of this subsection.

(c) PAYMENTS UNRELATED TO ABSENCE FROM WORK.—Gross income does not include amounts referred to in subsection (a) to the extent such amounts—

(1) constitute payment for the permanent loss or loss of use of a member or function of the body, or the permanent dis-

figurement, of the taxpayer, [his spouse] *the taxpayer's spouse* , or a dependent (as defined in section 152, determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B) thereof), and

(2) are computed with reference to the nature of the injury without regard to the period the employee is absent from work.

(e) ACCIDENT AND HEALTH PLANS.—For purposes of this section and section 104—

(1) amounts received under an accident or health plan for employees, and

(2) amounts received from a sickness and disability fund for employees maintained under the law of a State or the District of Columbia,

shall be treated as amounts received through accident or health insurance.

(f) RULES FOR APPLICATION OF SECTION 213.—For purposes of section 213(a) (relating to medical, dental, etc., expenses) amounts excluded from gross income under subsection (c) shall not be considered as compensation (by insurance or otherwise) for expenses paid for medical care.

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

(h) AMOUNT PAID TO HIGHLY COMPENSATED INDIVIDUALS UNDER A DISCRIMINATORY SELF-INSURED MEDICAL EXPENSE REIMBURSEMENT PLAN.—

(1) IN GENERAL.—In the case of amounts paid to a highly compensated individual under a self-insured medical reimbursement plan which does not satisfy the requirements of paragraph (2) for a plan year, subsection (b) shall not apply to such amounts to the extent they constitute an excess reimbursement of such highly compensated individual.

(2) PROHIBITION OF DISCRIMINATION.—A self-insured medical reimbursement plan satisfies the requirements of this paragraph only if—

(A) the plan does not discriminate in favor of highly compensated individuals as to eligibility to participate; and

(B) the benefits provided under the plan do not discriminate in favor of participants who are highly compensated individuals.

(3) NONDISCRIMINATORY ELIGIBILITY CLASSIFICATIONS.—

(A) IN GENERAL.—A self-insured medical reimbursement plan does not satisfy the requirements of subparagraph (A) of paragraph (2) unless such plan benefits—

(i) 70 percent or more of all employees, or 80 percent or more of all the employees who are eligible to benefit under the plan if 70 percent or more of all employees are eligible to benefit under the plan; or

(ii) such employees as qualify under a classification set up by the employer and found by the Secretary not to be discriminatory in favor of highly compensated individuals.

(B) EXCLUSION OF CERTAIN EMPLOYEES.—For purposes of subparagraph (A), there may be excluded from consideration—

(i) employees who have not completed 3 years of service;

(ii) employees who have not attained age 25;

(iii) part-time or seasonal employees;

(iv) employees not included in the plan who are included in a unit of employees covered by an agreement between employee representatives and one or more employers which the Secretary finds to be a collective bargaining agreement, if accident and health benefits were the subject of good faith bargaining between such employee representatives and such employer or employers; and

(v) employees who are nonresident aliens and who receive no earned income (within the meaning of section 911(d)(2)) from the employer which constitutes income from sources within the United States (within the meaning of section 861(a)(3)).

(4) NONDISCRIMINATORY BENEFITS.—A self-insured medical reimbursement plan does not meet the requirements of subparagraph (B) of paragraph (2) unless all benefits provided for participants who are highly compensated individuals are provided for all other participants.

(5) HIGHLY COMPENSATED INDIVIDUAL DEFINED.—For purposes of this subsection, the term "highly compensated individual" means an individual who is—

(A) one of the 5 highest paid officers,

(B) a shareholder who owns (with the application of section 318) more than 10 percent in value of the stock of the employer, or

(C) among the highest paid 25 percent of all employees (other than employees described in paragraph (3)(B) who are not participants).

(6) SELF-INSURED MEDICAL REIMBURSEMENT PLAN.—The term "self-insured medical reimbursement plan" means a plan of an employer to reimburse employees for expenses referred to in subsection (b) for which reimbursement is not provided under a policy of accident and health insurance.

(7) EXCESS REIMBURSEMENT OF HIGHLY COMPENSATED INDIVIDUAL.—For purposes of this section, the excess reimbursement of a highly compensated individual which is attributable to a self-insured medical reimbursement plan is—

(A) in the case of a benefit available to highly compensated individuals but not to all other participants (or which otherwise fails to satisfy the requirements of paragraph (2)(B)), the amount reimbursed under the plan to the employee with respect to such benefit, and

(B) in the case of benefits (other than benefits described in subparagraph (A)) paid to a highly compensated individual by a plan which fails to satisfy the requirements of paragraph (2), the total amount reimbursed to the highly compensated individual for the plan year multiplied by a fraction—

(i) the numerator of which is the total amount reimbursed to all participants who are highly compensated individuals under the plan for the plan year, and

(ii) the denominator of which is the total amount reimbursed to all employees under the plan for such plan year.

In determining the fraction under subparagraph (B), there shall not be taken into account any reimbursement which is attributable to a benefit described in subparagraph (A).

(8) CERTAIN CONTROLLED GROUPS, ETC..—All employees who are treated as employed by a single employer under subsection (b), (c), or (m) of section 414 shall be treated as employed by a single employer for purposes of this section.

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

(10) TIME OF INCLUSION.—Any amount paid for a plan year that is included in income by reason of this subsection shall be treated as received or accrued in the taxable year of the participant in which the plan year ends.

(i) SICK PAY UNDER RAILROAD UNEMPLOYMENT INSURANCE ACT.—Notwithstanding any other provision of law, gross income includes benefits paid under section 2(a) of the Railroad Unemployment Insurance Act for days of sickness; except to the extent such sickness (as determined in accordance with standards prescribed by the Railroad Retirement Board) is the result of on-the-job injury.

(j) SPECIAL RULE FOR CERTAIN GOVERNMENTAL PLANS.—

(1) IN GENERAL.—For purposes of subsection (b), amounts paid (directly or indirectly) to a qualified taxpayer from an accident or health plan described in paragraph (2) shall not fail to be excluded from gross income solely because such plan, on or before January 1, 2008, provides for reimbursements of health care expenses of a deceased employee's beneficiary (other than an individual described in paragraph (3)(B)).

(2) PLAN DESCRIBED.—An accident or health plan is described in this paragraph if such plan is funded by a medical trust that is established in connection with a public retirement system or established by or on behalf of a State or political subdivision thereof and that—

(A) has been authorized by a State legislature, or

(B) has received a favorable ruling from the Internal Revenue Service that the trust's income is not includible in gross income under section 115 or 501(c)(9).

(3) QUALIFIED TAXPAYER.—For purposes of paragraph (1), with respect to an accident or health plan described in paragraph (2), the term "qualified taxpayer" means a taxpayer who is—

(A) an employee, or

(B) the spouse, dependent (as defined for purposes of subsection (b)), or child (as defined for purposes of such subsection) of an employee.

* * * * * * *

SEC. 119. MEALS OR LODGING FURNISHED FOR THE CONVENIENCE OF THE EMPLOYER.

(a) MEALS AND LODGING FURNISHED TO EMPLOYEE[, HIS SPOUSE, AND HIS DEPENDENTS] *AND THE EMPLOYEE'S SPOUSE AND DEPENDENTS*, PURSUANT TO EMPLOYMENT.—There shall be excluded from

gross income of an employee the value of any meals or lodging furnished to [him, his spouse, or any of his dependents by or on behalf of his employer] *the employee or the employee's spouse or dependents by or on behalf of the employer of the employee* for the convenience of the employer, but only if—

(1) in the case of meals, the meals are furnished on the business premises of the employer, or

(2) in the case of lodging, the employee is required to accept such lodging on the business premises of [his] *the employee's* employer as a condition of [his] *the employee's* employment.

(b) SPECIAL RULES.—For purposes of subsection (a)—

(1) PROVISIONS OF EMPLOYMENT CONTRACT OR STATE STATUTE NOT TO BE DETERMINATIVE.—In determining whether meals or lodging are furnished for the convenience of the employer, the provisions of an employment contract or of a State statute fixing terms of employment shall not be determinative of whether the meals or lodging are intended as compensation.

(2) CERTAIN FACTORS NOT TAKEN INTO ACCOUNT WITH RESPECT TO MEALS.—In determining whether meals are furnished for the convenience of the employer, the fact that a charge is made for such meals, and the fact that the employee may accept or decline such meals, shall not be taken into account.

(3) CERTAIN FIXED CHARGES FOR MEALS.—

(A) IN GENERAL.—If—

(i) an employee is required to pay on a periodic basis a fixed charge for his meals, and

(ii) such meals are furnished by the employer for the convenience of the employer,

there shall be excluded from the employee's gross income an amount equal to such fixed charge.

(B) APPLICATION OF SUBPARAGRAPH (A).—Subparagraph (A) shall apply—

(i) whether the employee pays the fixed charge out of his stated compensation or out of his own funds, and

(ii) only if the employee is required to make the payment whether he accepts or declines the meals.

(4) MEALS FURNISHED TO EMPLOYEES ON BUSINESS PREMISES WHERE MEALS OF MOST EMPLOYEES ARE OTHERWISE EXCLUDABLE.—All meals furnished on the business premises of an employer to such employer's employees shall be treated as furnished for the convenience of the employer if, without regard to this paragraph, more than half of the employees to whom such meals are furnished on such premises are furnished such meals for the convenience of the employer.

(c) EMPLOYEES LIVING IN CERTAIN CAMPS.—

(1) IN GENERAL.—In the case of an individual who is furnished lodging in a camp located in a foreign country by or on behalf of his employer, such camp shall be considered to be part of the business premises of the employer.

(2) CAMP.—For purposes of this section, a camp constitutes lodging which is—

(A) provided by or on behalf of the employer for the convenience of the employer because the place at which such

individual renders services is in a remote area where satisfactory housing is not available on the open market,

(B) located, as near as practicable, in the vicinity of the place at which such individual renders services, and

(C) furnished in a common area (or enclave) which is not available to the public and which normally accommodates 10 or more employees.

(d) LODGING FURNISHED BY CERTAIN EDUCATIONAL INSTITUTIONS TO EMPLOYEES.—

(1) IN GENERAL.—In the case of an employee of an educational institution, gross income shall not include the value of qualified campus lodging furnished to such employee during the taxable year.

(2) EXCEPTION IN CASES OF INADEQUATE RENT.—Paragraph (1) shall not apply to the extent of the excess of—

(A) the lesser of—

(i) 5 percent of the appraised value of the qualified campus lodging, or

(ii) the average of the rentals paid by individuals (other than employees or students of the educational institution) during such calendar year for lodging provided by the educational institution which is comparable to the qualified campus lodging provided to the employee, over

(B) the rent paid by the employee for the qualified campus lodging during such calendar year.

The appraised value under subparagraph (A)(i) shall be determined as of the close of the calendar year in which the taxable year begins, or, in the case of a rental period not greater than 1 year, at any time during the calendar year in which such period begins.

(3) QUALIFIED CAMPUS LODGING.—For purposes of this subsection, the term "qualified campus lodging" means lodging to which subsection (a) does not apply and which is—

(A) located on, or in the proximity of, a campus of the educational institution, and

(B) furnished to the employee, [his spouse, and any of his dependents] *the employee's spouse, and any of the employee's dependents* by or on behalf of such institution for use as a residence.

(4) EDUCATIONAL INSTITUTION, ETC..—For purposes of this subsection—

(A) IN GENERAL.—The term "educational institution" means—

(i) an institution described in section 170(b)(1)(A)(ii) (or an entity organized under State law and composed of public institutions so described), or

(ii) an academic health center.

(B) ACADEMIC HEALTH CENTER.—For purposes of subparagraph (A), the term "academic health center" means an entity—

(i) which is described in section 170(b)(1)(A)(iii),

(ii) which receives (during the calendar year in which the taxable year of the taxpayer begins) payments under subsection (d)(5)(B) or (h) of section 1886

of the Social Security Act (relating to graduate medical education), and

(iii) which has as one of its principal purposes or functions the providing and teaching of basic and clinical medical science and research with the entity's own faculty.

* * * * * * *

SEC. 121. EXCLUSION OF GAIN FROM SALE OF PRINCIPAL RESIDENCE.

(a) EXCLUSION.—Gross income shall not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 years or more.

(b) LIMITATIONS.—

(1) IN GENERAL.—The amount of gain excluded from gross income under subsection (a) with respect to any sale or exchange shall not exceed $250,000.

(2) SPECIAL RULES FOR JOINT RETURNS.—In the case of a [husband and wife who make] *married couple who makes* a joint return for the taxable year of the sale or exchange of the property—

(A) $500,000 LIMITATION FOR CERTAIN JOINT RETURNS.—Paragraph (1) shall be applied by substituting "$500,000" for "$250,000" if—

(i) either spouse meets the ownership requirements of subsection (a) with respect to such property;

(ii) both spouses meet the use requirements of subsection (a) with respect to such property; and

(iii) neither spouse is ineligible for the benefits of subsection (a) with respect to such property by reason of paragraph (3).

(B) OTHER JOINT RETURNS.—If such spouses do not meet the requirements of subparagraph (A), the limitation under paragraph (1) shall be the sum of the limitations under paragraph (1) to which each spouse would be entitled if such spouses had not been married. For purposes of the preceding sentence, each spouse shall be treated as owning the property during the period that either spouse owned the property.

(3) APPLICATION TO ONLY 1 SALE OR EXCHANGE EVERY 2 YEARS.—Subsection (a) shall not apply to any sale or exchange by the taxpayer if, during the 2-year period ending on the date of such sale or exchange, there was any other sale or exchange by the taxpayer to which subsection (a) applied.

(4) SPECIAL RULE FOR CERTAIN SALES BY SURVIVING SPOUSES.—In the case of a sale or exchange of property by an unmarried individual whose spouse is deceased on the date of such sale, paragraph (1) shall be applied by substituting "$500,000" for "$250,000" if such sale occurs not later than 2 years after the date of death of such spouse and the requirements of paragraph (2)(A) were met immediately before such date of death.

(5) EXCLUSION OF GAIN ALLOCATED TO NONQUALIFIED USE.—

(A) IN GENERAL.—Subsection (a) shall not apply to so much of the gain from the sale or exchange of property as is allocated to periods of nonqualified use.

(B) GAIN ALLOCATED TO PERIODS OF NONQUALIFIED USE.—For purposes of subparagraph (A), gain shall be allocated to periods of nonqualified use based on the ratio which—

(i) the aggregate periods of nonqualified use during the period such property was owned by the taxpayer, bears to

(ii) the period such property was owned by the taxpayer.

(C) PERIOD OF NONQUALIFIED USE.—For purposes of this paragraph—

(i) IN GENERAL.—The term "period of nonqualified use" means any period (other than the portion of any period preceding January 1, 2009) during which the property is not used as the principal residence of the taxpayer or the taxpayer's spouse or former spouse.

(ii) EXCEPTIONS.—The term "period of nonqualified use" does not include—

(I) any portion of the 5-year period described in subsection (a) which is after the last date that such property is used as the principal residence of the taxpayer or the taxpayer's spouse,

(II) any period (not to exceed an aggregate period of 10 years) during which the taxpayer or the taxpayer's spouse is serving on qualified official extended duty (as defined in subsection (d)(9)(C)) described in clause (i), (ii), or (iii) of subsection (d)(9)(A), and

(III) any other period of temporary absence (not to exceed an aggregate period of 2 years) due to change of employment, health conditions, or such other unforeseen circumstances as may be specified by the Secretary.

(D) COORDINATION WITH RECOGNITION OF GAIN ATTRIBUTABLE TO DEPRECIATION.—For purposes of this paragraph—

(i) subparagraph (A) shall be applied after the application of subsection (d)(6), and

(ii) subparagraph (B) shall be applied without regard to any gain to which subsection (d)(6) applies.

(c) EXCLUSION FOR TAXPAYERS FAILING TO MEET CERTAIN REQUIREMENTS.—

(1) IN GENERAL.—In the case of a sale or exchange to which this subsection applies, the ownership and use requirements of subsection (a), and subsection (b)(3), shall not apply; but the dollar limitation under paragraph (1) or (2) of subsection (b), whichever is applicable, shall be equal to—

(A) the amount which bears the same ratio to such limitation (determined without regard to this paragraph) as

(B)(i) the shorter of—

(I) the aggregate periods, during the 5-year period ending on the date of such sale or exchange, such

property has been owned and used by the taxpayer as the taxpayer's principal residence; or

(II) the period after the date of the most recent prior sale or exchange by the taxpayer to which subsection (a) applied and before the date of such sale or exchange, bears to

(ii) 2 years.

(2) SALES AND EXCHANGES TO WHICH SUBSECTION APPLIES.—This subsection shall apply to any sale or exchange if—

(A) subsection (a) would not (but for this subsection) apply to such sale or exchange by reason of—

(i) a failure to meet the ownership and use requirements of subsection (a), or

(ii) subsection (b)(3), and

(B) such sale or exchange is by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances.

(d) SPECIAL RULES.—

(1) JOINT RETURNS.—If a [husband and wife make] *married couple makes* a joint return for the taxable year of the sale or exchange of the property, subsections (a) and (c) shall apply if either spouse meets the ownership and use requirements of subsection (a) with respect to such property.

(2) PROPERTY OF DECEASED SPOUSE.—For purposes of this section, in the case of an unmarried individual whose spouse is deceased on the date of the sale or exchange of property, the period such unmarried individual owned and used such property shall include the period such deceased spouse owned and used such property before death.

(3) PROPERTY OWNED BY SPOUSE OR FORMER SPOUSE.—For purposes of this section—

(A) PROPERTY TRANSFERRED TO INDIVIDUAL FROM SPOUSE OR FORMER SPOUSE.—In the case of an individual holding property transferred to such individual in a transaction described in section 1041(a), the period such individual owns such property shall include the period the transferor owned the property.

(B) PROPERTY USED BY FORMER SPOUSE PURSUANT TO DIVORCE DECREE, ETC..—Solely for purposes of this section, an individual shall be treated as using property as such individual's principal residence during any period of ownership while such individual's spouse or former spouse is granted use of the property under a divorce or separation instrument.

(C) DIVORCE OR SEPARATION INSTRUMENT.—For purposes of this paragraph, the term "divorce or separation instrument" means—

(i) a decree of divorce or separate maintenance or a written instrument incident to such a decree,

(ii) a written separation agreement, or

(iii) a decree (not described in clause (i)) requiring a spouse to make payments for the support or maintenance of the other spouse.

(4) TENANT-STOCKHOLDER IN COOPERATIVE HOUSING CORPORATION.—For purposes of this section, if the taxpayer holds

stock as a tenant-stockholder (as defined in section 216) in a cooperative housing corporation (as defined in such section), then—

(A) the holding requirements of subsection (a) shall be applied to the holding of such stock, and

(B) the use requirements of subsection (a) shall be applied to the house or apartment which the taxpayer was entitled to occupy as such stockholder.

(5) INVOLUNTARY CONVERSIONS.—

(A) IN GENERAL.—For purposes of this section, the destruction, theft, seizure, requisition, or condemnation of property shall be treated as the sale of such property.

(B) APPLICATION OF SECTION 1033.—In applying section 1033 (relating to involuntary conversions), the amount realized from the sale or exchange of property shall be treated as being the amount determined without regard to this section, reduced by the amount of gain not included in gross income pursuant to this section.

(C) PROPERTY ACQUIRED AFTER INVOLUNTARY CONVERSION.—If the basis of the property sold or exchanged is determined (in whole or in part) under section 1033(b) (relating to basis of property acquired through involuntary conversion), then the holding and use by the taxpayer of the converted property shall be treated as holding and use by the taxpayer of the property sold or exchanged.

(6) RECOGNITION OF GAIN ATTRIBUTABLE TO DEPRECIATION.—Subsection (a) shall not apply to so much of the gain from the sale of any property as does not exceed the portion of the depreciation adjustments (as defined in section 1250(b)(3)) attributable to periods after May 6, 1997, in respect of such property.

(7) DETERMINATION OF USE DURING PERIODS OF OUT-OF-RESIDENCE CARE.—In the case of a taxpayer who—

(A) becomes physically or mentally incapable of self-care, and

(B) owns property and uses such property as the taxpayer's principal residence during the 5-year period described in subsection (a) for periods aggregating at least 1 year,

then the taxpayer shall be treated as using such property as the taxpayer's principal residence during any time during such 5-year period in which the taxpayer owns the property and resides in any facility (including a nursing home) licensed by a State or political subdivision to care for an individual in the taxpayer's condition.

(8) SALES OF REMAINDER INTERESTS.—For purposes of this section—

(A) IN GENERAL.—At the election of the taxpayer, this section shall not fail to apply to the sale or exchange of an interest in a principal residence by reason of such interest being a remainder interest in such residence, but this section shall not apply to any other interest in such residence which is sold or exchanged separately.

(B) EXCEPTION FOR SALES TO RELATED PARTIES.—Subparagraph (A) shall not apply to any sale to, or exchange

with, any person who bears a relationship to the taxpayer which is described in section 267(b) or 707(b).

(9) UNIFORMED SERVICES, FOREIGN SERVICE, AND INTELLIGENCE COMMUNITY.—

(A) IN GENERAL.—At the election of an individual with respect to a property, the running of the 5-year period described in subsections (a) and (c)(1)(B) and paragraph (7) of this subsection with respect to such property shall be suspended during any period that such individual or such individual's spouse is serving on qualified official extended duty—

(i) as a member of the uniformed services,

(ii) as a member of the Foreign Service of the United States, or

(iii) as an employee of the intelligence community.

(B) MAXIMUM PERIOD OF SUSPENSION.—The 5-year period described in subsection (a) shall not be extended more than 10 years by reason of subparagraph (A).

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

(i) IN GENERAL.—The term "qualified official extended duty" means any extended duty while serving at a duty station which is at least 50 miles from such property or while residing under Government orders in Government quarters.

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

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

(iv) EMPLOYEE OF INTELLIGENCE COMMUNITY.—The term "employee of the intelligence community" means an employee (as defined by section 2105 of title 5, United States Code) of—

(I) the Office of the Director of National Intelligence,

(II) the Central Intelligence Agency,

(III) the National Security Agency,

(IV) the Defense Intelligence Agency,

(V) the National Geospatial-Intelligence Agency,

(VI) the National Reconnaissance Office,

(VII) any other office within the Department of Defense for the collection of specialized national intelligence through reconnaissance programs,

(VIII) any of the intelligence elements of the Army, the Navy, the Air Force, the Marine Corps, the Federal Bureau of Investigation, the Department of Treasury, the Department of Energy, and the Coast Guard,

(IX) the Bureau of Intelligence and Research of the Department of State, or

(X) any of the elements of the Department of Homeland Security concerned with the analyses of foreign intelligence information.

(v) EXTENDED DUTY.—The term "extended duty" means any period of active duty pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period.

(D) SPECIAL RULES RELATING TO ELECTION.—

(i) ELECTION LIMITED TO 1 PROPERTY AT A TIME.—An election under subparagraph (A) with respect to any property may not be made if such an election is in effect with respect to any other property.

(ii) REVOCATION OF ELECTION.—An election under subparagraph (A) may be revoked at any time.

(10) PROPERTY ACQUIRED IN LIKE-KIND EXCHANGE.—If a taxpayer acquires property in an exchange with respect to which gain is not recognized (in whole or in part) to the taxpayer under subsection (a) or (b) of section 1031, subsection (a) shall not apply to the sale or exchange of such property by such taxpayer (or by any person whose basis in such property is determined, in whole or in part, by reference to the basis in the hands of such taxpayer) during the 5-year period beginning with the date of such acquisition.

(12) PEACE CORPS.—

(A) IN GENERAL.—At the election of an individual with respect to a property, the running of the 5-year period described in subsections (a) and (c)(1)(B) and paragraph (7) of this subsection with respect to such property shall be suspended during any period that such individual or such individual's spouse is serving outside the United States—

(i) on qualified official extended duty (as defined in paragraph (9)(C)) as an employee of the Peace Corps, or

(ii) as an enrolled volunteer or volunteer leader under section 5 or 6 (as the case may be) of the Peace Corps Act (22 U.S.C. 2504, 2505).

(B) APPLICABLE RULES.—For purposes of subparagraph (A), rules similar to the rules of subparagraphs (B) and (D) of paragraph (9) shall apply.

(e) DENIAL OF EXCLUSION FOR EXPATRIATES.—This section shall not apply to any sale or exchange by an individual if the treatment provided by section 877(a)(1) applies to such individual.

(f) ELECTION TO HAVE SECTION NOT APPLY.—This section shall not apply to any sale or exchange with respect to which the taxpayer elects not to have this section apply.

(g) RESIDENCES ACQUIRED IN ROLLOVERS UNDER SECTION 1034.—For purposes of this section, in the case of property the acquisition of which by the taxpayer resulted under section 1034 (as in effect on the day before the date of the enactment of this section) in the nonrecognition of any part of the gain realized on the sale or exchange of another residence, in determining the period for which the taxpayer has owned and used such property as the taxpayer's principal residence, there shall be included the aggregate periods

for which such other residence (and each prior residence taken into account under section 1223(6) in determining the holding period of such property) had been so owned and used.

* * * * * * *

SEC. 129. DEPENDENT CARE ASSISTANCE PROGRAMS.

(a) EXCLUSION.—

(1) IN GENERAL.—Gross income of an employee does not include amounts paid or incurred by the employer for dependent care assistance provided to such employee if the assistance is furnished pursuant to a program which is described in subsection (d).

(2) LIMITATION OF EXCLUSION.—

(A) IN GENERAL.—The amount which may be excluded under paragraph (1) for dependent care assistance with respect to dependent care services provided during a taxable year shall not exceed $5,000 ($2,500 in the case of a separate return by a married individual).

(B) YEAR OF INCLUSION.—The amount of any excess under subparagraph (A) shall be included in gross income in the taxable year in which the dependent care services were provided (even if payment of dependent care assistance for such services occurs in a subsequent taxable year).

(C) MARITAL STATUS.—For purposes of this paragraph, marital status shall be determined under the rules of paragraphs (3) and (4) of section 21(e).

(b) EARNED INCOME LIMITATION.—

(1) IN GENERAL.—The amount excluded from the income of an employee under subsection (a) for any taxable year shall not exceed—

(A) in the case of an employee who is not married at the close of such taxable year, the earned income of such employee for such taxable year, or

(B) in the case of an employee who is married at the close of such taxable year, the lesser of—

(i) the earned income of such employee for such taxable year, or

(ii) the earned income of the spouse of such employee for such taxable year.

(2) SPECIAL RULE FOR CERTAIN SPOUSES.—For purposes of paragraph (1), the provisions of section 21(d)(2) shall apply in determining the earned income of a spouse who is a student or incapable of caring for **[**himself**]** *the spouse's self* .

(c) PAYMENTS TO RELATED INDIVIDUALS.—No amount paid or incurred during the taxable year of an employee by an employer in providing dependent care assistance to such employee shall be excluded under subsection (a) if such amount was paid or incurred to an individual—

(1) with respect to whom, for such taxable year, a deduction is allowable under section 151(c) (relating to personal exemptions for dependents) to such employee or the spouse of such employee, or

(2) who is a child of such employee (within the meaning of section 152(f)(1)) under the age of 19 at the close of such taxable year.

(d) DEPENDENT CARE ASSISTANCE PROGRAM.—

(1) IN GENERAL.—For purposes of this section a dependent care assistance program is a separate written plan of an employer for the exclusive benefit of his employees to provide such employees with dependent care assistance which meets the requirements of paragraphs (2) through (8) of this subsection. If any plan would qualify as a dependent care assistance program but for a failure to meet the requirements of this subsection, then, notwithstanding such failure, such plan shall be treated as a dependent care assistance program in the case of employees who are not highly compensated employees.

(2) DISCRIMINATION.—The contributions or benefits provided under the plan shall not discriminate in favor of employees who are highly compensated employees (within the meaning of section 414(q)) or their dependents.

(3) ELIGIBILITY.—The program shall benefit employees who qualify under a classification set up by the employer and found by the Secretary not to be discriminatory in favor of employees described in paragraph (2), or their dependents.

(4) PRINCIPAL SHAREHOLDERS OR OWNERS.—Not more than 25 percent of the amounts paid or incurred by the employer for dependent care assistance during the year may be provided for the class of individuals who are shareholders or owners (or their spouses or dependents), each of whom (on any day of the year) owns more than 5 percent of the stock or of the capital or profits interest in the employer.

(5) NO FUNDING REQUIRED.—A program referred to in paragraph (1) is not required to be funded.

(6) NOTIFICATION OF ELIGIBLE EMPLOYEES.—Reasonable notification of the availability and terms of the program shall be provided to eligible employees.

(7) STATEMENT OF EXPENSES.—The plan shall furnish to an employee, on or before January 31, a written statement showing the amounts paid or expenses incurred by the employer in providing dependent care assistance to such employee during the previous calendar year.

(8) BENEFITS.—

(A) IN GENERAL.—A plan meets the requirements of this paragraph if the average benefits provided to employees who are not highly compensated employees under all plans of the employer is at least 55 percent of the average benefits provided to highly compensated employees under all plans of the employer.

(B) SALARY REDUCTION AGREEMENTS.—For purposes of subparagraph (A), in the case of any benefits provided through a salary reduction agreement, a plan may disregard any employees whose compensation is less than $25,000. For purposes of this subparagraph, the term "compensation" has the meaning given such term by section 414(q)(4), except that, under rules prescribed by the Secretary, an employer may elect to determine compensa-

tion on any other basis which does not discriminate in favor of highly compensated employees.

(9) EXCLUDED EMPLOYEES.—For purposes of paragraphs (3) and (8), there shall be excluded from consideration—

(A) subject to rules similar to the rules of section 410(b)(4), employees who have not attained the age of 21 and completed 1 year of service (as defined in section 410(a)(3)), and

(B) employees not included in a dependent care assistance program who are included in a unit of employees covered by an agreement which the Secretary finds to be a collective bargaining agreement between employee representatives and 1 or more employees, if there is evidence that dependent care benefits were the subject of good faith bargaining between such employee representatives and such employer or employers.

(e) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) DEPENDENT CARE ASSISTANCE.—The term "dependent care assistance" means the payment of, or provision of, those services which if paid for by the employee would be considered employment-related expenses under section 21(b)(2) (relating to expenses for household and dependent care services necessary for gainful employment).

(2) EARNED INCOME.—The term "earned income" shall have the meaning given such term in section 32(c)(2), but such term shall not include any amounts paid or incurred by an employer for dependent care assistance to an employee.

(3) EMPLOYEE.—The term "employee" includes, for any year, an individual who is an employee within the meaning of section 401(c)(1) (relating to self-employed individuals).

(4) EMPLOYER.—An individual who owns the entire interest in an unincorporated trade or business shall be treated as his own employer. A partnership shall be treated as the employer of each partner who is an employee within the meaning of paragraph (3).

(5) ATTRIBUTION RULES.—

(A) OWNERSHIP OF STOCK.—Ownership of stock in a corporation shall be determined in accordance with the rules provided under subsections (d) and (e) of section 1563 (without regard to section 1563(e)(3)(C)).

(B) INTEREST IN UNINCORPORATED TRADE OR BUSINESS.—The interest of an employee in a trade or business which is not incorporated shall be determined in accordance with regulations prescribed by the Secretary, which shall be based on principles similar to the principles which apply in the case of subparagraph (A).

(6) UTILIZATION TEST NOT APPLICABLE.—A dependent care assistance program shall not be held or considered to fail to meet any requirements of subsection (d) (other than paragraphs (4) and (8) thereof) merely because of utilization rates for the different types of assistance made available under the program.

(7) DISALLOWANCE OF EXCLUDED AMOUNTS AS CREDIT OR DEDUCTION.—No deduction or credit shall be allowed to the employee under any other section of this chapter for any amount

excluded from the gross income of the employee by reason of this section.

(8) TREATMENT OF ONSITE FACILITIES.—In the case of an onsite facility maintained by an employer, except to the extent provided in regulations, the amount of dependent care assistance provided to an employee excluded with respect to any dependent shall be based on—

(A) utilization of the facility by a dependent of the employee, and

(B) the value of the services provided with respect to such dependent.

(9) IDENTIFYING INFORMATION REQUIRED WITH RESPECT TO SERVICE PROVIDER.—No amount paid or incurred by an employer for dependent care assistance provided to an employee shall be excluded from the gross income of such employee unless—

(A) the name, address, and taxpayer identification number of the person performing the services are included on the return to which the exclusion relates, or

(B) if such person is an organization described in section 501(c)(3) and exempt from tax under section 501(a), the name and address of such person are included on the return to which the exclusion relates.

In the case of a failure to provide the information required under the preceding sentence, the preceding sentence shall not apply if it is shown that the taxpayer exercised due diligence in attempting to provide the information so required.

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SEC. 132. CERTAIN FRINGE BENEFITS.

(a) EXCLUSION FROM GROSS INCOME.—Gross income shall not include any fringe benefit which qualifies as a—

(1) no-additional-cost service,

(2) qualified employee discount,

(3) working condition fringe,

(4) de minimis fringe,

(5) qualified transportation fringe,

(6) qualified moving expense reimbursement,

(7) qualified retirement planning services, or

(8) qualified military base realignment and closure fringe.

(b) NO-ADDITIONAL-COST SERVICE DEFINED.—For purposes of this section, the term "no-additional-cost service" means any service provided by an employer to an employee for use by such employee if—

(1) such service is offered for sale to customers in the ordinary course of the line of business of the employer in which the employee is performing services, and

(2) the employer incurs no substantial additional cost (including forgone revenue) in providing such service to the employee (determined without regard to any amount paid by the employee for such service).

(c) QUALIFIED EMPLOYEE DISCOUNT DEFINED.—For purposes of this section—

(1) QUALIFIED EMPLOYEE DISCOUNT.—The term "qualified employee discount" means any employee discount with respect

to qualified property or services to the extent such discount does not exceed—

(A) in the case of property, the gross profit percentage of the price at which the property is being offered by the employer to customers, or

(B) in the case of services, 20 percent of the price at which the services are being offered by the employer to customers.

(2) GROSS PROFIT PERCENTAGE.—

(A) IN GENERAL.—The term "gross profit percentage" means the percent which—

(i) the excess of the aggregate sales price of property sold by the employer to customers over the aggregate cost of such property to the employer, is of

(ii) the aggregate sale price of such property.

(B) DETERMINATION OF GROSS PROFIT PERCENTAGE.—Gross profit percentage shall be determined on the basis of—

(i) all property offered to customers in the ordinary course of the line of business of the employer in which the employee is performing services (or a reasonable classification of property selected by the employer), and

(ii) the employer's experience during a representative period.

(3) EMPLOYEE DISCOUNT DEFINED.—The term "employee discount" means the amount by which—

(A) the price at which the property or services are provided by the employer to an employee for use by such employee, is less than

(B) the price at which such property or services are being offered by the employer to customers.

(4) QUALIFIED PROPERTY OR SERVICES.—The term "qualified property or services" means any property (other than real property and other than personal property of a kind held for investment) or services which are offered for sale to customers in the ordinary course of the line of business of the employer in which the employee is performing services.

(d) WORKING CONDITION FRINGE DEFINED.—For purposes of this section, the term "working condition fringe" means any property or services provided to an employee of the employer to the extent that, if the employee paid for such property or services, such payment would be allowable as a deduction under section 162 or 167.

(e) DE MINIMIS FRINGE DEFINED.—For purposes of this section—

(1) IN GENERAL.—The term "de minimis fringe" means any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees) so small as to make accounting for it unreasonable or administratively impracticable.

(2) TREATMENT OF CERTAIN EATING FACILITIES.—The operation by an employer of any eating facility for employees shall be treated as a de minimis fringe if—

(A) such facility is located on or near the business premises of the employer, and

(B) revenue derived from such facility normally equals or exceeds the direct operating costs of such facility.

The preceding sentence shall apply with respect to any highly compensated employee only if access to the facility is available on substantially the same terms to each member of a group of employees which is defined under a reasonable classification set up by the employer which does not discriminate in favor of highly compensated employees. For purposes of subparagraph (B), an employee entitled under section 119 to exclude the value of a meal provided at such facility shall be treated as having paid an amount for such meal equal to the direct operating costs of the facility attributable to such meal.

(f) QUALIFIED TRANSPORTATION FRINGE.—

(1) IN GENERAL.—For purposes of this section, the term "qualified transportation fringe" means any of the following provided by an employer to an employee:

(A) Transportation in a commuter highway vehicle if such transportation is in connection with travel between the employee's residence and place of employment.

(B) Any transit pass.

(C) Qualified parking.

(D) Any qualified bicycle commuting reimbursement.

(2) LIMITATION ON EXCLUSION.—The amount of the fringe benefits which are provided by an employer to any employee and which may be excluded from gross income under subsection (a)(5) shall not exceed—

(A) $175 per month in the case of the aggregate of the benefits described in subparagraphs (A) and (B) of paragraph (1),

(B) $175 per month in the case of qualified parking, and

(C) the applicable annual limitation in the case of any qualified bicycle commuting reimbursement.

(3) CASH REIMBURSEMENTS.—For purposes of this subsection, the term "qualified transportation fringe" includes a cash reimbursement by an employer to an employee for a benefit described in paragraph (1). The preceding sentence shall apply to a cash reimbursement for any transit pass only if a voucher or similar item which may be exchanged only for a transit pass is not readily available for direct distribution by the employer to the employee.

(4) NO CONSTRUCTIVE RECEIPT.—No amount shall be included in the gross income of an employee solely because the employee may choose between any qualified transportation fringe (other than a qualified bicycle commuting reimbursement) and compensation which would otherwise be includible in gross income of such employee.

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

(A) TRANSIT PASS.—The term "transit pass" means any pass, token, farecard, voucher, or similar item entitling a person to transportation (or transportation at a reduced price) if such transportation is—

(i) on mass transit facilities (whether or not publicly owned), or

(ii) provided by any person in the business of transporting persons for compensation or hire if such trans-

portation is provided in a vehicle meeting the requirements of subparagraph (B)(i).

(B) COMMUTER HIGHWAY VEHICLE.—The term "commuter highway vehicle" means any highway vehicle—

(i) the seating capacity of which is at least 6 adults (not including the driver), and

(ii) at least 80 percent of the mileage use of which can reasonably be expected to be—

(I) for purposes of transporting employees in connection with travel between their residences and their place of employment, and

(II) on trips during which the number of employees transported for such purposes is at least 1/2 of the adult seating capacity of such vehicle (not including the driver).

(C) QUALIFIED PARKING.—The term "qualified parking" means parking provided to an employee on or near the business premises of the employer or on or near a location from which the employee commutes to work by transportation described in subparagraph (A), in a commuter highway vehicle, or by carpool. Such term shall not include any parking on or near property used by the employee for residential purposes.

(D) TRANSPORTATION PROVIDED BY EMPLOYER.—Transportation referred to in paragraph (1)(A) shall be considered to be provided by an employer if such transportation is furnished in a commuter highway vehicle operated by or for the employer.

(E) EMPLOYEE.—For purposes of this subsection, the term "employee" does not include an individual who is an employee within the meaning of section 401(c)(1).

(F) DEFINITIONS RELATED TO BICYCLE COMMUTING REIMBURSEMENT.—

(i) QUALIFIED BICYCLE COMMUTING REIMBURSEMENT.—The term "qualified bicycle commuting reimbursement" means, with respect to any calendar year, any employer reimbursement during the 15-month period beginning with the first day of such calendar year for reasonable expenses incurred by the employee during such calendar year for the purchase of a bicycle and bicycle improvements, repair, and storage, if such bicycle is regularly used for travel between the employee's residence and place of employment.

(ii) APPLICABLE ANNUAL LIMITATION.—The term "applicable annual limitation" means, with respect to any employee for any calendar year, the product of $20 multiplied by the number of qualified bicycle commuting months during such year.

(iii) QUALIFIED BICYCLE COMMUTING MONTH.—The term "qualified bicycle commuting month" means, with respect to any employee, any month during which such employee—

(I) regularly uses the bicycle for a substantial portion of the travel between the employee's residence and place of employment, and

(II) does not receive any benefit described in subparagraph (A), (B), or (C) of paragraph (1).

(6) INFLATION ADJUSTMENT.—

(A) IN GENERAL.—In the case of any taxable year beginning in a calendar year after 1999, the dollar amounts contained in subparagraphs (A) and (B) of paragraph (2) shall be increased by an amount equal to—

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting "calendar year 1998" for "calendar year 2016" in subparagraph (A)(ii) thereof.

(B) ROUNDING.—If any increase determined under subparagraph (A) is not a multiple of $5, such increase shall be rounded to the next lowest multiple of $5.

(7) COORDINATION WITH OTHER PROVISIONS.—For purposes of this section, the terms "working condition fringe" and "de minimis fringe" shall not include any qualified transportation fringe (determined without regard to paragraph (2)).

(8) SUSPENSION OF QUALIFIED BICYCLE COMMUTING REIMBURSEMENT EXCLUSION.—Paragraph (1)(D) shall not apply to any taxable year beginning after December 31, 2017, and before January 1, 2026.

(g) QUALIFIED MOVING EXPENSE REIMBURSEMENT.—For purposes of this section—

(1) IN GENERAL.—The term "qualified moving expense reimbursement" means any amount received (directly or indirectly) by an individual from an employer as a payment for (or a reimbursement of) expenses which would be deductible as moving expenses under section 217 if directly paid or incurred by the individual. Such term shall not include any payment for (or reimbursement of) an expense actually deducted by the individual in a prior taxable year.

(2) SUSPENSION FOR TAXABLE YEARS 2018 THROUGH 2025.—Except in the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military order and incident to a permanent change of station, subsection (a)(6) shall not apply to any taxable year beginning after December 31, 2017, and before January 1, 2026.

(h) CERTAIN INDIVIDUALS TREATED AS EMPLOYEES FOR PURPOSES OF SUBSECTIONS (A)(1) AND (2).—For purposes of paragraphs (1) and (2) of subsection (a)—

(1) RETIRED AND DISABLED EMPLOYEES AND SURVIVING SPOUSE OF EMPLOYEE TREATED AS EMPLOYEE.—With respect to a line of business of an employer, the term "employee" includes—

(A) any individual who was formerly employed by such employer in such line of business and who separated from service with such employer in such line of business by reason of retirement or disability, and

(B) any widow or widower of any individual who died while employed by such employer in such line of business or while an employee within the meaning of subparagraph (A).

(2) SPOUSE AND DEPENDENT CHILDREN.—

(A) IN GENERAL.—Any use by the spouse or a dependent child of the employee shall be treated as use by the employee.

(B) DEPENDENT CHILD.—For purposes of subparagraph (A), the term "dependent child" means any child (as defined in section 152(f)(1)) of the employee—

(i) who is a dependent of the employee, or

(ii) both of whose parents are deceased and who has not attained age 25.

For purposes of the preceding sentence, any child to whom section 152(e) applies shall be treated as the dependent of both parents.

(3) SPECIAL RULE FOR PARENTS IN THE CASE OF AIR TRANSPORTATION.—Any use of air transportation by a parent of an employee (determined without regard to paragraph (1)(B)) shall be treated as use by the employee.

(i) RECIPROCAL AGREEMENTS.—For purposes of paragraph (1) of subsection (a), any service provided by an employer to an employee of another employer shall be treated as provided by the employer of such employee if—

(1) such service is provided pursuant to a written agreement between such employers, and

(2) neither of such employers incurs any substantial additional costs (including foregone revenue) in providing such service or pursuant to such agreement.

(j) SPECIAL RULES.—

(1) EXCLUSIONS UNDER SUBSECTION (A)(1) AND (2) APPLY TO HIGHLY COMPENSATED EMPLOYEES ONLY IF NO DISCRIMINATION.—Paragraphs (1) and (2) of subsection (a) shall apply with respect to any fringe benefit described therein provided with respect to any highly compensated employee only if such fringe benefit is available on substantially the same terms to each member of a group of employees which is defined under a reasonable classification set up by the employer which does not discriminate in favor of highly compensated employees.

(2) SPECIAL RULE FOR LEASED SECTIONS OF DEPARTMENT STORES.—

(A) IN GENERAL.—For purposes of paragraph (2) of subsection (a), in the case of a leased section of a department store—

(i) such section shall be treated as part of the line of business of the person operating the department store, and

(ii) employees in the leased section shall be treated as employees of the person operating the department store.

(B) LEASED SECTION OF DEPARTMENT STORE.—For purposes of subparagraph (A), a leased section of a department store is any part of a department store where over-the-counter sales of property are made under a lease or similar arrangement where it appears to the general public that individuals making such sales are employed by the person operating the department store.

(3) AUTO SALESMEN.—

(A) IN GENERAL.—For purposes of subsection (a)(3), qualified automobile demonstration use shall be treated as a working condition fringe.

(B) QUALIFIED AUTOMOBILE DEMONSTRATION USE.—For purposes of subparagraph (A), the term "qualified automobile demonstration use" means any use of an automobile by a full-time automobile salesman in the sales area in which the automobile dealer's sales office is located if—

(i) such use is provided primarily to facilitate the salesman's performance of services for the employer, and

(ii) there are substantial restrictions on the personal use of such automobile by such salesman.

(4) ON-PREMISES GYMS AND OTHER ATHLETIC FACILITIES.—

(A) IN GENERAL.—Gross income shall not include the value of any on-premises athletic facility provided by an employer to his employees.

(B) ON-PREMISES ATHLETIC FACILITY.—For purposes of this paragraph, the term "on-premises athletic facility" means any gym or other athletic facility—

(i) which is located on the premises of the employer,

(ii) which is operated by the employer, and

(iii) substantially all the use of which is by employees of the employer, their spouses, and their dependent children (within the meaning of subsection (h)).

(5) SPECIAL RULE FOR AFFILIATES OF AIRLINES.—

(A) IN GENERAL.—If—

(i) a qualified affiliate is a member of an affiliated group another member of which operates an airline, and

(ii) employees of the qualified affiliate who are directly engaged in providing airline-related services are entitled to no-additional-cost service with respect to air transportation provided by such other member,

then, for purposes of applying paragraph (1) of subsection (a) to such no-additional-cost service provided to such employees, such qualified affiliate shall be treated as engaged in the same line of business as such other member.

(B) QUALIFIED AFFILIATE.—For purposes of this paragraph, the term "qualified affiliate" means any corporation which is predominantly engaged in airline-related services.

(C) AIRLINE-RELATED SERVICES.—For purposes of this paragraph, the term "airline-related services" means any of the following services provided in connection with air transportation:

(i) Catering.

(ii) Baggage handling.

(iii) Ticketing and reservations.

(iv) Flight planning and weather analysis.

(v) Restaurants and gift shops located at an airport.

(vi) Such other similar services provided to the airline as the Secretary may prescribe.

(D) AFFILIATED GROUP.—For purposes of this paragraph, the term "affiliated group" has the meaning given such term by section 1504(a).

(6) HIGHLY COMPENSATED EMPLOYEE.—For purposes of this section, the term "highly compensated employee" has the meaning given such term by section 414(q).

(7) AIR CARGO.—For purposes of subsection (b), the transportation of cargo by air and the transportation of passengers by air shall be treated as the same service.

(8) APPLICATION OF SECTION TO OTHERWISE TAXABLE EDUCATIONAL OR TRAINING BENEFITS.—Amounts paid or expenses incurred by the employer for education or training provided to the employee which are not excludable from gross income under section 127 shall be excluded from gross income under this section if (and only if) such amounts or expenses are a working condition fringe.

(k) CUSTOMERS NOT TO INCLUDE EMPLOYEES.—For purposes of this section (other than subsection (c)(2)), the term "customers" shall only include customers who are not employees.

(l) SECTION NOT TO APPLY TO FRINGE BENEFITS EXPRESSLY PROVIDED FOR ELSEWHERE.—This section (other than subsections (e) and (g)) shall not apply to any fringe benefits of a type the tax treatment of which is expressly provided for in any other section of this chapter.

(m) QUALIFIED RETIREMENT PLANNING SERVICES.—

(1) IN GENERAL.—For purposes of this section, the term "qualified retirement planning services" means any retirement planning advice or information provided to an employee and [his spouse] *the employee's spouse* by an employer maintaining a qualified employer plan.

(2) NONDISCRIMINATION RULE.—Subsection (a)(7) shall apply in the case of highly compensated employees only if such services are available on substantially the same terms to each member of the group of employees normally provided education and information regarding the employer's qualified employer plan.

(3) QUALIFIED EMPLOYER PLAN.—For purposes of this subsection, the term "qualified employer plan" means a plan, contract, pension, or account described in section 219(g)(5).

(n) QUALIFIED MILITARY BASE REALIGNMENT AND CLOSURE FRINGE.—For purposes of this section—

(1) IN GENERAL.—The term "qualified military base realignment and closure fringe" means 1 or more payments under the authority of section 1013 of the Demonstration Cities and Metropolitan Development Act of 1966 (42 U.S.C. 3374) (as in effect on the date of the enactment of the American Recovery and Reinvestment Tax Act of 2009).

(2) LIMITATION.—With respect to any property, such term shall not include any payment referred to in paragraph (1) to the extent that the sum of all of such payments related to such property exceeds the maximum amount described in subsection (c) of such section (as in effect on such date).

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

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SEC. 135. INCOME FROM UNITED STATES SAVINGS BONDS USED TO PAY HIGHER EDUCATION TUITION AND FEES.

(a) GENERAL RULE.—In the case of an individual who pays qualified higher education expenses during the taxable year, no amount shall be includible in gross income by reason of the redemption during such year of any qualified United States savings bond.

(b) LIMITATIONS.—

(1) LIMITATION WHERE REDEMPTION PROCEEDS EXCEED HIGHER EDUCATION EXPENSES.—

(A) IN GENERAL.—If—

(i) the aggregate proceeds of qualified United States savings bonds redeemed by the taxpayer during the taxable year exceed

(ii) the qualified higher education expenses paid by the taxpayer during such taxable year,

the amount excludable from gross income under subsection (a) shall not exceed the applicable fraction of the amount excludable from gross income under subsection (a) without regard to this subsection.

(B) APPLICABLE FRACTION.—For purposes of subparagraph (A), the term "applicable fraction" means the fraction the numerator of which is the amount described in subparagraph (A)(ii) and the denominator of which is the amount described in subparagraph (A)(i).

(2) LIMITATION BASED ON MODIFIED ADJUSTED GROSS INCOME.—

(A) IN GENERAL.—If the modified adjusted gross income of the taxpayer for the taxable year exceeds $40,000 ($60,000 in the case of a joint return), the amount which would (but for this paragraph) be excludable from gross income under subsection (a) shall be reduced (but not below zero) by the amount which bears the same ratio to the amount which would be so excludable as such excess bears to $15,000 ($30,000 in the case of a joint return).

(B) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 1990, the $40,000 and $60,000 amounts contained in subparagraph (A) shall be increased by an amount equal to—

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting "calendar year 1989" for "calendar year 2016" in subparagraph (A)(ii) thereof.

(C) ROUNDING.—If any amount as adjusted under subparagraph (B) is not a multiple of $50, such amount shall be rounded to the nearest multiple of $50 (or if such amount is a multiple of $25, such amount shall be rounded to the next highest multiple of $50).

(c) DEFINITIONS.—For purposes of this section—

(1) QUALIFIED UNITED STATES SAVINGS BOND.—The term "qualified United States savings bond" means any United States savings bond issued—

(A) after December 31, 1989,

(B) to an individual who has attained age 24 before the date of issuance, and

(C) at discount under section 3105 of title 31, United States Code.

(2) QUALIFIED HIGHER EDUCATION EXPENSES.—

(A) IN GENERAL.—The term "qualified higher education expenses" means tuition and fees required for the enrollment or attendance of—

(i) the taxpayer,

(ii) the taxpayer's spouse, or

(iii) any dependent of the taxpayer with respect to whom the taxpayer is allowed a deduction under section 151,

at an eligible educational institution.

(B) EXCEPTION FOR EDUCATION INVOLVING SPORTS, ETC..—Such term shall not include expenses with respect to any course or other education involving sports, games, or hobbies other than as part of a degree program.

(C) CONTRIBUTIONS TO QUALIFIED TUITION PROGRAM AND COVERDELL EDUCATION SAVINGS ACCOUNTS.—Such term shall include any contribution to a qualified tuition program (as defined in section 529) on behalf of a designated beneficiary (as defined in such section), or to a Coverdell education savings account (as defined in section 530) on behalf of an account beneficiary, who is an individual described in subparagraph (A); but there shall be no increase in the investment in the contract for purposes of applying section 72 by reason of any portion of such contribution which is not includible in gross income by reason of this subparagraph.

(3) ELIGIBLE EDUCATIONAL INSTITUTION.—The term "eligible educational institution" has the meaning given such term by section 529(e)(5).

(4) MODIFIED ADJUSTED GROSS INCOME.—The term "modified adjusted gross income" means the adjusted gross income of the taxpayer for the taxable year determined—

(A) without regard to this section and sections 137, 221, 222, 911, 931, and 933, and

(B) after the application of sections 86, 469, and 219.

(d) SPECIAL RULES.—

(1) ADJUSTMENT FOR CERTAIN SCHOLARSHIPS AND VETERANS BENEFITS.—The amount of qualified higher education expenses otherwise taken into account under subsection (a) with respect to the education of an individual shall be reduced (before the application of subsection (b)) by the sum of the amounts received with respect to such individual for the taxable year as—

(A) a qualified scholarship which under section 117 is not includable in gross income,

(B) an educational assistance allowance under chapter 30, 31, 32, 34, or 35 of title 38, United States Code,

(C) a payment (other than a gift, bequest, devise, or inheritance within the meaning of section 102(a)) for educational expenses, or attributable to attendance at an eligible educational institution, which is exempt from income taxation by any law of the United States, or

(D) a payment, waiver, or reimbursement of qualified higher education expenses under a qualified tuition program (within the meaning of section 529(b)).

(2) COORDINATION WITH OTHER HIGHER EDUCATION BENEFITS.—The amount of the qualified higher education expenses otherwise taken into account under subsection (a) with respect to the education of an individual shall be reduced (before the application of subsection (b)) by—

(A) the amount of such expenses which are taken into account in determining the credit allowed to the taxpayer or any other person under section 25A with respect to such expenses; and

(B) the amount of such expenses which are taken into account in determining the exclusions under sections 529(c)(3)(B) and 530(d)(2).

(3) NO EXCLUSION FOR MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—If the taxpayer is a married individual (within the meaning of section 7703), this section shall apply only if the taxpayer and [his spouse] *the taxpayer's spouse* file a joint return for the taxable year.

(4) REGULATIONS.—The Secretary may prescribe such regulations as may be necessary or appropriate to carry out this section, including regulations requiring record keeping and information reporting.

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PART V—DEDUCTIONS FOR PERSONAL EXEMPTIONS

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SEC. 151. ALLOWANCE OF DEDUCTIONS FOR PERSONAL EXEMPTIONS.

(a) ALLOWANCE OF DEDUCTIONS.—In the case of an individual, the exemptions provided by this section shall be allowed as deductions in computing taxable income.

(b) TAXPAYER AND SPOUSE.—An exemption of the exemption amount for the taxpayer; and an additional exemption of the exemption amount for the spouse of the taxpayer if a joint return is not made by the taxpayer and [his spouse] *the taxpayer's spouse* , and if the spouse, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer.

(c) ADDITIONAL EXEMPTION FOR DEPENDENTS.—An exemption of the exemption amount for each individual who is a dependent (as defined in section 152) of the taxpayer for the taxable year.

(d) EXEMPTION AMOUNT.—For purposes of this section—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the term "exemption amount" means $2,000.

(2) EXEMPTION AMOUNT DISALLOWED IN CASE OF CERTAIN DEPENDENTS.—In the case of an individual with respect to whom a deduction under this section is allowable to another taxpayer for a taxable year beginning in the calendar year in which the

individual's taxable year begins, the exemption amount applicable to such individual for such individual's taxable year shall be zero.

(3) PHASEOUT.—

(A) IN GENERAL.—In the case of any taxpayer whose adjusted gross income for the taxable year exceeds the applicable amount in effect under section 68(b), the exemption amount shall be reduced by the applicable percentage.

(B) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A), the term "applicable percentage" means 2 percentage points for each $2,500 (or fraction thereof) by which the taxpayer's adjusted gross income for the taxable year exceeds the applicable amount in effect under section 68(b). In the case of a married individual filing a separate return, the preceding sentence shall be applied by substituting "$1,250" for "$2,500". In no event shall the applicable percentage exceed 100 percent.

(C) COORDINATION WITH OTHER PROVISIONS.—The provisions of this paragraph shall not apply for purposes of determining whether a deduction under this section with respect to any individual is allowable to another taxpayer for any taxable year.

(4) INFLATION ADJUSTMENT.—Except as provided in paragraph (5), in the case of any taxable year beginning in a calendar year after 1989, the dollar amount contained in paragraph (1) shall be increased by an amount equal to—

(A) such dollar amount, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting "calendar year 1988" for "calendar year 2016" in subparagraph (A)(ii) thereof.

(5) SPECIAL RULES FOR TAXABLE YEARS 2018 THROUGH 2025.—In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026—

(A) EXEMPTION AMOUNT.—The term "exemption amount" means zero.

(B) REFERENCES.—For purposes of any other provision of this title, the reduction of the exemption amount to zero under subparagraph (A) shall not be taken into account in determining whether a deduction is allowed or allowable, or whether a taxpayer is entitled to a deduction, under this section.

(e) IDENTIFYING INFORMATION REQUIRED.—No exemption shall be allowed under this section with respect to any individual unless the TIN of such individual is included on the return claiming the exemption.

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PART VI—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

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SEC. 165. LOSSES.

(a) GENERAL RULE.—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

(b) AMOUNT OF DEDUCTION.—For purposes of subsection (a), the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.

(c) LIMITATION ON LOSSES OF INDIVIDUALS.—In the case of an individual, the deduction under subsection (a) shall be limited to—

(1) losses incurred in a trade or business;

(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; and

(3) except as provided in subsection (h), losses of property not connected with a trade or business or a transaction entered into for profit, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft.

(d) WAGERING LOSSES.—Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions. For purposes of the preceding sentence, in the case of taxable years beginning after December 31, 2017, and before January 1, 2026, the term "losses from wagering transactions" includes any deduction otherwise allowable under this chapter incurred in carrying on any wagering transaction.

(e) THEFT LOSSES.—For purposes of subsection (a), any loss arising from theft shall be treated as sustained during the taxable year in which the taxpayer discovers such loss.

(f) CAPITAL LOSSES.—Losses from sales or exchanges of capital assets shall be allowed only to the extent allowed in sections 1211 and 1212.

(g) WORTHLESS SECURITIES.—

(1) GENERAL RULE.—If any security which is a capital asset becomes worthless during the taxable year, the loss resulting therefrom shall, for purposes of this subtitle, be treated as a loss from the sale or exchange, on the last day of the taxable year, of a capital asset.

(2) SECURITY DEFINED.—For purposes of this subsection, the term "security" means—

(A) a share of stock in a corporation;

(B) a right to subscribe for, or to receive, a share of stock in a corporation; or

(C) a bond, debenture, note, or certificate, or other evidence of indebtedness, issued by a corporation or by a government or political subdivision thereof, with interest coupons or in registered form.

(3) SECURITIES IN AFFILIATED CORPORATION.—For purposes of paragraph (1), any security in a corporation affiliated with a taxpayer which is a domestic corporation shall not be treated as a capital asset. For purposes of the preceding sentence, a corporation shall be treated as affiliated with the taxpayer only if—

(A) the taxpayer owns directly stock in such corporation meeting the requirements of section 1504(a)(2), and

(B) more than 90 percent of the aggregate of its gross receipts for all taxable years has been from sources other

than royalties, rents (except rents derived from rental of properties to employees of the corporation in the ordinary course of its operating business), dividends, interest (except interest received on deferred purchase price of operating assets sold), annuities, and gains from sales or exchanges of stocks and securities.

In computing gross receipts for purposes of the preceding sentence, gross receipts from sales or exchanges of stocks and securities shall be taken into account only to the extent of gains therefrom.

(h) TREATMENT OF CASUALTY GAINS AND LOSSES.—

(1) DOLLAR LIMITATION PER CASUALTY.—Any loss of an individual described in subsection (c)(3) shall be allowed only to the extent that the amount of the loss to such individual arising from each casualty, or from each theft, exceeds $500 ($100 for taxable years beginning after December 31, 2009).

(2) NET CASUALTY LOSS ALLOWED ONLY TO THE EXTENT IT EXCEEDS 10 PERCENT OF ADJUSTED GROSS INCOME.—

(A) IN GENERAL.—If the personal casualty losses for any taxable year exceed the personal casualty gains for such taxable year, such losses shall be allowed for the taxable year only to the extent of the sum of—

(i) the amount of the personal casualty gains for the taxable year, plus

(ii) so much of such excess as exceeds 10 percent of the adjusted gross income of the individual.

(B) SPECIAL RULE WHERE PERSONAL CASUALTY GAINS EXCEED PERSONAL CASUALTY LOSSES.—If the personal casualty gains for any taxable year exceed the personal casualty losses for such taxable year—

(i) all such gains shall be treated as gains from sales or exchanges of capital assets, and

(ii) all such losses shall be treated as losses from sales or exchanges of capital assets.

(3) DEFINITIONS OF PERSONAL CASUALTY GAIN AND PERSONAL CASUALTY LOSS.—For purposes of this subsection—

(A) PERSONAL CASUALTY GAIN.—The term "personal casualty gain" means the recognized gain from any involuntary conversion of property which is described in subsection (c)(3) arising from fire, storm, shipwreck, or other casualty, or from theft.

(B) PERSONAL CASUALTY LOSS.—The term "personal casualty loss" means any loss described in subsection (c)(3). For purposes of paragraph (2), the amount of any personal casualty loss shall be determined after the application of paragraph (1).

(4) SPECIAL RULES.—

(A) PERSONAL CASUALTY LOSSES ALLOWABLE IN COMPUTING ADJUSTED GROSS INCOME TO THE EXTENT OF PERSONAL CASUALTY GAINS.—In any case to which paragraph (2)(A) applies, the deduction for personal casualty losses for any taxable year shall be treated as a deduction allowable in computing adjusted gross income to the extent such losses do not exceed the personal casualty gains for the taxable year.

(B) JOINT RETURNS.—For purposes of this subsection, a [husband and wife] *married couple* making a joint return for the taxable year shall be treated as 1 individual.

(C) DETERMINATION OF ADJUSTED GROSS INCOME IN CASE OF ESTATES AND TRUSTS.—For purposes of paragraph (2), the adjusted gross income of an estate or trust shall be computed in the same manner as in the case of an individual, except that the deductions for costs paid or incurred in connection with the administration of the estate or trust shall be treated as allowable in arriving at adjusted gross income.

(D) COORDINATION WITH ESTATE TAX.—No loss described in subsection (c)(3) shall be allowed if, at the time of filing the return, such loss has been claimed for estate tax purposes in the estate tax return.

(E) CLAIM REQUIRED TO BE FILED IN CERTAIN CASES.—Any loss of an individual described in subsection (c)(3) to the extent covered by insurance shall be taken into account under this section only if the individual files a timely insurance claim with respect to such loss.

(5) LIMITATION FOR TAXABLE YEARS 2018 THROUGH 2025.—

(A) IN GENERAL.—In the case of an individual, except as provided in subparagraph (B), any personal casualty loss which (but for this paragraph) would be deductible in a taxable year beginning after December 31, 2017, and before January 1, 2026, shall be allowed as a deduction under subsection (a) only to the extent it is attributable to a Federally declared disaster (as defined in subsection (i)(5)).

(B) EXCEPTION RELATED TO PERSONAL CASUALTY GAINS.—If a taxpayer has personal casualty gains for any taxable year to which subparagraph (A) applies—

(i) subparagraph (A) shall not apply to the portion of the personal casualty loss not attributable to a Federally declared disaster (as so defined) to the extent such loss does not exceed such gains, and

(ii) in applying paragraph (2) for purposes of subparagraph (A) to the portion of personal casualty loss which is so attributable to such a disaster, the amount of personal casualty gains taken into account under paragraph (2)(A) shall be reduced by the portion of such gains taken into account under clause (i).

(i) DISASTER LOSSES.—

(1) ELECTION TO TAKE DEDUCTION FOR PRECEDING YEAR.—Notwithstanding the provisions of subsection (a), any loss occurring in a disaster area and attributable to a federally declared disaster may, at the election of the taxpayer, be taken into account for the taxable year immediately preceding the taxable year in which the disaster occurred.

(2) YEAR OF LOSS.—If an election is made under this subsection, the casualty resulting in the loss shall be treated for purposes of this title as having occurred in the taxable year for which the deduction is claimed.

(3) AMOUNT OF LOSS.—The amount of the loss taken into account in the preceding taxable year by reason of paragraph (1)

shall not exceed the uncompensated amount determined on the basis of the facts existing at the date the taxpayer claims the loss.

(4) USE OF DISASTER LOAN APPRAISALS TO ESTABLISH AMOUNT OF LOSS.—Nothing in this title shall be construed to prohibit the Secretary from prescribing regulations or other guidance under which an appraisal for the purpose of obtaining a loan of Federal funds or a loan guarantee from the Federal Government as a result of a federally declared disaster may be used to establish the amount of any loss described in paragraph (1) or (2).

(5) FEDERALLY DECLARED DISASTERS.—For purposes of this subsection—

(A) IN GENERAL.—The term "Federally declared disaster" means any disaster subsequently determined by the President of the United States to warrant assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

(B) DISASTER AREA.—The term "disaster area" means the area so determined to warrant such assistance.

(j) DENIAL OF DEDUCTION FOR LOSSES ON CERTAIN OBLIGATIONS NOT IN REGISTERED FORM.—

(1) IN GENERAL.—Nothing in subsection (a) or in any other provision of law shall be construed to provide a deduction for any loss sustained on any registration-required obligation unless such obligation is in registered form (or the issuance of such obligation was subject to tax under section 4701).

(2) DEFINITIONS.—For purposes of this subsection—

(A) REGISTRATION-REQUIRED OBLIGATION.—The term "registration-required obligation" has the meaning given to such term by section 163(f)(2).

(B) REGISTERED FORM.—The term "registered form" has the same meaning as when used in section 163(f).

(3) EXCEPTIONS.—The Secretary may, by regulations, provide that this subsection and section 1287 shall not apply with respect to obligations held by any person if—

(A) such person holds such obligations in connection with a trade or business outside the United States,

(B) such person holds such obligations as a broker dealer (registered under Federal or State law) for sale to customers in the ordinary course of his trade or business,

(C) such person complies with reporting requirements with respect to ownership, transfers, and payments as the Secretary may require, or

(D) such person promptly surrenders the obligation to the issuer for the issuance of a new obligation in registered form,

but only if such obligations are held under arrangements provided in regulations or otherwise which are designed to assure that such obligations are not delivered to any United States person other than a person described in subparagraph (A), (B), or (C).

(k) TREATMENT AS DISASTER LOSS WHERE TAXPAYER ORDERED TO DEMOLISH OR RELOCATE RESIDENCE IN DISASTER AREA BECAUSE OF DISASTER.—In the case of a taxpayer whose residence is located in

an area which has been determined by the President of the United States to warrant assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, if—

(1) not later than the 120th day after the date of such determination, the taxpayer is ordered, by the government of the State or any political subdivision thereof in which such residence is located, to demolish or relocate such residence, and

(2) the residence has been rendered unsafe for use as a residence by reason of the disaster,

any loss attributable to such disaster shall be treated as a loss which arises from a casualty and which is described in subsection (i).

(l) TREATMENT OF CERTAIN LOSSES IN INSOLVENT FINANCIAL INSTITUTIONS.—

(1) IN GENERAL.—If—

(A) as of the close of the taxable year, it can reasonably be estimated that there is a loss on a qualified individual's deposit in a qualified financial institution, and

(B) such loss is on account of the bankruptcy or insolvency of such institution,

then the taxpayer may elect to treat the amount so estimated as a loss described in subsection (c)(3) incurred during the taxable year.

(2) QUALIFIED INDIVIDUAL DEFINED.—For purposes of this subsection, the term "qualified individual" means any individual, except an individual—

(A) who owns at least 1 percent in value of the outstanding stock of the qualified financial institution,

(B) who is an officer of the qualified financial institution,

(C) who is a sibling (whether by the whole or half blood), spouse, aunt, uncle, nephew, niece, ancestor, or lineal descendant of an individual described in subparagraph (A) or (B), or

(D) who otherwise is a related person (as defined in section 267(b)) with respect to an individual described in subparagraph (A) or (B).

(3) QUALIFIED FINANCIAL INSTITUTION.—For purposes of this subsection, the term "qualified financial institution" means—

(A) any bank (as defined in section 581),

(B) any institution described in section 591,

(C) any credit union the deposits or accounts in which are insured under Federal or State law or are protected or guaranteed under State law, or

(D) any similar institution chartered and supervised under Federal or State law.

(4) DEPOSIT.—For purposes of this subsection, the term "deposit" means any deposit, withdrawable account, or withdrawable or repurchasable share.

(5) ELECTION TO TREAT AS ORDINARY LOSS.—

(A) IN GENERAL.—In lieu of any election under paragraph (1), the taxpayer may elect to treat the amount referred to in paragraph (1) for the taxable year as an ordinary loss described in subsection (c)(2) incurred during the taxable year.

(B) LIMITATIONS.—

(i) DEPOSIT MAY NOT BE FEDERALLY INSURED.—No election may be made under subparagraph (A) with respect to any loss on a deposit in a qualified financial institution if part or all of such deposit is insured under Federal law.

(ii) DOLLAR LIMITATION.—With respect to each financial institution, the aggregate amount of losses attributable to deposits in such financial institution to which an election under subparagraph (A) may be made by the taxpayer for any taxable year shall not exceed $20,000 ($10,000 in the case of a separate return by a married individual). The limitation of the preceding sentence shall be reduced by the amount of any insurance proceeds under any State law which can reasonably be expected to be received with respect to losses on deposits in such institution.

(6) ELECTION.—Any election by the taxpayer under this subsection for any taxable year—

(A) shall apply to all losses for such taxable year of the taxpayer on deposits in the institution with respect to which such election was made, and

(B) may be revoked only with the consent of the Secretary.

(7) COORDINATION WITH SECTION 166.—Section 166 shall not apply to any loss to which an election under this subsection applies.

(m) CROSS REFERENCES.—

(1) For special rule for banks with respect to worthless securities, see section 582.

(2) For disallowance of deduction for worthlessness of securities to which subsection (g)(2)(C) applies, if issued by a political party or similar organization, see section 271.

(3) For special rule for losses on stock in a small business investment company, see section 1242.

(4) For special rule for losses of a small business investment company, see section 1243.

(5) For special rule for losses on small business stock, see section 1244.

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SEC. 170. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.

(a) ALLOWANCE OF DEDUCTION.—

(1) GENERAL RULE.—There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary.

(2) CORPORATIONS ON ACCRUAL BASIS.—In the case of a corporation reporting its taxable income on the accrual basis, if—

(A) the board of directors authorizes a charitable contribution during any taxable year, and

(B) payment of such contribution is made after the close of such taxable year and on or before the 15th day of the fourth month following the close of such taxable year,

then the taxpayer may elect to treat such contribution as paid during such taxable year. The election may be made only at the time of the filing of the return for such taxable year, and shall be signified in such manner as the Secretary shall by regulations prescribe.

(3) FUTURE INTERESTS IN TANGIBLE PERSONAL PROPERTY.—For purposes of this section, payment of a charitable contribution which consists of a future interest in tangible personal property shall be treated as made only when all intervening interests in, and rights to the actual possession or enjoyment of, the property have expired or are held by persons other than the taxpayer or those standing in a relationship to the taxpayer described in section 267(b) or 707(b). For purposes of the preceding sentence, a fixture which is intended to be severed from the real property shall be treated as tangible personal property.

(b) PERCENTAGE LIMITATIONS.—

(1) INDIVIDUALS.—In the case of an individual, the deduction provided in subsection (a) shall be limited as provided in the succeeding subparagraphs.

(A) GENERAL RULE.—Any charitable contribution to—

(i) a church or a convention or association of churches,

(ii) an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on,

(iii) an organization the principal purpose or functions of which are the providing of medical or hospital care or medical education or medical research, if the organization is a hospital, or if the organization is a medical research organization directly engaged in the continuous active conduct of medical research in conjunction with a hospital, and during the calendar year in which the contribution is made such organization is committed to spend such contributions for such research before January 1 of the fifth calendar year which begins after the date such contribution is made,

(iv) an organization which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from the United States or any State or political subdivision thereof or from direct or indirect contributions from the general public, and which is organized and operated exclusively to receive, hold, invest, and administer property and to make expenditures to or for the benefit of a college or university which is an organization referred to in clause (ii) of this subparagraph and which is an agency or instrumentality of a State or political subdivision thereof, or which is owned or operated by a State or political sub-

division thereof or by an agency or instrumentality of one or more States or political subdivisions,

(v) a governmental unit referred to in subsection (c)(1),

(vi) an organization referred to in subsection (c)(2) which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from a governmental unit referred to in subsection (c)(1) or from direct or indirect contributions from the general public,

(vii) a private foundation described in subparagraph (F),

(viii) an organization described in section 509(a)(2) or (3), or

(ix) an agricultural research organization directly engaged in the continuous active conduct of agricultural research (as defined in section 1404 of the National Agricultural Research, Extension, and Teaching Policy Act of 1977) in conjunction with a land-grant college or university (as defined in such section) or a non-land grant college of agriculture (as defined in such section), and during the calendar year in which the contribution is made such organization is committed to spend such contribution for such research before January 1 of the fifth calendar year which begins after the date such contribution is made,

shall be allowed to the extent that the aggregate of such contributions does not exceed 50 percent of the taxpayer's contribution base for the taxable year.

(B) OTHER CONTRIBUTIONS.—Any charitable contribution other than a charitable contribution to which subparagraph (A) applies shall be allowed to the extent that the aggregate of such contributions does not exceed the lesser of—

(i) 30 percent of the taxpayer's contribution base for the taxable year, or

(ii) the excess of 50 percent of the taxpayer's contribution base for the taxable year over the amount of charitable contributions allowable under subparagraph (A) (determined without regard to subparagraph (C)).

If the aggregate of such contributions exceeds the limitation of the preceding sentence, such excess shall be treated (in a manner consistent with the rules of subsection (d)(1)) as a charitable contribution (to which subparagraph (A) does not apply) in each of the 5 succeeding taxable years in order of time.

(C) SPECIAL LIMITATION WITH RESPECT TO CONTRIBUTIONS DESCRIBED IN SUBPARAGRAPH (A) OF CERTAIN CAPITAL GAIN PROPERTY.—

(i) In the case of charitable contributions described in subparagraph (A) of capital gain property to which subsection (e)(1)(B) does not apply, the total amount of

contributions of such property which may be taken into account under subsection (a) for any taxable year shall not exceed 30 percent of the taxpayer's contribution base for such year. For purposes of this subsection, contributions of capital gain property to which this subparagraph applies shall be taken into account after all other charitable contributions (other than charitable contributions to which subparagraph (D) applies).

(ii) If charitable contributions described in subparagraph (A) of capital gain property to which clause (i) applies exceeds 30 percent of the taxpayer's contribution base for any taxable year, such excess shall be treated, in a manner consistent with the rules of subsection (d)(1), as a charitable contribution of capital gain property to which clause (i) applies in each of the 5 succeeding taxable years in order of time.

(iii) At the election of the taxpayer (made at such time and in such manner as the Secretary prescribes by regulations), subsection (e)(1) shall apply to all contributions of capital gain property (to which subsection (e)(1)(B) does not otherwise apply) made by the taxpayer during the taxable year. If such an election is made, clauses (i) and (ii) shall not apply to contributions of capital gain property made during the taxable year, and, in applying subsection (d)(1) for such taxable year with respect to contributions of capital gain property made in any prior contribution year for which an election was not made under this clause, such contributions shall be reduced as if subsection (e)(1) had applied to such contributions in the year in which made.

(iv) For purposes of this paragraph, the term "capital gain property" means, with respect to any contribution, any capital asset the sale of which at its fair market value at the time of the contribution would have resulted in gain which would have been long-term capital gain. For purposes of the preceding sentence, any property which is property used in the trade or business (as defined in section 1231(b)) shall be treated as a capital asset.

(D) SPECIAL LIMITATION WITH RESPECT TO CONTRIBUTIONS OF CAPITAL GAIN PROPERTY TO ORGANIZATIONS NOT DESCRIBED IN SUBPARAGRAPH (A).—

(i) IN GENERAL.—In the case of charitable contributions (other than charitable contributions to which subparagraph (A) applies) of capital gain property, the total amount of such contributions of such property taken into account under subsection (a) for any taxable year shall not exceed the lesser of—

(I) 20 percent of the taxpayer's contribution base for the taxable year, or

(II) the excess of 30 percent of the taxpayer's contribution base for the taxable year over the

amount of the contributions of capital gain property to which subparagraph (C) applies.

For purposes of this subsection, contributions of capital gain property to which this subparagraph applies shall be taken into account after all other charitable contributions.

(ii) CARRYOVER.—If the aggregate amount of contributions described in clause (i) exceeds the limitation of clause (i), such excess shall be treated (in a manner consistent with the rules of subsection (d)(1)) as a charitable contribution of capital gain property to which clause (i) applies in each of the 5 succeeding taxable years in order of time.

(E) CONTRIBUTIONS OF QUALIFIED CONSERVATION CONTRIBUTIONS.—

(i) IN GENERAL.—Any qualified conservation contribution (as defined in subsection (h)(1)) shall be allowed to the extent the aggregate of such contributions does not exceed the excess of 50 percent of the taxpayer's contribution base over the amount of all other charitable contributions allowable under this paragraph.

(ii) CARRYOVER.—If the aggregate amount of contributions described in clause (i) exceeds the limitation of clause (i), such excess shall be treated (in a manner consistent with the rules of subsection (d)(1)) as a charitable contribution to which clause (i) applies in each of the 15 succeeding years in order of time.

(iii) COORDINATION WITH OTHER SUBPARAGRAPHS.—For purposes of applying this subsection and subsection (d)(1), contributions described in clause (i) shall not be treated as described in subparagraph (A), (B), (C), or (D) and such subparagraphs shall apply without regard to such contributions.

(iv) SPECIAL RULE FOR CONTRIBUTION OF PROPERTY USED IN AGRICULTURE OR LIVESTOCK PRODUCTION.—

(I) IN GENERAL.—If the individual is a qualified farmer or rancher for the taxable year for which the contribution is made, clause (i) shall be applied by substituting "100 percent" for "50 percent".

(II) EXCEPTION.—Subclause (I) shall not apply to any contribution of property made after the date of the enactment of this subparagraph which is used in agriculture or livestock production (or available for such production) unless such contribution is subject to a restriction that such property remain available for such production. This subparagraph shall be applied separately with respect to property to which subclause (I) does not apply by reason of the preceding sentence prior to its application to property to which subclause (I) does apply.

(v) DEFINITION.—For purposes of clause (iv), the term "qualified farmer or rancher" means a taxpayer whose gross income from the trade or business of

farming (within the meaning of section 2032A(e)(5)) is greater than 50 percent of the taxpayer's gross income for the taxable year.

(F) CERTAIN PRIVATE FOUNDATIONS.—The private foundations referred to in subparagraph (A)(vii) and subsection (e)(1)(B) are—

(i) a private operating foundation (as defined in section 4942(j)(3)),

(ii) any other private foundation (as defined in section 509(a)) which, not later than the 15th day of the third month after the close of the foundation's taxable year in which contributions are received, makes qualifying distributions (as defined in section 4942(g), without regard to paragraph (3) thereof), which are treated, after the application of section 4942(g)(3), as distributions out of corpus (in accordance with section 4942(h)) in an amount equal to 100 percent of such contributions, and with respect to which the taxpayer obtains adequate records or other sufficient evidence from the foundation showing that the foundation made such qualifying distributions, and

(iii) a private foundation all of the contributions to which are pooled in a common fund and which would be described in section 509(a)(3) but for the right of any substantial contributor (hereafter in this clause called "donor") or [his spouse] *the spouse of such donor* to designate annually the recipients, from among organizations described in paragraph (1) of section 509(a), of the income attributable to the donor's contribution to the fund and to direct (by deed or by will) the payment, to an organization described in such paragraph (1), of the corpus in the common fund attributable to the donor's contribution; but this clause shall apply only if all of the income of the common fund is required to be (and is) distributed to one or more organizations described in such paragraph (1) not later than the 15th day of the third month after the close of the taxable year in which the income is realized by the fund and only if all of the corpus attributable to any donor's contribution to the fund is required to be (and is) distributed to one or more of such organizations not later than one year after [his death or after the death of his surviving spouse if she] *the death of the donor or after the death of the donor's surviving spouse if such surviving spouse* has the right to designate the recipients of such corpus.

(G) INCREASED LIMITATION FOR CASH CONTRIBUTIONS.—

(i) IN GENERAL.—In the case of any contribution of cash to an organization described in subparagraph (A), the total amount of such contributions which may be taken into account under subsection (a) for any taxable year beginning after December 31, 2017, and before January 1, 2026, shall not exceed 60 percent of the taxpayer's contribution base for such year.

(ii) CARRYOVER.—If the aggregate amount of contributions described in clause (i) exceeds the applicable limitation under clause (i) for any taxable year described in such clause, such excess shall be treated (in a manner consistent with the rules of subsection (d)(1)) as a charitable contribution to which clause (i) applies in each of the 5 succeeding years in order of time.

(iii) COORDINATION WITH SUBPARAGRAPHS (A) AND (B).—

(I) IN GENERAL.—Contributions taken into account under this subparagraph shall not be taken into account under subparagraph (A).

(II) LIMITATION REDUCTION.—For each taxable year described in clause (i), and each taxable year to which any contribution under this subparagraph is carried over under clause (ii), subparagraph (A) shall be applied by reducing (but not below zero) the contribution limitation allowed for the taxable year under such subparagraph by the aggregate contributions allowed under this subparagraph for such taxable year, and subparagraph (B) shall be applied by treating any reference to subparagraph (A) as a reference to both subparagraph (A) and this subparagraph.

(H) CONTRIBUTION BASE DEFINED.—For purposes of this section, the term "contribution base" means adjusted gross income (computed without regard to any net operating loss carryback to the taxable year under section 172).

(2) CORPORATIONS.—In the case of a corporation—

(A) IN GENERAL.—The total deductions under subsection (a) for any taxable year (other than for contributions to which subparagraph (B) or (C) applies) shall not exceed 10 percent of the taxpayer's taxable income.

(B) QUALIFIED CONSERVATION CONTRIBUTIONS BY CERTAIN CORPORATE FARMERS AND RANCHERS.—

(i) IN GENERAL.—Any qualified conservation contribution (as defined in subsection (h)(1))—

(I) which is made by a corporation which, for the taxable year during which the contribution is made, is a qualified farmer or rancher (as defined in paragraph (1)(E)(v)) and the stock of which is not readily tradable on an established securities market at any time during such year, and

(II) which, in the case of contributions made after the date of the enactment of this subparagraph, is a contribution of property which is used in agriculture or livestock production (or available for such production) and which is subject to a restriction that such property remain available for such production,

shall be allowed to the extent the aggregate of such contributions does not exceed the excess of the taxpayer's taxable income over the amount of charitable contributions allowable under subparagraph (A).

(ii) CARRYOVER.—If the aggregate amount of contributions described in clause (i) exceeds the limitation of clause (i), such excess shall be treated (in a manner consistent with the rules of subsection (d)(2)) as a charitable contribution to which clause (i) applies in each of the 15 succeeding taxable years in order of time.

(C) QUALIFIED CONSERVATION CONTRIBUTIONS BY CERTAIN NATIVE CORPORATIONS.—

(i) IN GENERAL.—Any qualified conservation contribution (as defined in subsection (h)(1)) which—

(I) is made by a Native Corporation, and

(II) is a contribution of property which was land conveyed under the Alaska Native Claims Settlement Act,

shall be allowed to the extent that the aggregate amount of such contributions does not exceed the excess of the taxpayer's taxable income over the amount of charitable contributions allowable under subparagraph (A).

(ii) CARRYOVER.—If the aggregate amount of contributions described in clause (i) exceeds the limitation of clause (i), such excess shall be treated (in a manner consistent with the rules of subsection (d)(2)) as a charitable contribution to which clause (i) applies in each of the 15 succeeding taxable years in order of time.

(iii) NATIVE CORPORATION.—For purposes of this subparagraph, the term "Native Corporation" has the meaning given such term by section 3(m) of the Alaska Native Claims Settlement Act.

(D) TAXABLE INCOME.—For purposes of this paragraph, taxable income shall be computed without regard to—

(i) this section,

(ii) part VIII (except section 248),

(iii) any net operating loss carryback to the taxable year under section 172,

(iv) any capital loss carryback to the taxable year under section 1212(a)(1)

(v) section 199A(g).

(c) CHARITABLE CONTRIBUTION DEFINED.—For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of—

(1) A State, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.

(2) A corporation, trust, or community chest, fund, or foundation—

(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States;

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competi-

tion (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals;

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and

(D) which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

A contribution or gift by a corporation to a trust, chest, fund, or foundation shall be deductible by reason of this paragraph only if it is to be used within the United States or any of its possessions exclusively for purposes specified in subparagraph (B). Rules similar to the rules of section 501(j) shall apply for purposes of this paragraph.

(3) A post or organization of war veterans, or an auxiliary unit or society of, or trust or foundation for, any such post or organization—

(A) organized in the United States or any of its possessions, and

(B) no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(4) In the case of a contribution or gift by an individual, a domestic fraternal society, order, or association, operating under the lodge system, but only if such contribution or gift is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

(5) A cemetery company owned and operated exclusively for the benefit of its members, or any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, if such company or corporation is not operated for profit and no part of the net earnings of such company or corporation inures to the benefit of any private shareholder or individual.

For purposes of this section, the term "charitable contribution" also means an amount treated under subsection (g) as paid for the use of an organization described in paragraph (2), (3), or (4).

(d) CARRYOVERS OF EXCESS CONTRIBUTIONS.—

(1) INDIVIDUALS.—

(A) IN GENERAL.—In the case of an individual, if the amount of charitable contributions described in subsection (b)(1)(A) payment of which is made within a taxable year (hereinafter in this paragraph referred to as the "contribution year") exceeds 50 percent of the taxpayer's contribution base for such year, such excess shall be treated as a charitable contribution described in subsection (b)(1)(A) paid in each of the 5 succeeding taxable years in order of time, but, with respect to any such succeeding taxable year, only to the extent of the lesser of the two following amounts:

(i) the amount by which 50 percent of the taxpayer's contribution base for such succeeding taxable year exceeds the sum of the charitable contributions described in subsection (b)(1)(A) payment of which is made by the taxpayer within such succeeding taxable year (determined without regard to this subparagraph) and the charitable contributions described in subsection (b)(1)(A) payment of which was made in taxable years before the contribution year which are treated under this subparagraph as having been paid in such succeeding taxable year; or

(ii) in the case of the first succeeding taxable year, the amount of such excess, and in the case of the second, third, fourth, or fifth succeeding taxable year, the portion of such excess not treated under this subparagraph as a charitable contribution described in subsection (b)(1)(A) paid in any taxable year intervening between the contribution year and such succeeding taxable year.

(B) SPECIAL RULE FOR NET OPERATING LOSS CARRYOVERS.—In applying subparagraph (A), the excess determined under subparagraph (A) for the contribution year shall be reduced to the extent that such excess reduces taxable income (as computed for purposes of the second sentence of section 172(b)(2)) and increases the net operating loss deduction for a taxable year succeeding the contribution year.

(2) CORPORATIONS.—

(A) IN GENERAL.—Any contribution made by a corporation in a taxable year (hereinafter in this paragraph referred to as the "contribution year") in excess of the amount deductible for such year under subsection (b)(2)(A) shall be deductible for each of the 5 succeeding taxable years in order of time, but only to the extent of the lesser of the two following amounts: (i) the excess of the maximum amount deductible for such succeeding taxable year under subsection (b)(2)(A) over the sum of the contributions made in such year plus the aggregate of the excess contributions which were made in taxable years before the contribution year and which are deductible under this subparagraph for such succeeding taxable year; or (ii) in the case of the first succeeding taxable year, the amount of such excess contribution, and in the case of the second, third, fourth, or fifth succeeding taxable year, the portion of such excess contribution not deductible under this subparagraph for any taxable year intervening between the contribution year and such succeeding taxable year.

(B) SPECIAL RULE FOR NET OPERATING LOSS CARRYOVERS.—For purposes of subparagraph (A), the excess of—

(i) the contributions made by a corporation in a taxable year to which this section applies, over

(ii) the amount deductible in such year under the limitation in subsection (b)(2)(A),

shall be reduced to the extent that such excess reduces taxable income (as computed for purposes of the second sentence of section 172(b)(2)) and increases a net operating loss carryover under section 172 to a succeeding taxable year.

(e) CERTAIN CONTRIBUTIONS OF ORDINARY INCOME AND CAPITAL GAIN PROPERTY.—

(1) GENERAL RULE.—The amount of any charitable contribution of property otherwise taken into account under this section shall be reduced by the sum of—

(A) the amount of gain which would not have been long-term capital gain (determined without regard to section 1221(b)(3)) if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution), and

(B) in the case of a charitable contribution—

(i) of tangible personal property—

(I) if the use by the donee is unrelated to the purpose or function constituting the basis for its exemption under section 501 (or, in the case of a governmental unit, to any purpose or function described in subsection (c)), or

(II) which is applicable property (as defined in paragraph (7)(C), but without regard to clause (ii) thereof) which is sold, exchanged, or otherwise disposed of by the donee before the last day of the taxable year in which the contribution was made and with respect to which the donee has not made a certification in accordance with paragraph (7)(D),

(ii) to or for the use of a private foundation (as defined in section 509(a)), other than a private foundation described in subsection (b)(1)(F),

(iii) of any patent, copyright (other than a copyright described in section 1221(a)(3) or 1231(b)(1)(C)), trademark, trade name, trade secret, know-how, software (other than software described in section 197(e)(3)(A)(i)), or similar property, or applications or registrations of such property, or

(iv) of any taxidermy property which is contributed by the person who prepared, stuffed, or mounted the property or by any person who paid or incurred the cost of such preparation, stuffing, or mounting,

the amount of gain which would have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution).

For purposes of applying this paragraph (other than in the case of gain to which section 617(d)(1), 1245(a), 1250(a), 1252(a), or 1254(a) applies), property which is property used in the trade or business (as defined in section 1231(b)) shall be treated as a capital asset. For purposes of applying this paragraph in the case of a charitable contribution of stock in an S corporation, rules similar to the rules of section 751 shall apply

in determining whether gain on such stock would have been long-term capital gain if such stock were sold by the taxpayer.

(2) ALLOCATION OF BASIS.—For purposes of paragraph (1), in the case of a charitable contribution of less than the taxpayer's entire interest in the property contributed, the taxpayer's adjusted basis in such property shall be allocated between the interest contributed and any interest not contributed in accordance with regulations prescribed by the Secretary.

(3) SPECIAL RULE FOR CERTAIN CONTRIBUTIONS OF INVENTORY AND OTHER PROPERTY.—

(A) QUALIFIED CONTRIBUTIONS.—For purposes of this paragraph, a qualified contribution shall mean a charitable contribution of property described in paragraph (1) or (2) of section 1221(a), by a corporation (other than a corporation which is an S corporation) to an organization which is described in section 501(c)(3) and is exempt under section 501(a) (other than a private foundation, as defined in section 509(a), which is not an operating foundation, as defined in section 4942(j)(3)), but only if—

(i) the use of the property by the donee is related to the purpose or function constituting the basis for its exemption under section 501 and the property is to be used by the donee solely for the care of the ill, the needy, or infants;

(ii) the property is not transferred by the donee in exchange for money, other property, or services;

(iii) the taxpayer receives from the donee a written statement representing that its use and disposition of the property will be in accordance with the provisions of clauses (i) and (ii); and

(iv) in the case where the property is subject to regulation under the Federal Food, Drug, and Cosmetic Act, as amended, such property must fully satisfy the applicable requirements of such Act and regulations promulgated thereunder on the date of transfer and for one hundred and eighty days prior thereto.

(B) AMOUNT OF REDUCTION.—The reduction under paragraph (1)(A) for any qualified contribution (as defined in subparagraph (A)) shall be no greater than the sum of—

(i) one-half of the amount computed under paragraph (1)(A) (computed without regard to this paragraph), and

(ii) the amount (if any) by which the charitable contribution deduction under this section for any qualified contribution (computed by taking into account the amount determined in clause (i), but without regard to this clause) exceeds twice the basis of such property.

(C) SPECIAL RULE FOR CONTRIBUTIONS OF FOOD INVENTORY.—

(i) GENERAL RULE.—In the case of a charitable contribution of food from any trade or business of the taxpayer, this paragraph shall be applied—

(I) without regard to whether the contribution is made by a C corporation, and

(II) only to food that is apparently wholesome food.

(ii) LIMITATION.—The aggregate amount of such contributions for any taxable year which may be taken into account under this section shall not exceed—

(I) in the case of any taxpayer other than a C corporation, 15 percent of the taxpayer's aggregate net income for such taxable year from all trades or businesses from which such contributions were made for such year, computed without regard to this section, and

(II) in the case of a C corporation, 15 percent of taxable income (as defined in subsection (b)(2)(D)).

(iii) RULES RELATED TO LIMITATION.—

(I) CARRYOVER.—If such aggregate amount exceeds the limitation imposed under clause (ii), such excess shall be treated (in a manner consistent with the rules of subsection (d)) as a charitable contribution described in clause (i) in each of the 5 succeeding taxable years in order of time.

(II) COORDINATION WITH OVERALL CORPORATE LIMITATION.—In the case of any charitable contribution which is allowable after the application of clause (ii)(II), subsection (b)(2)(A) shall not apply to such contribution, but the limitation imposed by such subsection shall be reduced (but not below zero) by the aggregate amount of such contributions. For purposes of subsection (b)(2)(B), such contributions shall be treated as allowable under subsection (b)(2)(A).

(iv) DETERMINATION OF BASIS FOR CERTAIN TAXPAYERS.—If a taxpayer—

(I) does not account for inventories under section 471, and

(II) is not required to capitalize indirect costs under section 263A,

the taxpayer may elect, solely for purposes of subparagraph (B), to treat the basis of any apparently wholesome food as being equal to 25 percent of the fair market value of such food.

(v) DETERMINATION OF FAIR MARKET VALUE.—In the case of any such contribution of apparently wholesome food which cannot or will not be sold solely by reason of internal standards of the taxpayer, lack of market, or similar circumstances, or by reason of being produced by the taxpayer exclusively for the purposes of transferring the food to an organization described in subparagraph (A), the fair market value of such contribution shall be determined—

(I) without regard to such internal standards, such lack of market, such circumstances, or such exclusive purpose, and

(II) by taking into account the price at which the same or substantially the same food items (as to both type and quality) are sold by the taxpayer

at the time of the contribution (or, if not so sold at such time, in the recent past).

(vi) APPARENTLY WHOLESOME FOOD.—For purposes of this subparagraph, the term "apparently wholesome food" has the meaning given to such term by section 22(b)(2) of the Bill Emerson Good Samaritan Food Donation Act (42 U.S.C. 1791(b)(2)), as in effect on the date of the enactment of this subparagraph.

(D) This paragraph shall not apply to so much of the amount of the gain described in paragraph (1)(A) which would be long-term capital gain but for the application of sections 617, 1245, 1250, or 1252.

(4) SPECIAL RULE FOR CONTRIBUTIONS OF SCIENTIFIC PROPERTY USED FOR RESEARCH.—

(A) LIMIT ON REDUCTION.—In the case of a qualified research contribution, the reduction under paragraph (1)(A) shall be no greater than the amount determined under paragraph (3)(B).

(B) QUALIFIED RESEARCH CONTRIBUTIONS.—For purposes of this paragraph, the term "qualified research contribution" means a charitable contribution by a corporation of tangible personal property described in paragraph (1) of section 1221(a), but only if—

(i) the contribution is to an organization described in subparagraph (A) or subparagraph (B) of section 41(e)(6),

(ii) the property is constructed or assembled by the taxpayer,

(iii) the contribution is made not later than 2 years after the date the construction or assembly of the property is substantially completed,

(iv) the original use of the property is by the donee,

(v) the property is scientific equipment or apparatus substantially all of the use of which by the donee is for research or experimentation (within the meaning of section 174), or for research training, in the United States in physical or biological sciences,

(vi) the property is not transferred by the donee in exchange for money, other property, or services, and

(vii) the taxpayer receives from the donee a written statement representing that its use and disposition of the property will be in accordance with the provisions of clauses (v) and (vi).

(C) CONSTRUCTION OF PROPERTY BY TAXPAYER.—For purposes of this paragraph, property shall be treated as constructed by the taxpayer only if the cost of the parts used in the construction of such property (other than parts manufactured by the taxpayer or a related person) do not exceed 50 percent of the taxpayer's basis in such property.

(D) CORPORATION.—For purposes of this paragraph, the term "corporation" shall not include—

(i) an S corporation,

(ii) a personal holding company (as defined in section 542), and

(iii) a service organization (as defined in section 414(m)(3)).

(5) SPECIAL RULE FOR CONTRIBUTIONS OF STOCK FOR WHICH MARKET QUOTATIONS ARE READILY AVAILABLE.—

(A) IN GENERAL.—Subparagraph (B)(ii) of paragraph (1) shall not apply to any contribution of qualified appreciated stock.

(B) QUALIFIED APPRECIATED STOCK.—Except as provided in subparagraph (C), for purposes of this paragraph, the term "qualified appreciated stock" means any stock of a corporation—

(i) for which (as of the date of the contribution) market quotations are readily available on an established securities market, and

(ii) which is capital gain property (as defined in subsection (b)(1)(C)(iv)).

(C) DONOR MAY NOT CONTRIBUTE MORE THAN 10 PERCENT OF STOCK OF CORPORATION.—

(i) IN GENERAL.—In the case of any donor, the term "qualified appreciated stock" shall not include any stock of a corporation contributed by the donor in a contribution to which paragraph (1)(B)(ii) applies (determined without regard to this paragraph) to the extent that the amount of the stock so contributed (when increased by the aggregate amount of all prior such contributions by the donor of stock in such corporation) exceeds 10 percent (in value) of all of the outstanding stock of such corporation.

(ii) SPECIAL RULE.—For purposes of clause (i), an individual shall be treated as making all contributions made by any member of his family (as defined in section 267(c)(4)).

(7) RECAPTURE OF DEDUCTION ON CERTAIN DISPOSITIONS OF EXEMPT USE PROPERTY.—

(A) IN GENERAL.—In the case of an applicable disposition of applicable property, there shall be included in the income of the donor of such property for the taxable year of such donor in which the applicable disposition occurs an amount equal to the excess (if any) of—

(i) the amount of the deduction allowed to the donor under this section with respect to such property, over

(ii) the donor's basis in such property at the time such property was contributed.

(B) APPLICABLE DISPOSITION.—For purposes of this paragraph, the term "applicable disposition" means any sale, exchange, or other disposition by the donee of applicable property—

(i) after the last day of the taxable year of the donor in which such property was contributed, and

(ii) before the last day of the 3-year period beginning on the date of the contribution of such property,

unless the donee makes a certification in accordance with subparagraph (D).

(C) APPLICABLE PROPERTY.—For purposes of this paragraph, the term "applicable property" means charitable deduction property (as defined in section 6050L(a)(2)(A))—

(i) which is tangible personal property the use of which is identified by the donee as related to the purpose or function constituting the basis of the donee's exemption under section 501, and

(ii) for which a deduction in excess of the donor's basis is allowed.

(D) CERTIFICATION.—A certification meets the requirements of this subparagraph if it is a written statement which is signed under penalty of perjury by an officer of the donee organization and—

(i) which—

(I) certifies that the use of the property by the donee was substantial and related to the purpose or function constituting the basis for the donee's exemption under section 501, and

(II) describes how the property was used and how such use furthered such purpose or function, or

(ii) which—

(I) states the intended use of the property by the donee at the time of the contribution, and

(II) certifies that such intended use has become impossible or infeasible to implement.

(f) DISALLOWANCE OF DEDUCTION IN CERTAIN CASES AND SPECIAL RULES.—

(1) IN GENERAL.—No deduction shall be allowed under this section for a contribution to or for the use of an organization or trust described in section 508(d) or 4948(c)(4) subject to the conditions specified in such sections.

(2) CONTRIBUTIONS OF PROPERTY PLACED IN TRUST.—

(A) REMAINDER INTEREST.—In the case of property transferred in trust, no deduction shall be allowed under this section for the value of a contribution of a remainder interest unless the trust is a charitable remainder annuity trust or a charitable remainder unitrust (described in section 664), or a pooled income fund (described in section 642(c)(5)).

(B) INCOME INTERESTS, ETC..—No deduction shall be allowed under this section for the value of any interest in property (other than a remainder interest) transferred in trust unless the interest is in the form of a guaranteed annuity or the trust instrument specifies that the interest is a fixed percentage distributed yearly of the fair market value of the trust property (to be determined yearly) and the grantor is treated as the owner of such interest for purposes of applying section 671. If the donor ceases to be treated as the owner of such an interest for purposes of applying section 671, at the time the donor ceases to be so treated, the donor shall for purposes of this chapter be considered as having received an amount of income equal to the amount of any deduction he received under this section for the contribution reduced by the discounted value of all

amounts of income earned by the trust and taxable to him before the time at which he ceases to be treated as the owner of the interest. Such amounts of income shall be discounted to the date of the contribution. The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subparagraph.

(C) DENIAL OF DEDUCTION IN CASE OF PAYMENTS BY CERTAIN TRUSTS.—In any case in which a deduction is allowed under this section for the value of an interest in property described in subparagraph (B), transferred in trust, no deduction shall be allowed under this section to the grantor or any other person for the amount of any contribution made by the trust with respect to such interest.

(D) EXCEPTION.—This paragraph shall not apply in a case in which the value of all interests in property transferred in trust are deductible under subsection (a).

(3) DENIAL OF DEDUCTION IN CASE OF CERTAIN CONTRIBUTIONS OF PARTIAL INTERESTS IN PROPERTY.—

(A) IN GENERAL.—In the case of a contribution (not made by a transfer in trust) of an interest in property which consists of less than the taxpayer's entire interest in such property, a deduction shall be allowed under this section only to the extent that the value of the interest contributed would be allowable as a deduction under this section if such interest had been transferred in trust. For purposes of this subparagraph, a contribution by a taxpayer of the right to use property shall be treated as a contribution of less than the taxpayer's entire interest in such property.

(B) EXCEPTIONS.—Subparagraph (A) shall not apply to—

(i) a contribution of a remainder interest in a personal residence or farm,

(ii) a contribution of an undivided portion of the taxpayer's entire interest in property, and

(iii) a qualified conservation contribution.

(4) VALUATION OF REMAINDER INTEREST IN REAL PROPERTY.—For purposes of this section, in determining the value of a remainder interest in real property, depreciation (computed on the straight line method) and depletion of such property shall be taken into account, and such value shall be discounted at a rate of 6 percent per annum, except that the Secretary may prescribe a different rate.

(5) REDUCTION FOR CERTAIN INTEREST.—If, in connection with any charitable contribution, a liability is assumed by the recipient or by any other person, or if a charitable contribution is of property which is subject to a liability, then, to the extent necessary to avoid the duplication of amounts, the amount taken into account for purposes of this section as the amount of the charitable contribution—

(A) shall be reduced for interest (i) which has been paid (or is to be paid) by the taxpayer, (ii) which is attributable to the liability, and (iii) which is attributable to any period after the making of the contribution, and

(B) in the case of a bond, shall be further reduced for interest (i) which has been paid (or is to be paid) by the taxpayer on indebtedness incurred or continued to purchase

or carry such bond, and (ii) which is attributable to any period before the making of the contribution.

The reduction pursuant to subparagraph (B) shall not exceed the interest (including interest equivalent) on the bond which is attributable to any period before the making of the contribution and which is not (under the taxpayer's method of accounting) includible in the gross income of the taxpayer for any taxable year. For purposes of this paragraph, the term "bond" means any bond, debenture, note, or certificate or other evidence of indebtedness.

(6) DEDUCTIONS FOR OUT-OF-POCKET EXPENDITURES.—No deduction shall be allowed under this section for an out-of-pocket expenditure made by any person on behalf of an organization described in subsection (c) (other than an organization described in section 501(h)(5) (relating to churches, etc.)) if the expenditure is made for the purpose of influencing legislation (within the meaning of section 501(c)(3)).

(7) REFORMATIONS TO COMPLY WITH PARAGRAPH (2).—

(A) IN GENERAL.—A deduction shall be allowed under subsection (a) in respect of any qualified reformation (within the meaning of section 2055(e)(3)(B)).

(B) RULES SIMILAR TO SECTION 2055(E)(3) TO APPLY.—For purposes of this paragraph, rules similar to the rules of section 2055(e)(3) shall apply.

(8) SUBSTANTIATION REQUIREMENT FOR CERTAIN CONTRIBUTIONS.—

(A) GENERAL RULE.—No deduction shall be allowed under subsection (a) for any contribution of $250 or more unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgment of the contribution by the donee organization that meets the requirements of subparagraph (B).

(B) CONTENT OF ACKNOWLEDGEMENT.—An acknowledgement meets the requirements of this subparagraph if it includes the following information:

(i) The amount of cash and a description (but not value) of any property other than cash contributed.

(ii) Whether the donee organization provided any goods or services in consideration, in whole or in part, for any property described in clause (i).

(iii) A description and good faith estimate of the value of any goods or services referred to in clause (ii) or, if such goods or services consist solely of intangible religious benefits, a statement to that effect.

For purposes of this subparagraph, the term "intangible religious benefit" means any intangible religious benefit which is provided by an organization organized exclusively for religious purposes and which generally is not sold in a commercial transaction outside the donative context.

(C) CONTEMPORANEOUS.—For purposes of subparagraph (A), an acknowledgment shall be considered to be contemporaneous if the taxpayer obtains the acknowledgment on or before the earlier of—

(i) the date on which the taxpayer files a return for the taxable year in which the contribution was made, or

(ii) the due date (including extensions) for filing such return.

(D) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations that may provide that some or all of the requirements of this paragraph do not apply in appropriate cases.

(9) DENIAL OF DEDUCTION WHERE CONTRIBUTION FOR LOBBYING ACTIVITIES.—No deduction shall be allowed under this section for a contribution to an organization which conducts activities to which section 162(e)(1) applies on matters of direct financial interest to the donor's trade or business, if a principal purpose of the contribution was to avoid Federal income tax by securing a deduction for such activities under this section which would be disallowed by reason of section 162(e) if the donor had conducted such activities directly. No deduction shall be allowed under section 162(a) for any amount for which a deduction is disallowed under the preceding sentence.

(10) SPLIT-DOLLAR LIFE INSURANCE, ANNUITY, AND ENDOWMENT CONTRACTS.—

(A) IN GENERAL.—Nothing in this section or in section 545(b)(2), 642(c), 2055, 2106(a)(2), or 2522 shall be construed to allow a deduction, and no deduction shall be allowed, for any transfer to or for the use of an organization described in subsection (c) if in connection with such transfer—

(i) the organization directly or indirectly pays, or has previously paid, any premium on any personal benefit contract with respect to the transferor, or

(ii) there is an understanding or expectation that any person will directly or indirectly pay any premium on any personal benefit contract with respect to the transferor.

(B) PERSONAL BENEFIT CONTRACT.—For purposes of subparagraph (A), the term "personal benefit contract" means, with respect to the transferor, any life insurance, annuity, or endowment contract if any direct or indirect beneficiary under such contract is the transferor, any member of the transferor's family, or any other person (other than an organization described in subsection (c)) designated by the transferor.

(C) APPLICATION TO CHARITABLE REMAINDER TRUSTS.—In the case of a transfer to a trust referred to in subparagraph (E), references in subparagraphs (A) and (F) to an organization described in subsection (c) shall be treated as a reference to such trust.

(D) EXCEPTION FOR CERTAIN ANNUITY CONTRACTS.—If, in connection with a transfer to or for the use of an organization described in subsection (c), such organization incurs an obligation to pay a charitable gift annuity (as defined in section 501(m)) and such organization purchases any annuity contract to fund such obligation, persons receiving

payments under the charitable gift annuity shall not be treated for purposes of subparagraph (B) as indirect beneficiaries under such contract if—

(i) such organization possesses all of the incidents of ownership under such contract,

(ii) such organization is entitled to all the payments under such contract, and

(iii) the timing and amount of payments under such contract are substantially the same as the timing and amount of payments to each such person under such obligation (as such obligation is in effect at the time of such transfer).

(E) EXCEPTION FOR CERTAIN CONTRACTS HELD BY CHARITABLE REMAINDER TRUSTS.—A person shall not be treated for purposes of subparagraph (B) as an indirect beneficiary under any life insurance, annuity, or endowment contract held by a charitable remainder annuity trust or a charitable remainder unitrust (as defined in section 664(d)) solely by reason of being entitled to any payment referred to in paragraph (1)(A) or (2)(A) of section 664(d) if—

(i) such trust possesses all of the incidents of ownership under such contract, and

(ii) such trust is entitled to all the payments under such contract.

(F) EXCISE TAX ON PREMIUMS PAID.—

(i) IN GENERAL.—There is hereby imposed on any organization described in subsection (c) an excise tax equal to the premiums paid by such organization on any life insurance, annuity, or endowment contract if the payment of premiums on such contract is in connection with a transfer for which a deduction is not allowable under subparagraph (A), determined without regard to when such transfer is made.

(ii) PAYMENTS BY OTHER PERSONS.—For purposes of clause (i), payments made by any other person pursuant to an understanding or expectation referred to in subparagraph (A) shall be treated as made by the organization.

(iii) REPORTING.—Any organization on which tax is imposed by clause (i) with respect to any premium shall file an annual return which includes—

(I) the amount of such premiums paid during the year and the name and TIN of each beneficiary under the contract to which the premium relates, and

(II) such other information as the Secretary may require.

The penalties applicable to returns required under section 6033 shall apply to returns required under this clause. Returns required under this clause shall be furnished at such time and in such manner as the Secretary shall by forms or regulations require.

(iv) CERTAIN RULES TO APPLY.—The tax imposed by this subparagraph shall be treated as imposed by

chapter 42 for purposes of this title other than subchapter B of chapter 42.

(G) SPECIAL RULE WHERE STATE REQUIRES SPECIFICATION OF CHARITABLE GIFT ANNUITANT IN CONTRACT.—In the case of an obligation to pay a charitable gift annuity referred to in subparagraph (D) which is entered into under the laws of a State which requires, in order for the charitable gift annuity to be exempt from insurance regulation by such State, that each beneficiary under the charitable gift annuity be named as a beneficiary under an annuity contract issued by an insurance company authorized to transact business in such State, the requirements of clauses (i) and (ii) of subparagraph (D) shall be treated as met if—

(i) such State law requirement was in effect on February 8, 1999,

(ii) each such beneficiary under the charitable gift annuity is a bona fide resident of such State at the time the obligation to pay a charitable gift annuity is entered into, and

(iii) the only persons entitled to payments under such contract are persons entitled to payments as beneficiaries under such obligation on the date such obligation is entered into.

(H) MEMBER OF FAMILY.—For purposes of this paragraph, an individual's family consists of the individual's grandparents, the grandparents of such individual's spouse, the lineal descendants of such grandparents, and any spouse of such a lineal descendant.

(I) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations to prevent the avoidance of such purposes.

(11) QUALIFIED APPRAISAL AND OTHER DOCUMENTATION FOR CERTAIN CONTRIBUTIONS.—

(A) IN GENERAL.—

(i) DENIAL OF DEDUCTION.—In the case of an individual, partnership, or corporation, no deduction shall be allowed under subsection (a) for any contribution of property for which a deduction of more than $500 is claimed unless such person meets the requirements of subparagraphs (B), (C), and (D), as the case may be, with respect to such contribution.

(ii) EXCEPTIONS.—

(I) READILY VALUED PROPERTY.—Subparagraphs (C) and (D) shall not apply to cash, property described in subsection (e)(1)(B)(iii) or section 1221(a)(1), publicly traded securities (as defined in section 6050L(a)(2)(B)), and any qualified vehicle described in paragraph (12)(A)(ii) for which an acknowledgement under paragraph (12)(B)(iii) is provided.

(II) REASONABLE CAUSE.—Clause (i) shall not apply if it is shown that the failure to meet such requirements is due to reasonable cause and not to willful neglect.

(B) PROPERTY DESCRIPTION FOR CONTRIBUTIONS OF MORE THAN $500.—In the case of contributions of property for which a deduction of more than $500 is claimed, the requirements of this subparagraph are met if the individual, partnership or corporation includes with the return for the taxable year in which the contribution is made a description of such property and such other information as the Secretary may require. The requirements of this subparagraph shall not apply to a C corporation which is not a personal service corporation or a closely held C corporation.

(C) QUALIFIED APPRAISAL FOR CONTRIBUTIONS OF MORE THAN $5,000.—In the case of contributions of property for which a deduction of more than $5,000 is claimed, the requirements of this subparagraph are met if the individual, partnership, or corporation obtains a qualified appraisal of such property and attaches to the return for the taxable year in which such contribution is made such information regarding such property and such appraisal as the Secretary may require.

(D) SUBSTANTIATION FOR CONTRIBUTIONS OF MORE THAN $500,000.—In the case of contributions of property for which a deduction of more than $500,000 is claimed, the requirements of this subparagraph are met if the individual, partnership, or corporation attaches to the return for the taxable year a qualified appraisal of such property.

(E) QUALIFIED APPRAISAL AND APPRAISER.—For purposes of this paragraph—

(i) QUALIFIED APPRAISAL.—The term "qualified appraisal" means, with respect to any property, an appraisal of such property which—

(I) is treated for purposes of this paragraph as a qualified appraisal under regulations or other guidance prescribed by the Secretary, and

(II) is conducted by a qualified appraiser in accordance with generally accepted appraisal standards and any regulations or other guidance prescribed under subclause (I).

(ii) QUALIFIED APPRAISER.—Except as provided in clause (iii), the term "qualified appraiser" means an individual who—

(I) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations prescribed by the Secretary,

(II) regularly performs appraisals for which the individual receives compensation, and

(III) meets such other requirements as may be prescribed by the Secretary in regulations or other guidance.

(iii) SPECIFIC APPRAISALS.—An individual shall not be treated as a qualified appraiser with respect to any specific appraisal unless—

(I) the individual demonstrates verifiable education and experience in valuing the type of property subject to the appraisal, and

(II) the individual has not been prohibited from practicing before the Internal Revenue Service by the Secretary under section 330(c) of title 31, United States Code, at any time during the 3-year period ending on the date of the appraisal.

(F) AGGREGATION OF SIMILAR ITEMS OF PROPERTY.—For purposes of determining thresholds under this paragraph, property and all similar items of property donated to 1 or more donees shall be treated as 1 property.

(G) SPECIAL RULE FOR PASS-THRU ENTITIES.—In the case of a partnership or S corporation, this paragraph shall be applied at the entity level, except that the deduction shall be denied at the partner or shareholder level.

(H) REGULATIONS.—The Secretary may prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations that may provide that some or all of the requirements of this paragraph do not apply in appropriate cases.

(12) CONTRIBUTIONS OF USED MOTOR VEHICLES, BOATS, AND AIRPLANES.—

(A) IN GENERAL.—In the case of a contribution of a qualified vehicle the claimed value of which exceeds $500—

(i) paragraph (8) shall not apply and no deduction shall be allowed under subsection (a) for such contribution unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgement of the contribution by the donee organization that meets the requirements of subparagraph (B) and includes the acknowledgement with the taxpayer's return of tax which includes the deduction, and

(ii) if the organization sells the vehicle without any significant intervening use or material improvement of such vehicle by the organization, the amount of the deduction allowed under subsection (a) shall not exceed the gross proceeds received from such sale.

(B) CONTENT OF ACKNOWLEDGEMENT.—An acknowledgement meets the requirements of this subparagraph if it includes the following information:

(i) The name and taxpayer identification number of the donor.

(ii) The vehicle identification number or similar number.

(iii) In the case of a qualified vehicle to which subparagraph (A)(ii) applies—

(I) a certification that the vehicle was sold in an arm's length transaction between unrelated parties,

(II) the gross proceeds from the sale, and

(III) a statement that the deductible amount may not exceed the amount of such gross proceeds.

(iv) In the case of a qualified vehicle to which subparagraph (A)(ii) does not apply—

(I) a certification of the intended use or material improvement of the vehicle and the intended duration of such use, and

(II) a certification that the vehicle would not be transferred in exchange for money, other property, or services before completion of such use or improvement.

(v) Whether the donee organization provided any goods or services in consideration, in whole or in part, for the qualified vehicle.

(vi) A description and good faith estimate of the value of any goods or services referred to in clause (v) or, if such goods or services consist solely of intangible religious benefits (as defined in paragraph (8)(B)), a statement to that effect.

(C) CONTEMPORANEOUS.—For purposes of subparagraph (A), an acknowledgement shall be considered to be contemporaneous if the donee organization provides it within 30 days of—

(i) the sale of the qualified vehicle, or

(ii) in the case of an acknowledgement including a certification described in subparagraph (B)(iv), the contribution of the qualified vehicle.

(D) INFORMATION TO SECRETARY.—A donee organization required to provide an acknowledgement under this paragraph shall provide to the Secretary the information contained in the acknowledgement. Such information shall be provided at such time and in such manner as the Secretary may prescribe.

(E) QUALIFIED VEHICLE.—For purposes of this paragraph, the term "qualified vehicle" means any—

(i) motor vehicle manufactured primarily for use on public streets, roads, and highways,

(ii) boat, or

(iii) airplane.

Such term shall not include any property which is described in section 1221(a)(1).

(F) REGULATIONS OR OTHER GUIDANCE.—The Secretary shall prescribe such regulations or other guidance as may be necessary to carry out the purposes of this paragraph. The Secretary may prescribe regulations or other guidance which exempts sales by the donee organization which are in direct furtherance of such organization's charitable purpose from the requirements of subparagraphs (A)(ii) and (B)(iv)(II).

(13) CONTRIBUTIONS OF CERTAIN INTERESTS IN BUILDINGS LOCATED IN REGISTERED HISTORIC DISTRICTS.—

(A) IN GENERAL.—No deduction shall be allowed with respect to any contribution described in subparagraph (B) unless the taxpayer includes with the return for the taxable year of the contribution a $500 filing fee.

(B) CONTRIBUTION DESCRIBED.—A contribution is described in this subparagraph if such contribution is a

qualified conservation contribution (as defined in subsection (h)) which is a restriction with respect to the exterior of a building described in subsection (h)(4)(C)(ii) and for which a deduction is claimed in excess of $10,000.

(C) DEDICATION OF FEE.—Any fee collected under this paragraph shall be used for the enforcement of the provisions of subsection (h).

(14) REDUCTION FOR AMOUNTS ATTRIBUTABLE TO REHABILITATION CREDIT.—In the case of any qualified conservation contribution (as defined in subsection (h)), the amount of the deduction allowed under this section shall be reduced by an amount which bears the same ratio to the fair market value of the contribution as—

(A) the sum of the credits allowed to the taxpayer under section 47 for the 5 preceding taxable years with respect to any building which is a part of such contribution, bears to

(B) the fair market value of the building on the date of the contribution.

(15) SPECIAL RULE FOR TAXIDERMY PROPERTY.—

(A) BASIS.—For purposes of this section and notwithstanding section 1012, in the case of a charitable contribution of taxidermy property which is made by the person who prepared, stuffed, or mounted the property or by any person who paid or incurred the cost of such preparation, stuffing, or mounting, only the cost of the preparing, stuffing, or mounting shall be included in the basis of such property.

(B) TAXIDERMY PROPERTY.—For purposes of this section, the term "taxidermy property" means any work of art which—

(i) is the reproduction or preservation of an animal, in whole or in part,

(ii) is prepared, stuffed, or mounted for purposes of recreating one or more characteristics of such animal, and

(iii) contains a part of the body of the dead animal.

(16) CONTRIBUTIONS OF CLOTHING AND HOUSEHOLD ITEMS.—

(A) IN GENERAL.—In the case of an individual, partnership, or corporation, no deduction shall be allowed under subsection (a) for any contribution of clothing or a household item unless such clothing or household item is in good used condition or better.

(B) ITEMS OF MINIMAL VALUE.—Notwithstanding subparagraph (A), the Secretary may by regulation deny a deduction under subsection (a) for any contribution of clothing or a household item which has minimal monetary value.

(C) EXCEPTION FOR CERTAIN PROPERTY.—Subparagraphs (A) and (B) shall not apply to any contribution of a single item of clothing or a household item for which a deduction of more than $500 is claimed if the taxpayer includes with the taxpayer's return a qualified appraisal with respect to the property.

(D) HOUSEHOLD ITEMS.—For purposes of this paragraph—

(i) IN GENERAL.—The term "household items" includes furniture, furnishings, electronics, appliances, linens, and other similar items.

(ii) EXCLUDED ITEMS.—Such term does not include—

(I) food,

(II) paintings, antiques, and other objects of art,

(III) jewelry and gems, and

(IV) collections.

(E) SPECIAL RULE FOR PASS-THRU ENTITIES.—In the case of a partnership or S corporation, this paragraph shall be applied at the entity level, except that the deduction shall be denied at the partner or shareholder level.

(17) RECORDKEEPING.—No deduction shall be allowed under subsection (a) for any contribution of a cash, check, or other monetary gift unless the donor maintains as a record of such contribution a bank record or a written communication from the donee showing the name of the donee organization, the date of the contribution, and the amount of the contribution.

(18) CONTRIBUTIONS TO DONOR ADVISED FUNDS.—A deduction otherwise allowed under subsection (a) for any contribution to a donor advised fund (as defined in section 4966(d)(2)) shall only be allowed if—

(A) the sponsoring organization (as defined in section 4966(d)(1)) with respect to such donor advised fund is not—

(i) described in paragraph (3), (4), or (5) of subsection (c), or

(ii) a type III supporting organization (as defined in section 4943(f)(5)(A)) which is not a functionally integrated type III supporting organization (as defined in section 4943(f)(5)(B)), and

(B) the taxpayer obtains a contemporaneous written acknowledgment (determined under rules similar to the rules of paragraph (8)(C)) from the sponsoring organization (as so defined) of such donor advised fund that such organization has exclusive legal control over the assets contributed.

(g) AMOUNTS PAID TO MAINTAIN CERTAIN STUDENTS AS MEMBERS OF TAXPAYER'S HOUSEHOLD.—

(1) IN GENERAL.—Subject to the limitations provided by paragraph (2), amounts paid by the taxpayer to maintain an individual (other than a dependent, as defined in section 152 (determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B) thereof), or a relative of the taxpayer) as a member of his household during the period that such individual is—

(A) a member of the taxpayer's household under a written agreement between the taxpayer and an organization described in paragraph (2), (3), or (4) of subsection (c) to implement a program of the organization to provide educational opportunities for pupils or students in private homes, and

(B) a full-time pupil or student in the twelfth or any lower grade at an educational organization described in section 170(b)(1)(A)(ii) located in the United States,

shall be treated as amounts paid for the use of the organization.

(2) LIMITATIONS.—

(A) AMOUNT.—Paragraph (1) shall apply to amounts paid within the taxable year only to the extent that such amounts do not exceed $50 multiplied by the number of full calendar months during the taxable year which fall within the period described in paragraph (1). For purposes of the preceding sentence, if 15 or more days of a calendar month fall within such period such month shall be considered as a full calendar month.

(B) COMPENSATION OR REIMBURSEMENT.—Paragraph (1) shall not apply to any amount paid by the taxpayer within the taxable year if the taxpayer receives any money or other property as compensation or reimbursement for maintaining the individual in his household during the period described in paragraph (1).

(3) RELATIVE DEFINED.—For purposes of paragraph (1), the term "relative of the taxpayer" means an individual who, with respect to the taxpayer, bears any of the relationships described in subparagraphs (A) through (G) of section 152(d)(2).

(4) NO OTHER AMOUNT ALLOWED AS DEDUCTION.—No deduction shall be allowed under subsection (a) for any amount paid by a taxpayer to maintain an individual as a member of his household under a program described in paragraph (1)(A) except as provided in this subsection.

(h) QUALIFIED CONSERVATION CONTRIBUTION.—

(1) IN GENERAL.—For purposes of subsection (f)(3)(B)(iii), the term "qualified conservation contribution" means a contribution—

(A) of a qualified real property interest,

(B) to a qualified organization,

(C) exclusively for conservation purposes.

(2) QUALIFIED REAL PROPERTY INTEREST.—For purposes of this subsection, the term "qualified real property interest" means any of the following interests in real property:

(A) the entire interest of the donor other than a qualified mineral interest,

(B) a remainder interest, and

(C) a restriction (granted in perpetuity) on the use which may be made of the real property.

(3) QUALIFIED ORGANIZATION.—For purposes of paragraph (1), the term "qualified organization" means an organization which—

(A) is described in clause (v) or (vi) of subsection (b)(1)(A), or

(B) is described in section 501(c)(3) and—

(i) meets the requirements of section 509(a)(2), or

(ii) meets the requirements of section 509(a)(3) and is controlled by an organization described in subparagraph (A) or in clause (i) of this subparagraph.

(4) CONSERVATION PURPOSE DEFINED.—

(A) IN GENERAL.—For purposes of this subsection, the term "conservation purpose" means—

(i) the preservation of land areas for outdoor recreation by, or the education of, the general public,

(ii) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem,

(iii) the preservation of open space (including farmland and forest land) where such preservation is—

(I) for the scenic enjoyment of the general public, or

(II) pursuant to a clearly delineated Federal, State, or local governmental conservation policy,

and will yield a significant public benefit, or

(iv) the preservation of an historically important land area or a certified historic structure.

(B) SPECIAL RULES WITH RESPECT TO BUILDINGS IN REGISTERED HISTORIC DISTRICTS.—In the case of any contribution of a qualified real property interest which is a restriction with respect to the exterior of a building described in subparagraph (C)(ii), such contribution shall not be considered to be exclusively for conservation purposes unless—

(i) such interest—

(I) includes a restriction which preserves the entire exterior of the building (including the front, sides, rear, and height of the building), and

(II) prohibits any change in the exterior of the building which is inconsistent with the historical character of such exterior,

(ii) the donor and donee enter into a written agreement certifying, under penalty of perjury, that the donee—

(I) is a qualified organization (as defined in paragraph (3)) with a purpose of environmental protection, land conservation, open space preservation, or historic preservation, and

(II) has the resources to manage and enforce the restriction and a commitment to do so, and

(iii) in the case of any contribution made in a taxable year beginning after the date of the enactment of this subparagraph, the taxpayer includes with the taxpayer's return for the taxable year of the contribution—

(I) a qualified appraisal (within the meaning of subsection (f)(11)(E)) of the qualified property interest,

(II) photographs of the entire exterior of the building, and

(III) a description of all restrictions on the development of the building.

(C) CERTIFIED HISTORIC STRUCTURE.—For purposes of subparagraph (A)(iv), the term "certified historic structure" means—

(i) any building, structure, or land area which is listed in the National Register, or

(ii) any building which is located in a registered historic district (as defined in section 47(c)(3)(B)) and is certified by the Secretary of the Interior to the Secretary as being of historic significance to the district.

A building, structure, or land area satisfies the preceding sentence if it satisfies such sentence either at the time of the transfer or on the due date (including extensions) for filing the transferor's return under this chapter for the taxable year in which the transfer is made.

(5) EXCLUSIVELY FOR CONSERVATION PURPOSES.—For purposes of this subsection—

(A) CONSERVATION PURPOSE MUST BE PROTECTED.—A contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.

(B) NO SURFACE MINING PERMITTED.—

(i) IN GENERAL.—Except as provided in clause (ii), in the case of a contribution of any interest where there is a retention of a qualified mineral interest, subparagraph (A) shall not be treated as met if at any time there may be extraction or removal of minerals by any surface mining method.

(ii) SPECIAL RULE.—With respect to any contribution of property in which the ownership of the surface estate and mineral interests has been and remains separated, subparagraph (A) shall be treated as met if the probability of surface mining occurring on such property is so remote as to be negligible.

(6) QUALIFIED MINERAL INTEREST.—For purposes of this subsection, the term "qualified mineral interest" means—

(A) subsurface oil, gas, or other minerals, and

(B) the right to access to such minerals.

(i) STANDARD MILEAGE RATE FOR USE OF PASSENGER AUTOMOBILE.—For purposes of computing the deduction under this section for use of a passenger automobile, the standard mileage rate shall be 14 cents per mile.

(j) DENIAL OF DEDUCTION FOR CERTAIN TRAVEL EXPENSES.—No deduction shall be allowed under this section for traveling expenses (including amounts expended for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel.

(l) TREATMENT OF CERTAIN AMOUNTS PAID TO OR FOR THE BENEFIT OF INSTITUTIONS OF HIGHER EDUCATION.—

(1) IN GENERAL.—No deduction shall be allowed under this section for any amount described in paragraph (2).

(2) AMOUNT DESCRIBED.—For purposes of paragraph (1), an amount is described in this paragraph if—

(A) the amount is paid by the taxpayer to or for the benefit of an educational organization—

(i) which is described in subsection (b)(1)(A)(ii), and

(ii) which is an institution of higher education (as defined in section 3304(f)), and

(B) the taxpayer receives (directly or indirectly) as a result of paying such amount the right to purchase tickets

for seating at an athletic event in an athletic stadium of such institution.

If any portion of a payment is for the purchase of such tickets, such portion and the remaining portion (if any) of such payment shall be treated as separate amounts for purposes of this subsection.

(m) CERTAIN DONEE INCOME FROM INTELLECTUAL PROPERTY TREATED AS AN ADDITIONAL CHARITABLE CONTRIBUTION.—

(1) TREATMENT AS ADDITIONAL CONTRIBUTION.—In the case of a taxpayer who makes a qualified intellectual property contribution, the deduction allowed under subsection (a) for each taxable year of the taxpayer ending on or after the date of such contribution shall be increased (subject to the limitations under subsection (b)) by the applicable percentage of qualified donee income with respect to such contribution which is properly allocable to such year under this subsection.

(2) REDUCTION IN ADDITIONAL DEDUCTIONS TO EXTENT OF INITIAL DEDUCTION.—With respect to any qualified intellectual property contribution, the deduction allowed under subsection (a) shall be increased under paragraph (1) only to the extent that the aggregate amount of such increases with respect to such contribution exceed the amount allowed as a deduction under subsection (a) with respect to such contribution determined without regard to this subsection.

(3) QUALIFIED DONEE INCOME.—For purposes of this subsection, the term "qualified donee income" means any net income received by or accrued to the donee which is properly allocable to the qualified intellectual property.

(4) ALLOCATION OF QUALIFIED DONEE INCOME TO TAXABLE YEARS OF DONOR.—For purposes of this subsection, qualified donee income shall be treated as properly allocable to a taxable year of the donor if such income is received by or accrued to the donee for the taxable year of the donee which ends within or with such taxable year of the donor.

(5) 10-YEAR LIMITATION.—Income shall not be treated as properly allocable to qualified intellectual property for purposes of this subsection if such income is received by or accrued to the donee after the 10-year period beginning on the date of the contribution of such property.

(6) BENEFIT LIMITED TO LIFE OF INTELLECTUAL PROPERTY.—Income shall not be treated as properly allocable to qualified intellectual property for purposes of this subsection if such income is received by or accrued to the donee after the expiration of the legal life of such property.

(7) APPLICABLE PERCENTAGE.—For purposes of this subsection, the term "applicable percentage" means the percentage determined under the following table which corresponds to a taxable year of the donor ending on or after the date of the qualified intellectual property contribution:

(8) QUALIFIED INTELLECTUAL PROPERTY CONTRIBUTION.—For purposes of this subsection, the term "qualified intellectual property contribution" means any charitable contribution of qualified intellectual property—

(A) the amount of which taken into account under this section is reduced by reason of subsection (e)(1), and

(B) with respect to which the donor informs the donee at the time of such contribution that the donor intends to treat such contribution as a qualified intellectual property contribution for purposes of this subsection and section 6050L.

(9) QUALIFIED INTELLECTUAL PROPERTY.—For purposes of this subsection, the term "qualified intellectual property" means property described in subsection (e)(1)(B)(iii) (other than property contributed to or for the use of an organization described in subsection (e)(1)(B)(ii)).

(10) OTHER SPECIAL RULES.—

(A) APPLICATION OF LIMITATIONS ON CHARITABLE CONTRIBUTIONS.—Any increase under this subsection of the deduction provided under subsection (a) shall be treated for purposes of subsection (b) as a deduction which is attributable to a charitable contribution to the donee to which such increase relates.

(B) NET INCOME DETERMINED BY DONEE.—The net income taken into account under paragraph (3) shall not exceed the amount of such income reported under section 6050L(b)(1).

(C) DEDUCTION LIMITED TO 12 TAXABLE YEARS.—Except as may be provided under subparagraph (D)(i), this subsection shall not apply with respect to any qualified intellectual property contribution for any taxable year of the donor after the 12th taxable year of the donor which ends on or after the date of such contribution.

(D) REGULATIONS.—The Secretary may issue regulations or other guidance to carry out the purposes of this subsection, including regulations or guidance—

(i) modifying the application of this subsection in the case of a donor or donee with a short taxable year, and

(ii) providing for the determination of an amount to be treated as net income of the donee which is properly allocable to qualified intellectual property in the case of a donee who uses such property to further a purpose or function constituting the basis of the donee's exemption under section 501 (or, in the case of a governmental unit, any purpose described in section 170(c)) and does not possess a right to receive any payment from a third party with respect to such property.

(n) EXPENSES PAID BY CERTAIN WHALING CAPTAINS IN SUPPORT OF NATIVE ALASKAN SUBSISTENCE WHALING.—

(1) IN GENERAL.—In the case of an individual who is recognized by the Alaska Eskimo Whaling Commission as a whaling captain charged with the responsibility of maintaining and carrying out sanctioned whaling activities and who engages in such activities during the taxable year, the amount described in paragraph (2) (to the extent such amount does not exceed $10,000 for the taxable year) shall be treated for purposes of this section as a charitable contribution.

(2) AMOUNT DESCRIBED.—

(A) IN GENERAL.—The amount described in this paragraph is the aggregate of the reasonable and necessary

whaling expenses paid by the taxpayer during the taxable year in carrying out sanctioned whaling activities.

(B) WHALING EXPENSES.—For purposes of subparagraph (A), the term "whaling expenses" includes expenses for—

(i) the acquisition and maintenance of whaling boats, weapons, and gear used in sanctioned whaling activities,

(ii) the supplying of food for the crew and other provisions for carrying out such activities, and

(iii) storage and distribution of the catch from such activities.

(3) SANCTIONED WHALING ACTIVITIES.—For purposes of this subsection, the term "sanctioned whaling activities" means subsistence bowhead whale hunting activities conducted pursuant to the management plan of the Alaska Eskimo Whaling Commission.

(4) SUBSTANTIATION OF EXPENSES.—The Secretary shall issue guidance requiring that the taxpayer substantiate the whaling expenses for which a deduction is claimed under this subsection, including by maintaining appropriate written records with respect to the time, place, date, amount, and nature of the expense, as well as the taxpayer's eligibility for such deduction, and that (to the extent provided by the Secretary) such substantiation be provided as part of the taxpayer's return of tax.

(o) SPECIAL RULES FOR FRACTIONAL GIFTS.—

(1) DENIAL OF DEDUCTION IN CERTAIN CASES.—

(A) IN GENERAL.—No deduction shall be allowed for a contribution of an undivided portion of a taxpayer's entire interest in tangible personal property unless all interests in the property are held immediately before such contribution by—

(i) the taxpayer, or

(ii) the taxpayer and the donee.

(B) EXCEPTIONS.—The Secretary may, by regulation, provide for exceptions to subparagraph (A) in cases where all persons who hold an interest in the property make proportional contributions of an undivided portion of the entire interest held by such persons.

(2) VALUATION OF SUBSEQUENT GIFTS.—In the case of any additional contribution, the fair market value of such contribution shall be determined by using the lesser of—

(A) the fair market value of the property at the time of the initial fractional contribution, or

(B) the fair market value of the property at the time of the additional contribution.

(3) RECAPTURE OF DEDUCTION IN CERTAIN CASES; ADDITION TO TAX.—

(A) RECAPTURE.—The Secretary shall provide for the recapture of the amount of any deduction allowed under this section (plus interest) with respect to any contribution of an undivided portion of a taxpayer's entire interest in tangible personal property—

(i) in any case in which the donor does not contribute all of the remaining interests in such property to the donee (or, if such donee is no longer in exist-

ence, to any person described in section 170(c)) on or before the earlier of—

(I) the date that is 10 years after the date of the initial fractional contribution, or

(II) the date of the death of the donor, and

(ii) in any case in which the donee has not, during the period beginning on the date of the initial fractional contribution and ending on the date described in clause (i)—

(I) had substantial physical possession of the property, and

(II) used the property in a use which is related to a purpose or function constituting the basis for the organizations' exemption under section 501.

(B) ADDITION TO TAX.—The tax imposed under this chapter for any taxable year for which there is a recapture under subparagraph (A) shall be increased by 10 percent of the amount so recaptured.

(4) DEFINITIONS.—For purposes of this subsection—

(A) ADDITIONAL CONTRIBUTION.—The term "additional contribution" means any charitable contribution by the taxpayer of any interest in property with respect to which the taxpayer has previously made an initial fractional contribution.

(B) INITIAL FRACTIONAL CONTRIBUTION.—The term "initial fractional contribution" means, with respect to any taxpayer, the first charitable contribution of an undivided portion of the taxpayer's entire interest in any tangible personal property.

(p) OTHER CROSS REFERENCES.—

(1) For treatment of certain organizations providing child care, see section 501(k).

(2) For charitable contributions of estates and trusts, see section 642(c).

(3) For nondeductibility of contributions by common trust funds, see section 584.

(4) For charitable contributions of partners, see section 702.

(5) For charitable contributions of nonresident aliens, see section 873.

(6) For treatment of gifts for benefit of or use in connection with the Naval Academy as gifts to or for use of the United States, see section 8473 of title 10, United States Code.

(7) For treatment of gifts accepted by the Secretary of State, the Director of the International Communication Agency, or the Director of the United States International Development Cooperation Agency, as gifts to or for the use of the United States, see section 25 of the State Department Basic Authorities Act of 1956.

(8) For treatment of gifts of money accepted by the Attorney General for credit to the "Commissary Funds Federal Prisons" as gifts to or for the use of the United States, see section 4043 of title 18, United States Code.

(9) For charitable contributions to or for the use of Indian tribal governments (or their subdivisions), see section 7871.

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SEC. 179. ELECTION TO EXPENSE CERTAIN DEPRECIABLE BUSINESS ASSETS.

(a) TREATMENT AS EXPENSES.—A taxpayer may elect to treat the cost of any section 179 property as an expense which is not chargeable to capital account. Any cost so treated shall be allowed as a deduction for the taxable year in which the section 179 property is placed in service.

(b) LIMITATIONS.—

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

(2) REDUCTION IN LIMITATION.—The limitation under paragraph (1) for any taxable year shall be reduced (but not below zero) by the amount by which the cost of section 179 property placed in service during such taxable year exceeds $2,500,000.

(3) LIMITATION BASED ON INCOME FROM TRADE OR BUSINESS.—

(A) IN GENERAL.—The amount allowed as a deduction under subsection (a) for any taxable year (determined after the application of paragraphs (1) and (2)) shall not exceed the aggregate amount of taxable income of the taxpayer for such taxable year which is derived from the active conduct by the taxpayer of any trade or business during such taxable year.

(B) CARRYOVER OF DISALLOWED DEDUCTION.—The amount allowable as a deduction under subsection (a) for any taxable year shall be increased by the lesser of—

(i) the aggregate amount disallowed under subparagraph (A) for all prior taxable years (to the extent not previously allowed as a deduction by reason of this subparagraph), or

(ii) the excess (if any) of—

(I) the limitation of paragraphs (1) and (2) (or if lesser, the aggregate amount of taxable income referred to in subparagraph (A)), over

(II) the amount allowable as a deduction under subsection (a) for such taxable year without regard to this subparagraph.

(C) COMPUTATION OF TAXABLE INCOME.—For purposes of this paragraph, taxable income derived from the conduct of a trade or business shall be computed without regard to the deduction allowable under this section.

(4) MARRIED INDIVIDUALS FILING SEPARATELY.—In the case of [a husband and wife filing] *individuals married to one another who file* separate returns for the taxable year—

(A) such individuals shall be treated as 1 taxpayer for purposes of paragraphs (1) and (2), and

(B) unless such individuals elect otherwise, 50 percent of the cost which may be taken into account under subsection

(a) for such taxable year (before application of paragraph (3)) shall be allocated to each such individual.

(5) LIMITATION ON COST TAKEN INTO ACCOUNT FOR CERTAIN PASSENGER VEHICLES.—

(A) IN GENERAL.—The cost of any sport utility vehicle for any taxable year which may be taken into account under this section shall not exceed $25,000.

(B) SPORT UTILITY VEHICLE.—For purposes of subparagraph (A)—

(i) IN GENERAL.—The term "sport utility vehicle" means any 4-wheeled vehicle—

(I) which is primarily designed or which can be used to carry passengers over public streets, roads, or highways (except any vehicle operated exclusively on a rail or rails),

(II) which is not subject to section 280F, and

(III) which is rated at not more than 14,000 pounds gross vehicle weight.

(ii) CERTAIN VEHICLES EXCLUDED.—Such term does not include any vehicle which—

(I) is designed to have a seating capacity of more than 9 persons behind the driver's seat,

(II) is equipped with a cargo area of at least 6 feet in interior length which is an open area or is designed for use as an open area but is enclosed by a cap and is not readily accessible directly from the passenger compartment, or

(III) has an integral enclosure, fully enclosing the driver compartment and load carrying device, does not have seating rearward of the driver's seat, and has no body section protruding more than 30 inches ahead of the leading edge of the windshield.

(6) INFLATION ADJUSTMENT.—

(A) IN GENERAL.—In the case of any taxable year beginning after 2018, the dollar amounts in paragraphs (1), (2), and (5)(A) shall each be increased by an amount equal to—

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting "calendar year 2017" for "calendar year 2016" in subparagraph (A)(ii) thereof.

(B) ROUNDING.—The amount of any increase under subparagraph (A) shall be rounded to the nearest multiple of $10,000 ($100 in the case of any increase in the amount under paragraph (5)(A)).

(c) ELECTION.—

(1) IN GENERAL.—An election under this section for any taxable year shall—

(A) specify the items of section 179 property to which the election applies and the portion of the cost of each of such items which is to be taken into account under subsection (a), and

(B) be made on the taxpayer's return of the tax imposed by this chapter for the taxable year.

Such election shall be made in such manner as the Secretary may by regulations prescribe.

(2) ELECTION.—Any election made under this section, and any specification contained in any such election, may be revoked by the taxpayer with respect to any property, and such revocation, once made, shall be irrevocable.

(d) DEFINITIONS AND SPECIAL RULES.—

(1) SECTION 179 PROPERTY.—For purposes of this section, the term "section 179 property" means property—

(A) which is—

(i) tangible property (to which section 168 applies), or

(ii) computer software (as defined in section 197(e)(3)(B)) which is described in section 197(e)(3)(A)(i) and to which section 167 applies,

(B) which is—

(i) section 1245 property (as defined in section 1245(a)(3)), or

(ii) at the election of the taxpayer, qualified real property (as defined in subsection (e)), and

(C) which is acquired by purchase for use in the active conduct of a trade or business.

Such term shall not include any property described in section 50(b) (other than paragraph (2) thereof).

(2) PURCHASE DEFINED.—For purposes of paragraph (1), the term "purchase" means any acquisition of property, but only if—

(A) the property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under section 267 or 707(b) (but, in applying section 267(b) and (c) for purposes of this section, paragraph (4) of section 267(c) shall be treated as providing that the family of an individual shall include only [his spouse] *the individual's spouse*, ancestors, and lineal descendants),

(B) the property is not acquired by one component member of a controlled group from another component member of the same controlled group, and

(C) the basis of the property in the hands of the person acquiring it is not determined—

(i) in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or

(ii) under section 1014(a) (relating to property acquired from a decedent).

(3) COST.—For purposes of this section, the cost of property does not include so much of the basis of such property as is determined by reference to the basis of other property held at any time by the person acquiring such property.

(4) SECTION NOT TO APPLY TO ESTATES AND TRUSTS.—This section shall not apply to estates and trusts.

(5) SECTION NOT TO APPLY TO CERTAIN NONCORPORATE LESSORS.—This section shall not apply to any section 179 property

which is purchased by a person who is not a corporation and with respect to which such person is the lessor unless—

(A) the property subject to the lease has been manufactured or produced by the lessor, or

(B) the term of the lease (taking into account options to renew) is less than 50 percent of the class life of the property (as defined in section 168(i)(1)), and for the period consisting of the first 12 months after the date on which the property is transferred to the lessee the sum of the deductions with respect to such property which are allowable to the lessor solely by reason of section 162 (other than rents and reimbursed amounts with respect to such property) exceeds 15 percent of the rental income produced by such property.

(6) DOLLAR LIMITATION OF CONTROLLED GROUP.—For purposes of subsection (b) of this section—

(A) all component members of a controlled group shall be treated as one taxpayer, and

(B) the Secretary shall apportion the dollar limitation contained in subsection (b)(1) among the component members of such controlled group in such manner as he shall by regulations prescribe.

(7) CONTROLLED GROUP DEFINED.—For purposes of paragraphs (2) and (6), the term "controlled group" has the meaning assigned to it by section 1563(a), except that, for such purposes, the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in section 1563(a)(1).

(8) TREATMENT OF PARTNERSHIPS AND S CORPORATIONS.—In the case of a partnership, the limitations of subsection (b) shall apply with respect to the partnership and with respect to each partner. A similar rule shall apply in the case of an S corporation and its shareholders.

(9) COORDINATION WITH SECTION 38.—No credit shall be allowed under section 38 with respect to any amount for which a deduction is allowed under subsection (a).

(10) RECAPTURE IN CERTAIN CASES.—The Secretary shall, by regulations, provide for recapturing the benefit under any deduction allowable under subsection (a) with respect to any property which is not used predominantly in a trade or business at any time.

(e) QUALIFIED REAL PROPERTY.—For purposes of this section, the term "qualified real property" means—

(1) any qualified improvement property described in section 168(e)(6), and

(2) any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service:

(A) Roofs.

(B) Heating, ventilation, and air-conditioning property.

(C) Fire protection and alarm systems.

(D) Security systems.

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PART VII—ADDITIONAL ITEMIZED DEDUCTIONS FOR INDIVIDUALS

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SEC. 213. MEDICAL, DENTAL, ETC., EXPENSES.

(a) ALLOWANCE OF DEDUCTION.—There shall be allowed as a deduction the expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, [his spouse] *the taxpayer's spouse*, or a dependent (as defined in section 152, determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B) thereof), to the extent that such expenses exceed 10 percent of adjusted gross income.

(b) LIMITATION WITH RESPECT TO MEDICINE AND DRUGS.—An amount paid during the taxable year for medicine or a drug shall be taken into account under subsection (a) only if such medicine or drug is a prescribed drug or is insulin.

(c) SPECIAL RULE FOR DECEDENTS.—

(1) TREATMENT OF EXPENSES PAID AFTER DEATH.—For purposes of subsection (a), expenses for the medical care of the taxpayer which are paid out of [his estate] *the estate of the taxpayer* during the 1-year period beginning with the day after the date of [his death] *the death of the taxpayer* shall be treated as paid by the taxpayer at the time incurred.

(2) LIMITATION.—Paragraph (1) shall not apply if the amount paid is allowable under section 2053 as a deduction in computing the taxable estate of the decedent, but this paragraph shall not apply if (within the time and in the manner and form prescribed by the Secretary) there is filed—

(A) a statement that such amount has not been allowed as a deduction under section 2053, and

(B) a waiver of the right to have such amount allowed at any time as a deduction under section 2053.

(d) DEFINITIONS.—For purposes of this section—

(1) The term "medical care" means amounts paid—

(A) for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body,

(B) for transportation primarily for and essential to medical care referred to in subparagraph (A),

(C) for qualified long-term care services (as defined in section 7702B(c)), or

(D) for insurance (including amounts paid as premiums under part B of title XVIII of the Social Security Act, relating to supplementary medical insurance for the aged) covering medical care referred to in subparagraphs (A) and (B) or for any qualified long-term care insurance contract (as defined in section 7702B(b)).

In the case of a qualified long-term care insurance contract (as defined in section 7702B(b)), only eligible long-term care premiums (as defined in paragraph (10)) shall be taken into account under subparagraph (D).

(2) AMOUNTS PAID FOR CERTAIN LODGING AWAY FROM HOME TREATED AS PAID FOR MEDICAL CARE.—Amounts paid for lodging (not lavish or extravagant under the circumstances) while away from home primarily for and essential to medical care re-

ferred to in paragraph (1)(A) shall be treated as amounts paid for medical care if—

(A) the medical care referred to in paragraph (1)(A) is provided by a physician in a licensed hospital (or in a medical care facility which is related to, or the equivalent of, a licensed hospital), and

(B) there is no significant element of personal pleasure, recreation, or vacation in the travel away from home.

The amount taken into account under the preceding sentence shall not exceed $50 for each night for each individual.

(3) PRESCRIBED DRUG.—The term "prescribed drug" means a drug or biological which requires a prescription of a physician for its use by an individual.

(4) PHYSICIAN.—The term "physician" has the meaning given to such term by section 1861(r) of the Social Security Act (42 U.S.C. 1395x(r)).

(5) SPECIAL RULE IN THE CASE OF CHILD OF DIVORCED PARENTS, ETC.—Any child to whom section 152(e) applies shall be treated as a dependent of both parents for purposes of this section.

(6) In the case of an insurance contract under which amounts are payable for other than medical care referred to in subparagraphs (A), (B), and (C) of paragraph (1)—

(A) no amount shall be treated as paid for insurance to which paragraph (1)(D) applies unless the charge for such insurance is either separately stated in the contract, or furnished to the policyholder by the insurance company in a separate statement,

(B) the amount taken into account as the amount paid for such insurance shall not exceed such charge, and

(C) no amount shall be treated as paid for such insurance if the amount specified in the contract (or furnished to the policyholder by the insurance company in a separate statement) as the charge for such insurance is unreasonably large in relation to the total charges under the contract.

(7) Subject to the limitations of paragraph (6), premiums paid during the taxable year by a taxpayer before [he] *the taxpayer* attains the age of 65 for insurance covering medical care (within the meaning of subparagraphs (A), (B), and (C) of paragraph (1)) for the taxpayer, [his spouse] *the taxpayer's spouse*, or a dependent after the taxpayer attains the age of 65 shall be treated as expenses paid during the taxable year for insurance which constitutes medical care if premiums for such insurance are payable (on a level payment basis) under the contract for a period of 10 years or more or until the year in which the taxpayer attains the age of 65 (but in no case for a period of less than 5 years).

(8) The determination of whether an individual is married at any time during the taxable year shall be made in accordance with the provisions of section 6013(d) (relating to determination of [status as husband and wife] *marital status*).

(9) COSMETIC SURGERY.—

(A) IN GENERAL.—The term "medical care" does not include cosmetic surgery or other similar procedures, unless

the surgery or procedure is necessary to ameliorate a deformity arising from, or directly related to, a congenital abnormality, a personal injury resulting from an accident or trauma, or disfiguring disease.

(B) COSMETIC SURGERY DEFINED.—For purposes of this paragraph, the term "cosmetic surgery" means any procedure which is directed at improving the patient's appearance and does not meaningfully promote the proper function of the body or prevent or treat illness or disease.

(10) ELIGIBLE LONG-TERM CARE PREMIUMS.—

(A) IN GENERAL.—For purposes of this section, the term "eligible long-term care premiums" means the amount paid during a taxable year for any qualified long-term care insurance contract (as defined in section 7702B(b)) covering an individual, to the extent such amount does not exceed the limitation determined under the following table:

(B) INDEXING.—

(i) IN GENERAL.—In the case of any taxable year beginning in a calendar year after 1997, each dollar amount contained in subparagraph (A) shall be increased by the medical care cost adjustment of such amount for such calendar year. If any increase determined under the preceding sentence is not a multiple of $10, such increase shall be rounded to the nearest multiple of $10.

(ii) MEDICAL CARE COST ADJUSTMENT.—For purposes of clause (i), the medical care cost adjustment for any calendar year is the percentage (if any) by which—

(I) the medical care component of the C-CPI-U (as defined in section 1(f)(6)) for August of the preceding calendar year, exceeds

(II) such component of the CPI (as defined in section 1(f)(4)) for August of 1996, multiplied by the amount determined under section 1(f)(3)(B).

The Secretary shall, in consultation with the Secretary of Health and Human Services, prescribe an adjustment which the Secretary determines is more appropriate for purposes of this paragraph than the adjustment described in the preceding sentence, and the adjustment so prescribed shall apply in lieu of the adjustment described in the preceding sentence.

(11) CERTAIN PAYMENTS TO RELATIVES TREATED AS NOT PAID FOR MEDICAL CARE.—An amount paid for a qualified long-term care service (as defined in section 7702B(c)) provided to an individual shall be treated as not paid for medical care if such service is provided—

(A) by the spouse of the individual or by a relative (directly or through a partnership, corporation, or other entity) unless the service is provided by a licensed professional with respect to such service, or

(B) by a corporation or partnership which is related (within the meaning of section 267(b) or 707(b)) to the individual.

For purposes of this paragraph, the term "relative" means an individual bearing a relationship to the individual which is de-

scribed in any of subparagraphs (A) through (G) of section 152(d)(2). This paragraph shall not apply for purposes of section 105(b) with respect to reimbursements through insurance.

(e) EXCLUSION OF AMOUNTS ALLOWED FOR CARE OF CERTAIN DEPENDENTS.—Any expense allowed as a credit under section 21 shall not be treated as an expense paid for medical care.

(f) SPECIAL RULES FOR 2013 THROUGH 2018.—In the case of any taxable year—

(1) beginning after December 31, 2012, and ending before January 1, 2017, in the case of a taxpayer if such taxpayer or such taxpayer's spouse has attained age 65 before the close of such taxable year, and

(2) beginning after December 31, 2016, and ending before January 1, 2019, in the case of any taxpayer,

subsection (a) shall be applied with respect to a taxpayer by substituting "7.5 percent" for "10 percent".

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SEC. 217. MOVING EXPENSES.

(a) DEDUCTION ALLOWED.—There shall be allowed as a deduction moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee or as a self-employed individual at a new principal place of work.

(b) DEFINITION OF MOVING EXPENSES.—

(1) IN GENERAL.—For purposes of this section, the term "moving expenses" means only the reasonable expenses—

(A) of moving household goods and personal effects from the former residence to the new residence, and

(B) of traveling (including lodging) from the former residence to the new place of residence.

Such term shall not include any expenses for meals.

(2) INDIVIDUALS OTHER THAN TAXPAYER.—In the case of any individual other than the taxpayer, expenses referred to in paragraph (1) shall be taken into account only if such individual has both the former residence and the new residence as his principal place of abode and is a member of the taxpayer's household.

(c) CONDITIONS FOR ALLOWANCE.—No deduction shall be allowed under this section unless—

(1) the taxpayer's new principal place of work—

(A) is at least 50 miles farther from his former residence than was his former principal place of work, or

(B) if he had no former principal place of work, is at least 50 miles from his former residence, and

(2) either—

(A) during the 12-month period immediately following his arrival in the general location of his new principal place of work, the taxpayer is a full-time employee, in such general location, during at least 39 weeks, or

(B) during the 24-month period immediately following his arrival in the general location of his new principal place of work, the taxpayer is a full-time employee or performs services as a self-employed individual on a full-time basis, in such general location, during at least 78 weeks,

of which not less than 39 weeks are during the 12-month period referred to in subparagraph (A).

For purposes of paragraph (1), the distance between two points shall be the shortest of the more commonly traveled routes between such two points.

(d) RULES FOR APPLICATION OF SUBSECTION (C)(2).—

(1) The condition of subsection (c)(2) shall not apply if the taxpayer is unable to satisfy such condition by reason of—

(A) death or disability, or

(B) involuntary separation (other than for willful misconduct) from the service of, or transfer for the benefit of, an employer after obtaining full-time employment in which the taxpayer could reasonably have been expected to satisfy such condition.

(2) If a taxpayer has not satisfied the condition of subsection (c)(2) before the time prescribed by law (including extensions thereof) for filing the return for the taxable year during which he paid or incurred moving expenses which would otherwise be deductible under this section, but may still satisfy such condition, then such expenses may (at the election of the taxpayer) be deducted for such taxable year notwithstanding subsection (c)(2).

(3) If—

(A) for any taxable year moving expenses have been deducted in accordance with the rule provided in paragraph (2), and

(B) the condition of subsection (c)(2) cannot be satisfied at the close of a subsequent taxable year,

then an amount equal to the expenses which were so deducted shall be included in gross income for the first such subsequent taxable year.

(f) SELF-EMPLOYED INDIVIDUAL.—For purposes of this section, the term "self-employed individual" means an individual who performs personal services—

(1) as the owner of the entire interest in an unincorporated trade or business, or

(2) as a partner in a partnership carrying on a trade or business.

(g) RULES FOR MEMBERS OF THE ARMED FORCES OF THE UNITED STATES.—In the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military order and incident to a permanent change of station—

(1) the limitations under subsection (c) shall not apply;

(2) any moving and storage expenses which are furnished in kind (or for which reimbursement or an allowance is provided, but only to the extent of the expenses paid or incurred) to such member**[**, his spouse, or his dependents**]** *or the spouse or dependents of such member*, shall not be includible in gross income, and no reporting with respect to such expenses shall be required by the Secretary of Defense or the Secretary of Transportation, as the case may be; and

(3) if moving and storage expenses are furnished in kind (or if reimbursement or an allowance for such expenses is provided) to such member's spouse and **[**his dependents**]** *dependents* with regard to moving to a location other than the one to

which such member moves (or from a location other than the one from which such member moves), this section shall apply with respect to the moving expenses of [his spouse] *the member's spouse* and dependents—

(A) as if [his spouse] *the member's spouse* commenced work as an employee at a new principal place of work at such location; and

(B) without regard to the limitations under subsection (c).

(h) SPECIAL RULES FOR FOREIGN MOVES.—

(1) ALLOWANCE OF CERTAIN STORAGE FEES.—In the case of a foreign move, for purposes of this section, the moving expenses described in subsection (b)(1)(A) include the reasonable expenses—

(A) of moving household goods and personal effects to and from storage, and

(B) of storing such goods and effects for part or all of the period during which the new place of work continues to be the taxpayer's principal place of work.

(2) FOREIGN MOVE.—For purposes of this subsection, the term "foreign move" means the commencement of work by the taxpayer at a new principal place of work located outside the United States.

(3) UNITED STATES DEFINED.—For purposes of this subsection and subsection (i), the term "United States" includes the possessions of the United States.

(i) ALLOWANCE OF DEDUCTIONS IN CASE OF RETIREES OR DECEDENTS WHO WERE WORKING ABROAD.—

(1) IN GENERAL.—In the case of any qualified retiree moving expenses or qualified survivor moving expenses—

(A) this section (other than subsection (h)) shall be applied with respect to such expenses as if they were incurred in connection with the commencement of work by the taxpayer as an employee at a new principal place of work located within the United States, and

(B) the limitations of subsection (c)(2) shall not apply.

(2) QUALIFIED RETIREE MOVING EXPENSES.—For purposes of paragraph (1), the term "qualified retiree moving expenses" means any moving expenses—

(A) which are incurred by an individual whose former principal place of work and former residence were outside the United States, and

(B) which are incurred for a move to a new residence in the United States in connection with the bona fide retirement of the individual.

(3) QUALIFIED SURVIVOR MOVING EXPENSES.—For purposes of paragraph (1), the term "qualified survivor moving expenses" means moving expenses—

(A) which are paid or incurred by the spouse or any dependent of any decedent who (as of the time of [his] death) had a principal place of work outside the United States, and

(B) which are incurred for a move which begins within 6 months after the death of such decedent and which is to a residence in the United States from a former residence

outside the United States which (as of the time of the decedent's death) was the residence of such decedent and the individual paying or incurring the expense.

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

(k) SUSPENSION OF DEDUCTION FOR TAXABLE YEARS 2018 THROUGH 2025.—Except in the case of an individual to whom subsection (g) applies, this section shall not apply to any taxable year beginning after December 31, 2017, and before January 1, 2026.

* * * * * * *

SEC. 219. RETIREMENT SAVINGS.

(a) ALLOWANCE OF DEDUCTION.—In the case of an individual, there shall be allowed as a deduction an amount equal to the qualified retirement contributions of the individual for the taxable year.

(b) MAXIMUM AMOUNT OF DEDUCTION.—

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

(A) the deductible amount, or

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

(2) SPECIAL RULE FOR EMPLOYER CONTRIBUTIONS UNDER SIMPLIFIED EMPLOYEE PENSIONS.—This section shall not apply with respect to an employer contribution to a simplified employee pension.

(3) PLANS UNDER SECTION 501(C)(18).—Notwithstanding paragraph (1), the amount allowable as a deduction under subsection (a) with respect to any contributions on behalf of an employee to a plan described in section 501(c)(18) shall not exceed the lesser of—

(A) $7,000, or

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

(4) SPECIAL RULE FOR SIMPLE RETIREMENT ACCOUNTS.—This section shall not apply with respect to any amount contributed to a simple retirement account established under section 408(p).

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

(A) IN GENERAL.—The deductible amount is $5,000.

(B) CATCH-UP CONTRIBUTIONS FOR INDIVIDUALS 50 OR OLDER.—

(i) IN GENERAL.—In the case of an individual who has attained the age of 50 before the close of the taxable year, the deductible amount for such taxable year shall be increased by the applicable amount.

(ii) APPLICABLE AMOUNT.—For purposes of clause (i), the applicable amount is $1,000.

(C) COST-OF-LIVING ADJUSTMENT.—

(i) IN GENERAL.—In the case of any taxable year beginning in a calendar year after 2008, the $5,000 amount under subparagraph (A) shall be increased by an amount equal to—

(I) such dollar amount, multiplied by

(II) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting "calendar year 2007" for "calendar year 2016" in subparagraph (A)(ii) thereof.

(ii) ROUNDING RULES.—If any amount after adjustment under clause (i) is not a multiple of $500, such amount shall be rounded to the next lower multiple of $500.

(c) KAY BAILEY HUTCHISON SPOUSAL IRA.—

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

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

(B) the sum of—

(i) the compensation includible in such individual's gross income for the taxable year, plus

(ii) the compensation includible in the gross income of such individual's spouse for the taxable year reduced by—

(I) the amount allowed as a deduction under subsection (a) to such spouse for such taxable year,

(II) the amount of any designated nondeductible contribution (as defined in section 408(*o*)) on behalf of such spouse for such taxable year, and

(III) the amount of any contribution on behalf of such spouse to a Roth IRA under section 408A for such taxable year.

(2) INDIVIDUALS TO WHOM PARAGRAPH (1) APPLIES.—Paragraph (1) shall apply to any individual if—

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

(B) the amount of compensation (if any) includible in such individual's gross income for the taxable year is less than the compensation includible in the gross income of such individual's spouse for the taxable year.

(d) OTHER LIMITATIONS AND RESTRICTIONS.—

(1) BENEFICIARY MUST BE UNDER AGE 701/2.—No deduction shall be allowed under this section with respect to any qualified retirement contribution for the benefit of an individual if such individual has attained age 701/2 before the close of such individual's taxable year for which the contribution was made.

(2) RECONTRIBUTED AMOUNTS.—No deduction shall be allowed under this section with respect to a rollover contribution described in section 402(c), 403(a)(4), 403(b)(8), 408(d)(3), or 457(e)(16).

(3) AMOUNTS CONTRIBUTED UNDER ENDOWMENT CONTRACT.—In the case of an endowment contract described in section 408(b), no deduction shall be allowed under this section for that portion of the amounts paid under the contract for the taxable year which is properly allocable, under regulations prescribed by the Secretary, to the cost of life insurance.

(4) DENIAL OF DEDUCTION FOR AMOUNT CONTRIBUTED TO INHERITED ANNUITIES OR ACCOUNTS.—No deduction shall be allowed under this section with respect to any amount paid to an inherited individual retirement account or individual retirement annuity (within the meaning of section 408(d)(3)(C)(ii)).

(e) QUALIFIED RETIREMENT CONTRIBUTION.—For purposes of this section, the term "qualified retirement contribution" means—

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

(2) any amount contributed on behalf of any individual to a plan described in section 501(c)(18).

(f) OTHER DEFINITIONS AND SPECIAL RULES.—

(1) COMPENSATION.—For purposes of this section, the term "compensation" includes earned income (as defined in section 401(c)(2)). The term "compensation" does not include any amount received as a pension or annuity and does not include any amount received as deferred compensation. For purposes of this paragraph, section 401(c)(2) shall be applied as if the term trade or business for purposes of section 1402 included service described in subsection (c)(6). The term "compensation" includes any differential wage payment (as defined in section 3401(h)(2)).

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

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

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

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

(A) IN GENERAL.—If for the taxable year the maximum amount allowable as a deduction under this section for contributions to an individual retirement plan exceeds the amount contributed, then the taxpayer shall be treated as having made an additional contribution for the taxable year in an amount equal to the lesser of—

(i) the amount of such excess, or

(ii) the amount of the excess contributions for such taxable year (determined under section 4973(b)(2) without regard to subparagraph (C) thereof).

(B) AMOUNT CONTRIBUTED.—For purposes of this paragraph, the amount contributed—

(i) shall be determined without regard to this paragraph, and

(ii) shall not include any rollover contribution.

(C) SPECIAL RULE WHERE EXCESS DEDUCTION WAS ALLOWED FOR CLOSED YEAR.—Proper reduction shall be made in the amount allowable as a deduction by reason of this paragraph for any amount allowed as a deduction under this section for a prior taxable year for which the period for assessing deficiency has expired if the amount so allowed exceeds the amount which should have been allowed for such prior taxable year.

(7) SPECIAL RULE FOR COMPENSATION EARNED BY MEMBERS OF THE ARMED FORCES FOR SERVICE IN A COMBAT ZONE..—For purposes of subsections (b)(1)(B) and (c), the amount of compensation includible in an individual's gross income shall be determined without regard to section 112.

(8) ELECTION NOT TO DEDUCT CONTRIBUTIONS.—For election not to deduct contributions to individual retirement plans, see section 408(*o*)(2)(B)(ii).

(g) LIMITATION ON DEDUCTION FOR ACTIVE PARTICIPANTS IN CERTAIN PENSION PLANS.—

(1) IN GENERAL.—If (for any part of any plan year ending with or within a taxable year) an individual or the individual's spouse is an active participant, each of the dollar limitations contained in subsections (b)(1)(A) and (c)(1)(A) for such taxable year shall be reduced (but not below zero) by the amount determined under paragraph (2).

(2) AMOUNT OF REDUCTION.—

(A) IN GENERAL.—The amount determined under this paragraph with respect to any dollar limitation shall be the amount which bears the same ratio to such limitation as—

(i) the excess of—

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

(II) the applicable dollar amount, bears to

(ii) $10,000 ($20,000 in the case of a joint return).

(B) NO REDUCTION BELOW $200 UNTIL COMPLETE PHASEOUT.—No dollar limitation shall be reduced below $200 under paragraph (1) unless (without regard to this subparagraph) such limitation is reduced to zero.

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

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

(A) ADJUSTED GROSS INCOME.—Adjusted gross income of any taxpayer shall be determined—

(i) after application of sections 86 and 469, and

(ii) without regard to sections 135, 137, 221, 222, and 911 or the deduction allowable under this section.

(B) APPLICABLE DOLLAR AMOUNT.—The term "applicable dollar amount" means the following:

(i) In the case of a taxpayer filing a joint return, $80,000.

(ii) In the case of any other taxpayer (other than a married individual filing a separate return), $50,000.

(iii) In the case of a married individual filing a separate return, zero.

(4) SPECIAL RULE FOR MARRIED INDIVIDUALS FILING SEPARATELY AND LIVING APART.— [A husband and wife] *Married individuals* who—

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

(B) live apart at all times during such taxable year,

shall not be treated as married individuals for purposes of this subsection.

(5) ACTIVE PARTICIPANT.—For purposes of this subsection, the term "active participant" means, with respect to any plan year, an individual—

(A) who is an active participant in—

(i) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

(ii) an annuity plan described in section 403(a),

(iii) a plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing,

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

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

(vi) any simple retirement account (within the meaning of section 408(p)), or

(B) who makes deductible contributions to a trust described in section 501(c)(18).

The determination of whether an individual is an active participant shall be made without regard to whether or not such individual's rights under a plan, trust, or contract are nonforfeitable. An eligible deferred compensation plan (within the meaning of section 457(b)) shall not be treated as a plan described in subparagraph (A)(iii).

(6) CERTAIN INDIVIDUALS NOT TREATED AS ACTIVE PARTICIPANTS.—For purposes of this subsection, any individual described in any of the following subparagraphs shall not be treated as an active participant for any taxable year solely because of any participation so described:

(A) MEMBERS OF RESERVE COMPONENTS.—Participation in a plan described in subparagraph (A)(iii) of paragraph (5) by reason of service as a member of a reserve component of the Armed Forces (as defined in section 10101 of title 10), unless such individual has served in excess of 90 days on active duty (other than active duty for training) during the year.

(B) VOLUNTEER FIREFIGHTERS.—A volunteer firefighter—

(i) who is a participant in a plan described in subparagraph (A)(iii) of paragraph (5) based on his activity as a volunteer firefighter, and

(ii) whose accrued benefit as of the beginning of the taxable year is not more than an annual benefit of

$1,800 (when expressed as a single life annuity commencing at age 65).

(7) SPECIAL RULE FOR SPOUSES WHO ARE NOT ACTIVE PARTICIPANTS.—If this subsection applies to an individual for any taxable year solely because their spouse is an active participant, then, in applying this subsection to the individual (but not their spouse)—

(A) the applicable dollar amount under paragraph (3)(B)(i) shall be $150,000; and

(B) the amount applicable under paragraph (2)(A)(ii) shall be $10,000.

(8) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 2006, each of the dollar amounts in paragraphs (3)(B)(i), (3)(B)(ii), and (7)(A) shall be be increased by an amount equal to—

(A) such dollar amount, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting "calendar year 2005" for "calendar year 2016" in subparagraph (A)(ii) thereof.

Any increase determined under the preceding sentence shall be rounded to the nearest multiple of $1,000.

* * * * * * *

PART IX—ITEMS NOT DEDUCTIBLE

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SEC. 267. LOSSES, EXPENSES, AND INTEREST WITH RESPECT TO TRANSACTIONS BETWEEN RELATED TAXPAYERS.

(a) IN GENERAL.—

(1) DEDUCTION FOR LOSSES DISALLOWED.—No deduction shall be allowed in respect of any loss from the sale or exchange of property, directly or indirectly, between persons specified in any of the paragraphs of subsection (b). The preceding sentence shall not apply to any loss of the distributing corporation (or the distributee) in the case of a distribution in complete liquidation.

(2) MATCHING OF DEDUCTION AND PAYEE INCOME ITEM IN THE CASE OF EXPENSES AND INTEREST.—If—

(A) by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not (unless paid) includible in the gross income of such person, and

(B) at the close of the taxable year of the taxpayer for which (but for this paragraph) the amount would be deductible under this chapter, both the taxpayer and the person to whom the payment is to be made are persons specified in any of the paragraphs of subsection (b),

then any deduction allowable under this chapter in respect of such amount shall be allowable as of the day as of which such amount is includible in the gross income of the person to whom the payment is made (or, if later, as of the day on which it would be so allowable but for this paragraph). For purposes of this paragraph, in the case of a personal service corporation (within the meaning of section 441(i)(2)), such corporation and

any employee-owner (within the meaning of section 269A(b)(2), as modified by section 441(i)(2)) shall be treated as persons specified in subsection (b).

(3) PAYMENTS TO FOREIGN PERSONS.—

(A) IN GENERAL.—The Secretary shall by regulations apply the matching principle of paragraph (2) in cases in which the person to whom the payment is to be made is not a United States person.

(B) SPECIAL RULE FOR CERTAIN FOREIGN ENTITIES.—

(i) IN GENERAL.—Notwithstanding subparagraph (A), in the case of any item payable to a controlled foreign corporation (as defined in section 957) or a passive foreign investment company (as defined in section 1297), a deduction shall be allowable to the payor with respect to such amount for any taxable year before the taxable year in which paid only to the extent that an amount attributable to such item is includible (determined without regard to properly allocable deductions and qualified deficits under section 952(c)(1)(B)) during such prior taxable year in the gross income of a United States person who owns (within the meaning of section 958(a)) stock in such corporation.

(ii) SECRETARIAL AUTHORITY.—The Secretary may by regulation exempt transactions from the application of clause (i), including any transaction which is entered into by a payor in the ordinary course of a trade or business in which the payor is predominantly engaged and in which the payment of the accrued amounts occurs within 81/2 months after accrual or within such other period as the Secretary may prescribe.

(b) RELATIONSHIPS.—The persons referred to in subsection (a) are:

(1) Members of a family, as defined in subsection (c)(4);

(2) An individual and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(3) Two corporations which are members of the same controlled group (as defined in subsection (f));

(4) A grantor and a fiduciary of any trust;

(5) A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;

(6) A fiduciary of a trust and a beneficiary of such trust;

(7) A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts;

(8) A fiduciary of a trust and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust;

(9) A person and an organization to which section 501 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such person or (if such person is an individual) by members of the family of such individual;

(10) A corporation and a partnership if the same persons own—

(A) more than 50 percent in value of the outstanding stock of the corporation, and

(B) more than 50 percent of the capital interest, or the profits interest, in the partnership;

(11) An S corporation and another S corporation if the same persons own more than 50 percent in value of the outstanding stock of each corporation;

(12) An S corporation and a C corporation, if the same persons own more than 50 percent in value of the outstanding stock of each corporation; or

(13) Except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate.

(c) CONSTRUCTIVE OWNERSHIP OF STOCK.—For purposes of determining, in applying subsection (b), the ownership of stock—

(1) Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries;

(2) An individual shall be considered as owning the stock owned, directly or indirectly, by or for [his] *the individual's* family;

(3) An individual owning (otherwise than by the application of paragraph (2)) any stock in a corporation shall be considered as owning the stock owned, directly or indirectly, by or for [his] *the individual's* partner;

(4) The family of an individual shall include only [his] *the individual's* brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; and

(5) Stock constructively owned by a person by reason of the application of paragraph (1) shall, for the purpose of applying paragraph (1), (2), or (3), be treated as actually owned by such person, but stock constructively owned by an individual by reason of the application of paragraph (2) or (3) shall not be treated as owned by him for the purpose of again applying either of such paragraphs in order to make another the constructive owner of such stock.

(d) AMOUNT OF GAIN WHERE LOSS PREVIOUSLY DISALLOWED.—

(1) IN GENERAL.—If—

(A) in the case of a sale or exchange of property to the taxpayer a loss sustained by the transferor is not allowable to the transferor as a deduction by reason of subsection (a)(1), and

(B) the taxpayer sells or otherwise disposes of such property (or of other property the basis of which in the taxpayer's hands is determined directly or indirectly by reference to such property) at a gain,

then such gain shall be recognized only to the extent that it exceeds so much of such loss as is properly allocable to the property sold or otherwise disposed of by the taxpayer.

(2) EXCEPTION FOR WASH SALES.—Paragraph (1) shall not apply if the loss sustained by the transferor is not allowable to the transferor as a deduction by reason of section 1091 (relating to wash sales).

(3) EXCEPTION FOR TRANSFERS FROM TAX INDIFFERENT PARTIES.—Paragraph (1) shall not apply to the extent any loss sustained by the transferor (if allowed) would not be taken into account in determining a tax imposed under section 1 or 11 or a tax computed as provided by either of such sections.

(e) SPECIAL RULES FOR PASS-THRU ENTITIES.—

(1) IN GENERAL.—In the case of any amount paid or incurred by, to, or on behalf of, a pass-thru entity, for purposes of applying subsection (a)(2)—

(A) such entity,

(B) in the case of—

(i) a partnership, any person who owns (directly or indirectly) any capital interest or profits interest of such partnership, or

(ii) an S corporation, any person who owns (directly or indirectly) any of the stock of such corporation,

(C) any person who owns (directly or indirectly) any capital interest or profits interest of a partnership in which such entity owns (directly or indirectly) any capital interest or profits interest, and

(D) any person related (within the meaning of subsection (b) of this section or section 707(b)(1)) to a person described in subparagraph (B) or (C),

shall be treated as persons specified in a paragraph of subsection (b). Subparagraph (C) shall apply to a transaction only if such transaction is related either to the operations of the partnership described in such subparagraph or to an interest in such partnership.

(2) PASS-THRU ENTITY.—For purposes of this section, the term "pass-thru entity" means—

(A) a partnership, and

(B) an S corporation.

(3) CONSTRUCTIVE OWNERSHIP IN THE CASE OF PARTNERSHIPS.—For purposes of determining ownership of a capital interest or profits interest of a partnership, the principles of subsection (c) shall apply, except that—

(A) paragraph (3) of subsection (c) shall not apply, and

(B) interests owned (directly or indirectly) by or for a C corporation shall be considered as owned by or for any shareholder only if such shareholder owns (directly or indirectly) 5 percent or more in value of the stock of such corporation.

(4) SUBSECTION (A)(2) NOT TO APPLY TO CERTAIN GUARANTEED PAYMENTS OF PARTNERSHIPS.—In the case of any amount paid or incurred by a partnership, subsection (a)(2) shall not apply to the extent that section 707(c) applies to such amount.

(5) EXCEPTION FOR CERTAIN EXPENSES AND INTEREST OF PARTNERSHIPS OWNING LOW-INCOME HOUSING.—

(A) IN GENERAL.—This subsection shall not apply with respect to qualified expenses and interest paid or incurred by a partnership owning low-income housing to—

(i) any qualified 5-percent or less partner of such partnership, or

(ii) any person related (within the meaning of subsection (b) of this section or section 707(b)(1)) to any qualified 5-percent or less partner of such partnership.

(B) QUALIFIED 5-PERCENT OR LESS PARTNER.—For purposes of this paragraph, the term "qualified 5-percent or less partner" means any partner who has (directly or indirectly) an interest of 5 percent or less in the aggregate capital and profits interests of the partnership but only if—

(i) such partner owned the low-income housing at all times during the 2-year period ending on the date such housing was transferred to the partnership, or

(ii) such partnership acquired the low-income housing pursuant to a purchase, assignment, or other transfer from the Department of Housing and Urban Development or any State or local housing authority.

For purposes of the preceding sentence, a partner shall be treated as holding any interest in the partnership which is held (directly or indirectly) by any person related (within the meaning of subsection (b) of this section or section 707(b)(1)) to such partner.

(C) QUALIFIED EXPENSES AND INTEREST.—For purpose of this paragraph, the term "qualified expenses and interest" means any expense or interest incurred by the partnership with respect to low-income housing held by the partnership but—

(i) only if the amount of such expense or interest (as the case may be) is unconditionally required to be paid by the partnership not later than 10 years after the date such amount was incurred, and

(ii) in the case of such interest, only if such interest is incurred at an annual rate not in excess of 12 percent.

(D) LOW-INCOME HOUSING.—For purposes of this paragraph, the term "low-income housing" means—

(i) any interest in property described in clause (i), (ii), (iii), or (iv) of section 1250(a)(1)(B), and

(ii) any interest in a partnership owning such property.

(6) CROSS REFERENCE.—For additional rules relating to partnerships, see section 707(b).

(f) CONTROLLED GROUP DEFINED; SPECIAL RULES APPLICABLE TO CONTROLLED GROUPS.—

(1) CONTROLLED GROUP DEFINED.—For purposes of this section, the term "controlled group" has the meaning given to such term by section 1563(a), except that—

(A) "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears in section 1563(a), and

(B) the determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of section 1563.

(2) DEFERRAL (RATHER THAN DENIAL) OF LOSS FROM SALE OR EXCHANGE BETWEEN MEMBERS.—In the case of any loss from the sale or exchange of property which is between members of the same controlled group and to which subsection (a)(1) ap-

plies (determined without regard to this paragraph but with regard to paragraph (3))—

(A) subsections (a)(1) and (d) shall not apply to such loss, but

(B) such loss shall be deferred until the property is transferred outside such controlled group and there would be recognition of loss under consolidated return principles or until such other time as may be prescribed in regulations.

(3) LOSS DEFERRAL RULES NOT TO APPLY IN CERTAIN CASES.—

(A) TRANSFER TO DISC.—For purposes of applying subsection (a)(1), the term "controlled group" shall not include a DISC.

(B) CERTAIN SALES OF INVENTORY.—Except to the extent provided in regulations prescribed by the Secretary, subsection (a)(1) shall not apply to the sale or exchange of property between members of the same controlled group (or persons described in subsection (b)(10)) if—

(i) such property in the hands of the transferor is property described in section 1221(a)(1),

(ii) such sale or exchange is in the ordinary course of the transferor's trade or business,

(iii) such property in the hands of the transferee is property described in section 1221(a)(1), and

(iv) the transferee or the transferor is a foreign corporation.

(C) CERTAIN FOREIGN CURRENCY LOSSES.—To the extent provided in regulations, subsection (a)(1) shall not apply to any loss sustained by a member of a controlled group on the repayment of a loan made to another member of such group if such loan is payable in a foreign currency or is denominated in such a currency and such loss is attributable to a reduction in value of such foreign currency.

(D) REDEMPTIONS BY FUND-OF-FUNDS REGULATED INVESTMENT COMPANIES.—Except to the extent provided in regulations prescribed by the Secretary, subsection (a)(1) shall not apply to any distribution in redemption of stock of a regulated investment company if—

(i) such company issues only stock which is redeemable upon the demand of the stockholder, and

(ii) such redemption is upon the demand of another regulated investment company.

(4) DETERMINATION OF RELATIONSHIP RESULTING IN DISALLOWANCE OF LOSS, FOR PURPOSES OF OTHER PROVISIONS.—For purposes of any other section of this title which refers to a relationship which would result in a disallowance of losses under this section, deferral under paragraph (2) shall be treated as disallowance.

(g) COORDINATION WITH SECTION 1041.—Subsection (a)(1) shall not apply to any transfer described in section 1041(a) (relating to transfers of property between spouses or incident to divorce).

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SEC. 274. DISALLOWANCE OF CERTAIN ENTERTAINMENT, ETC., EXPENSES.

(a) ENTERTAINMENT, AMUSEMENT, RECREATION, OR QUALIFIED TRANSPORTATION FRINGES.—

(1) IN GENERAL.—No deduction otherwise allowable under this chapter shall be allowed for any item—

(A) ACTIVITY.—With respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or

(B) FACILITY.—With respect to a facility used in connection with an activity referred to in subparagraph (A).

(2) SPECIAL RULES.—For purposes of applying paragraph (1)—

(A) Dues or fees to any social, athletic, or sporting club or organization shall be treated as items with respect to facilities.

(B) An activity described in section 212 shall be treated as a trade or business.

(3) DENIAL OF DEDUCTION FOR CLUB DUES.—Notwithstanding the preceding provisions of this subsection, no deduction shall be allowed under this chapter for amounts paid or incurred for membership in any club organized for business, pleasure, recreation, or other social purpose.

(4) QUALIFIED TRANSPORTATION FRINGES.—No deduction shall be allowed under this chapter for the expense of any qualified transportation fringe (as defined in section 132(f)) provided to an employee of the taxpayer.

(b) GIFTS.—

(1) LIMITATION.—No deduction shall be allowed under section 162 or section 212 for any expense for gifts made directly or indirectly to any individual to the extent that such expense, when added to prior expenses of the taxpayer for gifts made to such individual during the same taxable year, exceeds $25. For purposes of this section, the term "gift" means any item excludable from gross income of the recipient under section 102 which is not excludable from his gross income under any other provision of this chapter, but such term does not include—

(A) an item having a cost to the taxpayer not in excess of $4.00 on which the name of the taxpayer is clearly and permanently imprinted and which is one of a number of identical items distributed generally by the taxpayer, or

(B) a sign, display rack, or other promotional material to be used on the business premises of the recipient.

(2) SPECIAL RULES.—

(A) In the case of a gift by a partnership, the limitation contained in paragraph (1) shall apply to the partnership as well as to each member thereof.

(B) For purposes of paragraph (1), a [husband and wife] *married couple* shall be treated as one taxpayer.

(c) CERTAIN FOREIGN TRAVEL.—

(1) IN GENERAL.—In the case of any individual who travels outside the United States away from home in pursuit of a trade or business or in pursuit of an activity described in section 212, no deduction shall be allowed under section 162 or section 212 for that portion of the expenses of such travel oth-

erwise allowable under such section which, under regulations prescribed by the Secretary, is not allocable to such trade or business or to such activity.

(2) EXCEPTION.—Paragraph (1) shall not apply to the expenses of any travel outside the United States away from home if—

(A) such travel does not exceed one week, or

(B) the portion of the time of travel outside the United States away from home which is not attributable to the pursuit of the taxpayer's trade or business or an activity described in section 212 is less than 25 percent of the total time on such travel.

(3) DOMESTIC TRAVEL EXCLUDED.—For purposes of this subsection, travel outside the United States does not include any travel from one point in the United States to another point in the United States.

(d) SUBSTANTIATION REQUIRED.—No deduction or credit shall be allowed—

(1) under section 162 or 212 for any traveling expense (including meals and lodging while away from home),

(2) for any expense for gifts, or

(3) with respect to any listed property (as defined in section 280F(d)(4)),

unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement (A) the amount of such expense or other item, (B) the time and place of the travel or the date and description of the gift, (C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer of the person receiving the benefit. The Secretary may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations. This subsection shall not apply to any qualified nonpersonal use vehicle (as defined in subsection (i)).

(e) SPECIFIC EXCEPTIONS TO APPLICATION OF SUBSECTION (A).—Subsection (a) shall not apply to—

(1) FOOD AND BEVERAGES FOR EMPLOYEES.—Expenses for food and beverages (and facilities used in connection therewith) furnished on the business premises of the taxpayer primarily for his employees.

(2) EXPENSES TREATED AS COMPENSATION.—

(A) IN GENERAL.—Except as provided in subparagraph (B), expenses for goods, services, and facilities, to the extent that the expenses are treated by the taxpayer, with respect to the recipient of the entertainment, amusement, or recreation, as compensation to an employee on the taxpayer's return of tax under this chapter and as wages to such employee for purposes of chapter 24 (relating to withholding of income tax at source on wages).

(B) SPECIFIED INDIVIDUALS.—

(i) IN GENERAL.—In the case of a recipient who is a specified individual, subparagraph (A) and paragraph (9) shall each be applied by substituting "to the extent that the expenses do not exceed the amount of the expenses which" for "to the extent that the expenses".

(ii) SPECIFIED INDIVIDUAL.—For purposes of clause (i), the term "specified individual" means any individual who—

(I) is subject to the requirements of section 16(a) of the Securities Exchange Act of 1934 with respect to the taxpayer or a related party to the taxpayer, or

(II) would be subject to such requirements if the taxpayer (or such related party) were an issuer of equity securities referred to in such section.

For purposes of this clause, a person is a related party with respect to another person if such person bears a relationship to such other person described in section 267(b) or 707(b).

(3) REIMBURSED EXPENSES.—Expenses paid or incurred by the taxpayer, in connection with the performance by him of services for another person (whether or not such other person is his employer), under a reimbursement or other expense allowance arrangement with such other person, but this paragraph shall apply—

(A) where the services are performed for an employer, only if the employer has not treated such expenses in the manner provided in paragraph (2), or

(B) where the services are performed for a person other than an employer, only if the taxpayer accounts (to the extent provided by subsection (d)) to such person.

(4) RECREATIONAL, ETC., EXPENSES FOR EMPLOYEES.—Expenses for recreational, social, or similar activities (including facilities therefor) primarily for the benefit of employees (other than employees who are highly compensated employees (within the meaning of section 414(q))). For purposes of this paragraph, an individual owning less than a 10-percent interest in the taxpayer's trade or business shall not be considered a shareholder or other owner, and for such purposes an individual shall be treated as owning any interest owned by a member of his family (within the meaning of section 267(c)(4)). This paragraph shall not apply for purposes of subsection (a)(3).

(5) EMPLOYEES, STOCKHOLDER, ETC., BUSINESS MEETINGS.—Expenses incurred by a taxpayer which are directly related to business meetings of his employees, stockholders, agents, or directors.

(6) MEETINGS OF BUSINESS LEAGUES, ETC..—Expenses directly related and necessary to attendance at a business meeting or convention of any organization described in section 501(c)(6) (relating to business leagues, chambers of commerce, real estate boards, and boards of trade) and exempt from taxation under section 501(a).

(7) ITEMS AVAILABLE TO PUBLIC.—Expenses for goods, services, and facilities made available by the taxpayer to the general public.

(8) ENTERTAINMENT SOLD TO CUSTOMERS.—Expenses for goods or services (including the use of facilities) which are sold by the taxpayer in a bona fide transaction for an adequate and full consideration in money or money's worth.

(9) EXPENSES INCLUDIBLE IN INCOME OF PERSONS WHO ARE NOT EMPLOYEES.—Expenses paid or incurred by the taxpayer for goods, services, and facilities to the extent that the expenses are includible in the gross income of a recipient of the entertainment, amusement, or recreation who is not an employee of the taxpayer as compensation for services rendered or as a prize or award under section 74. The preceding sentence shall not apply to any amount paid or incurred by the taxpayer if such amount is required to be included (or would be so required except that the amount is less than $600) in any information return filed by such taxpayer under part III of subchapter A of chapter 61 and is not so included.

For purposes of this subsection, any item referred to in subsection (a) shall be treated as an expense.

(f) INTEREST, TAXES, CASUALTY LOSSES, ETC..—This section shall not apply to any deduction allowable to the taxpayer without regard to its connection with his trade or business (or with his income-producing activity). In the case of a taxpayer which is not an individual, the preceding sentence shall be applied as if it were an individual.

(g) TREATMENT OF ENTERTAINMENT, ETC., TYPE FACILITY.—For purposes of this chapter, if deductions are disallowed under subsection (a) with respect to any portion of a facility, such portion shall be treated as an asset which is used for personal, living, and family purposes (and not as an asset used in the trade or business).

(h) ATTENDANCE AT CONVENTIONS, ETC..—

(1) IN GENERAL.—In the case of any individual who attends a convention, seminar, or similar meeting which is held outside the North American area, no deduction shall be allowed under section 162 for expenses allocable to such meeting unless the taxpayer establishes that the meeting is directly related to the active conduct of his trade or business and that, after taking into account in the manner provided by regulations prescribed by the Secretary—

(A) the purpose of such meeting and the activities taking place at such meeting,

(B) the purposes and activities of the sponsoring organizations or groups,

(C) the residences of the active members of the sponsoring organization and the places at which other meetings of the sponsoring organization or groups have been held or will be held, and

(D) such other relevant factors as the taxpayer may present,

it is as reasonable for the meeting to be held outside the North American area as within the North American area.

(2) CONVENTIONS ON CRUISE SHIPS.—In the case of any individual who attends a convention, seminar, or other meeting which is held on any cruise ship, no deduction shall be allowed under section 162 for expenses allocable to such meeting, unless the taxpayer meets the requirements of paragraph (5) and establishes that the meeting is directly related to the active conduct of his trade or business and that—

(A) the cruise ship is a vessel registered in the United States; and

(B) all ports of call of such cruise ship are located in the United States or in possessions of the United States.

With respect to cruises beginning in any calendar year, not more than $2,000 of the expenses attributable to an individual attending one or more meetings may be taken into account under section 162 by reason of the preceding sentence.

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

(A) NORTH AMERICAN AREA.—The term "North American area" means the United States, its possessions, and the Trust Territory of the Pacific Islands, and Canada and Mexico.

(B) CRUISE SHIP.—The term "cruise ship" means any vessel sailing within or without the territorial waters of the United States.

(4) SUBSECTION TO APPLY TO EMPLOYER AS WELL AS TO TRAVELER.—

(A) Except as provided in subparagraph (B), this subsection shall apply to deductions otherwise allowable under section 162 to any person, whether or not such person is the individual attending the convention, seminar, or similar meeting.

(B) This subsection shall not deny a deduction to any person other than the individual attending the convention, seminar, or similar meeting with respect to any amount paid by such person to or on behalf of such individual if includible in the gross income of such individual. The preceding sentence shall not apply if the amount is required to be included in any information return filed by such person under part III of subchapter A of chapter 61 and is not so included.

(5) REPORTING REQUIREMENTS.—No deduction shall be allowed under section 162 for expenses allocable to attendance at a convention, seminar, or similar meeting on any cruise ship unless the taxpayer claiming the deduction attaches to the return of tax on which the deduction is claimed—

(A) a written statement signed by the individual attending the meeting which includes—

(i) information with respect to the total days of the trip, excluding the days of transportation to and from the cruise ship port, and the number of hours of each day of the trip which such individual devoted to scheduled business activities,

(ii) a program of the scheduled business activities of the meeting, and

(iii) such other information as may be required in regulations prescribed by the Secretary; and

(B) a written statement signed by an officer of the organization or group sponsoring the meeting which includes—

(i) a schedule of the business activities of each day of the meeting,

(ii) the number of hours which the individual attending the meeting attended such scheduled business activities, and

(iii) such other information as may be required in regulations prescribed by the Secretary.

(6) TREATMENT OF CONVENTIONS IN CERTAIN CARIBBEAN COUNTRIES.—

(A) IN GENERAL.—For purposes of this subsection, the term "North American area" includes, with respect to any convention, seminar, or similar meeting, any beneficiary country if (as of the time such meeting begins)—

(i) there is in effect a bilateral or multilateral agreement described in subparagraph (C) between such country and the United States providing for the exchange of information between the United States and such country, and

(ii) there is not in effect a finding by the Secretary that the tax laws of such country discriminate against conventions held in the United States.

(B) BENEFICIARY COUNTRY.—For purposes of this paragraph, the term "beneficiary country" has the meaning given to such term by section 212(a)(1)(A) of the Caribbean Basin Economic Recovery Act; except that such term shall include Bermuda.

(C) AUTHORITY TO CONCLUDE EXCHANGE OF INFORMATION AGREEMENTS.—

(i) IN GENERAL.—The Secretary is authorized to negotiate and conclude an agreement for the exchange of information with any beneficiary country. Except as provided in clause (ii), an exchange of information agreement shall provide for the exchange of such information (not limited to information concerning nationals or residents of the United States or the beneficiary country) as may be necessary or appropriate to carry out and enforce the tax laws of the United States and the beneficiary country (whether criminal or civil proceedings), including information which may otherwise be subject to nondisclosure provisions of the local law of the beneficiary country such as provisions respecting bank secrecy and bearer shares. The exchange of information agreement shall be terminable by either country on reasonable notice and shall provide that information received by either country will be disclosed only to persons or authorities (including courts and administrative bodies) involved in the administration or oversight of, or in the determination of appeals in respect of, taxes of the United States or the beneficiary country and will be used by such persons or authorities only for such purposes.

(ii) NONDISCLOSURE OF QUALIFIED CONFIDENTIAL INFORMATION SOUGHT FOR CIVIL TAX PURPOSES.—An exchange of information agreement need not provide for the exchange of qualified confidential information which is sought only for civil tax purposes if—

(I) the Secretary of the Treasury, after making all reasonable efforts to negotiate an agreement which includes the exchange of such information, determines that such an agreement cannot be negotiated but that the agreement which was negotiated will significantly assist in the administra-

tion and enforcement of the tax laws of the United States, and

(II) the President determines that the agreement as negotiated is in the national security interest of the United States.

(iii) QUALIFIED CONFIDENTIAL INFORMATION DEFINED.—For purposes of this subparagraph, the term "qualified confidential information" means information which is subject to the nondisclosure provisions of any local law of the beneficiary country regarding bank secrecy or ownership of bearer shares.

(iv) CIVIL TAX PURPOSES.—For purposes of this subparagraph, the determination of whether information is sought only for civil tax purposes shall be made by the requesting party.

(D) COORDINATION WITH OTHER PROVISIONS.—Any exchange of information agreement negotiated under subparagraph (C) shall be treated as an income tax convention for purposes of section 6103(k)(4). The Secretary may exercise his authority under subchapter A of chapter 78 to carry out any obligation of the United States under an agreement referred to in subparagraph (C).

(E) DETERMINATIONS PUBLISHED IN THE FEDERAL REGISTER.—The following shall be published in the Federal Register—

(i) any determination by the President under subparagraph (C)(ii) (including the reasons for such determination),

(ii) any determination by the Secretary under subparagraph (C)(ii) (including the reasons for such determination), and

(iii) any finding by the Secretary under subparagraph (A)(ii) (and any termination thereof).

(7) SEMINARS, ETC. FOR SECTION 212 PURPOSES.—No deduction shall be allowed under section 212 for expenses allocable to a convention, seminar, or similar meeting.

(i) QUALIFIED NONPERSONAL USE VEHICLE.—For purposes of subsection (d), the term "qualified nonpersonal use vehicle" means any vehicle which, by reason of its nature, is not likely to be used more than a de minimis amount for personal purposes.

(j) EMPLOYEE ACHIEVEMENT AWARDS.—

(1) GENERAL RULE.—No deduction shall be allowed under section 162 or section 212 for the cost of an employee achievement award except to the extent that such cost does not exceed the deduction limitations of paragraph (2).

(2) DEDUCTION LIMITATIONS.—The deduction for the cost of an employee achievement award made by an employer to an employee—

(A) which is not a qualified plan award, when added to the cost to the employer for all other employee achievement awards made to such employee during the taxable year which are not qualified plan awards, shall not exceed $400, and

(B) which is a qualified plan award, when added to the cost to the employer for all other employee achievement

awards made to such employee during the taxable year (including employee achievement awards which are not qualified plan awards), shall not exceed $1,600.

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

(A) EMPLOYEE ACHIEVEMENT AWARD.—

(i) IN GENERAL.—The term "employee achievement award" means an item of tangible personal property which is—

(I) transferred by an employer to an employee for length of service achievement or safety achievement,

(II) awarded as part of a meaningful presentation, and

(III) awarded under conditions and circumstances that do not create a significant likelihood of the payment of disguised compensation.

(ii) TANGIBLE PERSONAL PROPERTY.—For purposes of clause (i), the term "tangible personal property" shall not include—

(I) cash, cash equivalents, gift cards, gift coupons, or gift certificates (other than arrangements conferring only the right to select and receive tangible personal property from a limited array of such items pre-selected or pre-approved by the employer), or

(II) vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, other securities, and other similar items.

(B) QUALIFIED PLAN AWARD.—

(i) IN GENERAL.—The term "qualified plan award" means an employee achievement award awarded as part of an established written plan or program of the taxpayer which does not discriminate in favor of highly compensated employees (within the meaning of section 414(q)) as to eligibility or benefits.

(ii) LIMITATION.—An employee achievement award shall not be treated as a qualified plan award for any taxable year if the average cost of all employee achievement awards which are provided by the employer during the year, and which would be qualified plan awards but for this subparagraph, exceeds $400. For purposes of the preceding sentence, average cost shall be determined by including the entire cost of qualified plan awards, without taking into account employee achievement awards of nominal value.

(4) SPECIAL RULES.—For purposes of this subsection—

(A) PARTNERSHIPS.—In the case of an employee achievement award made by a partnership, the deduction limitations contained in paragraph (2) shall apply to the partnership as well as to each member thereof.

(B) LENGTH OF SERVICE AWARDS.—An item shall not be treated as having been provided for length of service achievement if the item is received during the recipient's 1st 5 years of employment or if the recipient received a length of service achievement award (other than an award

excludable under section 132(e)(1)) during that year or any of the prior 4 years.

(C) SAFETY ACHIEVEMENT AWARDS.—An item provided by an employer to an employee shall not be treated as having been provided for safety achievement if—

(i) during the taxable year, employee achievement awards (other than awards excludable under section 132(e)(1)) for safety achievement have previously been awarded by the employer to more than 10 percent of the employees of the employer (excluding employees described in clause (ii)), or

(ii) such item is awarded to a manager, administrator, clerical employee, or other professional employee.

(k) BUSINESS MEALS.—

(1) IN GENERAL.—No deduction shall be allowed under this chapter for the expense of any food or beverages unless—

(A) such expense is not lavish or extravagant under the circumstances, and

(B) the taxpayer (or an employee of the taxpayer) is present at the furnishing of such food or beverages.

(2) EXCEPTIONS.—Paragraph (1) shall not apply to—

(A) any expense described in paragraph (2), (3), (4), (7), (8), or (9) of subsection (e), and

(B) any other expense to the extent provided in regulations.

(l) TRANSPORTATION AND COMMUTING BENEFITS.—

(1) IN GENERAL.—No deduction shall be allowed under this chapter for any expense incurred for providing any transportation, or any payment or reimbursement, to an employee of the taxpayer in connection with travel between the employee's residence and place of employment, except as necessary for ensuring the safety of the employee.

(2) EXCEPTION.—In the case of any qualified bicycle commuting reimbursement (as described in section 132(f)(5)(F)), this subsection shall not apply for any amounts paid or incurred after December 31, 2017, and before January 1, 2026.

(m) ADDITIONAL LIMITATIONS ON TRAVEL EXPENSES.—

(1) LUXURY WATER TRANSPORTATION.—

(A) IN GENERAL.—No deduction shall be allowed under this chapter for expenses incurred for transportation by water to the extent such expenses exceed twice the aggregate per diem amounts for days of such transportation. For purposes of the preceding sentence, the term "per diem amounts" means the highest amount generally allowable with respect to a day to employees of the executive branch of the Federal Government for per diem while away from home but serving in the United States.

(B) EXCEPTIONS.—Subparagraph (A) shall not apply to—

(i) any expense allocable to a convention, seminar, or other meeting which is held on any cruise ship, and

(ii) any expense described in paragraph (2), (3), (4), (7), (8), or (9) of subsection (e).

(2) TRAVEL AS FORM OF EDUCATION.—No deduction shall be allowed under this chapter for expenses for travel as a form of education.

(3) TRAVEL EXPENSES OF SPOUSE, DEPENDENT, OR OTHERS.—No deduction shall be allowed under this chapter (other than section 217) for travel expenses paid or incurred with respect to a spouse, dependent, or other individual accompanying the taxpayer (or an officer or employee of the taxpayer) on business travel, unless—

(A) the spouse, dependent, or other individual is an employee of the taxpayer,

(B) the travel of the spouse, dependent, or other individual is for a bona fide business purpose, and

(C) such expenses would otherwise be deductible by the spouse, dependent, or other individual.

(n) ONLY 50 PERCENT OF MEAL EXPENSES ALLOWED AS DEDUCTION.—

(1) IN GENERAL.—The amount allowable as a deduction under this chapter for any expense for food or beverages shall not exceed 50 percent of the amount of such expense which would (but for this paragraph) be allowable as a deduction under this chapter.

(2) EXCEPTIONS.—Paragraph (1) shall not apply to any expense if—

(A) such expense is described in paragraph (2), (3), (4), (7), (8), or (9) of subsection (e),

(B) in the case of an employer who pays or reimburses moving expenses of an employee, such expenses are includible in the income of the employee under section 82, or

(C) such expense is for food or beverages—

(i) required by any Federal law to be provided to crew members of a commercial vessel,

(ii) provided to crew members of a commercial vessel—

(I) which is operating on the Great Lakes, the Saint Lawrence Seaway, or any inland waterway of the United States, and

(II) which is of a kind which would be required by Federal law to provide food and beverages to crew members if it were operated at sea,

(iii) provided on an oil or gas platform or drilling rig if the platform or rig is located offshore, or

(iv) provided on an oil or gas platform or drilling rig, or at a support camp which is in proximity and integral to such platform or rig, if the platform or rig is located in the United States north of 54 degrees north latitude.

Clauses (i) and (ii) of subparagraph (C) shall not apply to vessels primarily engaged in providing luxury water transportation (determined under the principles of subsection (m)). In the case of the employee, the exception of subparagraph (A) shall not apply to expenses described in subparagraph (B).

(3) SPECIAL RULE FOR INDIVIDUALS SUBJECT TO FEDERAL HOURS OF SERVICE.—In the case of any expenses for food or beverages consumed while away from home (within the mean-

ing of section 162(a)(2)) by an individual during, or incident to, the period of duty subject to the hours of service limitations of the Department of Transportation, paragraph (1) shall be applied by substituting "80 percent" for "50 percent".

(o) REGULATORY AUTHORITY.—The Secretary shall prescribe such regulations as he may deem necessary to carry out the purposes of this section, including regulations prescribing whether subsection (a) or subsection (b) applies in cases where both such subsections would otherwise apply.

Subchapter C—CORPORATE DISTRIBUTIONS AND ADJUSTMENTS

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PART I—DISTRIBUTIONS BY CORPORATIONS

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Subpart C—DEFINITIONS; CONSTRUCTIVE OWNERSHIP OF STOCK

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SEC. 318. CONSTRUCTIVE OWNERSHIP OF STOCK.

(a) GENERAL RULE.—For purposes of those provisions of this subchapter to which the rules contained in this section are expressly made applicable—

(1) MEMBERS OF FAMILY.—

(A) IN GENERAL.—An individual shall be considered as owning the stock owned, directly or indirectly, by or for—

(i) [his spouse] *the individual's spouse* (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), and

(ii) [his] *the individual's* children, grandchildren, and parents.

(B) EFFECT OF ADOPTION.—For purposes of subparagraph (A)(ii), a legally adopted child of an individual shall be treated as a child of such individual by blood.

(2) ATTRIBUTION FROM PARTNERSHIPS, ESTATES, TRUSTS, AND CORPORATIONS.—

(A) FROM PARTNERSHIPS AND ESTATES.—Stock owned, directly or indirectly, by or for a partnership or estate shall be considered as owned proportionately by its partners or beneficiaries.

(B) FROM TRUSTS.—

(i) Stock owned, directly or indirectly, by or for a trust (other than an employees' trust described in section 401(a) which is exempt from tax under section 501(a)) shall be considered as owned by its beneficiaries in proportion to the actuarial interest of such beneficiaries in such trust.

(ii) Stock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart E of part I of subchapter J (relat-

ing to grantors and others treated as substantial owners) shall be considered as owned by such person.

(C) FROM CORPORATIONS.—If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such person shall be considered as owning the stock owned, directly or indirectly, by or for such corporation, in that proportion which the value of the stock which such person so owns bears to the value of all the stock in such corporation.

(3) ATTRIBUTION TO PARTNERSHIPS, ESTATES, TRUSTS, AND CORPORATIONS.—

(A) TO PARTNERSHIPS AND ESTATES.—Stock owned, directly or indirectly, by or for a partner or a beneficiary of an estate shall be considered as owned by the partnership or estate.

(B) TO TRUSTS.—

(i) Stock owned, directly or indirectly, by or for a beneficiary of a trust (other than an employees' trust described in section 401(a) which is exempt from tax under section 501(a)) shall be considered as owned by the trust, unless such beneficiary's interest in the trust is a remote contingent interest. For purposes of this clause, a contingent interest of a beneficiary in a trust shall be considered remote if, under the maximum exercise of discretion by the trustee in favor of such beneficiary, the value of such interest, computed actuarially, is 5 percent or less of the value of the trust property.

(ii) Stock owned, directly or indirectly, by or for a person who is considered the owner of any portion of a trust under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as owned by the trust.

(C) TO CORPORATIONS.—If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such corporation shall be considered as owning the stock owned, directly or indirectly, by or for such person.

(4) OPTIONS.—If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

(5) OPERATING RULES.—

(A) IN GENERAL.—Except as provided in subparagraphs (B) and (C), stock constructively owned by a person by reason of the application of paragraph (1), (2), (3), or (4), shall, for purposes of applying paragraphs (1), (2), (3), and (4), be considered as actually owned by such person.

(B) MEMBERS OF FAMILY.—Stock constructively owned by an individual by reason of the application of paragraph (1) shall not be considered as owned by him for purposes of again applying paragraph (1) in order to make another the constructive owner of such stock.

(C) PARTNERSHIPS, ESTATES, TRUSTS, AND CORPORATIONS.—Stock constructively owned by a partnership, estate, trust, or corporation by reason of the application of paragraph (3) shall not be considered as owned by it for purposes of applying paragraph (2) in order to make another the constructive owner of such stock.

(D) OPTION RULE IN LIEU OF FAMILY RULE.—For purposes of this paragraph, if stock may be considered as owned by an individual under paragraph (1) or (4), it shall be considered as owned by him under paragraph (4).

(E) S CORPORATION TREATED AS PARTNERSHIP.—For purposes of this subsection—

(i) an S corporation shall be treated as a partnership, and

(ii) any shareholder of the S corporation shall be treated as a partner of such partnership.

The preceding sentence shall not apply for purposes of determining whether stock in the S corporation is constructively owned by any person.

(b) CROSS REFERENCES.—For provisions to which the rules contained in subsection (a) apply, see—

(1) section 302 (relating to redemption of stock);

(2) section 304 (relating to redemption by related corporations);

(3) section 306(b)(1)(A) (relating to disposition of section 306 stock);

(4) section 338(h)(3) (defining purchase);

(5) section 382(*l*)(3) (relating to special limitations on net operating loss carryovers);

(6) section 856(d) (relating to definition of rents from real property in the case of real estate investment trusts);

(7) section 958(b) (relating to constructive ownership rules with respect to controlled foreign corporations); and

(8) section 6038(e)(2) (relating to information with respect to certain foreign corporations).

Subchapter D—DEFERRED COMPENSATION, ETC.

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PART I—PENSION, PROFIT-SHARING, STOCK BONUS PLANS, ETC.

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Subpart A—GENERAL RULE

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SEC. 401. QUALIFIED PENSION, PROFIT-SHARING, AND STOCK BONUS PLANS.

(a) REQUIREMENTS FOR QUALIFICATION.—A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section—

(1) if contributions are made to the trust by such employer, or employees, or both, or by another employer who is entitled to deduct his contributions under section 404(a)(3)(B) (relating to deduction for contributions to profit-sharing and stock bonus plans), or by a charitable remainder trust pursuant to a qualified gratuitous transfer (as defined in section 664(g)(1)), for the purpose of distributing to such employees or their beneficiaries the corpus and income of the fund accumulated by the trust in accordance with such plan;

(2) if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries (but this paragraph shall not be construed, in the case of a multiemployer plan, to prohibit the return of a contribution within 6 months after the plan administrator determines that the contribution was made by a mistake of fact or law (other than a mistake relating to whether the plan is described in section 401(a) or the trust which is part of such plan is exempt from taxation under section 501(a), or the return of any withdrawal liability payment determined to be an overpayment within 6 months of such determination));

(3) if the plan of which such trust is a part satisfies the requirements of section 410 (relating to minimum participation standards); and

(4) if the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees (within the meaning of section 414(q)). For purposes of this paragraph, there shall be excluded from consideration employees described in section 410(b)(3)(A) and (C).

(5) SPECIAL RULES RELATING TO NONDISCRIMINATION REQUIREMENTS.—

(A) SALARIED OR CLERICAL EMPLOYEES.—A classification shall not be considered discriminatory within the meaning of paragraph (4) or section 410(b)(2)(A)(i) merely because it is limited to salaried or clerical employees.

(B) CONTRIBUTIONS AND BENEFITS MAY BEAR UNIFORM RELATIONSHIP TO COMPENSATION.—A plan shall not be considered discriminatory within the meaning of paragraph (4) merely because the contributions or benefits of, or on behalf of, the employees under the plan bear a uniform relationship to the compensation (within the meaning of section 414(s)) of such employees.

(C) CERTAIN DISPARITY PERMITTED.—A plan shall not be considered discriminatory within the meaning of paragraph (4) merely because the contributions or benefits of, or on behalf of, the employees under the plan favor highly compensated employees (as defined in section 414(q)) in the manner permitted under subsection (l).

(D) INTEGRATED DEFINED BENEFIT PLAN.—

(i) IN GENERAL.—A defined benefit plan shall not be considered discriminatory within the meaning of paragraph (4) merely because the plan provides that the

employer-derived accrued retirement benefit for any participant under the plan may not exceed the excess (if any) of—

(I) the participant's final pay with the employer, over

(II) the employer-derived retirement benefit created under Federal law attributable to service by the participant with the employer.

For purposes of this clause, the employer-derived retirement benefit created under Federal law shall be treated as accruing ratably over 35 years.

(ii) FINAL PAY.—For purposes of this subparagraph, the participant's final pay is the compensation (as defined in section 414(q)(4)) paid to the participant by the employer for any year—

(I) which ends during the 5-year period ending with the year in which the participant separated from service for the employer, and

(II) for which the participant's total compensation from the employer was highest.

(E) 2 OR MORE PLANS TREATED AS SINGLE PLAN.—For purposes of determining whether 2 or more plans of an employer satisfy the requirements of paragraph (4) when considered as a single plan—

(i) CONTRIBUTIONS.—If the amount of contributions on behalf of the employees allowed as a deduction under section 404 for the taxable year with respect to such plans, taken together, bears a uniform relationship to the compensation (within the meaning of section 414(s)) of such employees, the plans shall not be considered discriminatory merely because the rights of employees to, or derived from, the employer contributions under the separate plans do not become nonforfeitable at the same rate.

(ii) BENEFITS.—If the employees' rights to benefits under the separate plans do not become nonforfeitable at the same rate, but the levels of benefits provided by the separate plans satisfy the requirements of regulations prescribed by the Secretary to take account of the differences in such rates, the plans shall not be considered discriminatory merely because of the difference in such rates.

(F) SOCIAL SECURITY RETIREMENT AGE.—For purposes of testing for discrimination under paragraph (4)—

(i) the social security retirement age (as defined in section 415(b)(8)) shall be treated as a uniform retirement age, and

(ii) subsidized early retirement benefits and joint and survivor annuities shall not be treated as being unavailable to employees on the same terms merely because such benefits or annuities are based in whole or in part on an employee's social security retirement age (as so defined).

(G) GOVERNMENTAL PLANS.—Paragraphs (3) and (4) shall not apply to a governmental plan (within the meaning of section 414(d)).

(6) A plan shall be considered as meeting the requirements of paragraph (3) during the whole of any taxable year of the plan if on one day in each quarter it satisfied such requirements.

(7) A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part satisfies the requirements of section 411 (relating to minimum vesting standards).

(8) A trust forming part of a defined benefit plan shall not constitute a qualified trust under this section unless the plan provides that forfeitures must not be applied to increase the benefits any employee would otherwise receive under the plan.

(9) REQUIRED DISTRIBUTIONS.—

(A) IN GENERAL.—A trust shall not constitute a qualified trust under this subsection unless the plan provides that the entire interest of each employee—

(i) will be distributed to such employee not later than the required beginning date, or

(ii) will be distributed, beginning not later than the required beginning date, in accordance with regulations, over the life of such employee or over the lives of such employee and a designated beneficiary (or over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a designated beneficiary).

(B) REQUIRED DISTRIBUTION WHERE EMPLOYEE DIES BEFORE ENTIRE INTEREST IS DISTRIBUTED.—

(i) WHERE DISTRIBUTIONS HAVE BEGUN UNDER SUBPARAGRAPH (A)(II).—A trust shall not constitute a qualified trust under this section unless the plan provides that if—

(I) the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii), and

(II) the employee dies before his entire interest has been distributed to him,

the remaining portion of such interest will be distributed at least as rapidly as under the method of distributions being used under subparagraph (A)(ii) as of the date of his death.

(ii) 5-YEAR RULE FOR OTHER CASES.—A trust shall not constitute a qualified trust under this section unless the plan provides that, if an employee dies before the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii), the entire interest of the employee will be distributed within 5 years after the death of such employee.

(iii) EXCEPTION TO 5-YEAR RULE FOR CERTAIN AMOUNTS PAYABLE OVER LIFE OF BENEFICIARY.—If—

(I) any portion of the employee's interest is payable to (or for the benefit of) a designated beneficiary,

(II) such portion will be distributed (in accordance with regulations) over the life of such designated beneficiary (or over a period not extending beyond the life expectancy of such beneficiary), and

(III) such distributions begin not later than 1 year after the date of the employee's death or such later date as the Secretary may by regulations prescribe,

for purposes of clause (ii), the portion referred to in subclause (I) shall be treated as distributed on the date on which such distributions begin.

(iv) SPECIAL RULE FOR SURVIVING SPOUSE OF EMPLOYEE.—If the designated beneficiary referred to in clause (iii)(I) is the surviving spouse of the employee—

(I) the date on which the distributions are required to begin under clause (iii)(III) shall not be earlier than the date on which the employee would have attained age 701/2, and

(II) if the surviving spouse dies before the distributions to such spouse begin, this subparagraph shall be applied as if the surviving spouse were the employee.

(C) REQUIRED BEGINNING DATE.—For purposes of this paragraph—

(i) IN GENERAL.—The term "required beginning date" means April 1 of the calendar year following the later of—

(I) the calendar year in which the employee attains age 701/2, or

(II) the calendar year in which the employee retires.

(ii) EXCEPTION.—Subclause (II) of clause (i) shall not apply—

(I) except as provided in section 409(d), in the case of an employee who is a 5-percent owner (as defined in section 416) with respect to the plan year ending in the calendar year in which the employee attains age 701/2, or

(II) for purposes of section 408(a)(6) or (b)(3).

(iii) ACTUARIAL ADJUSTMENT.—In the case of an employee to whom clause (i)(II) applies who retires in a calendar year after the calendar year in which the employee attains age 701/2, the employee's accrued benefit shall be actuarially increased to take into account the period after age 701/2 in which the employee was not receiving any benefits under the plan.

(iv) EXCEPTION FOR GOVERNMENTAL AND CHURCH PLANS.—Clauses (ii) and (iii) shall not apply in the case of a governmental plan or church plan. For purposes of this clause, the term "church plan" means a plan maintained by a church for church employees, and the term "church" means any church (as defined in section 3121(w)(3)(A)) or qualified church-controlled organization (as defined in section 3121(w)(3)(B)).

(D) LIFE EXPECTANCY.—For purposes of this paragraph, the life expectancy of an employee and the employee's spouse (other than in the case of a life annuity) may be redetermined but not more frequently than annually.

(E) DESIGNATED BENEFICIARY.—For purposes of this paragraph, the term "designated beneficiary" means any individual designated as a beneficiary by the employee.

(F) TREATMENT OF PAYMENTS TO CHILDREN.—Under regulations prescribed by the Secretary, for purposes of this paragraph, any amount paid to a child shall be treated as if it had been paid to the surviving spouse if such amount will become payable to the surviving spouse upon such child reaching majority (or other designated event permitted under regulations).

(G) TREATMENT OF INCIDENTAL DEATH BENEFIT DISTRIBUTIONS.—For purposes of this title, any distribution required under the incidental death benefit requirements of this subsection shall be treated as a distribution required under this paragraph.

(10) OTHER REQUIREMENTS.—

(A) PLANS BENEFITING OWNER-EMPLOYEES.—In the case of any plan which provides contributions or benefits for employees some or all of whom are owner-employees (as defined in subsection (c)(3)), a trust forming part of such plan shall constitute a qualified trust under this section only if the requirements of subsection (d) are also met.

(B) TOP-HEAVY PLANS.—

(i) IN GENERAL.—In the case of any top-heavy plan, a trust forming part of such plan shall constitute a qualified trust under this section only if the requirements of section 416 are met.

(ii) PLANS WHICH MAY BECOME TOP-HEAVY.—Except to the extent provided in regulations, a trust forming part of a plan (whether or not a top-heavy plan) shall constitute a qualified trust under this section only if such plan contains provisions—

(I) which will take effect if such plan becomes a top-heavy plan, and

(II) which meet the requirements of section 416.

(iii) EXEMPTION FOR GOVERNMENTAL PLANS.—This subparagraph shall not apply to any governmental plan.

(11) REQUIREMENT OF JOINT AND SURVIVOR ANNUITY AND PRERETIREMENT SURVIVOR ANNUITY.—

(A) IN GENERAL.—In the case of any plan to which this paragraph applies, except as provided in section 417, a trust forming part of such plan shall not constitute a qualified trust under this section unless—

(i) in the case of a vested participant who does not die before the annuity starting date, the accrued benefit payable to such participant is provided in the form of a qualified joint and survivor annuity, and

(ii) in the case of a vested participant who dies before the annuity starting date and who has a surviving

spouse, a qualified preretirement survivor annuity is provided to the surviving spouse of such participant.

(B) PLANS TO WHICH PARAGRAPH APPLIES.—This paragraph shall apply to—

(i) any defined benefit plan,

(ii) any defined contribution plan which is subject to the funding standards of section 412, and

(iii) any participant under any other defined contribution plan unless—

(I) such plan provides that the participant's nonforfeitable accrued benefit (reduced by any security interest held by the plan by reason of a loan outstanding to such participant) is payable in full, on the death of the participant, to the participant's surviving spouse (or, if there is no surviving spouse or the surviving spouse consents in the manner required under section 417(a)(2), to a designated beneficiary),

(II) such participant does not elect a payment of benefits in the form of a life annuity, and

(III) with respect to such participant, such plan is not a direct or indirect transferee (in a transfer after December 31, 1984) of a plan which is described in clause (i) or (ii) or to which this clause applied with respect to the participant.

Clause (iii)(III) shall apply only with respect to the transferred assets (and income therefrom) if the plan separately accounts for such assets and any income therefrom.

(C) EXCEPTION FOR CERTAIN ESOP BENEFITS.—

(i) IN GENERAL.—In the case of—

(I) a tax credit employee stock ownership plan (as defined in section 409(a)), or

(II) an employee stock ownership plan (as defined in section 4975(e)(7)),

subparagraph (A) shall not apply to that portion of the employee's accrued benefit to which the requirements of section 409(h) apply.

(ii) NONFORFEITABLE BENEFIT MUST BE PAID IN FULL, ETC.—In the case of any participant, clause (i) shall apply only if the requirements of subclauses (I), (II), and (III) of subparagraph (B)(iii) are met with respect to such participant.

(D) SPECIAL RULE WHERE PARTICIPANT AND SPOUSE MARRIED LESS THAN 1 YEAR.—A plan shall not be treated as failing to meet the requirements of subparagraphs (B)(iii) or (C) merely because the plan provides that benefits will not be payable to the surviving spouse of the participant unless the participant and such spouse had been married throughout the 1-year period ending on the earlier of the participant's annuity starting date or the date of the participant's death.

(E) EXCEPTION FOR PLANS DESCRIBED IN SECTION 404(C).—This paragraph shall not apply to a plan which the Secretary has determined is a plan described in section 404(c) (or a continuation thereof) in which participation is sub-

stantially limited to individuals who, before January 1, 1976, ceased employment covered by the plan.

(F) CROSS REFERENCE.—For—

(i) provisions under which participants may elect to waive the requirements of this paragraph, and

(ii) other definitions and special rules for purposes of this paragraph,

see section 417.

(12) A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that in the case of any merger or consolidation with, or transfer of assets or liabilities to, any other plan after September 2, 1974, each participant in the plan would (if the plan then terminated) receive a benefit immediately after the merger, consolidation, or transfer which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger, consolidation, or transfer (if the plan had then terminated). The preceding sentence does not apply to any multiemployer plan with respect to any transaction to the extent that participants either before or after the transaction are covered under a multiemployer plan to which title IV of the Employee Retirement Income Security Act of 1974 applies.

(13) ASSIGNMENT AND ALIENATION.—

(A) IN GENERAL.—A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that benefits provided under the plan may not be assigned or alienated. For purposes of the preceding sentence, there shall not be taken into account any voluntary and revocable assignment of not to exceed 10 percent of any benefit payment made by any participant who is receiving benefits under the plan unless the assignment or alienation is made for purposes of defraying plan administration costs. For purposes of this paragraph a loan made to a participant or beneficiary shall not be treated as an assignment or alienation if such loan is secured by the participant's accrued nonforfeitable benefit and is exempt from the tax imposed by section 4975 (relating to tax on prohibited transactions) by reason of section 4975(d)(1). This paragraph shall take effect on January 1, 1976 and shall not apply to assignments which were irrevocable on September 2, 1974.

(B) SPECIAL RULES FOR DOMESTIC RELATIONS ORDERS.—Subparagraph (A) shall apply to the creation, assignment, or recognition of a right to any benefit payable with respect to a participant pursuant to a domestic relations order, except that subparagraph (A) shall not apply if the order is determined to be a qualified domestic relations order.

(C) SPECIAL RULE FOR CERTAIN JUDGMENTS AND SETTLEMENTS.—Subparagraph (A) shall not apply to any offset of a participant's benefits provided under a plan against an amount that the participant is ordered or required to pay to the plan if—

(i) the order or requirement to pay arises—

(I) under a judgment of conviction for a crime involving such plan,

(II) under a civil judgment (including a consent order or decree) entered by a court in an action brought in connection with a violation (or alleged violation) of part 4 of subtitle B of title I of the Employee Retirement Income Security Act of 1974, or

(III) pursuant to a settlement agreement between the Secretary of Labor and the participant, or a settlement agreement between the Pension Benefit Guaranty Corporation and the participant, in connection with a violation (or alleged violation) of part 4 of such subtitle by a fiduciary or any other person,

(ii) the judgment, order, decree, or settlement agreement expressly provides for the offset of all or part of the amount ordered or required to be paid to the plan against the participant's benefits provided under the plan, and

(iii) in a case in which the survivor annuity requirements of section 401(a)(11) apply with respect to distributions from the plan to the participant, if the participant has a spouse at the time at which the offset is to be made—

(I) either such spouse has consented in writing to such offset and such consent is witnessed by a notary public or representative of the plan (or it is established to the satisfaction of a plan representative that such consent may not be obtained by reason of circumstances described in section 417(a)(2)(B)), or an election to waive the right of the spouse to either a qualified joint and survivor annuity or a qualified preretirement survivor annuity is in effect in accordance with the requirements of section 417(a),

(II) such spouse is ordered or required in such judgment, order, decree, or settlement to pay an amount to the plan in connection with a violation of part 4 of such subtitle, or

(III) in such judgment, order, decree, or settlement, such spouse retains the right to receive the survivor annuity under a qualified joint and survivor annuity provided pursuant to section 401(a)(11)(A)(i) and under a qualified preretirement survivor annuity provided pursuant to section 401(a)(11)(A)(ii), determined in accordance with subparagraph (D).

A plan shall not be treated as failing to meet the requirements of this subsection, subsection (k), section 403(b), or section 409(d) solely by reason of an offset described in this subparagraph.

(D) SURVIVOR ANNUITY.—

(i) IN GENERAL.—The survivor annuity described in subparagraph (C)(iii)(III) shall be determined as if—

(I) the participant terminated employment on the date of the offset,

(II) there was no offset,

(III) the plan permitted commencement of benefits only on or after normal retirement age,

(IV) the plan provided only the minimum-required qualified joint and survivor annuity, and

(V) the amount of the qualified preretirement survivor annuity under the plan is equal to the amount of the survivor annuity payable under the minimum-required qualified joint and survivor annuity.

(ii) DEFINITION.—For purposes of this subparagraph, the term "minimum-required qualified joint and survivor annuity" means the qualified joint and survivor annuity which is the actuarial equivalent of the participant's accrued benefit (within the meaning of section 411(a)(7)) and under which the survivor annuity is 50 percent of the amount of the annuity which is payable during the joint lives of the participant and the spouse.

(14) A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that, unless the participant otherwise elects, the payment of benefits under the plan to the participant will begin not later than the 60th day after the latest of the close of the plan year in which—

(A) the date on which the participant attains the earlier of age 65 or the normal retirement age specified under the plan,

(B) occurs the 10th anniversary of the year in which the participant commenced participation in the plan, or

(C) the participant terminates his service with the employer.

In the case of a plan which provides for the payment of an early retirement benefit, a trust forming a part of such plan shall not constitute a qualified trust under this section unless a participant who satisfied the service requirements for such early retirement benefit, but separated from the service (with any nonforfeitable right to an accrued benefit) before satisfying the age requirement for such early retirement benefit, is entitled upon satisfaction of such age requirement to receive a benefit not less than the benefit to which he would be entitled at the normal retirement age, actuarially, reduced under regulations prescribed by the Secretary.

(15) A trust shall not constitute a qualified trust under this section unless under the plan of which such trust is a part—

(A) in the case of a participant or beneficiary who is receiving benefits under such plan, or

(B) in the case of a participant who is separated from the service and who has nonforfeitable rights to benefits,

such benefits are not decreased by reason of any increase in the benefit levels payable under title II of the Social Security Act or any increase in the wage base under such title II, if such increase takes place after September 2, 1974, or (if later)

the earlier of the date of first receipt of such benefits or the date of such separation, as the case may be.

(16) A trust shall not constitute a qualified trust under this section if the plan of which such trust is a part provides for benefits or contributions which exceed the limitations of section 415.

(17) COMPENSATION LIMIT.—

(A) IN GENERAL.—A trust shall not constitute a qualified trust under this section unless, under the plan of which such trust is a part, the annual compensation of each employee taken into account under the plan for any year does not exceed $200,000.

(B) COST-OF-LIVING ADJUSTMENT.—The Secretary shall adjust annually the $200,000 amount in subparagraph (A) for increases in the cost-of-living at the same time and in the same manner as adjustments under section 415(d); except that the base period shall be the calendar quarter beginning July 1, 2001, and any increase which is not a multiple of $5,000 shall be rounded to the next lowest multiple of $5,000.

(19) A trust shall not constitute a qualified trust under this section if under the plan of which such trust is a part any part of a participant's accrued benefit derived from employer contributions (whether or not otherwise nonforfeitable), is forfeitable solely because of withdrawal by such participant of any amount attributable to the benefit derived from contributions made by such participant. The preceding sentence shall not apply to the accrued benefit of any participant unless, at the time of such withdrawal, such participant has a nonforfeitable right to at least 50 percent of such accrued benefit (as determined under section 411). The first sentence of this paragraph shall not apply to the extent that an accrued benefit is permitted to be forfeited in accordance with section 411(a)(3)(D)(iii) (relating to proportional forfeitures of benefits accrued before September 2, 1974, in the event of withdrawal of certain mandatory contributions).

(20) A trust forming part of a pension plan shall not be treated as failing to constitute a qualified trust under this section merely because the pension plan of which such trust is a part makes 1 or more distributions within 1 taxable year to a distributee on account of a termination of the plan of which the trust is a part, or in the case of a profit-sharing or stock bonus plan, a complete discontinuance of contributions under such plan. This paragraph shall not apply to a defined benefit plan unless the employer maintaining such plan files a notice with the Pension Benefit Guaranty Corporation (at the time and in the manner prescribed by the Pension Benefit Guaranty Corporation) notifying the Corporation of such payment or distribution and the Corporation has approved such payment or distribution or, within 90 days after the date on which such notice was filed, has failed to disapprove such payment or distribution. For purposes of this paragraph, rules similar to the rules of section 402(a)(6)(B) (as in effect before its repeal by section 521 of the Unemployment Compensation Amendments of 1992) shall apply.

(22) If a defined contribution plan (other than a profit-sharing plan)—

(A) is established by an employer whose stock is not readily tradable on an established market, and

(B) after acquiring securities of the employer, more than 10 percent of the total assets of the plan are securities of the employer,

any trust forming part of such plan shall not constitute a qualified trust under this section unless the plan meets the requirements of subsection (e) of section 409. The requirements of subsection (e) of section 409 shall not apply to any employees of an employer who are participants in any defined contribution plan established and maintained by such employer if the stock of such employer is not readily tradable on an established market and the trade or business of such employer consists of publishing on a regular basis a newspaper for general circulation. For purposes of the preceding sentence, subsections (b), (c), (m), and (*o*) of section 414 shall not apply except for determining whether stock of the employer is not readily tradable on an established market.

(23) A stock bonus plan shall not be treated as meeting the requirements of this section unless such plan meets the requirements of subsections (h) and (*o*) of section 409, except that in applying section 409(h) for purposes of this paragraph, the term "employer securities" shall include any securities of the employer held by the plan.

(24) Any group trust which otherwise meets the requirements of this section shall not be treated as not meeting such requirements on account of the participation or inclusion in such trust of the moneys of any plan or governmental unit described in section 818(a)(6).

(25) REQUIREMENT THAT ACTUARIAL ASSUMPTIONS BE SPECIFIED.—A defined benefit plan shall not be treated as providing definitely determinable benefits unless, whenever the amount of any benefit is to be determined on the basis of actuarial assumptions, such assumptions are specified in the plan in a way which precludes employer discretion.

(26) ADDITIONAL PARTICIPATION REQUIREMENTS.—

(A) IN GENERAL.—In the case of a trust which is a part of a defined benefit plan, such trust shall not constitute a qualified trust under this subsection unless on each day of the plan year such trust benefits at least the lesser of—

(i) 50 employees of the employer, or

(ii) the greater of—

(I) 40 percent of all employees of the employer, or

(II) 2 employees (or if there is only 1 employee, such employee).

(B) TREATMENT OF EXCLUDABLE EMPLOYEES.—

(i) IN GENERAL.—A plan may exclude from consideration under this paragraph employees described in paragraphs (3) and (4)(A) of section 410(b).

(ii) SEPARATE APPLICATION FOR CERTAIN EXCLUDABLE EMPLOYEES.—If employees described in section 410(b)(4)(B) are covered under a plan which meets the

requirements of subparagraph (A) separately with respect to such employees, such employees may be excluded from consideration in determining whether any plan of the employer meets such requirements if—

(I) the benefits for such employees are provided under the same plan as benefits for other employees,

(II) the benefits provided to such employees are not greater than comparable benefits provided to other employees under the plan, and

(III) no highly compensated employee (within the meaning of section 414(q)) is included in the group of such employees for more than 1 year.

(C) SPECIAL RULE FOR COLLECTIVE BARGAINING UNITS.—Except to the extent provided in regulations, a plan covering only employees described in section 410(b)(3)(A) may exclude from consideration any employees who are not included in the unit or units in which the covered employees are included.

(D) PARAGRAPH NOT TO APPLY TO MULTIEMPLOYER PLANS.—Except to the extent provided in regulations, this paragraph shall not apply to employees in a multiemployer plan (within the meaning of section 414(f)) who are covered by collective bargaining agreements.

(E) SPECIAL RULE FOR CERTAIN DISPOSITIONS OR ACQUISITIONS.—Rules similar to the rules of section 410(b)(6)(C) shall apply for purposes of this paragraph.

(F) SEPARATE LINES OF BUSINESS.—At the election of the employer and with the consent of the Secretary, this paragraph may be applied separately with respect to each separate line of business of the employer. For purposes of this paragraph, the term "separate line of business" has the meaning given such term by section 414(r) (without regard to paragraph (2)(A) or (7) thereof).

(G) EXCEPTION FOR GOVERNMENTAL PLANS.—This paragraph shall not apply to a governmental plan (within the meaning of section 414(d)).

(H) REGULATIONS.—The Secretary may by regulation provide that any separate benefit structure, any separate trust, or any other separate arrangement is to be treated as a separate plan for purposes of applying this paragraph.

(27) DETERMINATIONS AS TO PROFIT-SHARING PLANS.—

(A) CONTRIBUTIONS NEED NOT BE BASED ON PROFITS.—The determination of whether the plan under which any contributions are made is a profit-sharing plan shall be made without regard to current or accumulated profits of the employer and without regard to whether the employer is a tax-exempt organization.

(B) PLAN MUST DESIGNATE TYPE.—In the case of a plan which is intended to be a money purchase pension plan or a profit-sharing plan, a trust forming part of such plan shall not constitute a qualified trust under this subsection unless the plan designates such intent at such time and in such manner as the Secretary may prescribe.

(28) ADDITIONAL REQUIREMENTS RELATING TO EMPLOYEE STOCK OWNERSHIP PLANS.—

(A) IN GENERAL.—In the case of a trust which is part of an employee stock ownership plan (within the meaning of section 4975(e)(7)) or a plan which meets the requirements of section 409(a), such trust shall not constitute a qualified trust under this section unless such plan meets the requirements of subparagraphs (B) and (C).

(B) DIVERSIFICATION OF INVESTMENTS.—

(i) IN GENERAL.—A plan meets the requirements of this subparagraph if each qualified participant in the plan may elect within 90 days after the close of each plan year in the qualified election period to direct the plan as to the investment of at least 25 percent of the participant's account in the plan (to the extent such portion exceeds the amount to which a prior election under this subparagraph applies). In the case of the election year in which the participant can make his last election, the preceding sentence shall be applied by substituting "50 percent" for "25 percent".

(ii) METHOD OF MEETING REQUIREMENTS.—A plan shall be treated as meeting the requirements of clause (i) if—

(I) the portion of the participant's account covered by the election under clause (i) is distributed within 90 days after the period during which the election may be made, or

(II) the plan offers at least 3 investment options (not inconsistent with regulations prescribed by the Secretary) to each participant making an election under clause (i) and within 90 days after the period during which the election may be made, the plan invests the portion of the participant's account covered by the election in accordance with such election.

(iii) QUALIFIED PARTICIPANT.—For purposes of this subparagraph, the term "qualified participant" means any employee who has completed at least 10 years of participation under the plan and has attained age 55.

(iv) QUALIFIED ELECTION PERIOD.—For purposes of this subparagraph, the term "qualified election period" means the 6-plan-year period beginning with the later of—

(I) the 1st plan year in which the individual first became a qualified participant, or

(II) the 1st plan year beginning after December 31, 1986.

For purposes of the preceding sentence, an employer may elect to treat an individual first becoming a qualified participant in the 1st plan year beginning in 1987 as having become a participant in the 1st plan year beginning in 1988.

(v) EXCEPTION.—This subparagraph shall not apply to an applicable defined contribution plan (as defined in paragraph (35)(E)).

(C) USE OF INDEPENDENT APPRAISER.—A plan meets the requirements of this subparagraph if all valuations of employer securities which are not readily tradable on an established securities market with respect to activities carried on by the plan are by an independent appraiser. For purposes of the preceding sentence, the term "independent appraiser" means any appraiser meeting requirements similar to the requirements of the regulations prescribed under section 170(a)(1).

(29) BENEFIT LIMITATIONS.—In the case of a defined benefit plan (other than a multiemployer plan or a CSEC plan) to which the requirements of section 412 apply, the trust of which the plan is a part shall not constitute a qualified trust under this subsection unless the plan meets the requirements of section 436.

(30) LIMITATIONS ON ELECTIVE DEFERRALS.—In the case of a trust which is part of a plan under which elective deferrals (within the meaning of section 402(g)(3)) may be made with respect to any individual during a calendar year, such trust shall not constitute a qualified trust under this subsection unless the plan provides that the amount of such deferrals under such plan and all other plans, contracts, or arrangements of an employer maintaining such plan may not exceed the amount of the limitation in effect under section 402(g)(1)(A) for taxable years beginning in such calendar year.

(31) DIRECT TRANSFER OF ELIGIBLE ROLLOVER DISTRIBUTIONS.—

(A) IN GENERAL.—A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that if the distributee of any eligible rollover distribution—

(i) elects to have such distribution paid directly to an eligible retirement plan, and

(ii) specifies the eligible retirement plan to which such distribution is to be paid (in such form and at such time as the plan administrator may prescribe),

such distribution shall be made in the form of a direct trustee-to-trustee transfer to the eligible retirement plan so specified.

(B) CERTAIN MANDATORY DISTRIBUTIONS.—

(i) IN GENERAL.—In case of a trust which is part of an eligible plan, such trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that if—

(I) a distribution described in clause (ii) in excess of $1,000 is made, and

(II) the distributee does not make an election under subparagraph (A) and does not elect to receive the distribution directly,

the plan administrator shall make such transfer to an individual retirement plan of a designated trustee or issuer and shall notify the distributee in writing (either separately or as part of the notice under section 402(f)) that the distribution may be transferred to another individual retirement plan.

(ii) ELIGIBLE PLAN.—For purposes of clause (i), the term "eligible plan" means a plan which provides that any nonforfeitable accrued benefit for which the present value (as determined under section 411(a)(11)) does not exceed $5,000 shall be immediately distributed to the participant.

(C) LIMITATION.—Subparagraphs (A) and (B) shall apply only to the extent that the eligible rollover distribution would be includible in gross income if not transferred as provided in subparagraph (A) (determined without regard to sections 402(c), 403(a)(4), 403(b)(8), and 457(e)(16)). The preceding sentence shall not apply to such distribution if the plan to which such distribution is transferred—

(i) is a qualified trust which is part of a plan which is a defined contribution plan and agrees to separately account for amounts so transferred, including separately accounting for the portion of such distribution which is includible in gross income and the portion of such distribution which is not so includible, or

(ii) is an eligible retirement plan described in clause (i) or (ii) of section 402(c)(8)(B).

(D) ELIGIBLE ROLLOVER DISTRIBUTION.—For purposes of this paragraph, the term "eligible rollover distribution" has the meaning given such term by section 402(f)(2)(A).

(E) ELIGIBLE RETIREMENT PLAN.—For purposes of this paragraph, the term "eligible retirement plan" has the meaning given such term by section 402(c)(8)(B), except that a qualified trust shall be considered an eligible retirement plan only if it is a defined contribution plan, the terms of which permit the acceptance of rollover distributions.

(32) TREATMENT OF FAILURE TO MAKE CERTAIN PAYMENTS IF PLAN HAS LIQUIDITY SHORTFALL.—

(A) IN GENERAL.—A trust forming part of a pension plan to which section 430(j)(4) or 433(f)(5) applies shall not be treated as failing to constitute a qualified trust under this section merely because such plan ceases to make any payment described in subparagraph (B) during any period that such plan has a liquidity shortfall (as defined in section 430(j)(4) or 433(f)(5)).

(B) PAYMENTS DESCRIBED.—A payment is described in this subparagraph if such payment is—

(i) any payment, in excess of the monthly amount paid under a single life annuity (plus any social security supplements described in the last sentence of section 411(a)(9)), to a participant or beneficiary whose annuity starting date (as defined in section 417(f)(2)) occurs during the period referred to in subparagraph (A),

(ii) any payment for the purchase of an irrevocable commitment from an insurer to pay benefits, and

(iii) any other payment specified by the Secretary by regulations.

(C) PERIOD OF SHORTFALL.—For purposes of this paragraph, a plan has a liquidity shortfall during the period

that there is an underpayment of an installment under section 430(j)(3) or 433(f) by reason of section 430(j)(4)(A) or 433(f)(5), respectively.

(33) PROHIBITION ON BENEFIT INCREASES WHILE SPONSOR IS IN BANKRUPTCY.—

(A) IN GENERAL.—A trust which is part of a plan to which this paragraph applies shall not constitute a qualified trust under this section if an amendment to such plan is adopted while the employer is a debtor in a case under title 11, United States Code, or similar Federal or State law, if such amendment increases liabilities of the plan by reason of—

(i) any increase in benefits,

(ii) any change in the accrual of benefits, or

(iii) any change in the rate at which benefits become nonforfeitable under the plan,

with respect to employees of the debtor, and such amendment is effective prior to the effective date of such employer's plan of reorganization.

(B) EXCEPTIONS.—This paragraph shall not apply to any plan amendment if—

(i) the plan, were such amendment to take effect, would have a funding target attainment percentage (as defined in section 430(d)(2)) of 100 percent or more,

(ii) the Secretary determines that such amendment is reasonable and provides for only de minimis increases in the liabilities of the plan with respect to employees of the debtor,

(iii) such amendment only repeals an amendment described in section 412(d)(2), or

(iv) such amendment is required as a condition of qualification under this part.

(C) PLANS TO WHICH THIS PARAGRAPH APPLIES.—This paragraph shall apply only to plans (other than multiemployer plans or CSEC plans) covered under section 4021 of the Employee Retirement Income Security Act of 1974.

(D) EMPLOYER.—For purposes of this paragraph, the term "employer" means the employer referred to in section 412(b)(1), without regard to section 412(b)(2).

(34) BENEFITS OF MISSING PARTICIPANTS ON PLAN TERMINATION.—In the case of a plan covered by title IV of the Employee Retirement Income Security Act of 1974, a trust forming part of such plan shall not be treated as failing to constitute a qualified trust under this section merely because the pension plan of which such trust is a part, upon its termination, transfers benefits of missing participants to the Pension Benefit Guaranty Corporation in accordance with section 4050 of such Act.

(35) DIVERSIFICATION REQUIREMENTS FOR CERTAIN DEFINED CONTRIBUTION PLANS.—

(A) IN GENERAL.—A trust which is part of an applicable defined contribution plan shall not be treated as a qualified trust unless the plan meets the diversification requirements of subparagraphs (B), (C), and (D).

(B) EMPLOYEE CONTRIBUTIONS AND ELECTIVE DEFERRALS INVESTED IN EMPLOYER SECURITIES.—In the case of the portion of an applicable individual's account attributable to employee contributions and elective deferrals which is invested in employer securities, a plan meets the requirements of this subparagraph if the applicable individual may elect to direct the plan to divest any such securities and to reinvest an equivalent amount in other investment options meeting the requirements of subparagraph (D).

(C) EMPLOYER CONTRIBUTIONS INVESTED IN EMPLOYER SECURITIES.—In the case of the portion of the account attributable to employer contributions other than elective deferrals which is invested in employer securities, a plan meets the requirements of this subparagraph if each applicable individual who—

(i) is a participant who has completed at least 3 years of service, or

(ii) is a beneficiary of a participant described in clause (i) or of a deceased participant,

may elect to direct the plan to divest any such securities and to reinvest an equivalent amount in other investment options meeting the requirements of subparagraph (D).

(D) INVESTMENT OPTIONS.—

(i) IN GENERAL.—The requirements of this subparagraph are met if the plan offers not less than 3 investment options, other than employer securities, to which an applicable individual may direct the proceeds from the divestment of employer securities pursuant to this paragraph, each of which is diversified and has materially different risk and return characteristics.

(ii) TREATMENT OF CERTAIN RESTRICTIONS AND CONDITIONS.—

(I) TIME FOR MAKING INVESTMENT CHOICES.—A plan shall not be treated as failing to meet the requirements of this subparagraph merely because the plan limits the time for divestment and reinvestment to periodic, reasonable opportunities occurring no less frequently than quarterly.

(II) CERTAIN RESTRICTIONS AND CONDITIONS NOT ALLOWED.—Except as provided in regulations, a plan shall not meet the requirements of this subparagraph if the plan imposes restrictions or conditions with respect to the investment of employer securities which are not imposed on the investment of other assets of the plan. This subclause shall not apply to any restrictions or conditions imposed by reason of the application of securities laws.

(E) APPLICABLE DEFINED CONTRIBUTION PLAN.—For purposes of this paragraph—

(i) IN GENERAL.—The term "applicable defined contribution plan" means any defined contribution plan which holds any publicly traded employer securities.

(ii) EXCEPTION FOR CERTAIN ESOPS.—Such term does not include an employee stock ownership plan if—

(I) there are no contributions to such plan (or earnings thereunder) which are held within such plan and are subject to subsection (k) or (m), and

(II) such plan is a separate plan for purposes of section 414(*l*) with respect to any other defined benefit plan or defined contribution plan maintained by the same employer or employers.

(iii) EXCEPTION FOR ONE PARTICIPANT PLANS.—Such term does not include a one-participant retirement plan.

(iv) ONE-PARTICIPANT RETIREMENT PLAN.—For purposes of clause (iii), the term "one-participant retirement plan" means a retirement plan that on the first day of the plan year—

(I) covered only one individual (or the individual and the individual's spouse) and the individual (or the individual and the individual's spouse) owned 100 percent of the plan sponsor (whether or not incorporated), or

(II) covered only one or more partners (or partners and their spouses) in the plan sponsor.

(F) CERTAIN PLANS TREATED AS HOLDING PUBLICLY TRADED EMPLOYER SECURITIES.—

(i) IN GENERAL.—Except as provided in regulations or in clause (ii), a plan holding employer securities which are not publicly traded employer securities shall be treated as holding publicly traded employer securities if any employer corporation, or any member of a controlled group of corporations which includes such employer corporation, has issued a class of stock which is a publicly traded employer security.

(ii) EXCEPTION FOR CERTAIN CONTROLLED GROUPS WITH PUBLICLY TRADED SECURITIES.—Clause (i) shall not apply to a plan if—

(I) no employer corporation, or parent corporation of an employer corporation, has issued any publicly traded employer security, and

(II) no employer corporation, or parent corporation of an employer corporation, has issued any special class of stock which grants particular rights to, or bears particular risks for, the holder or issuer with respect to any corporation described in clause (i) which has issued any publicly traded employer security.

(iii) DEFINITIONS.—For purposes of this subparagraph, the term—

(I) "controlled group of corporations" has the meaning given such term by section 1563(a), except that "50 percent" shall be substituted for "80 percent" each place it appears,

(II) "employer corporation" means a corporation which is an employer maintaining the plan, and

(III) "parent corporation" has the meaning given such term by section 424(e).

(G) OTHER DEFINITIONS.—For purposes of this paragraph—

(i) APPLICABLE INDIVIDUAL.—The term "applicable individual" means—

(I) any participant in the plan, and

(II) any beneficiary who has an account under the plan with respect to which the beneficiary is entitled to exercise the rights of a participant.

(ii) ELECTIVE DEFERRAL.—The term "elective deferral" means an employer contribution described in section 402(g)(3)(A).

(iii) EMPLOYER SECURITY.—The term "employer security" has the meaning given such term by section 407(d)(1) of the Employee Retirement Income Security Act of 1974.

(iv) EMPLOYEE STOCK OWNERSHIP PLAN.—The term "employee stock ownership plan" has the meaning given such term by section 4975(e)(7).

(v) PUBLICLY TRADED EMPLOYER SECURITIES.—The term "publicly traded employer securities" means employer securities which are readily tradable on an established securities market.

(vi) YEAR OF SERVICE.—The term "year of service" has the meaning given such term by section 411(a)(5).

(H) TRANSITION RULE FOR SECURITIES ATTRIBUTABLE TO EMPLOYER CONTRIBUTIONS.—

(i) RULES PHASED IN OVER 3 YEARS.—

(I) IN GENERAL.—In the case of the portion of an account to which subparagraph (C) applies and which consists of employer securities acquired in a plan year beginning before January 1, 2007, subparagraph (C) shall only apply to the applicable percentage of such securities. This subparagraph shall be applied separately with respect to each class of securities.

(II) EXCEPTION FOR CERTAIN PARTICIPANTS AGED 55 OR OVER.—Subclause (I) shall not apply to an applicable individual who is a participant who has attained age 55 and completed at least 3 years of service before the first plan year beginning after December 31, 2005.

(ii) APPLICABLE PERCENTAGE.—For purposes of clause (i), the applicable percentage shall be determined as follows:

(36) DISTRIBUTIONS DURING WORKING RETIREMENT.—A trust forming part of a pension plan shall not be treated as failing to constitute a qualified trust under this section solely because the plan provides that a distribution may be made from such trust to an employee who has attained age 62 and who is not separated from employment at the time of such distribution.

(37) DEATH BENEFITS UNDER USERRA-QUALIFIED ACTIVE MILITARY SERVICE.—A trust shall not constitute a qualified trust unless the plan provides that, in the case of a participant who dies while performing qualified military service (as defined in section 414(u)), the survivors of the participant are entitled to

any additional benefits (other than benefit accruals relating to the period of qualified military service) provided under the plan had the participant resumed and then terminated employment on account of death.

Paragraphs (11), (12), (13), (14), (15), (19), and (20) shall apply only in the case of a plan to which section 411 (relating to minimum vesting standards) applies without regard to subsection (e)(2) of such section.

(b) CERTAIN RETROACTIVE CHANGES IN PLAN.—A stock bonus, pension, profit-sharing, or annuity plan shall be considered as satisfying the requirements of subsection (a) for the period beginning with the date on which it was put into effect, or for the period beginning with the earlier of the date on which there was adopted or put into effect any amendment which caused the plan to fail to satisfy such requirements, and ending with the time prescribed by law for filing the return of the employer for his taxable year in which such plan or amendment was adopted (including extensions thereof) or such later time as the Secretary may designate, if all provisions of the plan which are necessary to satisfy such requirements are in effect by the end of such period and have been made effective for all purposes for the whole of such period.

(c) DEFINITIONS AND RULES RELATING TO SELF-EMPLOYED INDIVIDUALS AND OWNER-EMPLOYEES.—For purposes of this section—

(1) SELF-EMPLOYED INDIVIDUAL TREATED AS EMPLOYEE.—

(A) IN GENERAL.—The term "employee" includes, for any taxable year, an individual who is a self-employed individual for such taxable year.

(B) SELF-EMPLOYED INDIVIDUAL.—The term "self-employed individual" means, with respect to any taxable year, an individual who has earned income (as defined in paragraph (2)) for such taxable year. To the extent provided in regulations prescribed by the Secretary, such term also includes, for any taxable year—

(i) an individual who would be a self-employed individual within the meaning of the preceding sentence but for the fact that the trade or business carried on by such individual did not have net profits for the taxable year, and

(ii) an individual who has been a self-employed individual within the meaning of the preceding sentence for any prior taxable year.

(2) EARNED INCOME.—

(A) IN GENERAL.—The term "earned income" means the net earnings from self-employment (as defined in section 1402(a)), but such net earnings shall be determined—

(i) only with respect to a trade or business in which personal services of the taxpayer are a material income-producing factor,

(ii) without regard to paragraphs (4) and (5) of section 1402(c),

(iii) in the case of any individual who is treated as an employee under subparagraph (A), (C), or (D) of section 3121(d)(3), without regard to section 1402(c)(2),

(iv) without regard to items which are not included in gross income for purposes of this chapter, and the

deductions properly allocable to or chargeable against such items,

(v) with regard to the deductions allowed by section 404 to the taxpayer, and

(vi) with regard to the deduction allowed to the taxpayer by section 164(f).

For purposes of this subparagraph, section 1402, as in effect for a taxable year ending on December 31, 1962, shall be treated as having been in effect for all taxable years ending before such date. For purposes of this part only (other than sections 419 and 419A), this subparagraph shall be applied as if the term "trade or business" for purposes of section 1402 included service described in section 1402(c)(6).

(C) INCOME FROM DISPOSITION OF CERTAIN PROPERTY.—For purposes of this section, the term "earned income" includes gains (other than any gain which is treated under any provision of this chapter as gain from the sale or exchange of a capital asset) and net earnings derived from the sale or other disposition of, the transfer of any interest in, or the licensing of the use of property (other than good will) by an individual whose personal efforts created such property.

(3) OWNER-EMPLOYEE.—The term "owner-employee" means an employee who—

(A) owns the entire interest in an unincorporated trade or business, or

(B) in the case of a partnership, is a partner who owns more than 10 percent of either the capital interest or the profits interest in such partnership.

To the extent provided in regulations prescribed by the Secretary, such term also means an individual who has been an owner-employee within the meaning of the preceding sentence.

(4) EMPLOYER.—An individual who owns the entire interest in an unincorporated trade or business shall be treated as his own employer. A partnership shall be treated as the employer of each partner who is an employee within the meaning of paragraph (1).

(5) CONTRIBUTIONS ON BEHALF OF OWNER-EMPLOYEES.—The term "contribution on behalf of an owner-employee" includes, except as the context otherwise requires, a contribution under a plan—

(A) by the employer for an owner-employee, and

(B) by an owner-employee as an employee.

(6) SPECIAL RULE FOR CERTAIN FISHERMEN.—For purposes of this subsection, the term "self-employed individual" includes an individual described in section 3121(b)(20) (relating to certain fishermen).

(d) CONTRIBUTION LIMIT ON OWNER-EMPLOYEES.—A trust forming part of a pension or profit-sharing plan which provides contributions or benefits for employees some or all of whom are owner-employees shall constitute a qualified trust under this section only if, in addition to meeting the requirements of subsection (a), the plan provides that contributions on behalf of any owner-employee may be made only with respect to the earned income of such owner-em-

ployee which is derived from the trade or business with respect to which such plan is established.

(f) CERTAIN CUSTODIAL ACCOUNTS AND CONTRACTS.—For purposes of this title, a custodial account, an annuity contract, or a contract (other than a life, health or accident, property, casualty, or liability insurance contract) issued by an insurance company qualified to do business in a State shall be treated as a qualified trust under this section if—

(1) the custodial account or contract would, except for the fact that it is not a trust, constitute a qualified trust under this section, and

(2) in the case of a custodial account the assets thereof are held by a bank (as defined in section 408(n)) or another person who demonstrates, to the satisfaction of the Secretary, that the manner in which he will hold the assets will be consistent with the requirements of this section.

For purposes of this title, in the case of a custodial account or contract treated as a qualified trust under this section by reason of this subsection, the person holding the assets of such account or holding such contract shall be treated as the trustee thereof.

(g) ANNUITY DEFINED.—For purposes of this section and sections 402, 403, and 404, the term "annuity" includes a face-amount certificate, as defined in section 2(a)(15) of the Investment Company Act of 1940 (15 U.S.C., sec. 80a–2); but does not include any contract or certificate issued after December 31, 1962, which is transferable, if any person other than the trustee of a trust described in section 401(a) which is exempt from tax under section 501(a) is the owner of such contract or certificate.

(h) MEDICAL, ETC., BENEFITS FOR RETIRED EMPLOYEES AND THEIR SPOUSES AND DEPENDENTS.—Under regulations prescribed by the Secretary, and subject to the provisions of section 420, a pension or annuity plan may provide for the payment of benefits for sickness, accident, hospitalization, and medical expenses of retired employees, their spouses and their dependents, but only if—

(1) such benefits are subordinate to the retirement benefits provided by the plan,

(2) a separate account is established and maintained for such benefits,

(3) the employer's contributions to such separate account are reasonable and ascertainable,

(4) it is impossible, at any time prior to the satisfaction of all liabilities under the plan to provide such benefits, for any part of the corpus or income of such separate account to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of such benefits,

(5) notwithstanding the provisions of subsection (a)(2), upon the satisfaction of all liabilities under the plan to provide such benefits, any amount remaining in such separate account must, under the terms of the plan, be returned to the employer, and

(6) in the case of an employee who is a key employee, a separate account is established and maintained for such benefits payable to such employee (and [his spouse] *the employee's spouse* and dependents) and such benefits (to the extent attributable to plan years beginning after March 31, 1984, for which

the employee is a key employee) are only payable to such employee (and [his spouse] *the employee's spouse* and dependents) from such separate account.

For purposes of paragraph (6), the term "key employee" means any employee, who at any time during the plan year or any preceding plan year during which contributions were made on behalf of such employee, is or was a key employee as defined in section 416(i). In no event shall the requirements of paragraph (1) be treated as met if the aggregate actual contributions for medical benefits, when added to actual contributions for life insurance protection under the plan, exceed 25 percent of the total actual contributions to the plan (other than contributions to fund past service credits) after the date on which the account is established. For purposes of this subsection, the term "dependent" shall include any individual who is a child (as defined in section 152(f)(1)) of a retired employee who as of the end of the calendar year has not attained age 27.

(i) CERTAIN UNION-NEGOTIATED PENSION PLANS.—In the case of a trust forming part of a pension plan which has been determined by the Secretary to constitute a qualified trust under subsection (a) and to be exempt from taxation under section 501(a) for a period beginning after contributions were first made to or for such trust, if it is shown to the satisfaction of the Secretary that—

(1) such trust was created pursuant to a collective bargaining agreement between employee representatives and one or more employers,

(2) any disbursements of contributions, made to or for such trust before the time as of which the Secretary determined that the trust constituted a qualified trust, substantially complied with the terms of the trust, and the plan of which the trust is a part, as subsequently qualified, and

(3) before the time as of which the Secretary determined that the trust constitutes a qualified trust, the contributions to or for such trust were not used in a manner which would jeopardize the interests of its beneficiaries,

then such trust shall be considered as having constituted a qualified trust under subsection (a) and as having been exempt from taxation under section 501(a) for the period beginning on the date on which contributions were first made to or for such trust and ending on the date such trust first constituted (without regard to this subsection) a qualified trust under subsection (a).

(k) CASH OR DEFERRED ARRANGEMENTS.—

(1) GENERAL RULE.—A profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan shall not be considered as not satisfying the requirements of subsection (a) merely because the plan includes a qualified cash or deferred arrangement.

(2) QUALIFIED CASH OR DEFERRED ARRANGEMENT.—A qualified cash or deferred arrangement is any arrangement which is part of a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan which meets the requirements of subsection (a)—

(A) under which a covered employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash;

(B) under which amounts held by the trust which are attributable to employer contributions made pursuant to the employee's election—

(i) may not be distributable to participants or other beneficiaries earlier than—

(I) severance from employment, death, or disability,

(II) an event described in paragraph (10),

(III) in the case of a profit-sharing or stock bonus plan, the attainment of age 591/2,

(IV) subject to the provisions of paragraph (14), upon hardship of the employee, or

(V) in the case of a qualified reservist distribution (as defined in section 72(t)(2)(G)(iii)), the date on which a period referred to in subclause (III) of such section begins, and

(ii) will not be distributable merely by reason of the completion of a stated period of participation or the lapse of a fixed number of years;

(C) which provides that an employee's right to his accrued benefit derived from employer contributions made to the trust pursuant to his election is nonforfeitable, and

(D) which does not require, as a condition of participation in the arrangement, that an employee complete a period of service with the employer (or employers) maintaining the plan extending beyond the period permitted under section 410(a)(1) (determined without regard to subparagraph (B)(i) thereof).

(3) APPLICATION OF PARTICIPATION AND DISCRIMINATION STANDARDS.—

(A) A cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement unless—

(i) those employees eligible to benefit under the arrangement satisfy the provisions of section 410(b)(1), and

(ii) the actual deferral percentage for eligible highly compensated employees (as defined in paragraph (5)) for the plan year bears a relationship to the actual deferral percentage for all other eligible employees for the preceding plan year which meets either of the following tests:

(I) The actual deferral percentage for the group of eligible highly compensated employees is not more than the actual deferral percentage of all other eligible employees multiplied by 1.25.

(II) The excess of the actual deferral percentage for the group of eligible highly compensated employees over that of all other eligible employees is not more than 2 percentage points, and the actual deferral percentage for the group of eligible highly compensated employees is not more than the actual deferral percentage of all other eligible employees multiplied by 2.

If 2 or more plans which include cash or deferred arrangements are considered as 1 plan for purposes of section

401(a)(4) or 410(b), the cash or deferred arrangements included in such plans shall be treated as 1 arrangement for purposes of this subparagraph.

If any highly compensated employee is a participant under 2 or more cash or deferred arrangements of the employer, for purposes of determining the deferral percentage with respect to such employee, all such cash or deferred arrangements shall be treated as 1 cash or deferred arrangement. An arrangement may apply clause (ii) by using the plan year rather than the preceding plan year if the employer so elects, except that if such an election is made, it may not be changed except as provided by the Secretary.

(B) For purposes of subparagraph (A), the actual deferral percentage for a specified group of employees for a plan year shall be the average of the ratios (calculated separately for each employee in such group) of—

(i) the amount of employer contributions actually paid over to the trust on behalf of each such employee for such plan year, to

(ii) the employee's compensation for such plan year.

(C) A cash or deferred arrangement shall be treated as meeting the requirements of subsection (a)(4) with respect to contributions if the requirements of subparagraph (A)(ii) are met.

(D) For purposes of subparagraph (B), the employer contributions on behalf of any employee—

(i) shall include any employer contributions made pursuant to the employee's election under paragraph (2), and

(ii) under such rules as the Secretary may prescribe, may, at the election of the employer, include—

(I) matching contributions (as defined in 401(m)(4)(A)) which meet the requirements of paragraph (2)(B) and (C), and

(II) qualified nonelective contributions (within the meaning of section 401(m)(4)(C)).

(E) For purposes of this paragraph, in the case of the first plan year of any plan (other than a successor plan), the amount taken into account as the actual deferral percentage of nonhighly compensated employees for the preceding plan year shall be—

(i) 3 percent, or

(ii) if the employer makes an election under this subclause, the actual deferral percentage of nonhighly compensated employees determined for such first plan year.

(F) SPECIAL RULE FOR EARLY PARTICIPATION.—If an employer elects to apply section 410(b)(4)(B) in determining whether a cash or deferred arrangement meets the requirements of subparagraph (A)(i), the employer may, in determining whether the arrangement meets the requirements of subparagraph (A)(ii), exclude from consideration all eligible employees (other than highly compensated employees) who have not met the minimum age and service requirements of section 410(a)(1)(A).

(G) GOVERNMENTAL PLAN.—A governmental plan (within the meaning of section 414(d)) shall be treated as meeting the requirements of this paragraph.

(4) OTHER REQUIREMENTS.—

(A) BENEFITS (OTHER THAN MATCHING CONTRIBUTIONS) MUST NOT BE CONTINGENT ON ELECTION TO DEFER.—A cash or deferred arrangement of any employer shall not be treated as a qualified cash or deferred arrangement if any other benefit is conditioned (directly or indirectly) on the employee electing to have the employer make or not make contributions under the arrangement in lieu of receiving cash. The preceding sentence shall not apply to any matching contribution (as defined in section 401(m)) made by reason of such an election.

(B) ELIGIBILITY OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.—

(i) TAX-EXEMPTS ELIGIBLE.—Except as provided in clause (ii), any organization exempt from tax under this subtitle may include a qualified cash or deferred arrangement as part of a plan maintained by it.

(ii) GOVERNMENTS INELIGIBLE.—A cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement if it is part of a plan maintained by a State or local government or political subdivision thereof, or any agency or instrumentality thereof. This clause shall not apply to a rural cooperative plan or to a plan of an employer described in clause (iii).

(iii) TREATMENT OF INDIAN TRIBAL GOVERNMENTS.—An employer which is an Indian tribal government (as defined in section 7701(a)(40)), a subdivision of an Indian tribal government (determined in accordance with section 7871(d)), an agency or instrumentality of an Indian tribal government or subdivision thereof, or a corporation chartered under Federal, State, or tribal law which is owned in whole or in part by any of the foregoing may include a qualified cash or deferred arrangement as part of a plan maintained by the employer.

(C) COORDINATION WITH OTHER PLANS.—Except as provided in section 401(m), any employer contribution made pursuant to an employee's election under a qualified cash or deferred arrangement shall not be taken into account for purposes of determining whether any other plan meets the requirements of section 401(a) or 410(b). This subparagraph shall not apply for purposes of determining whether a plan meets the average benefit requirement of section 410(b)(2)(A)(ii).

(5) HIGHLY COMPENSATED EMPLOYEE.—For purposes of this subsection, the term "highly compensated employee" has the meaning given such term by section 414(q).

(6) PRE-ERISA MONEY PURCHASE PLAN.—For purposes of this subsection, the term "pre-ERISA money purchase plan" means a pension plan—

(A) which is a defined contribution plan (as defined in section 414(i)),

(B) which was in existence on June 27, 1974, and which, on such date, included a salary reduction arrangement, and

(C) under which neither the employee contributions nor the employer contributions may exceed the levels provided for by the contribution formula in effect under the plan on such date.

(7) RURAL COOPERATIVE PLAN.—For purposes of this subsection—

(A) IN GENERAL.—The term "rural cooperative plan" means any pension plan—

(i) which is a defined contribution plan (as defined in section 414(i)), and

(ii) which is established and maintained by a rural cooperative.

(B) RURAL COOPERATIVE DEFINED.—For purposes of subparagraph (A), the term "rural cooperative" means—

(i) any organization which—

(I) is engaged primarily in providing electric service on a mutual or cooperative basis, or

(II) is engaged primarily in providing electric service to the public in its area of service and which is exempt from tax under this subtitle or which is a State or local government (or an agency or instrumentality thereof), other than a municipality (or an agency or instrumentality thereof),

(ii) any organization described in paragraph (4) or (6) of section 501(c) and at least 80 percent of the members of which are organizations described in clause (i),

(iii) a cooperative telephone company described in section 501(c)(12),

(iv) any organization which—

(I) is a mutual irrigation or ditch company described in section 501(c)(12) (without regard to the 85 percent requirement thereof), or

(II) is a district organized under the laws of a State as a municipal corporation for the purpose of irrigation, water conservation, or drainage, and

(v) an organization which is a national association of organizations described in clause (i), (ii),, (iii), or (iv).

(C) SPECIAL RULE FOR CERTAIN DISTRIBUTIONS.—A rural cooperative plan which includes a qualified cash or deferred arrangement shall not be treated as violating the requirements of section 401(a) or of paragraph (2) merely by reason of a hardship distribution or a distribution to a participant after attainment of age 591/2. For purposes of this section, the term "hardship distribution" means a distribution described in paragraph (2)(B)(i)(IV) (without regard to the limitation of its application to profit-sharing or stock bonus plans).

(8) ARRANGEMENT NOT DISQUALIFIED IF EXCESS CONTRIBUTIONS DISTRIBUTED.—

(A) IN GENERAL.—A cash or deferred arrangement shall not be treated as failing to meet the requirements of clause (ii) of paragraph (3)(A) for any plan year if, before the close of the following plan year—

(i) the amount of the excess contributions for such plan year (and any income allocable to such contributions through the end of such year) is distributed, or

(ii) to the extent provided in regulations, the employee elects to treat the amount of the excess contributions as an amount distributed to the employee and then contributed by the employee to the plan.

Any distribution of excess contributions (and income) may be made without regard to any other provision of law.

(B) EXCESS CONTRIBUTIONS.—For purposes of subparagraph (A), the term "excess contributions" means, with respect to any plan year, the excess of—

(i) the aggregate amount of employer contributions actually paid over to the trust on behalf of highly compensated employees for such plan year, over

(ii) the maximum amount of such contributions permitted under the limitations of clause (ii) of paragraph (3)(A) (determined by reducing contributions made on behalf of highly compensated employees in order of the actual deferral percentages beginning with the highest of such percentages).

(C) METHOD OF DISTRIBUTING EXCESS CONTRIBUTIONS.—Any distribution of the excess contributions for any plan year shall be made to highly compensated employees on the basis of the amount of contributions by, or on behalf of, each of such employees.

(D) ADDITIONAL TAX UNDER SECTION 72(T) NOT TO APPLY.—No tax shall be imposed under section 72(t) on any amount required to be distributed under this paragraph.

(E) TREATMENT OF MATCHING CONTRIBUTIONS FORFEITED BY REASON OF EXCESS DEFERRAL OR CONTRIBUTION OR PERMISSIBLE WITHDRAWAL.—For purposes of paragraph (2)(C), a matching contribution (within the meaning of subsection (m)) shall not be treated as forfeitable merely because such contribution is forfeitable if the contribution to which the matching contribution relates is treated as an excess contribution under subparagraph (B), an excess deferral under section 402(g)(2)(A), a permissible withdrawal under section 414(w), or an excess aggregate contribution under section 401(m)(6)(B).

(F) CROSS REFERENCE.—For excise tax on certain excess contributions, see section 4979.

(9) COMPENSATION.—For purposes of this subsection, the term "compensation" has the meaning given such term by section 414(s).

(10) DISTRIBUTIONS UPON TERMINATION OF PLAN.—

(A) IN GENERAL.—An event described in this subparagraph is the termination of the plan without establishment or maintenance of another defined contribution plan (other

than an employee stock ownership plan as defined in section 4975(e)(7)).

(B) DISTRIBUTIONS MUST BE LUMP SUM DISTRIBUTIONS.—

(i) IN GENERAL.—A termination shall not be treated as described in subparagraph (A) with respect to any employee unless the employee receives a lump sum distribution by reason of the termination.

(ii) LUMP-SUM DISTRIBUTION.—For purposes of this subparagraph, the term "lump-sum distribution" has the meaning given such term by section 402(e)(4)(D) (without regard to subclauses (I), (II), (III), and (IV) of clause (i) thereof). Such term includes a distribution of an annuity contract from—

(I) a trust which forms a part of a plan described in section 401(a) and which is exempt from tax under section 501(a), or

(II) an annuity plan described in section 403(a).

(11) ADOPTION OF SIMPLE PLAN TO MEET NONDISCRIMINATION TESTS.—

(A) IN GENERAL.—A cash or deferred arrangement maintained by an eligible employer shall be treated as meeting the requirements of paragraph (3)(A)(ii) if such arrangement meets—

(i) the contribution requirements of subparagraph (B),

(ii) the exclusive plan requirements of subparagraph (C), and

(iii) the vesting requirements of section 408(p)(3).

(B) CONTRIBUTION REQUIREMENTS.—

(i) IN GENERAL.—The requirements of this subparagraph are met if, under the arrangement—

(I) an employee may elect to have the employer make elective contributions for the year on behalf of the employee to a trust under the plan in an amount which is expressed as a percentage of compensation of the employee but which in no event exceeds the amount in effect under section 408(p)(2)(A)(ii),

(II) the employer is required to make a matching contribution to the trust for the year in an amount equal to so much of the amount the employee elects under subclause (I) as does not exceed 3 percent of compensation for the year, and

(III) no other contributions may be made other than contributions described in subclause (I) or (II).

(ii) EMPLOYER MAY ELECT 2-PERCENT NONELECTIVE CONTRIBUTION.—An employer shall be treated as meeting the requirements of clause (i)(II) for any year if, in lieu of the contributions described in such clause, the employer elects (pursuant to the terms of the arrangement) to make nonelective contributions of 2 percent of compensation for each employee who is eligible to participate in the arrangement and who has at least $5,000 of compensation from the employer for the

year. If an employer makes an election under this subparagraph for any year, the employer shall notify employees of such election within a reasonable period of time before the 60th day before the beginning of such year.

(iii) ADMINISTRATIVE REQUIREMENTS.—

(I) IN GENERAL.—Rules similar to the rules of subparagraphs (B) and (C) of section 408(p)(5) shall apply for purposes of this subparagraph.

(II) NOTICE OF ELECTION PERIOD.—The requirements of this subparagraph shall not be treated as met with respect to any year unless the employer notifies each employee eligible to participate, within a reasonable period of time before the 60th day before the beginning of such year (and, for the first year the employee is so eligible, the 60th day before the first day such employee is so eligible), of the rules similar to the rules of section 408(p)(5)(C) which apply by reason of subclause (I).

(C) EXCLUSIVE PLAN REQUIREMENT.—The requirements of this subparagraph are met for any year to which this paragraph applies if no contributions were made, or benefits were accrued, for services during such year under any qualified plan of the employer on behalf of any employee eligible to participate in the cash or deferred arrangement, other than contributions described in subparagraph (B).

(D) DEFINITIONS AND SPECIAL RULE.—

(i) DEFINITIONS.—For purposes of this paragraph, any term used in this paragraph which is also used in section 408(p) shall have the meaning given such term by such section.

(ii) COORDINATION WITH TOP-HEAVY RULES.—A plan meeting the requirements of this paragraph for any year shall not be treated as a top-heavy plan under section 416 for such year if such plan allows only contributions required under this paragraph.

(12) ALTERNATIVE METHODS OF MEETING NONDISCRIMINATION REQUIREMENTS.—

(A) IN GENERAL.—A cash or deferred arrangement shall be treated as meeting the requirements of paragraph (3)(A)(ii) if such arrangement—

(i) meets the contribution requirements of subparagraph (B) or (C), and

(ii) meets the notice requirements of subparagraph (D).

(B) MATCHING CONTRIBUTIONS.—

(i) IN GENERAL.—The requirements of this subparagraph are met if, under the arrangement, the employer makes matching contributions on behalf of each employee who is not a highly compensated employee in an amount equal to—

(I) 100 percent of the elective contributions of the employee to the extent such elective contribu-

tions do not exceed 3 percent of the employee's compensation, and

(II) 50 percent of the elective contributions of the employee to the extent that such elective contributions exceed 3 percent but do not exceed 5 percent of the employee's compensation.

(ii) RATE FOR HIGHLY COMPENSATED EMPLOYEES.—The requirements of this subparagraph are not met if, under the arrangement, the rate of matching contribution with respect to any elective contribution of a highly compensated employee at any rate of elective contribution is greater than that with respect to an employee who is not a highly compensated employee.

(iii) ALTERNATIVE PLAN DESIGNS.—If the rate of any matching contribution with respect to any rate of elective contribution is not equal to the percentage required under clause (i), an arrangement shall not be treated as failing to meet the requirements of clause (i) if—

(I) the rate of an employer's matching contribution does not increase as an employee's rate of elective contributions increase, and

(II) the aggregate amount of matching contributions at such rate of elective contribution is at least equal to the aggregate amount of matching contributions which would be made if matching contributions were made on the basis of the percentages described in clause (i).

(C) NONELECTIVE CONTRIBUTIONS.—The requirements of this subparagraph are met if, under the arrangement, the employer is required, without regard to whether the employee makes an elective contribution or employee contribution, to make a contribution to a defined contribution plan on behalf of each employee who is not a highly compensated employee and who is eligible to participate in the arrangement in an amount equal to at least 3 percent of the employee's compensation.

(D) NOTICE REQUIREMENT.—An arrangement meets the requirements of this paragraph if, under the arrangement, each employee eligible to participate is, within a reasonable period before any year, given written notice of the employee's rights and obligations under the arrangement which—

(i) is sufficiently accurate and comprehensive to apprise the employee of such rights and obligations, and

(ii) is written in a manner calculated to be understood by the average employee eligible to participate.

(E) OTHER REQUIREMENTS.—

(i) WITHDRAWAL AND VESTING RESTRICTIONS.—An arrangement shall not be treated as meeting the requirements of subparagraph (B) or (C) of this paragraph unless the requirements of subparagraphs (B) and (C) of paragraph (2) are met with respect to all employer contributions (including matching contributions) taken into account in determining whether the

requirements of subparagraphs (B) and (C) of this paragraph are met.

(ii) SOCIAL SECURITY AND SIMILAR CONTRIBUTIONS NOT TAKEN INTO ACCOUNT.—An arrangement shall not be treated as meeting the requirements of subparagraph (B) or (C) unless such requirements are met without regard to subsection (*l*), and, for purposes of subsection (*l*), employer contributions under subparagraph (B) or (C) shall not be taken into account.

(F) OTHER PLANS.—An arrangement shall be treated as meeting the requirements under subparagraph (A)(i) if any other plan maintained by the employer meets such requirements with respect to employees eligible under the arrangement.

(13) ALTERNATIVE METHOD FOR AUTOMATIC CONTRIBUTION ARRANGEMENTS TO MEET NONDISCRIMINATION REQUIREMENTS.—

(A) IN GENERAL.—A qualified automatic contribution arrangement shall be treated as meeting the requirements of paragraph (3)(A)(ii).

(B) QUALIFIED AUTOMATIC CONTRIBUTION ARRANGEMENT.—For purposes of this paragraph, the term "qualified automatic contribution arrangement" means any cash or deferred arrangement which meets the requirements of subparagraphs (C) through (E).

(C) AUTOMATIC DEFERRAL.—

(i) IN GENERAL.—The requirements of this subparagraph are met if, under the arrangement, each employee eligible to participate in the arrangement is treated as having elected to have the employer make elective contributions in an amount equal to a qualified percentage of compensation.

(ii) ELECTION OUT.—The election treated as having been made under clause (i) shall cease to apply with respect to any employee if such employee makes an affirmative election—

(I) to not have such contributions made, or

(II) to make elective contributions at a level specified in such affirmative election.

(iii) QUALIFIED PERCENTAGE.—For purposes of this subparagraph, the term "qualified percentage" means, with respect to any employee, any percentage determined under the arrangement if such percentage is applied uniformly, does not exceed 10 percent, and is at least—

(I) 3 percent during the period ending on the last day of the first plan year which begins after the date on which the first elective contribution described in clause (i) is made with respect to such employee,

(II) 4 percent during the first plan year following the plan year described in subclause (I),

(III) 5 percent during the second plan year following the plan year described in subclause (I), and

(IV) 6 percent during any subsequent plan year.

(iv) AUTOMATIC DEFERRAL FOR CURRENT EMPLOYEES NOT REQUIRED.—Clause (i) may be applied without taking into account any employee who—

(I) was eligible to participate in the arrangement (or a predecessor arrangement) immediately before the date on which such arrangement becomes a qualified automatic contribution arrangement (determined after application of this clause), and

(II) had an election in effect on such date either to participate in the arrangement or to not participate in the arrangement.

(D) MATCHING OR NONELECTIVE CONTRIBUTIONS.—

(i) IN GENERAL.—The requirements of this subparagraph are met if, under the arrangement, the employer—

(I) makes matching contributions on behalf of each employee who is not a highly compensated employee in an amount equal to the sum of 100 percent of the elective contributions of the employee to the extent that such contributions do not exceed 1 percent of compensation plus 50 percent of so much of such contributions as exceed 1 percent but do not exceed 6 percent of compensation, or

(II) is required, without regard to whether the employee makes an elective contribution or employee contribution, to make a contribution to a defined contribution plan on behalf of each employee who is not a highly compensated employee and who is eligible to participate in the arrangement in an amount equal to at least 3 percent of the employee's compensation.

(ii) APPLICATION OF RULES FOR MATCHING CONTRIBUTIONS.—The rules of clauses (ii) and (iii) of paragraph (12)(B) shall apply for purposes of clause (i)(I).

(iii) WITHDRAWAL AND VESTING RESTRICTIONS.—An arrangement shall not be treated as meeting the requirements of clause (i) unless, with respect to employer contributions (including matching contributions) taken into account in determining whether the requirements of clause (i) are met—

(I) any employee who has completed at least 2 years of service (within the meaning of section 411(a)) has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from such employer contributions, and

(II) the requirements of subparagraph (B) of paragraph (2) are met with respect to all such employer contributions.

(iv) APPLICATION OF CERTAIN OTHER RULES.—The rules of subparagraphs (E)(ii) and (F) of paragraph (12) shall apply for purposes of subclauses (I) and (II) of clause (i).

(E) NOTICE REQUIREMENTS.—

(i) IN GENERAL.—The requirements of this subparagraph are met if, within a reasonable period before each plan year, each employee eligible to participate in the arrangement for such year receives written notice of the employee's rights and obligations under the arrangement which—

(I) is sufficiently accurate and comprehensive to apprise the employee of such rights and obligations, and

(II) is written in a manner calculated to be understood by the average employee to whom the arrangement applies.

(ii) TIMING AND CONTENT REQUIREMENTS.—A notice shall not be treated as meeting the requirements of clause (i) with respect to an employee unless—

(I) the notice explains the employee's right under the arrangement to elect not to have elective contributions made on the employee's behalf (or to elect to have such contributions made at a different percentage),

(II) in the case of an arrangement under which the employee may elect among 2 or more investment options, the notice explains how contributions made under the arrangement will be invested in the absence of any investment election by the employee, and

(III) the employee has a reasonable period of time after receipt of the notice described in subclauses (I) and (II) and before the first elective contribution is made to make either such election.

(14) SPECIAL RULES RELATING TO HARDSHIP WITHDRAWALS.—For purposes of paragraph (2)(B)(i)(IV)—

(A) AMOUNTS WHICH MAY BE WITHDRAWN.—The following amounts may be distributed upon hardship of the employee:

(i) Contributions to a profit-sharing or stock bonus plan to which section 402(e)(3) applies.

(ii) Qualified nonelective contributions (as defined in subsection (m)(4)(C)).

(iii) Qualified matching contributions described in paragraph (3)(D)(ii)(I).

(iv) Earnings on any contributions described in clause (i), (ii), or (iii).

(B) NO REQUIREMENT TO TAKE AVAILABLE LOAN.—A distribution shall not be treated as failing to be made upon the hardship of an employee solely because the employee does not take any available loan under the plan.

(l) PERMITTED DISPARITY IN PLAN CONTRIBUTIONS OR BENEFITS.—

(1) IN GENERAL.—The requirements of this subsection are met with respect to a plan if—

(A) in the case of a defined contribution plan, the requirements of paragraph (2) are met, and

(B) in the case of a defined benefit plan, the requirements of paragraph (3) are met.

(2) DEFINED CONTRIBUTION PLAN.—

(A) IN GENERAL.—A defined contribution plan meets the requirements of this paragraph if the excess contribution percentage does not exceed the base contribution percentage by more than the lesser of—

(i) the base contribution percentage, or

(ii) the greater of—

(I) 5.7 percentage points, or

(II) the percentage equal to the portion of the rate of tax under section 3111(a) (in effect as of the beginning of the year) which is attributable to old-age insurance.

(B) CONTRIBUTION PERCENTAGES.—For purposes of this paragraph—

(i) EXCESS CONTRIBUTION PERCENTAGE.—The term "excess contribution percentage" means the percentage of compensation which is contributed by the employer under the plan with respect to that portion of each participant's compensation in excess of the integration level.

(ii) BASE CONTRIBUTION PERCENTAGE.—The term "base contribution percentage" means the percentage of compensation contributed by the employer under the plan with respect to that portion of each participant's compensation not in excess of the integration level.

(3) DEFINED BENEFIT PLAN.—A defined benefit plan meets the requirements of this paragraph if—

(A) EXCESS PLANS.—

(i) IN GENERAL.—In the case of a plan other than an offset plan—

(I) the excess benefit percentage does not exceed the base benefit percentage by more than the maximum excess allowance,

(II) any optional form of benefit, preretirement benefit, actuarial factor, or other benefit or feature provided with respect to compensation in excess of the integration level is provided with respect to compensation not in excess of such level, and

(III) benefits are based on average annual compensation.

(ii) BENEFIT PERCENTAGES.—For purposes of this subparagraph, the excess and base benefit percentages shall be computed in the same manner as the excess and base contribution percentages under paragraph (2)(B), except that such determination shall be made on the basis of benefits attributable to employer contributions rather than contributions.

(B) OFFSET PLANS.—In the case of an offset plan, the plan provides that—

(i) a participant's accrued benefit attributable to employer contributions (within the meaning of section 411(c)(1)) may not be reduced (by reason of the offset) by more than the maximum offset allowance, and

(ii) benefits are based on average annual compensation.

(4) DEFINITIONS RELATING TO PARAGRAPH (3).—For purposes of paragraph (3)—

(A) MAXIMUM EXCESS ALLOWANCE.—The maximum excess allowance is equal to—

(i) in the case of benefits attributable to any year of service with the employer taken into account under the plan, 3/4 of a percentage point, and

(ii) in the case of total benefits, 3/4 of a percentage point, multiplied by the participant's years of service (not in excess of 35) with the employer taken into account under the plan.

In no event shall the maximum excess allowance exceed the base benefit percentage.

(B) MAXIMUM OFFSET ALLOWANCE.—The maximum offset allowance is equal to—

(i) in the case of benefits attributable to any year of service with the employer taken into account under the plan, 3/4 percent of the participant's final average compensation, and

(ii) in the case of total benefits, 3/4 percent of the participant's final average compensation, multiplied by the participant's years of service (not in excess of 35) with the employer taken into account under the plan.

In no event shall the maximum offset allowance exceed 50 percent of the benefit which would have accrued without regard to the offset reduction.

(C) REDUCTIONS.—

(i) IN GENERAL.—The Secretary shall prescribe regulations requiring the reduction of the 3/4 percentage factor under subparagraph (A) or (B)—

(I) in the case of a plan other than an offset plan which has an integration level in excess of covered compensation, or

(II) with respect to any participant in an offset plan who has final average compensation in excess of covered compensation.

(ii) BASIS OF REDUCTIONS.—Any reductions under clause (i) shall be based on the percentages of compensation replaced by the employer-derived portions of primary insurance amounts under the Social Security Act for participants with compensation in excess of covered compensation.

(D) OFFSET PLAN.—The term "offset plan" means any plan with respect to which the benefit attributable to employer contributions for each participant is reduced by an amount specified in the plan.

(5) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

(A) INTEGRATION LEVEL.—

(i) IN GENERAL.—The term "integration level" means the amount of compensation specified under the plan (by dollar amount or formula) at or below which the rate at which contributions or benefits are provided

(expressed as a percentage) is less than such rate above such amount.

(ii) LIMITATION.—The integration level for any year may not exceed the contribution and benefit base in effect under section 230 of the Social Security Act for such year.

(iii) LEVEL TO APPLY TO ALL PARTICIPANTS.—A plan's integration level shall apply with respect to all participants in the plan.

(iv) MULTIPLE INTEGRATION LEVELS.—Under rules prescribed by the Secretary, a defined benefit plan may specify multiple integration levels.

(B) COMPENSATION.—The term "compensation" has the meaning given such term by section 414(s).

(C) AVERAGE ANNUAL COMPENSATION.—The term "average annual compensation" means the participant's highest average annual compensation for—

(i) any period of at least 3 consecutive years, or

(ii) if shorter, the participant's full period of service.

(D) FINAL AVERAGE COMPENSATION.—

(i) IN GENERAL.—The term "final average compensation" means the participant's average annual compensation for—

(I) the 3-consecutive year period ending with the current year, or

(II) if shorter, the participant's full period of service.

(ii) LIMITATION.—A participant's final average compensation shall be determined by not taking into account in any year compensation in excess of the contribution and benefit base in effect under section 230 of the Social Security Act for such year.

(E) COVERED COMPENSATION.—

(i) IN GENERAL.—The term "covered compensation" means, with respect to an employee, the average of the contribution and benefit bases in effect under section 230 of the Social Security Act for each year in the 35-year period ending with the year in which the employee attains the social security retirement age.

(ii) COMPUTATION FOR ANY YEAR.—For purposes of clause (i), the determination for any year preceding the year in which the employee attains the social security retirement age shall be made by assuming that there is no increase in the bases described in clause (i) after the determination year and before the employee attains the social security retirement age.

(iii) SOCIAL SECURITY RETIREMENT AGE.—For purposes of this subparagraph, the term "social security retirement age" has the meaning given such term by section 415(b)(8).

(F) REGULATIONS.—The Secretary shall prescribe such regulations as are necessary or appropriate to carry out the purposes of this subsection, including—

(i) in the case of a defined benefit plan which provides for unreduced benefits commencing before the

social security retirement age (as defined in section 415(b)(8)), rules providing for the reduction of the maximum excess allowance and the maximum offset allowance, and

(ii) in the case of an employee covered by 2 or more plans of the employer which fail to meet the requirements of subsection (a)(4) (without regard to this subsection), rules preventing the multiple use of the disparity permitted under this subsection with respect to any employee.

For purposes of clause (i), unreduced benefits shall not include benefits for disability (within the meaning of section 223(d) of the Social Security Act).

(6) SPECIAL RULE FOR PLAN MAINTAINED BY RAILROADS.—In determining whether a plan which includes employees of a railroad employer who are entitled to benefits under the Railroad Retirement Act of 1974 meets the requirements of this subsection, rules similar to the rules set forth in this subsection shall apply. Such rules shall take into account the employer-derived portion of the employees' tier 2 railroad retirement benefits and any supplemental annuity under the Railroad Retirement Act of 1974.

(m) NONDISCRIMINATION TEST FOR MATCHING CONTRIBUTIONS AND EMPLOYEE CONTRIBUTIONS.—

(1) IN GENERAL.—A defined contribution plan shall be treated as meeting the requirements of subsection (a)(4) with respect to the amount of any matching contribution or employee contribution for any plan year only if the contribution percentage requirement of paragraph (2) of this subsection is met for such plan year.

(2) REQUIREMENTS.—

(A) CONTRIBUTION PERCENTAGE REQUIREMENT.—A plan meets the contribution percentage requirement of this paragraph for any plan year only if the contribution percentage for eligible highly compensated employees for such plan year does not exceed the greater of—

(i) 125 percent of such percentage for all other eligible employees for the preceding plan year, or

(ii) the lesser of 200 percent of such percentage for all other eligible employees for the preceding plan year, or such percentage for all other eligible employees for the preceding plan year plus 2 percentage points.

This subparagraph may be applied by using the plan year rather than the preceding plan year if the employer so elects, except that if such an election is made, it may not be changed except as provided by the Secretary.

(B) MULTIPLE PLANS TREATED AS A SINGLE PLAN.—If two or more plans of an employer to which matching contributions, employee contributions, or elective deferrals are made are treated as one plan for purposes of section 410(b), such plans shall be treated as one plan for purposes of this subsection. If a highly compensated employee participates in two or more plans of an employer to which contributions to which this subsection applies are made,

all such contributions shall be aggregated for purposes of this subsection.

(3) CONTRIBUTION PERCENTAGE.—For purposes of paragraph (2), the contribution percentage for a specified group of employees for a plan year shall be the average of the ratios (calculated separately for each employee in such group) of—

(A) the sum of the matching contributions and employee contributions paid under the plan on behalf of each such employee for such plan year, to

(B) the employee's compensation (within the meaning of section 414(s)) for such plan year.

Under regulations, an employer may elect to take into account (in computing the contribution percentage) elective deferrals and qualified nonelective contributions under the plan or any other plan of the employer. If matching contributions are taken into account for purposes of subsection (k)(3)(A)(ii) for any plan year, such contributions shall not be taken into account under subparagraph (A) for such year. Rules similar to the rules of subsection (k)(3)(E) shall apply for purposes of this subsection.

(4) DEFINITIONS.—For purposes of this subsection—

(A) MATCHING CONTRIBUTION.—The term "matching contribution" means—

(i) any employer contribution made to a defined contribution plan on behalf of an employee on account of an employee contribution made by such employee, and

(ii) any employer contribution made to a defined contribution plan on behalf of an employee on account of an employee's elective deferral.

(B) ELECTIVE DEFERRAL.—The term "elective deferral" means any employer contribution described in section 402(g)(3).

(C) QUALIFIED NONELECTIVE CONTRIBUTIONS.—The term "qualified nonelective contribution" means any employer contribution (other than a matching contribution) with respect to which—

(i) the employee may not elect to have the contribution paid to the employee in cash instead of being contributed to the plan, and

(ii) the requirements of subparagraphs (B) and (C) of subsection (k)(2) are met.

(5) EMPLOYEES TAKEN INTO CONSIDERATION.—

(A) IN GENERAL.—Any employee who is eligible to make an employee contribution (or, if the employer takes elective contributions into account, elective contributions) or to receive a matching contribution under the plan being tested under paragraph (1) shall be considered an eligible employee for purposes of this subsection.

(B) CERTAIN NONPARTICIPANTS.—If an employee contribution is required as a condition of participation in the plan, any employee who would be a participant in the plan if such employee made such a contribution shall be treated as an eligible employee on behalf of whom no employer contributions are made.

(C) SPECIAL RULE FOR EARLY PARTICIPATION.—If an employer elects to apply section 410(b)(4)(B) in determining

whether a plan meets the requirements of section 410(b), the employer may, in determining whether the plan meets the requirements of paragraph (2), exclude from consideration all eligible employees (other than highly compensated employees) who have not met the minimum age and service requirements of section 410(a)(1)(A).

(6) PLAN NOT DISQUALIFIED IF EXCESS AGGREGATE CONTRIBUTIONS DISTRIBUTED BEFORE END OF FOLLOWING PLAN YEAR.—

(A) IN GENERAL.—A plan shall not be treated as failing to meet the requirements of paragraph (1) for any plan year if, before the close of the following plan year, the amount of the excess aggregate contributions for such plan year (and any income allocable to such contributions through the end of such year) is distributed (or, if forfeitable, is forfeited). Such contributions (and such income) may be distributed without regard to any other provision of law.

(B) EXCESS AGGREGATE CONTRIBUTIONS.—For purposes of subparagraph (A), the term "excess aggregate contributions" means, with respect to any plan year, the excess of—

(i) the aggregate amount of the matching contributions and employee contributions (and any qualified nonelective contribution or elective contribution taken into account in computing the contribution percentage) actually made on behalf of highly compensated employees for such plan year, over

(ii) the maximum amount of such contributions permitted under the limitations of paragraph (2)(A) (determined by reducing contributions made on behalf of highly compensated employees in order of their contribution percentages beginning with the highest of such percentages).

(C) METHOD OF DISTRIBUTING EXCESS AGGREGATE CONTRIBUTIONS.—Any distribution of the excess aggregate contributions for any plan year shall be made to highly compensated employees on the basis of the amount of contributions on behalf of, or by, each such employee. Forfeitures of excess aggregate contributions may not be allocated to participants whose contributions are reduced under this paragraph.

(D) COORDINATION WITH SUBSECTION (K) AND 402(G).—The determination of the amount of excess aggregate contributions with respect to a plan shall be made after—

(i) first determining the excess deferrals (within the meaning of section 402(g)), and

(ii) then determining the excess contributions under subsection (k).

(7) TREATMENT OF DISTRIBUTIONS.—

(A) ADDITIONAL TAX OF SECTION 72(T) NOT APPLICABLE.—No tax shall be imposed under section 72(t) on any amount required to be distributed under paragraph (6).

(B) EXCLUSION OF EMPLOYEE CONTRIBUTIONS.—Any distribution attributable to employee contributions shall not

be included in gross income except to the extent attributable to income on such contributions.

(8) HIGHLY COMPENSATED EMPLOYEE.—For purposes of this subsection, the term "highly compensated employee" has the meaning given to such term by section 414(q).

(9) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection and subsection (k), including regulations permitting appropriate aggregation of plans and contributions.

(10) ALTERNATIVE METHOD OF SATISFYING TESTS.—A defined contribution plan shall be treated as meeting the requirements of paragraph (2) with respect to matching contributions if the plan—

(A) meets the contribution requirements of subparagraph (B) of subsection (k)(11),

(B) meets the exclusive plan requirements of subsection (k)(11)(C), and

(C) meets the vesting requirements of section 408(p)(3).

(11) ADDITIONAL ALTERNATIVE METHOD OF SATISFYING TESTS.—

(A) IN GENERAL.—A defined contribution plan shall be treated as meeting the requirements of paragraph (2) with respect to matching contributions if the plan—

(i) meets the contribution requirements of subparagraph (B) or (C) of subsection (k)(12),

(ii) meets the notice requirements of subsection (k)(12)(D), and

(iii) meets the requirements of subparagraph (B).

(B) LIMITATION ON MATCHING CONTRIBUTIONS.—The requirements of this subparagraph are met if—

(i) matching contributions on behalf of any employee may not be made with respect to an employee's contributions or elective deferrals in excess of 6 percent of the employee's compensation,

(ii) the rate of an employer's matching contribution does not increase as the rate of an employee's contributions or elective deferrals increase, and

(iii) the matching contribution with respect to any highly compensated employee at any rate of an employee contribution or rate of elective deferral is not greater than that with respect to an employee who is not a highly compensated employee.

(12) ALTERNATIVE METHOD FOR AUTOMATIC CONTRIBUTION ARRANGEMENTS.—A defined contribution plan shall be treated as meeting the requirements of paragraph (2) with respect to matching contributions if the plan—

(A) is a qualified automatic contribution arrangement (as defined in subsection (k)(13)), and

(B) meets the requirements of paragraph (11)(B).

(13) CROSS REFERENCE.—For excise tax on certain excess contributions, see section 4979.

(n) COORDINATION WITH QUALIFIED DOMESTIC RELATIONS ORDERS.—The Secretary shall prescribe such rules or regulations as may be necessary to coordinate the requirements of subsection (a)(13)(B) and section 414(p) (and the regulations issued by the Sec-

retary of Labor thereunder) with the other provisions of this chapter.

(o) CROSS REFERENCE.—For exemption from tax of a trust qualified under this section, see section 501(a).

SEC. 402. TAXABILITY OF BENEFICIARY OF EMPLOYEES' TRUST.

(a) TAXABILITY OF BENEFICIARY OF EXEMPT TRUST.—Except as otherwise provided in this section, any amount actually distributed to any distributee by any employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to the distributee, in the taxable year of the distributee in which distributed, under section 72 (relating to annuities).

(b) TAXABILITY OF BENEFICIARY OF NONEXEMPT TRUST.—

(1) CONTRIBUTIONS.—Contributions to an employees' trust made by an employer during a taxable year of the employer which ends with or within a taxable year of the trust for which the trust is not exempt from tax under section 501(a) shall be included in the gross income of the employee in accordance with section 83 (relating to property transferred in connection with performance of services), except that the value of the employee's interest in the trust shall be substituted for the fair market value of the property for purposes of applying such section.

(2) DISTRIBUTIONS.—The amount actually distributed or made available to any distributee by any trust described in paragraph (1) shall be taxable to the distributee, in the taxable year in which so distributed or made available, under section 72 (relating to annuities), except that distributions of income of such trust before the annuity starting date (as defined in section 72(c)(4)) shall be included in the gross income of the employee without regard to section 72(e)(5) (relating to amounts not received as annuities).

(3) GRANTOR TRUSTS.—A beneficiary of any trust described in paragraph (1) shall not be considered the owner of any portion of such trust under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners).

(4) FAILURE TO MEET REQUIREMENTS OF SECTION 410(B).—

(A) HIGHLY COMPENSATED EMPLOYEES.—If 1 of the reasons a trust is not exempt from tax under section 501(a) is the failure of the plan of which it is a part to meet the requirements of section 401(a)(26) or 410(b), then a highly compensated employee shall, in lieu of the amount determined under paragraph (1) or (2) include in gross income for the taxable year with or within which the taxable year of the trust ends an amount equal to the vested accrued benefit of such employee (other than the employee's investment in the contract) as of the close of such taxable year of the trust.

(B) FAILURE TO MEET COVERAGE TESTS.—If a trust is not exempt from tax under section 501(a) for any taxable year solely because such trust is part of a plan which fails to meet the requirements of section 401(a)(26) or 410(b), paragraphs (1) and (2) shall not apply by reason of such failure to any employee who was not a highly compensated employee during—

(i) such taxable year, or

(ii) any preceding period for which service was creditable to such employee under the plan.

(C) HIGHLY COMPENSATED EMPLOYEE.—For purposes of this paragraph, the term "highly compensated employee" has the meaning given such term by section 414(q).

(c) RULES APPLICABLE TO ROLLOVERS FROM EXEMPT TRUSTS.—

(1) EXCLUSION FROM INCOME.—If—

(A) any portion of the balance to the credit of an employee in a qualified trust is paid to the employee in an eligible rollover distribution,

(B) the distributee transfers any portion of the property received in such distribution to an eligible retirement plan, and

(C) in the case of a distribution of property other than money, the amount so transferred consists of the property distributed,

then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid.

(2) MAXIMUM AMOUNT WHICH MAY BE ROLLED OVER.—In the case of any eligible rollover distribution, the maximum amount transferred to which paragraph (1) applies shall not exceed the portion of such distribution which is includible in gross income (determined without regard to paragraph (1)). The preceding sentence shall not apply to such distribution to the extent—

(A) such portion is transferred in a direct trustee-to-trustee transfer to a qualified trust or to an annuity contract described in section 403(b) and such trust or contract provides for separate accounting for amounts so transferred (and earnings thereon), including separately accounting for the portion of such distribution which is includible in gross income and the portion of such distribution which is not so includible, or

(B) such portion is transferred to an eligible retirement plan described in clause (i) or (ii) of paragraph (8)(B).

In the case of a transfer described in subparagraph (A) or (B), the amount transferred shall be treated as consisting first of the portion of such distribution that is includible in gross income (determined without regard to paragraph (1)).

(3) TIME LIMIT ON TRANSFERS.—

(A) IN GENERAL.—Except as provided in subparagraphs (B) and (C), paragraph (1) shall not apply to any transfer of a distribution made after the 60th day following the day on which the distributee received the property distributed.

(B) HARDSHIP EXCEPTION.—The Secretary may waive the 60-day requirement under subparagraph (A) where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement.

(C) ROLLOVER OF CERTAIN PLAN LOAN OFFSET AMOUNTS.—

(i) IN GENERAL.—In the case of a qualified plan loan offset amount, paragraph (1) shall not apply to any transfer of such amount made after the due date (in-

cluding extensions) for filing the return of tax for the taxable year in which such amount is treated as distributed from a qualified employer plan.

(ii) QUALIFIED PLAN LOAN OFFSET AMOUNT.—For purposes of this subparagraph, the term "qualified plan loan offset amount" means a plan loan offset amount which is treated as distributed from a qualified employer plan to a participant or beneficiary solely by reason of—

(I) the termination of the qualified employer plan, or

(II) the failure to meet the repayment terms of the loan from such plan because of the severance from employment of the participant.

(iii) PLAN LOAN OFFSET AMOUNT.—For purposes of clause (ii), the term "plan loan offset amount" means the amount by which the participant's accrued benefit under the plan is reduced in order to repay a loan from the plan.

(iv) LIMITATION.—This subparagraph shall not apply to any plan loan offset amount unless such plan loan offset amount relates to a loan to which section 72(p)(1) does not apply by reason of section 72(p)(2).

(v) QUALIFIED EMPLOYER PLAN.—For purposes of this subsection, the term "qualified employer plan" has the meaning given such term by section 72(p)(4).

(4) ELIGIBLE ROLLOVER DISTRIBUTION.—For purposes of this subsection, the term "eligible rollover distribution" means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified trust; except that such term shall not include—

(A) any distribution which is one of a series of substantially equal periodic payments (not less frequently than annually) made—

(i) for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or

(ii) for a specified period of 10 years or more,

(B) any distribution to the extent such distribution is required under section 401(a)(9), and

(C) any distribution which is made upon hardship of the employee.

If all or any portion of a distribution during 2009 is treated as an eligible rollover distribution but would not be so treated if the minimum distribution requirements under section 401(a)(9) had applied during 2009, such distribution shall not be treated as an eligible rollover distribution for purposes of section 401(a)(31) or 3405(c) or subsection (f) of this section.

(5) TRANSFER TREATED AS ROLLOVER CONTRIBUTION UNDER SECTION 408.—For purposes of this title, a transfer to an eligible retirement plan described in clause (i) or (ii) of paragraph (8)(B) resulting in any portion of a distribution being excluded from gross income under paragraph (1) shall be treated as a rollover contribution described in section 408(d)(3).

(6) SALES OF DISTRIBUTED PROPERTY.—For purposes of this subsection—

(A) TRANSFER OF PROCEEDS FROM SALE OF DISTRIBUTED PROPERTY TREATED AS TRANSFER OF DISTRIBUTED PROPERTY.—The transfer of an amount equal to any portion of the proceeds from the sale of property received in the distribution shall be treated as the transfer of property received in the distribution.

(B) PROCEEDS ATTRIBUTABLE TO INCREASE IN VALUE.—The excess of fair market value of property on sale over its fair market value on distribution shall be treated as property received in the distribution.

(C) DESIGNATION WHERE AMOUNT OF DISTRIBUTION EXCEEDS ROLLOVER CONTRIBUTION.—In any case where part or all of the distribution consists of property other than money—

(i) the portion of the money or other property which is to be treated as attributable to amounts not included in gross income, and

(ii) the portion of the money or other property which is to be treated as included in the rollover contribution,

shall be determined on a ratable basis unless the taxpayer designates otherwise. Any designation under this subparagraph for a taxable year shall be made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof). Any such designation, once made, shall be irrevocable.

(D) NONRECOGNITION OF GAIN OR LOSS.—No gain or loss shall be recognized on any sale described in subparagraph (A) to the extent that an amount equal to the proceeds is transferred pursuant to paragraph (1).

(7) SPECIAL RULE FOR FROZEN DEPOSITS.—

(A) IN GENERAL.—The 60-day period described in paragraph (3) shall not—

(i) include any period during which the amount transferred to the employee is a frozen deposit, or

(ii) end earlier than 10 days after such amount ceases to be a frozen deposit.

(B) FROZEN DEPOSITS.—For purposes of this subparagraph, the term "frozen deposit" means any deposit which may not be withdrawn because of—

(i) the bankruptcy or insolvency of any financial institution, or

(ii) any requirement imposed by the State in which such institution is located by reason of the bankruptcy or insolvency (or threat thereof) of 1 or more financial institutions in such State.

A deposit shall not be treated as a frozen deposit unless on at least 1 day during the 60-day period described in paragraph (3) (without regard to this paragraph) such deposit is described in the preceding sentence.

(8) DEFINITIONS.—For purposes of this subsection—

(A) QUALIFIED TRUST.—The term "qualified trust" means an employees' trust described in section 401(a) which is exempt from tax under section 501(a).

(B) ELIGIBLE RETIREMENT PLAN.—The term "eligible retirement plan" means—

(i) an individual retirement account described in section 408(a),

(ii) an individual retirement annuity described in section 408(b) (other than an endowment contract),

(iii) a qualified trust,

(iv) an annuity plan described in section 403(a),

(v) an eligible deferred compensation plan described in section 457(b) which is maintained by an eligible employer described in section 457(e)(1)(A), and

(vi) an annuity contract described in section 403(b).

If any portion of an eligible rollover distribution is attributable to payments or distributions from a designated Roth account (as defined in section 402A), an eligible retirement plan with respect to such portion shall include only another designated Roth account and a Roth IRA.

(9) ROLLOVER WHERE SPOUSE RECEIVES DISTRIBUTION AFTER DEATH OF EMPLOYEE.—If any distribution attributable to an employee is paid to the spouse of the employee after the employee's death, the preceding provisions of this subsection shall apply to such distribution in the same manner as if the spouse were the employee.

(10) SEPARATE ACCOUNTING.—Unless a plan described in clause (v) of paragraph (8)(B) agrees to separately account for amounts rolled into such plan from eligible retirement plans not described in such clause, the plan described in such clause may not accept transfers or rollovers from such retirement plans.

(11) DISTRIBUTIONS TO INHERITED INDIVIDUAL RETIREMENT PLAN OF NONSPOUSE BENEFICIARY.—

(A) IN GENERAL.—If, with respect to any portion of a distribution from an eligible retirement plan described in paragraph (8)(B)(iii) of a deceased employee, a direct trustee-to-trustee transfer is made to an individual retirement plan described in clause (i) or (ii) of paragraph (8)(B) established for the purposes of receiving the distribution on behalf of an individual who is a designated beneficiary (as defined by section 401(a)(9)(E)) of the employee and who is not the surviving spouse of the employee—

(i) the transfer shall be treated as an eligible rollover distribution,

(ii) the individual retirement plan shall be treated as an inherited individual retirement account or individual retirement annuity (within the meaning of section 408(d)(3)(C)) for purposes of this title, and

(iii) section 401(a)(9)(B) (other than clause (iv) thereof) shall apply to such plan.

(B) CERTAIN TRUSTS TREATED AS BENEFICIARIES.—For purposes of this paragraph, to the extent provided in rules prescribed by the Secretary, a trust maintained for the

benefit of one or more designated beneficiaries shall be treated in the same manner as a designated beneficiary.

(d) TAXABILITY OF BENEFICIARY OF CERTAIN FOREIGN SITUS TRUSTS.—For purposes of subsections (a), (b), and (c), a stock bonus, pension, or profit-sharing trust which would qualify for exemption from tax under section 501(a) except for the fact that it is a trust created or organized outside the United States shall be treated as if it were a trust exempt from tax under section 501(a).

(e) OTHER RULES APPLICABLE TO EXEMPT TRUSTS.—

(1) ALTERNATE PAYEES.—

(A) ALTERNATE PAYEE TREATED AS DISTRIBUTEE.—For purposes of subsection (a) and section 72, an alternate payee who is the spouse or former spouse of the participant shall be treated as the distributee of any distribution or payment made to the alternate payee under a qualified domestic relations order (as defined in section 414(p)).

(B) ROLLOVERS.—If any amount is paid or distributed to an alternate payee who is the spouse or former spouse of the participant by reason of any qualified domestic relations order (within the meaning of section 414(p)), subsection (c) shall apply to such distribution in the same manner as if such alternate payee were the employee.

(2) DISTRIBUTIONS BY UNITED STATES TO NONRESIDENT ALIENS.—The amount includible under subsection (a) in the gross income of a nonresident alien with respect to a distribution made by the United States in respect of services performed by an employee of the United States shall not exceed an amount which bears the same ratio to the amount includible in gross income without regard to this paragraph as—

(A) the aggregate basic pay paid by the United States to such employee for such services, reduced by the amount of such basic pay which was not includible in gross income by reason of being from sources without the United States, bears to

(B) the aggregate basic pay paid by the United States to such employee for such services.

In the case of distributions under the civil service retirement laws, the term "basic pay" shall have the meaning provided in section 8331(3) of title 5, United States Code.

(3) CASH OR DEFERRED ARRANGEMENTS.—For purposes of this title, contributions made by an employer on behalf of an employee to a trust which is a part of a qualified cash or deferred arrangement (as defined in section 401(k)(2)) or which is part of a salary reduction agreement under section 403(b) shall not be treated as distributed or made available to the employee nor as contributions made to the trust by the employee merely because the arrangement includes provisions under which the employee has an election whether the contribution will be made to the trust or received by the employee in cash.

(4) NET UNREALIZED APPRECIATION.—

(A) AMOUNTS ATTRIBUTABLE TO EMPLOYEE CONTRIBUTIONS.—For purposes of subsection (a) and section 72, in the case of a distribution other than a lump sum distribution, the amount actually distributed to any distributee from a trust described in subsection (a) shall not include

any net unrealized appreciation in securities of the employer corporation attributable to amounts contributed by the employee (other than deductible employee contributions within the meaning of section 72(*o*)(5)). This subparagraph shall not apply to a distribution to which subsection (c) applies.

(B) AMOUNTS ATTRIBUTABLE TO EMPLOYER CONTRIBUTIONS.—For purposes of subsection (a) and section 72, in the case of any lump sum distribution which includes securities of the employer corporation, there shall be excluded from gross income the net unrealized appreciation attributable to that part of the distribution which consists of securities of the employer corporation. In accordance with rules prescribed by the Secretary, a taxpayer may elect, on the return of tax on which a lump sum distribution is required to be included, not to have this subparagraph apply to such distribution.

(C) DETERMINATION OF AMOUNTS AND ADJUSTMENTS.—For purposes of subparagraphs (A) and (B), net unrealized appreciation and the resulting adjustments to basis shall be determined in accordance with regulations prescribed by the Secretary.

(D) LUMP-SUM DISTRIBUTION.—For purposes of this paragraph—

(i) IN GENERAL.—The term "lump-sum distribution" means the distribution or payment within one taxable year of the recipient of the balance to the credit of an employee which becomes payable to the recipient—

(I) on account of the employee's death,

(II) after the employee attains age 591/2,

(III) on account of the employee's separation from service, or

(IV) after the employee has become disabled (within the meaning of section 72(m)(7)),

from a trust which forms a part of a plan described in section 401(a) and which is exempt from tax under section 501 or from a plan described in section 403(a). Subclause (III) of this clause shall be applied only with respect to an individual who is an employee without regard to section 401(c)(1), and subclause (IV) shall be applied only with respect to an employee within the meaning of section 401(c)(1). For purposes of this clause, a distribution to two or more trusts shall be treated as a distribution to one recipient. For purposes of this paragraph, the balance to the credit of the employee does not include the accumulated deductible employee contributions under the plan (within the meaning of section 72(*o*)(5)).

(ii) AGGREGATION OF CERTAIN TRUSTS AND PLANS.—For purposes of determining the balance to the credit of an employee under clause (i)—

(I) all trusts which are part of a plan shall be treated as a single trust, all pension plans maintained by the employer shall be treated as a single plan, all profit-sharing plans maintained by the employer shall be treated as a single plan, and all

stock bonus plans maintained by the employer shall be treated as a single plan, and

(II) trusts which are not qualified trusts under section 401(a) and annuity contracts which do not satisfy the requirements of section 404(a)(2) shall not be taken into account.

(iii) COMMUNITY PROPERTY LAWS.—The provisions of this paragraph shall be applied without regard to community property laws.

(iv) AMOUNTS SUBJECT TO PENALTY.—This paragraph shall not apply to amounts described in subparagraph (A) of section 72(m)(5) to the extent that section 72(m)(5) applies to such amounts.

(v) BALANCE TO CREDIT OF EMPLOYEE NOT TO INCLUDE AMOUNTS PAYABLE UNDER QUALIFIED DOMESTIC RELATIONS ORDER.—For purposes of this paragraph, the balance to the credit of an employee shall not include any amount payable to an alternate payee under a qualified domestic relations order (within the meaning of section 414(p)).

(vi) TRANSFERS TO COST-OF-LIVING ARRANGEMENT NOT TREATED AS DISTRIBUTION.—For purposes of this paragraph, the balance to the credit of an employee under a defined contribution plan shall not include any amount transferred from such defined contribution plan to a qualified cost-of-living arrangement (within the meaning of section 415(k)(2)) under a defined benefit plan.

(vii) LUMP-SUM DISTRIBUTIONS OF ALTERNATE PAYEES.—If any distribution or payment of the balance to the credit of an employee would be treated as a lump-sum distribution, then, for purposes of this paragraph, the payment under a qualified domestic relations order (within the meaning of section 414(p)) of the balance to the credit of an alternate payee who is the spouse or former spouse of the employee shall be treated as a lump-sum distribution. For purposes of this clause, the balance to the credit of the alternate payee shall not include any amount payable to the employee.

(E) DEFINITIONS RELATING TO SECURITIES.—For purposes of this paragraph—

(i) SECURITIES.—The term "securities" means only shares of stock and bonds or debentures issued by a corporation with interest coupons or in registered form.

(ii) SECURITIES OF THE EMPLOYER.—The term "securities of the employer corporation" includes securities of a parent or subsidiary corporation (as defined in subsections (e) and (f) of section 424) of the employer corporation.

(6) DIRECT TRUSTEE-TO-TRUSTEE TRANSFERS.—Any amount transferred in a direct trustee-to-trustee transfer in accordance with section 401(a)(31) shall not be includible in gross income for the taxable year of such transfer.

(f) WRITTEN EXPLANATION TO RECIPIENTS OF DISTRIBUTIONS ELIGIBLE FOR ROLLOVER TREATMENT.—

(1) IN GENERAL.—The plan administrator of any plan shall, within a reasonable period of time before making an eligible rollover distribution, provide a written explanation to the recipient—

(A) of the provisions under which the recipient may have the distribution directly transferred to an eligible retirement plan and that the automatic distribution by direct transfer applies to certain distributions in accordance with section 401(a)(31)(B),

(B) of the provision which requires the withholding of tax on the distribution if it is not directly transferred to an eligible retirement plan,

(C) of the provisions under which the distribution will not be subject to tax if transferred to an eligible retirement plan within 60 days after the date on which the recipient received the distribution,

(D) if applicable, of the provisions of subsections (d) and (e) of this section, and

(E) of the provisions under which distributions from the eligible retirement plan receiving the distribution may be subject to restrictions and tax consequences which are different from those applicable to distributions from the plan making such distribution.

(2) DEFINITIONS.—For purposes of this subsection—

(A) ELIGIBLE ROLLOVER DISTRIBUTION.—The term "eligible rollover distribution" has the same meaning as when used in subsection (c) of this section, paragraph (4) of section 403(a), subparagraph (A) of section 403(b)(8), or subparagraph (A) of section 457(e)(16). Such term shall include any distribution to a designated beneficiary which would be treated as an eligible rollover distribution by reason of subsection (c)(11), or section 403(a)(4)(B), 403(b)(8)(B), or 457(e)(16)(B), if the requirements of subsection (c)(11) were satisfied.

(B) ELIGIBLE RETIREMENT PLAN.—The term "eligible retirement plan" has the meaning given such term by subsection (c)(8)(B).

(g) LIMITATION ON EXCLUSION FOR ELECTIVE DEFERRALS.—

(1) IN GENERAL.—

(A) LIMITATION.—Notwithstanding subsections (e)(3) and (h)(1)(B), the elective deferrals of any individual for any taxable year shall be included in such individual's gross income to the extent the amount of such deferrals for the taxable year exceeds the applicable dollar amount. The preceding sentence shall not apply to the portion of such excess as does not exceed the designated Roth contributions of the individual for the taxable year.

(B) APPLICABLE DOLLAR AMOUNT.—For purposes of subparagraph (A), the applicable dollar amount is $15,000.

(C) CATCH-UP CONTRIBUTIONS.—In addition to subparagraph (A), in the case of an eligible participant (as defined in section 414(v)), gross income shall not include elective deferrals in excess of the applicable dollar amount under

subparagraph (B) to the extent that the amount of such elective deferrals does not exceed the applicable dollar amount under section 414(v)(2)(B)(i) for the taxable year (without regard to the treatment of the elective deferrals by an applicable employer plan under section 414(v)).

(2) DISTRIBUTION OF EXCESS DEFERRALS.—

(A) IN GENERAL.—If any amount (hereinafter in this paragraph referred to as "excess deferrals") is included in the gross income of an individual under paragraph (1) (or would be included but for the last sentence thereof) for any taxable year—

(i) not later than the 1st March 1 following the close of the taxable year, the individual may allocate the amount of such excess deferrals among the plans under which the deferrals were made and may notify each such plan of the portion allocated to it, and

(ii) not later than the 1st April 15 following the close of the taxable year, each such plan may distribute to the individual the amount allocated to it under clause (i) (and any income allocable to such amount through the end of such taxable year).

The distribution described in clause (ii) may be made notwithstanding any other provision of law.

(B) TREATMENT OF DISTRIBUTION UNDER SECTION 401(K).—Except to the extent provided under rules prescribed by the Secretary, notwithstanding the distribution of any portion of an excess deferral from a plan under subparagraph (A)(ii), such portion shall, for purposes of applying section 401(k)(3)(A)(ii), be treated as an employer contribution.

(C) TAXATION OF DISTRIBUTION.—In the case of a distribution to which subparagraph (A) applies—

(i) except as provided in clause (ii), such distribution shall not be included in gross income, and

(ii) any income on the excess deferral shall, for purposes of this chapter, be treated as earned and received in the taxable year in which such income is distributed.

No tax shall be imposed under section 72(t) on any distribution described in the preceding sentence.

(D) PARTIAL DISTRIBUTIONS.—If a plan distributes only a portion of any excess deferral and income allocable thereto, such portion shall be treated as having been distributed ratably from the excess deferral and the income.

(3) ELECTIVE DEFERRALS.—For purposes of this subsection, the term "elective deferrals" means, with respect to any taxable year, the sum of—

(A) any employer contribution under a qualified cash or deferred arrangement (as defined in section 401(k)) to the extent not includible in gross income for the taxable year under subsection (e)(3) (determined without regard to this subsection),

(B) any employer contribution to the extent not includible in gross income for the taxable year under subsection (h)(1)(B) (determined without regard to this subsection),

(C) any employer contribution to purchase an annuity contract under section 403(b) under a salary reduction agreement (within the meaning of section 3121(a)(5)(D)), and

(D) any elective employer contribution under section 408(p)(2)(A)(i).

An employer contribution shall not be treated as an elective deferral described in subparagraph (C) if under the salary reduction agreement such contribution is made pursuant to a one-time irrevocable election made by the employee at the time of initial eligibility to participate in the agreement or is made pursuant to a similar arrangement involving a one-time irrevocable election specified in regulations.

(4) COST-OF-LIVING ADJUSTMENT.—In the case of taxable years beginning after December 31, 2006, the Secretary shall adjust the $15,000 amount under paragraph (1)(B) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2005, and any increase under this paragraph which is not a multiple of $500 shall be rounded to the next lowest multiple of $500.

(5) DISREGARD OF COMMUNITY PROPERTY LAWS.—This subsection shall be applied without regard to community property laws.

(6) COORDINATION WITH SECTION 72.—For purposes of applying section 72, any amount includible in gross income for any taxable year under this subsection but which is not distributed from the plan during such taxable year shall not be treated as investment in the contract.

(7) SPECIAL RULE FOR CERTAIN ORGANIZATIONS.—

(A) IN GENERAL.—In the case of a qualified employee of a qualified organization, with respect to employer contributions described in paragraph (3)(C) made by such organization, the limitation of paragraph (1) for any taxable year shall be increased by whichever of the following is the least:

(i) $3,000,

(ii) $15,000 reduced by the sum of—

(I) the amounts not included in gross income for prior taxable years by reason of this paragraph, plus

(II) the aggregate amount of designated Roth contributions (as defined in section 402A(c)) permitted for prior taxable years by reason of this paragraph, or

(iii) the excess of $5,000 multiplied by the number of years of service of the employee with the qualified organization over the employer contributions described in paragraph (3) made by the organization on behalf of such employee for prior taxable years (determined in the manner prescribed by the Secretary).

(B) QUALIFIED ORGANIZATION.—For purposes of this paragraph, the term "qualified organization" means any educational organization, hospital, home health service agency, health and welfare service agency, church, or con-

vention or association of churches. Such term includes any organization described in section 414(e)(3)(B)(ii). Terms used in this subparagraph shall have the same meaning as when used in section 415(c)(4) (as in effect before the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001).

(C) QUALIFIED EMPLOYEE.—For purposes of this paragraph, the term "qualified employee" means any employee who has completed 15 years of service with the qualified organization.

(D) YEARS OF SERVICE.—For purposes of this paragraph, the term "years of service" has the meaning given such term by section 403(b).

(8) MATCHING CONTRIBUTIONS ON BEHALF OF SELF-EMPLOYED INDIVIDUALS NOT TREATED AS ELECTIVE EMPLOYER CONTRIBUTIONS.—Except as provided in section 401(k)(3)(D)(ii), any matching contribution described in section 401(m)(4)(A) which is made on behalf of a self-employed individual (as defined in section 401(c)) shall not be treated as an elective employer contribution under a qualified cash or deferred arrangement (as defined in section 401(k)) for purposes of this title.

(h) SPECIAL RULES FOR SIMPLIFIED EMPLOYEE PENSIONS.—For purposes of this chapter—

(1) IN GENERAL.—Except as provided in paragraph (2), contributions made by an employer on behalf of an employee to an individual retirement plan pursuant to a simplified employee pension (as defined in section 408(k))—

(A) shall not be treated as distributed or made available to the employee or as contributions made by the employee, and

(B) if such contributions are made pursuant to an arrangement under section 408(k)(6) under which an employee may elect to have the employer make contributions to the simplified employee pension on behalf of the employee, shall not be treated as distributed or made available or as contributions made by the employee merely because the simplified employee pension includes provisions for such election.

(2) LIMITATIONS ON EMPLOYER CONTRIBUTIONS.—Contributions made by an employer to a simplified employee pension with respect to an employee for any year shall be treated as distributed or made available to such employee and as contributions made by the employee to the extent such contributions exceed the lesser of—

(A) 25 percent of the compensation (within the meaning of section 414(s)) from such employer includible in the employee's gross income for the year (determined without regard to the employer contributions to the simplified employee pension), or

(B) the limitation in effect under section 415(c)(1)(A), reduced in the case of any highly compensated employee (within the meaning of section 414(q)) by the amount taken into account with respect to such employee under section 408(k)(3)(D).

(3) DISTRIBUTIONS.—Any amount paid or distributed out of an individual retirement plan pursuant to a simplified employee pension shall be included in gross income by the payee or distributee, as the case may be, in accordance with the provisions of section 408(d).

(i) TREATMENT OF SELF-EMPLOYED INDIVIDUALS.—For purposes of this section, except as otherwise provided in subsection (e)(4)(D)(i), the term "employee" includes a self-employed individual (as defined in section 401(c)(1)(B)) and the employer of such individual shall be the person treated as his employer under section 401(c)(4).

(j) EFFECT OF DISPOSITION OF STOCK BY PLAN ON NET UNREALIZED APPRECIATION.—

(1) IN GENERAL.—For purposes of subsection (e)(4), in the case of any transaction to which this subsection applies, the determination of net unrealized appreciation shall be made without regard to such transaction.

(2) TRANSACTION TO WHICH SUBSECTION APPLIES.—This subsection shall apply to any transaction in which—

(A) the plan trustee exchanges the plan's securities of the employer corporation for other such securities, or

(B) the plan trustee disposes of securities of the employer corporation and uses the proceeds of such disposition to acquire securities of the employer corporation within 90 days (or such longer period as the Secretary may prescribe), except that this subparagraph shall not apply to any employee with respect to whom a distribution of money was made during the period after such disposition and before such acquisition.

(k) TREATMENT OF SIMPLE RETIREMENT ACCOUNTS.—Rules similar to the rules of paragraphs (1) and (3) of subsection (h) shall apply to contributions and distributions with respect to a simple retirement account under section 408(p).

(l) DISTRIBUTIONS FROM GOVERNMENTAL PLANS FOR HEALTH AND LONG-TERM CARE INSURANCE.—

(1) IN GENERAL.—In the case of an employee who is an eligible retired public safety officer who makes the election described in paragraph (6) with respect to any taxable year of such employee, gross income of such employee for such taxable year does not include any distribution from an eligible retirement plan maintained by the employer described in paragraph (4)(B) to the extent that the aggregate amount of such distributions does not exceed the amount paid by such employee for qualified health insurance premiums for such taxable year.

(2) LIMITATION.—The amount which may be excluded from gross income for the taxable year by reason of paragraph (1) shall not exceed $3,000.

(3) DISTRIBUTIONS MUST OTHERWISE BE INCLUDIBLE.—

(A) IN GENERAL.—An amount shall be treated as a distribution for purposes of paragraph (1) only to the extent that such amount would be includible in gross income without regard to paragraph (1).

(B) APPLICATION OF SECTION 72.—Notwithstanding section 72, in determining the extent to which an amount is treated as a distribution for purposes of subparagraph (A), the aggregate amounts distributed from an eligible retire-

ment plan in a taxable year (up to the amount excluded under paragraph (1)) shall be treated as includible in gross income (without regard to subparagraph (A)) to the extent that such amount does not exceed the aggregate amount which would have been so includible if all amounts to the credit of the eligible public safety officer in all eligible retirement plans maintained by the employer described in paragraph (4)(B) were distributed during such taxable year and all such plans were treated as 1 contract for purposes of determining under section 72 the aggregate amount which would have been so includible. Proper adjustments shall be made in applying section 72 to other distributions in such taxable year and subsequent taxable years.

(4) DEFINITIONS.—For purposes of this subsection—

(A) ELIGIBLE RETIREMENT PLAN.—For purposes of paragraph (1), the term "eligible retirement plan" means a governmental plan (within the meaning of section 414(d)) which is described in clause (iii), (iv), (v), or (vi) of subsection (c)(8)(B).

(B) ELIGIBLE RETIRED PUBLIC SAFETY OFFICER.—The term "eligible retired public safety officer" means an individual who, by reason of disability or attainment of normal retirement age, is separated from service as a public safety officer with the employer who maintains the eligible retirement plan from which distributions subject to paragraph (1) are made.

(C) PUBLIC SAFETY OFFICER.—The term "public safety officer" shall have the same meaning given such term by section 1204(9)(A) of the Omnibus Crime Control and Safe Streets Act of 1968 (42 U.S.C. 3796b(9)(A)), as in effect immediately before the enactment of the National Defense Authorization Act for Fiscal Year 2013.

(D) QUALIFIED HEALTH INSURANCE PREMIUMS.—The term "qualified health insurance premiums" means premiums for coverage for the eligible retired public safety officer**[**, his spouse, and dependents**]** *and the spouse and dependents of such officer* (as defined in section 152), by an accident or health plan or qualified long-term care insurance contract (as defined in section 7702B(b)).

(5) SPECIAL RULES.—For purposes of this subsection—

(A) DIRECT PAYMENT TO INSURER REQUIRED.—Paragraph (1) shall only apply to a distribution if payment of the premiums is made directly to the provider of the accident or health plan or qualified long-term care insurance contract by deduction from a distribution from the eligible retirement plan.

(B) RELATED PLANS TREATED AS 1.—All eligible retirement plans of an employer shall be treated as a single plan.

(6) ELECTION DESCRIBED.—

(A) IN GENERAL.—For purposes of paragraph (1), an election is described in this paragraph if the election is made by an employee after separation from service with respect to amounts not distributed from an eligible retirement

plan to have amounts from such plan distributed in order to pay for qualified health insurance premiums.

(B) SPECIAL RULE.—A plan shall not be treated as violating the requirements of section 401, or as engaging in a prohibited transaction for purposes of section 503(b), merely because it provides for an election with respect to amounts that are otherwise distributable under the plan or merely because of a distribution made pursuant to an election described in subparagraph (A).

(7) COORDINATION WITH MEDICAL EXPENSE DEDUCTION.—The amounts excluded from gross income under paragraph (1) shall not be taken into account under section 213.

(8) COORDINATION WITH DEDUCTION FOR HEALTH INSURANCE COSTS OF SELF-EMPLOYED INDIVIDUALS.—The amounts excluded from gross income under paragraph (1) shall not be taken into account under section 162(*l*).

* * * * * * *

SEC. 408. INDIVIDUAL RETIREMENT ACCOUNTS.

(a) INDIVIDUAL RETIREMENT ACCOUNT.—For purposes of this section, the term "individual retirement account" means a trust created or organized in the United States for the exclusive benefit of an individual or his beneficiaries, but only if the written governing instrument creating the trust meets the following requirements:

(1) Except in the case of a rollover contribution described in subsection (d)(3) or in section 402(c), 403(a)(4), 403(b)(8), or 457(e)(16), no contribution will be accepted unless it is in cash, and contributions will not be accepted for the taxable year on behalf of any individual in excess of the amount in effect for such taxable year under section 219(b)(1)(A).

(2) The trustee is a bank (as defined in subsection (n)) or such other person who demonstrates to the satisfaction of the Secretary that the manner in which such other person will administer the trust will be consistent with the requirements of this section.

(3) No part of the trust funds will be invested in life insurance contracts.

(4) The interest of an individual in the balance in his account is nonforfeitable.

(5) The assets of the trust will not be commingled with other property except in a common trust fund or common investment fund.

(6) Under regulations prescribed by the Secretary, rules similar to the rules of section 401(a)(9) and the incidental death benefit requirements of section 401(a) shall apply to the distribution of the entire interest of an individual for whose benefit the trust is maintained.

(b) INDIVIDUAL RETIREMENT ANNUITY.—For purposes of this section, the term "individual retirement annuity" means an annuity contract, or an endowment contract (as determined under regulations prescribed by the Secretary), issued by an insurance company which meets the following requirements:

(1) The contract is not transferable by the owner.

(2) Under the contract—

(A) the premiums are not fixed,

(B) the annual premium on behalf of any individual will not exceed the dollar amount in effect under section 219(b)(1)(A), and

(C) any refund of premiums will be applied before the close of the calendar year following the year of the refund toward the payment of future premiums or the purchase of additional benefits.

(3) Under regulations prescribed by the Secretary, rules similar to the rules of section 401(a)(9) and the incidental death benefit requirements of section 401(a) shall apply to the distribution of the entire interest of the owner.

(4) The entire interest of the owner is nonforfeitable.

Such term does not include such an annuity contract for any taxable year of the owner in which it is disqualified on the application of subsection (e) or for any subsequent taxable year. For purposes of this subsection, no contract shall be treated as an endowment contract if it matures later than the taxable year in which the individual in whose name such contract is purchased attains age 701/2; if it is not for the exclusive benefit of the individual in whose name it is purchased or his beneficiaries; or if the aggregate annual premiums under all such contracts purchased in the name of such individual for any taxable year exceed the dollar amount in effect under section 219(b)(1)(A).

(c) ACCOUNTS ESTABLISHED BY EMPLOYERS AND CERTAIN ASSOCIATIONS OF EMPLOYEES.—A trust created or organized in the United States by an employer for the exclusive benefit of his employees or their beneficiaries, or by an association of employees (which may include employees within the meaning of section 401(c)(1)) for the exclusive benefit of its members or their beneficiaries, shall be treated as an individual retirement account (described in subsection (a)), but only if the written governing instrument creating the trust meets the following requirements:

(1) The trust satisfies the requirements of paragraphs (1) through (6) of subsection (a).

(2) There is a separate accounting for the interest of each employee or member (or spouse of an employee or member).

The assets of the trust may be held in a common fund for the account of all individuals who have an interest in the trust.

(d) TAX TREATMENT OF DISTRIBUTIONS.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, any amount paid or distributed out of an individual retirement plan shall be included in gross income by the payee or distributee, as the case may be, in the manner provided under section 72.

(2) SPECIAL RULES FOR APPLYING SECTION 72.—For purposes of applying section 72 to any amount described in paragraph (1)—

(A) all individual retirement plans shall be treated as 1 contract,

(B) all distributions during any taxable year shall be treated as 1 distribution, and

(C) the value of the contract, income on the contract, and investment in the contract shall be computed as of the close of the calendar year in which the taxable year begins.

For purposes of subparagraph (C), the value of the contract shall be increased by the amount of any distributions during the calendar year.

(3) ROLLOVER CONTRIBUTION.—An amount is described in this paragraph as a rollover contribution if it meets the requirements of subparagraphs (A) and (B).

(A) IN GENERAL.—Paragraph (1) does not apply to any amount paid or distributed out of an individual retirement account or individual retirement annuity to the individual for whose benefit the account or annuity is maintained if—

(i) the entire amount received (including money and any other property) is paid into an individual retirement account or individual retirement annuity (other than an endowment contract) for the benefit of such individual not later than the 60th day after the day on which he receives the payment or distribution; or

(ii) the entire amount received (including money and any other property) is paid into an eligible retirement plan for the benefit of such individual not later than the 60th day after the date on which the payment or distribution is received, except that the maximum amount which may be paid into such plan may not exceed the portion of the amount received which is includible in gross income (determined without regard to this paragraph).

For purposes of clause (ii), the term "eligible retirement plan" means an eligible retirement plan described in clause (iii), (iv), (v), or (vi) of section 402(c)(8)(B).

(B) LIMITATION.—This paragraph does not apply to any amount described in subparagraph (A)(i) received by an individual from an individual retirement account or individual retirement annuity if at any time during the 1-year period ending on the day of such receipt such individual received any other amount described in that subparagraph from an individual retirement account or an individual retirement annuity which was not includible in his gross income because of the application of this paragraph.

(C) DENIAL OF ROLLOVER TREATMENT FOR INHERITED ACCOUNTS, ETC..—

(i) IN GENERAL.—In the case of an inherited individual retirement account or individual retirement annuity—

(I) this paragraph shall not apply to any amount received by an individual from such an account or annuity (and no amount transferred from such account or annuity to another individual retirement account or annuity shall be excluded from gross income by reason of such transfer), and

(II) such inherited account or annuity shall not be treated as an individual retirement account or annuity for purposes of determining whether any other amount is a rollover contribution.

(ii) INHERITED INDIVIDUAL RETIREMENT ACCOUNT OR ANNUITY.—An individual retirement account or indi-

vidual retirement annuity shall be treated as inherited if—

(I) the individual for whose benefit the account or annuity is maintained acquired such account by reason of the death of another individual, and

(II) such individual was not the surviving spouse of such other individual.

(D) PARTIAL ROLLOVERS PERMITTED.—

(i) IN GENERAL.—If any amount paid or distributed out of an individual retirement account or individual retirement annuity would meet the requirements of subparagraph (A) but for the fact that the entire amount was not paid into an eligible plan as required by clause (i) or (ii) of subparagraph (A), such amount shall be treated as meeting the requirements of subparagraph (A) to the extent it is paid into an eligible plan referred to in such clause not later than the 60th day referred to in such clause.

(ii) ELIGIBLE PLAN.—For purposes of clause (i), the term "eligible plan" means any account, annuity, contract, or plan referred to in subparagraph (A).

(E) DENIAL OF ROLLOVER TREATMENT FOR REQUIRED DISTRIBUTIONS.—This paragraph shall not apply to any amount to the extent such amount is required to be distributed under subsection (a)(6) or (b)(3).

(F) FROZEN DEPOSITS.—For purposes of this paragraph, rules similar to the rules of section 402(c)(7) (relating to frozen deposits) shall apply.

(G) SIMPLE RETIREMENT ACCOUNTS.—In the case of any payment or distribution out of a simple retirement account (as defined in subsection (p)) to which section 72(t)(6) applies, this paragraph shall not apply unless such payment or distribution is paid into another simple retirement account.

(H) APPLICATION OF SECTION 72.—

(i) IN GENERAL.—If—

(I) a distribution is made from an individual retirement plan, and

(II) a rollover contribution is made to an eligible retirement plan described in section 402(c)(8)(B)(iii), (iv), (v), or (vi) with respect to all or part of such distribution,

then, notwithstanding paragraph (2), the rules of clause (ii) shall apply for purposes of applying section 72.

(ii) APPLICABLE RULES.—In the case of a distribution described in clause (i)—

(I) section 72 shall be applied separately to such distribution,

(II) notwithstanding the pro rata allocation of income on, and investment in, the contract to distributions under section 72, the portion of such distribution rolled over to an eligible retirement plan described in clause (i) shall be treated as from income on the contract (to the extent of the

aggregate income on the contract from all individual retirement plans of the distributee), and

(III) appropriate adjustments shall be made in applying section 72 to other distributions in such taxable year and subsequent taxable years.

(I) WAIVER OF 60-DAY REQUIREMENT.—The Secretary may waive the 60-day requirement under subparagraphs (A) and (D) where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement.

(4) CONTRIBUTIONS RETURNED BEFORE DUE DATE OF RETURN.—Paragraph (1) does not apply to the distribution of any contribution paid during a taxable year to an individual retirement account or for an individual retirement annuity if—

(A) such distribution is received on or before the day prescribed by law (including extensions of time) for filing such individual's return for such taxable year,

(B) no deduction is allowed under section 219 with respect to such contribution, and

(C) such distribution is accompanied by the amount of net income attributable to such contribution.

In the case of such a distribution, for purposes of section 61, any net income described in subparagraph (C) shall be deemed to have been earned and receivable in the taxable year in which such contribution is made.

(5) DISTRIBUTIONS OF EXCESS CONTRIBUTIONS AFTER DUE DATE FOR TAXABLE YEAR AND CERTAIN EXCESS ROLLOVER CONTRIBUTIONS.—

(A) IN GENERAL.—In the case of any individual, if the aggregate contributions (other than rollover contributions) paid for any taxable year to an individual retirement account or for an individual retirement annuity do not exceed the dollar amount in effect under section 219(b)(1)(A), paragraph (1) shall not apply to the distribution of any such contribution to the extent that such contribution exceeds the amount allowable as a deduction under section 219 for the taxable year for which the contribution was paid—

(i) if such distribution is received after the date described in paragraph (4),

(ii) but only to the extent that no deduction has been allowed under section 219 with respect to such excess contribution.

If employer contributions on behalf of the individual are paid for the taxable year to a simplified employee pension, the dollar limitation of the preceding sentence shall be increased by the lesser of the amount of such contributions or the dollar limitation in effect under section 415(c)(1)(A) for such taxable year.

(B) EXCESS ROLLOVER CONTRIBUTIONS ATTRIBUTABLE TO ERRONEOUS INFORMATION.—If—

(i) the taxpayer reasonably relies on information supplied pursuant to subtitle F for determining the amount of a rollover contribution, but

(ii) the information was erroneous,

subparagraph (A) shall be applied by increasing the dollar limit set forth therein by that portion of the excess contribution which was attributable to such information.

For purposes of this paragraph, the amount allowable as a deduction under section 219 shall be computed without regard to section 219(g).

(6) TRANSFER OF ACCOUNT INCIDENT TO DIVORCE.—The transfer of an individual's interest in an individual retirement account or an individual retirement annuity to [his spouse] *the individual's spouse* or former spouse under a divorce or separation instrument described in clause (i) of section 121(d)(3)(C) is not to be considered a taxable transfer made by such individual notwithstanding any other provision of this subtitle, and such interest at the time of the transfer is to be treated as an individual retirement account of such spouse, and not of such individual. Thereafter such account or annuity for purposes of this subtitle is to be treated as maintained for the benefit of such spouse.

(7) SPECIAL RULES FOR SIMPLIFIED EMPLOYEE PENSIONS OR SIMPLE RETIREMENT ACCOUNTS.—

(A) TRANSFER OR ROLLOVER OF CONTRIBUTIONS PROHIBITED UNTIL DEFERRAL TEST MET.—Notwithstanding any other provision of this subsection or section 72(t), paragraph (1) and section 72(t)(1) shall apply to the transfer or distribution from a simplified employee pension of any contribution under a salary reduction arrangement described in subsection (k)(6) (or any income allocable thereto) before a determination as to whether the requirements of subsection (k)(6)(A)(iii) are met with respect to such contribution.

(B) CERTAIN EXCLUSIONS TREATED AS DEDUCTIONS.—For purposes of paragraphs (4) and (5) and section 4973, any amount excludable or excluded from gross income under section 402(h) or 402(k) shall be treated as an amount allowable or allowed as a deduction under section 219.

(8) DISTRIBUTIONS FOR CHARITABLE PURPOSES.—

(A) IN GENERAL.—So much of the aggregate amount of qualified charitable distributions with respect to a taxpayer made during any taxable year which does not exceed $100,000 shall not be includible in gross income of such taxpayer for such taxable year.

(B) QUALIFIED CHARITABLE DISTRIBUTION.—For purposes of this paragraph, the term "qualified charitable distribution" means any distribution from an individual retirement plan (other than a plan described in subsection (k) or (p))—

(i) which is made directly by the trustee to an organization described in section 170(b)(1)(A) (other than any organization described in section 509(a)(3) or any fund or account described in section 4966(d)(2)), and

(ii) which is made on or after the date that the individual for whose benefit the plan is maintained has attained age 701/2.

A distribution shall be treated as a qualified charitable distribution only to the extent that the distribution would be includible in gross income without regard to subparagraph (A).

(C) CONTRIBUTIONS MUST BE OTHERWISE DEDUCTIBLE.—For purposes of this paragraph, a distribution to an organization described in subparagraph (B)(i) shall be treated as a qualified charitable distribution only if a deduction for the entire distribution would be allowable under section 170 (determined without regard to subsection (b) thereof and this paragraph).

(D) APPLICATION OF SECTION 72.—Notwithstanding section 72, in determining the extent to which a distribution is a qualified charitable distribution, the entire amount of the distribution shall be treated as includible in gross income without regard to subparagraph (A) to the extent that such amount does not exceed the aggregate amount which would have been so includible if all amounts in all individual retirement plans of the individual were distributed during such taxable year and all such plans were treated as 1 contract for purposes of determining under section 72 the aggregate amount which would have been so includible. Proper adjustments shall be made in applying section 72 to other distributions in such taxable year and subsequent taxable years.

(E) DENIAL OF DEDUCTION.—Qualified charitable distributions which are not includible in gross income pursuant to subparagraph (A) shall not be taken into account in determining the deduction under section 170.

(9) DISTRIBUTION FOR HEALTH SAVINGS ACCOUNT FUNDING.—

(A) IN GENERAL.—In the case of an individual who is an eligible individual (as defined in section 223(c)) and who elects the application of this paragraph for a taxable year, gross income of the individual for the taxable year does not include a qualified HSA funding distribution to the extent such distribution is otherwise includible in gross income.

(B) QUALIFIED HSA FUNDING DISTRIBUTION.—For purposes of this paragraph, the term "qualified HSA funding distribution" means a distribution from an individual retirement plan (other than a plan described in subsection (k) or (p)) of the employee to the extent that such distribution is contributed to the health savings account of the individual in a direct trustee-to-trustee transfer.

(C) LIMITATIONS.—

(i) MAXIMUM DOLLAR LIMITATION.—The amount excluded from gross income by subparagraph (A) shall not exceed the excess of—

(I) the annual limitation under section 223(b) computed on the basis of the type of coverage under the high deductible health plan covering the individual at the time of the qualified HSA funding distribution, over

(II) in the case of a distribution described in clause (ii)(II), the amount of the earlier qualified HSA funding distribution.

(ii) ONE-TIME TRANSFER.—

(I) IN GENERAL.—Except as provided in subclause (II), an individual may make an election under subparagraph (A) only for one qualified HSA funding distribution during the lifetime of the individual. Such an election, once made, shall be irrevocable.

(II) CONVERSION FROM SELF-ONLY TO FAMILY COVERAGE.—If a qualified HSA funding distribution is made during a month in a taxable year during which an individual has self-only coverage under a high deductible health plan as of the first day of the month, the individual may elect to make an additional qualified HSA funding distribution during a subsequent month in such taxable year during which the individual has family coverage under a high deductible health plan as of the first day of the subsequent month.

(D) FAILURE TO MAINTAIN HIGH DEDUCTIBLE HEALTH PLAN COVERAGE.—

(i) IN GENERAL.—If, at any time during the testing period, the individual is not an eligible individual, then the aggregate amount of all contributions to the health savings account of the individual made under subparagraph (A)—

(I) shall be includible in the gross income of the individual for the taxable year in which occurs the first month in the testing period for which such individual is not an eligible individual, and

(II) the tax imposed by this chapter for any taxable year on the individual shall be increased by 10 percent of the amount which is so includible.

(ii) EXCEPTION FOR DISABILITY OR DEATH.—Subclauses (I) and (II) of clause (i) shall not apply if the individual ceased to be an eligible individual by reason of the death of the individual or the individual becoming disabled (within the meaning of section 72(m)(7)).

(iii) TESTING PERIOD.—The term "testing period" means the period beginning with the month in which the qualified HSA funding distribution is contributed to a health savings account and ending on the last day of the 12th month following such month.

(E) APPLICATION OF SECTION 72.—Notwithstanding section 72, in determining the extent to which an amount is treated as otherwise includible in gross income for purposes of subparagraph (A), the aggregate amount distributed from an individual retirement plan shall be treated as includible in gross income to the extent that such amount does not exceed the aggregate amount which would have been so includible if all amounts from all individual retirement plans were distributed. Proper adjustments shall be made in applying section 72 to other distributions in such taxable year and subsequent taxable years.

(e) TAX TREATMENT OF ACCOUNTS AND ANNUITIES.—

(1) EXEMPTION FROM TAX.—Any individual retirement account is exempt from taxation under this subtitle unless such account has ceased to be an individual retirement account by reason of paragraph (2) or (3). Notwithstanding the preceding sentence, any such account is subject to the taxes imposed by section 511 (relating to imposition of tax on unrelated business income of charitable, etc. organizations).

(2) LOSS OF EXEMPTION OF ACCOUNT WHERE EMPLOYEE ENGAGES IN PROHIBITED TRANSACTION.—

(A) IN GENERAL.—If, during any taxable year of the individual for whose benefit any individual retirement account is established, that individual or his beneficiary engages in any transaction prohibited by section 4975 with respect to such account, such account ceases to be an individual retirement account as of the first day of such taxable year. For purposes of this paragraph—

(i) the individual for whose benefit any account was established is treated as the creator of such account, and

(ii) the separate account for any individual within an individual retirement account maintained by an employer or association of employees is treated as a separate individual retirement account.

(B) ACCOUNT TREATED AS DISTRIBUTING ALL ITS ASSETS.—In any case in which any account ceases to be an individual retirement account by reason of subparagraph (A) as of the first day of any taxable year, paragraph (1) of subsection (d) applies as if there were a distribution on such first day in an amount equal to the fair market value (on such first day) of all assets in the account (on such first day).

(3) EFFECT OF BORROWING ON ANNUITY CONTRACT.—If during any taxable year the owner of an individual retirement annuity borrows any money under or by use of such contract, the contract ceases to be an individual retirement annuity as of the first day of such taxable year. Such owner shall include in gross income for such year an amount equal to the fair market value of such contract as of such first day.

(4) EFFECT OF PLEDGING ACCOUNT AS SECURITY.—If, during any taxable year of the individual for whose benefit an individual retirement account is established, that individual uses the account or any portion thereof as security for a loan, the portion so used is treated as distributed to that individual.

(5) PURCHASE OF ENDOWMENT CONTRACT BY INDIVIDUAL RETIREMENT ACCOUNT.—If the assets of an individual retirement account or any part of such assets are used to purchase an endowment contract for the benefit of the individual for whose benefit the account is established—

(A) to the extent that the amount of the assets involved in the purchase are not attributable to the purchase of life insurance, the purchase is treated as a rollover contribution described in subsection (d)(3), and

(B) to the extent that the amount of the assets involved in the purchase are attributable to the purchase of life, health, accident, or other insurance, such amounts are

treated as distributed to that individual (but the provisions of subsection (f) do not apply).

(6) COMMINGLING INDIVIDUAL RETIREMENT ACCOUNT AMOUNTS IN CERTAIN COMMON TRUST FUNDS AND COMMON INVESTMENT FUNDS.—Any common trust fund or common investment fund of individual retirement account assets which is exempt from taxation under this subtitle does not cease to be exempt on account of the participation or inclusion of assets of a trust exempt from taxation under section 501(a) which is described in section 401(a).

(g) COMMUNITY PROPERTY LAWS.—This section shall be applied without regard to any community property laws.

(h) CUSTODIAL ACCOUNTS.—For purposes of this section, a custodial account shall be treated as a trust if the assets of such account are held by a bank (as defined in subsection (n)) or another person who demonstrates, to the satisfaction of the Secretary, that the manner in which he will administer the account will be consistent with the requirements of this section, and if the custodial account would, except for the fact that it is not a trust, constitute an individual retirement account described in subsection (a). For purposes of this title, in the case of a custodial account treated as a trust by reason of the preceding sentence, the custodian of such account shall be treated as the trustee thereof.

(i) REPORTS.—The trustee of an individual retirement account and the issuer of an endowment contract described in subsection (b) or an individual retirement annuity shall make such reports regarding such account, contract, or annuity to the Secretary and to the individuals for whom the account, contract, or annuity is, or is to be, maintained with respect to contributions (and the years to which they relate), distributions aggregating $10 or more in any calendar year, and such other matters as the Secretary may require. The reports required by this subsection—

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

(2) shall be furnished to individuals—

(A) not later than January 31 of the calendar year following the calendar year to which such reports relate, and

(B) in such manner as the Secretary prescribes.

In the case of a simple retirement account under subsection (p), only one report under this subsection shall be required to be submitted each calendar year to the Secretary (at the time provided under paragraph (2)) but, in addition to the report under this subsection, there shall be furnished, within 31 days after each calendar year, to the individual on whose behalf the account is maintained a statement with respect to the account balance as of the close of, and the account activity during, such calendar year.

(j) INCREASE IN MAXIMUM LIMITATIONS FOR SIMPLIFIED EMPLOYEE PENSIONS.—In the case of any simplified employee pension, subsections (a)(1) and (b)(2) of this section shall be applied by increasing the amounts contained therein by the amount of the limitation in effect under section 415(c)(1)(A).

(k) SIMPLIFIED EMPLOYEE PENSION DEFINED.—

(1) IN GENERAL.—For purposes of this title, the term "simplified employee pension" means an individual retirement account or individual retirement annuity—

(A) with respect to which the requirements of paragraphs (2), (3), (4), and (5) of this subsection are met, and

(B) if such account or annuity is part of a top-heavy plan (as defined in section 416), with respect to which the requirements of section 416(c)(2) are met.

(2) PARTICIPATION REQUIREMENTS.—This paragraph is satisfied with respect to a simplified employee pension for a year only if for such year the employer contributes to the simplified employee pension of each employee who—

(A) has attained age 21,

(B) has performed service for the employer during at least 3 of the immediately preceding 5 years, and

(C) received at least $450 in compensation (within the meaning of section 414(q)(4)) from the employer for the year.

For purposes of this paragraph, there shall be excluded from consideration employees described in subparagraph (A) or (C) of section 410(b)(3). For purposes of any arrangement described in subsection (k)(6), any employee who is eligible to have employer contributions made on the employee's behalf under such arrangement shall be treated as if such a contribution was made.

(3) CONTRIBUTIONS MAY NOT DISCRIMINATE IN FAVOR OF THE HIGHLY COMPENSATED, ETC..—

(A) IN GENERAL.—The requirements of this paragraph are met with respect to a simplified employee pension for a year if for such year the contributions made by the employer to simplified employee pensions for his employees do not discriminate in favor of any highly compensated employee (within the meaning of section 414(q)).

(B) SPECIAL RULES.—For purposes of subparagraph (A), there shall be excluded from consideration employees described in subparagraph (A) or (C) of section 410(b)(3).

(C) CONTRIBUTIONS MUST BEAR UNIFORM RELATIONSHIP TO TOTAL COMPENSATION.—For purposes of subparagraph (A), and except as provided in subparagraph (D), employer contributions to simplified employee pensions (other than contributions under an arrangement described in paragraph (6)) shall be considered discriminatory unless contributions thereto bear a uniform relationship to the compensation (not in excess of the first $200,000) of each employee maintaining a simplified employee pension.

(D) PERMITTED DISPARITY.—For purposes of subparagraph (C), the rules of section 401(*l*)(2) shall apply to contributions to simplified employee pensions (other than contributions under an arrangement described in paragraph (6)).

(4) WITHDRAWALS MUST BE PERMITTED.—A simplified employee pension meets the requirements of this paragraph only if—

(A) employer contributions thereto are not conditioned on the retention in such pension of any portion of the amount contributed, and

(B) there is no prohibition imposed by the employer on withdrawals from the simplified employee pension.

(5) CONTRIBUTIONS MUST BE MADE UNDER WRITTEN ALLOCATION FORMULA.—The requirements of this paragraph are met with respect to a simplified employee pension only if employer contributions to such pension are determined under a definite written allocation formula which specifies—

(A) the requirements which an employee must satisfy to share in an allocation, and

(B) the manner in which the amount allocated is computed.

(6) EMPLOYEE MAY ELECT SALARY REDUCTION ARRANGEMENT.—

(A) ARRANGEMENTS WHICH QUALIFY.—

(i) IN GENERAL.—A simplified employee pension shall not fail to meet the requirements of this subsection for a year merely because, under the terms of the pension, an employee may elect to have the employer make payments—

(I) as elective employer contributions to the simplified employee pension on behalf of the employee, or

(II) to the employee directly in cash.

(ii) 50 PERCENT OF ELIGIBLE EMPLOYEES MUST ELECT.—Clause (i) shall not apply to a simplified employee pension unless an election described in clause (i)(I) is made or is in effect with respect to not less than 50 percent of the employees of the employer eligible to participate.

(iii) REQUIREMENTS RELATING TO DEFERRAL PERCENTAGE.—Clause (i) shall not apply to a simplified employee pension for any year unless the deferral percentage for such year of each highly compensated employee eligible to participate is not more than the product of—

(I) the average of the deferral percentages for such year of all employees (other than highly compensated employees) eligible to participate, multiplied by

(II) 1.25.

(iv) LIMITATIONS ON ELECTIVE DEFERRALS.—Clause (i) shall not apply to a simplified employee pension unless the requirements of section 401(a)(30) are met.

(B) EXCEPTION WHERE MORE THAN 25 EMPLOYEES.—This paragraph shall not apply with respect to any year in the case of a simplified employee pension maintained by an employer with more than 25 employees who were eligible to participate (or would have been required to be eligible to participate if a pension was maintained) at any time during the preceding year.

(C) DISTRIBUTIONS OF EXCESS CONTRIBUTIONS.—

(i) IN GENERAL.—Rules similar to the rules of section 401(k)(8) shall apply to any excess contribution under this paragraph. Any excess contribution under a simplified employee pension shall be treated as an excess contribution for purposes of section 4979.

(ii) EXCESS CONTRIBUTION.—For purposes of clause (i), the term "excess contribution" means, with respect to a highly compensated employee, the excess of elective employer contributions under this paragraph over the maximum amount of such contributions allowable under subparagraph (A)(iii).

(D) DEFERRAL PERCENTAGE.—For purposes of this paragraph, the deferral percentage for an employee for a year shall be the ratio of—

(i) the amount of elective employer contributions actually paid over to the simplified employee pension on behalf of the employee for the year, to

(ii) the employee's compensation (not in excess of the first $200,000) for the year.

(E) EXCEPTION FOR STATE AND LOCAL AND TAX-EXEMPT PENSIONS.—This paragraph shall not apply to a simplified employee pension maintained by—

(i) a State or local government or political subdivision thereof, or any agency or instrumentality thereof, or

(ii) an organization exempt from tax under this title.

(F) EXCEPTION WHERE PENSION DOES NOT MEET REQUIREMENTS NECESSARY TO INSURE DISTRIBUTION OF EXCESS CONTRIBUTIONS.—This paragraph shall not apply with respect to any year for which the simplified employee pension does not meet such requirements as the Secretary may prescribe as are necessary to insure that excess contributions are distributed in accordance with subparagraph (C), including—

(i) reporting requirements, and

(ii) requirements which, notwithstanding paragraph (4), provide that contributions (and any income allocable thereto) may not be withdrawn from a simplified employee pension until a determination has been made that the requirements of subparagraph (A)(iii) have been met with respect to such contributions.

(G) HIGHLY COMPENSATED EMPLOYEE.—For purposes of this paragraph, the term "highly compensated employee" has the meaning given such term by section 414(q).

(H) TERMINATION.—This paragraph shall not apply to years beginning after December 31, 1996. The preceding sentence shall not apply to a simplified employee pension of an employer if the terms of simplified employee pensions of such employer, as in effect on December 31, 1996, provide that an employee may make the election described in subparagraph (A).

(7) DEFINITIONS.—For purposes of this subsection and subsection (*l*)—

(A) EMPLOYEE, EMPLOYER, OR OWNER-EMPLOYEE.—The terms "employee", "employer", and "owner-employee" shall have the respective meanings given such terms by section 401(c).

(B) COMPENSATION.—Except as provided in paragraph (2)(C), the term "compensation" has the meaning given such term by section 414(s).

(C) YEAR.—The term "year" means—

(i) the calendar year, or

(ii) if the employer elects, subject to such terms and conditions as the Secretary may prescribe, to maintain the simplified employee pension on the basis of the employer's taxable year.

(8) COST-OF-LIVING ADJUSTMENT.—The Secretary shall adjust the $450 amount in paragraph (2)(C) at the same time and in the same manner as under section 415(d) and shall adjust the $200,000 amount in paragraphs (3)(C) and (6)(D)(ii) at the same time, and by the same amount, as any adjustment under section 401(a)(17)(B); except that any increase in the $450 amount which is not a multiple of $50 shall be rounded to the next lowest multiple of $50.

(9) CROSS REFERENCE.—For excise tax on certain excess contributions, see section 4979.

(l) SIMPLIFIED EMPLOYER REPORTS.—

(1) IN GENERAL.—An employer who makes a contribution on behalf of an employee to a simplified employee pension shall provide such simplified reports with respect to such contributions as the Secretary may require by regulations. The reports required by this subsection shall be filed at such time and in such manner, and information with respect to such contributions shall be furnished to the employee at such time and in such manner, as may be required by regulations.

(2) SIMPLE RETIREMENT ACCOUNTS.—

(A) NO EMPLOYER REPORTS.—Except as provided in this paragraph, no report shall be required under this section by an employer maintaining a qualified salary reduction arrangement under subsection (p).

(B) SUMMARY DESCRIPTION.—The trustee of any simple retirement account established pursuant to a qualified salary reduction arrangement under subsection (p) and the issuer of an annuity established under such an arrangement shall provide to the employer maintaining the arrangement, each year a description containing the following information:

(i) The name and address of the employer and the trustee or issuer.

(ii) The requirements for eligibility for participation.

(iii) The benefits provided with respect to the arrangement.

(iv) The time and method of making elections with respect to the arrangement.

(v) The procedures for, and effects of, withdrawals (including rollovers) from the arrangement.

(C) EMPLOYEE NOTIFICATION.—The employer shall notify each employee immediately before the period for which an election described in subsection (p)(5)(C) may be made of the employee's opportunity to make such election. Such notice shall include a copy of the description described in subparagraph (B).

(m) INVESTMENT IN COLLECTIBLES TREATED AS DISTRIBUTIONS.—

(1) IN GENERAL.—The acquisition by an individual retirement account or by an individually-directed account under a plan de-

scribed in section 401(a) of any collectible shall be treated (for purposes of this section and section 402) as a distribution from such account in an amount equal to the cost to such account of such collectible.

(2) COLLECTIBLE DEFINED.—For purposes of this subsection, the term "collectible" means—

(A) any work of art,

(B) any rug or antique,

(C) any metal or gem,

(D) any stamp or coin,

(E) any alcoholic beverage, or

(F) any other tangible personal property specified by the Secretary for purposes of this subsection.

(3) EXCEPTION FOR CERTAIN COINS AND BULLION.—For purposes of this subsection, the term "collectible" shall not include—

(A) any coin which is—

(i) a gold coin described in paragraph (7), (8), (9), or (10) of section 5112(a) of title 31, United States Code,

(ii) a silver coin described in section 5112(e) of title 31, United States Code,

(iii) a platinum coin described in section 5112(k) of title 31, United States Code, or

(iv) a coin issued under the laws of any State, or

(B) any gold, silver, platinum, or palladium bullion of a fineness equal to or exceeding the minimum fineness that a contract market (as described in section 5 of the Commodity Exchange Act, 7 U.S.C. 7) requires for metals which may be delivered in satisfaction of a regulated futures contract,

if such bullion is in the physical possession of a trustee described under subsection (a) of this section.

(n) BANK.—For purposes of subsection (a)(2), the term "bank" means—

(1) any bank (as defined in section 581),

(2) an insured credit union (within the meaning of paragraph (6) or (7) of section 101 of the Federal Credit Union Act), and

(3) a corporation which, under the laws of the State of its incorporation, is subject to supervision and examination by the Commissioner of Banking or other officer of such State in charge of the administration of the banking laws of such State.

(o) DEFINITIONS AND RULES RELATING TO NONDEDUCTIBLE CONTRIBUTIONS TO INDIVIDUAL RETIREMENT PLANS.—

(1) IN GENERAL.—Subject to the provisions of this subsection, designated nondeductible contributions may be made on behalf of an individual to an individual retirement plan.

(2) LIMITS ON AMOUNTS WHICH MAY BE CONTRIBUTED.—

(A) IN GENERAL.—The amount of the designated nondeductible contributions made on behalf of any individual for any taxable year shall not exceed the nondeductible limit for such taxable year.

(B) NONDEDUCTIBLE LIMIT.—For purposes of this paragraph—

(i) IN GENERAL.—The term "nondeductible limit" means the excess of—

(I) the amount allowable as a deduction under section 219 (determined without regard to section 219(g)), over

(II) the amount allowable as a deduction under section 219 (determined with regard to section 219(g)).

(ii) TAXPAYER MAY ELECT TO TREAT DEDUCTIBLE CONTRIBUTIONS AS NONDEDUCTIBLE.—If a taxpayer elects not to deduct an amount which (without regard to this clause) is allowable as a deduction under section 219 for any taxable year, the nondeductible limit for such taxable year shall be increased by such amount.

(C) DESIGNATED NONDEDUCTIBLE CONTRIBUTIONS.—

(i) IN GENERAL.—For purposes of this paragraph, the term "designated nondeductible contribution" means any contribution to an individual retirement plan for the taxable year which is designated (in such manner as the Secretary may prescribe) as a contribution for which a deduction is not allowable under section 219.

(ii) DESIGNATION.—Any designation under clause (i) shall be made on the return of tax imposed by chapter 1 for the taxable year.

(3) TIME WHEN CONTRIBUTIONS MADE.—In determining for which taxable year a designated nondeductible contribution is made, the rule of section 219(f)(3) shall apply.

(4) INDIVIDUAL REQUIRED TO REPORT AMOUNT OF DESIGNATED NONDEDUCTIBLE CONTRIBUTIONS.—

(A) IN GENERAL.—Any individual who—

(i) makes a designated nondeductible contribution to any individual retirement plan for any taxable year, or

(ii) receives any amount from any individual retirement plan for any taxable year,

shall include on his return of the tax imposed by chapter 1 for such taxable year and any succeeding taxable year (or on such other form as the Secretary may prescribe for any such taxable year) information described in subparagraph (B).

(B) INFORMATION REQUIRED TO BE SUPPLIED.—The following information is described in this subparagraph:

(i) The amount of designated nondeductible contributions for the taxable year.

(ii) The amount of distributions from individual retirement plans for the taxable year.

(iii) The excess (if any) of—

(I) the aggregate amount of designated nondeductible contributions for all preceding taxable years, over

(II) the aggregate amount of distributions from individual retirement plans which was excludable from gross income for such taxable years.

(iv) The aggregate balance of all individual retirement plans of the individual as of the close of the calendar year in which the taxable year begins.

(v) Such other information as the Secretary may prescribe.

(C) PENALTY FOR REPORTING CONTRIBUTIONS NOT MADE.—For penalty where individual reports designated nondeductible contributions not made, see section 6693(b).

(p) SIMPLE RETIREMENT ACCOUNTS.—

(1) IN GENERAL.—For purposes of this title, the term "simple retirement account" means an individual retirement plan (as defined in section 7701(a)(37))—

(A) with respect to which the requirements of paragraphs (3), (4), and (5) are met; and

(B) except in the case of a rollover contribution described in subsection (d)(3)(G) or a rollover contribution otherwise described in subsection (d)(3) or in section 402(c), 403(a)(4), 403(b)(8), or 457(e)(16), which is made after the 2-year period described in section 72(t)(6), with respect to which the only contributions allowed are contributions under a qualified salary reduction arrangement.

(2) QUALIFIED SALARY REDUCTION ARRANGEMENT.—

(A) IN GENERAL.—For purposes of this subsection, the term "qualified salary reduction arrangement" means a written arrangement of an eligible employer under which—

(i) an employee eligible to participate in the arrangement may elect to have the employer make payments—

(I) as elective employer contributions to a simple retirement account on behalf of the employee, or

(II) to the employee directly in cash,

(ii) the amount which an employee may elect under clause (i) for any year is required to be expressed as a percentage of compensation and may not exceed a total of the applicable dollar amount for any year,

(iii) the employer is required to make a matching contribution to the simple retirement account for any year in an amount equal to so much of the amount the employee elects under clause (i)(I) as does not exceed the applicable percentage of compensation for the year, and

(iv) no contributions may be made other than contributions described in clause (i) or (iii).

(B) EMPLOYER MAY ELECT 2-PERCENT NONELECTIVE CONTRIBUTION.—

(i) IN GENERAL.—An employer shall be treated as meeting the requirements of subparagraph (A)(iii) for any year if, in lieu of the contributions described in such clause, the employer elects to make nonelective contributions of 2 percent of compensation for each employee who is eligible to participate in the arrangement and who has at least $5,000 of compensation from the employer for the year. If an employer makes an election under this subparagraph for any year, the employer shall notify employees of such election within a reasonable period of time before the 60-day period for such year under paragraph (5)(C).

(ii) COMPENSATION LIMITATION.—The compensation taken into account under clause (i) for any year shall not exceed the limitation in effect for such year under section 401(a)(17).

(C) DEFINITIONS.—For purposes of this subsection—

(i) ELIGIBLE EMPLOYER.—

(I) IN GENERAL.—The term "eligible employer" means, with respect to any year, an employer which had no more than 100 employees who received at least $5,000 of compensation from the employer for the preceding year.

(II) 2-YEAR GRACE PERIOD.—An eligible employer who establishes and maintains a plan under this subsection for 1 or more years and who fails to be an eligible employer for any subsequent year shall be treated as an eligible employer for the 2 years following the last year the employer was an eligible employer. If such failure is due to any acquisition, disposition, or similar transaction involving an eligible employer, the preceding sentence shall not apply.

(ii) APPLICABLE PERCENTAGE.—

(I) IN GENERAL.—The term "applicable percentage" means 3 percent.

(II) ELECTION OF LOWER PERCENTAGE.—An employer may elect to apply a lower percentage (not less than 1 percent) for any year for all employees eligible to participate in the plan for such year if the employer notifies the employees of such lower percentage within a reasonable period of time before the 60-day election period for such year under paragraph (5)(C). An employer may not elect a lower percentage under this subclause for any year if that election would result in the applicable percentage being lower than 3 percent in more than 2 of the years in the 5-year period ending with such year.

(III) SPECIAL RULE FOR YEARS ARRANGEMENT NOT IN EFFECT.—If any year in the 5-year period described in subclause (II) is a year prior to the first year for which any qualified salary reduction arrangement is in effect with respect to the employer (or any predecessor), the employer shall be treated as if the level of the employer matching contribution was at 3 percent of compensation for such prior year.

(D) ARRANGEMENT MAY BE ONLY PLAN OF EMPLOYER.—

(i) IN GENERAL.—An arrangement shall not be treated as a qualified salary reduction arrangement for any year if the employer (or any predecessor employer) maintained a qualified plan with respect to which contributions were made, or benefits were accrued, for service in any year in the period beginning with the year such arrangement became effective and ending with the year for which the determination is being

made. If only individuals other than employees described in subparagraph (A) of section 410(b)(3) are eligible to participate in such arrangement, then the preceding sentence shall be applied without regard to any qualified plan in which only employees so described are eligible to participate.

(ii) QUALIFIED PLAN.—For purposes of this subparagraph, the term "qualified plan" means a plan, contract, pension, or trust described in subparagraph (A) or (B) of section 219(g)(5).

(E) APPLICABLE DOLLAR AMOUNT; COST-OF-LIVING ADJUSTMENT.—

(i) IN GENERAL.—For purposes of subparagraph (A)(ii), the applicable amount is $10,000.

(ii) COST-OF-LIVING ADJUSTMENT.—In the case of a year beginning after December 31, 2005, the Secretary shall adjust the $10,000 amount under clause (i) at the same time and in the same manner as under section 415(d), except that the base period taken into account shall be the calendar quarter beginning July 1, 2004, and any increase under this subparagraph which is not a multiple of $500 shall be rounded to the next lower multiple of $500.

(3) VESTING REQUIREMENTS.—The requirements of this paragraph are met with respect to a simple retirement account if the employee's rights to any contribution to the simple retirement account are nonforfeitable. For purposes of this paragraph, rules similar to the rules of subsection (k)(4) shall apply.

(4) PARTICIPATION REQUIREMENTS.—

(A) IN GENERAL.—The requirements of this paragraph are met with respect to any simple retirement account for a year only if, under the qualified salary reduction arrangement, all employees of the employer who—

(i) received at least $5,000 in compensation from the employer during any 2 preceding years, and

(ii) are reasonably expected to receive at least $5,000 in compensation during the year,

are eligible to make the election under paragraph (2)(A)(i) or receive the nonelective contribution described in paragraph (2)(B).

(B) EXCLUDABLE EMPLOYEES.—An employer may elect to exclude from the requirement under subparagraph (A) employees described in section 410(b)(3).

(5) ADMINISTRATIVE REQUIREMENTS.—The requirements of this paragraph are met with respect to any simple retirement account if, under the qualified salary reduction arrangement—

(A) an employer must—

(i) make the elective employer contributions under paragraph (2)(A)(i) not later than the close of the 30-day period following the last day of the month with respect to which the contributions are to be made, and

(ii) make the matching contributions under paragraph (2)(A)(iii) or the nonelective contributions under

paragraph (2)(B) not later than the date described in section 404(m)(2)(B),

(B) an employee may elect to terminate participation in such arrangement at any time during the year, except that if an employee so terminates, the arrangement may provide that the employee may not elect to resume participation until the beginning of the next year, and

(C) each employee eligible to participate may elect, during the 60-day period before the beginning of any year (and the 60-day period before the first day such employee is eligible to participate), to participate in the arrangement, or to modify the amounts subject to such arrangement, for such year.

(6) DEFINITIONS.—For purposes of this subsection—

(A) COMPENSATION.—

(i) IN GENERAL.—The term "compensation" means amounts described in paragraphs (3) and (8) of section 6051(a). For purposes of the preceding sentence, amounts described in section 6051(a)(3) shall be determined without regard to section 3401(a)(3).

(ii) SELF-EMPLOYED.—In the case of an employee described in subparagraph (B), the term "compensation" means net earnings from self-employment determined under section 1402(a) without regard to any contribution under this subsection. The preceding sentence shall be applied as if the term "trade or business" for purposes of section 1402 included service described in section 1402(c)(6).

(B) EMPLOYEE.—The term "employee" includes an employee as defined in section 401(c)(1).

(C) YEAR.—The term "year" means the calendar year.

(7) USE OF DESIGNATED FINANCIAL INSTITUTION.—A plan shall not be treated as failing to satisfy the requirements of this subsection or any other provision of this title merely because the employer makes all contributions to the individual retirement accounts or annuities of a designated trustee or issuer. The preceding sentence shall not apply unless each plan participant is notified in writing (either separately or as part of the notice under subsection (*l*)(2)(C)) that the participant's balance may be transferred without cost or penalty to another individual account or annuity in accordance with subsection (d)(3)(G).

(8) COORDINATION WITH MAXIMUM LIMITATION UNDER SUBSECTION (A).—In the case of any simple retirement account, subsections (a)(1) and (b)(2) shall be applied by substituting "the sum of the dollar amount in effect under paragraph (2)(A)(ii) of this subsection and the employer contribution required under subparagraph (A)(iii) or (B)(i) of paragraph (2) of this subsection, whichever is applicable" for "the dollar amount in effect under section 219(b)(1)(A)".

(9) MATCHING CONTRIBUTIONS ON BEHALF OF SELF-EMPLOYED INDIVIDUALS NOT TREATED AS ELECTIVE EMPLOYER CONTRIBUTIONS.—Any matching contribution described in paragraph (2)(A)(iii) which is made on behalf of a self-employed individual (as defined in section 401(c)) shall not be treated as an elective

employer contribution to a simple retirement account for purposes of this title.

(10) SPECIAL RULES FOR ACQUISITIONS, DISPOSITIONS, AND SIMILAR TRANSACTIONS.—

(A) IN GENERAL.—An employer which fails to meet any applicable requirement by reason of an acquisition, disposition, or similar transaction shall not be treated as failing to meet such requirement during the transition period if—

(i) the employer satisfies requirements similar to the requirements of section 410(b)(6)(C)(i)(II); and

(ii) the qualified salary reduction arrangement maintained by the employer would satisfy the requirements of this subsection after the transaction if the employer which maintained the arrangement before the transaction had remained a separate employer.

(B) APPLICABLE REQUIREMENT.—For purposes of this paragraph, the term "applicable requirement" means—

(i) the requirement under paragraph (2)(A)(i) that an employer be an eligible employer;

(ii) the requirement under paragraph (2)(D) that an arrangement be the only plan of an employer; and

(iii) the participation requirements under paragraph (4).

(C) TRANSITION PERIOD.—For purposes of this paragraph, the term "transition period" means the period beginning on the date of any transaction described in subparagraph (A) and ending on the last day of the second calendar year following the calendar year in which such transaction occurs.

(q) DEEMED IRAS UNDER QUALIFIED EMPLOYER PLANS.—

(1) GENERAL RULE.—If—

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

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

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

(2) SPECIAL RULES FOR QUALIFIED EMPLOYER PLANS.—For purposes of this title, a qualified employer plan shall not fail to meet any requirement of this title solely by reason of establishing and maintaining a program described in paragraph (1).

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

(A) QUALIFIED EMPLOYER PLAN.—The term "qualified employer plan" has the meaning given such term by section 72(p)(4)(A)(i); except that such term shall also include an eligible deferred compensation plan (as defined in sec-

tion 457(b)) of an eligible employer described in section 457(e)(1)(A).

(B) VOLUNTARY EMPLOYEE CONTRIBUTION.—The term "voluntary employee contribution" means any contribution (other than a mandatory contribution within the meaning of section 411(c)(2)(C))—

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

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

(r) CROSS REFERENCES.—

(1) For tax on excess contributions in individual retirement accounts or annuities, see section 4973.

(2) For tax on certain accumulations in individual retirement accounts or annuities, see section 4974.

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Subpart B—SPECIAL RULES

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SEC. 415. LIMITATIONS ON BENEFITS AND CONTRIBUTION UNDER QUALIFIED PLANS.

(a) GENERAL RULE.—

(1) TRUSTS.—A trust which is a part of a pension, profitsharing, or stock bonus plan shall not constitute a qualified trust under section 401(a) if—

(A) in the case of a defined benefit plan, the plan provides for the payment of benefits with respect to a participant which exceed the limitation of subsection (b), or

(B) in the case of a defined contribution plan, contributions and other additions under the plan with respect to any participant for any taxable year exceed the limitation of subsection (c).

(2) SECTION APPLIES TO CERTAIN ANNUITIES AND ACCOUNTS.—In the case of—

(A) an employee annuity plan described in section 403(a),

(B) an annuity contract described in section 403(b), or

(C) a simplified employee pension described in section 408(k),

such a contract, plan, or pension shall not be considered to be described in section 403(a), 403(b), or 408(k), as the case may be, unless it satisfies the requirements of subparagraph (A) or subparagraph (B) of paragraph (1), whichever is appropriate, and has not been disqualified under subsection (g). In the case of an annuity contract described in section 403(b), the preceding sentence shall apply only to the portion of the annuity contract which exceeds the limitation of subsection (b) or the limitation of subsection (c), whichever is appropriate.

(b) LIMITATION FOR DEFINED BENEFIT PLANS.—

(1) IN GENERAL.—Benefits with respect to a participant exceed the limitation of this subsection if, when expressed as an

annual benefit (within the meaning of paragraph (2)), such annual benefit is greater than the lesser of—

(A) $160,000, or

(B) 100 percent of the participant's average compensation for his high 3 years.

(2) ANNUAL BENEFIT.—

(A) IN GENERAL.—For purposes of paragraph (1), the term "annual benefit" means a benefit payable annually in the form of a straight life annuity (with no ancillary benefits) under a plan to which employees do not contribute and under which no rollover contributions (as defined in sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16)) are made.

(B) ADJUSTMENT FOR CERTAIN OTHER FORMS OF BENEFIT.—If the benefit under the plan is payable in any form other than the form described in subparagraph (A), or if the employees contribute to the plan or make rollover contributions (as defined in sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16)), the determinations as to whether the limitation described in paragraph (1) has been satisfied shall be made, in accordance with regulations prescribed by the Secretary by adjusting such benefit so that it is equivalent to the benefit described in subparagraph (A). For purposes of this subparagraph, any ancillary benefit which is not directly related to retirement income benefits shall not be taken into account; and that portion of any joint and survivor annuity which constitutes a qualified joint and survivor annuity (as defined in section 417) shall not be taken into account.

(C) ADJUSTMENT TO $160,000 LIMIT WHERE BENEFIT BEGINS BEFORE AGE 62.—If the retirement income benefit under the plan begins before age 62, the determination as to whether the $160,000 limitation set forth in paragraph (1)(A) has been satisfied shall be made, in accordance with regulations prescribed by the Secretary, by reducing the limitation of paragraph (1)(A) so that such limitation (as so reduced) equals an annual benefit (beginning when such retirement income benefit begins) which is equivalent to a $160,000 annual benefit beginning at age 62.

(D) ADJUSTMENT TO $160,000 LIMIT WHERE BENEFIT BEGINS AFTER AGE 65.—If the retirement income benefit under the plan begins after age 65, the determination as to whether the $160,000 limitation set forth in paragraph (1)(A) has been satisfied shall be made, in accordance with regulations prescribed by the Secretary, by increasing the limitation of paragraph (1)(A) so that such limitation (as so increased) equals an annual benefit (beginning when such retirement income benefit begins) which is equivalent to a $160,000 annual benefit beginning at age 65.

(E) LIMITATION ON CERTAIN ASSUMPTIONS.—(i) For purposes of adjusting any limitation under subparagraph (C) and, except as provided in clause (ii), for purposes of adjusting any benefit under subparagraph (B), the interest rate assumption shall not be less than the greater of 5 percent or the rate specified in the plan.

(ii) For purposes of adjusting any benefit under subparagraph (B) for any form of benefit subject to section 417(e)(3), the interest rate assumption shall not be less than the greatest of—

(I) 5.5 percent,

(II) the rate that provides a benefit of not more than 105 percent of the benefit that would be provided if the applicable interest rate (as defined in section 417(e)(3)) were the interest rate assumption, or

(III) the rate specified under the plan.

(iii) For purposes of adjusting any limitation under subparagraph (D), the interest rate assumption shall not be greater than the lesser of 5 percent or the rate specified in the plan.

(iv) For purposes of this subsection, no adjustments under subsection (d)(1) shall be taken into account before the year for which such adjustment first takes effect.

(v) For purposes of adjusting any benefit or limitation under subparagraph (B), (C), or (D), the mortality table used shall be the applicable mortality table (within the meaning of section 417(e)(3)(B)).

(vi) In the case of a plan maintained by an eligible employer (as defined in section 408(p)(2)(C)(i)), clause (ii) shall be applied without regard to subclause (II) thereof.

(G) SPECIAL LIMITATION FOR QUALIFIED POLICE OR FIREFIGHTERS.—In the case of a qualified participant, subparagraph (C) of this paragraph shall not apply.

(H) QUALIFIED PARTICIPANT DEFINED.—For purposes of subparagraph (G), the term "qualified participant" means a participant—

(i) in a defined benefit plan which is maintained by a State, Indian tribal government (as defined in section 7701(a)(40)), or any political subdivision thereof,

(ii) with respect to whom the period of service taken into account in determining the amount of the benefit under such defined benefit plan includes at least 15 years of service of the participant—

(I) as a full-time employee of any police department or fire department which is organized and operated by the State, Indian tribal government (as so defined), or any political subdivision maintaining such defined benefit plan to provide police protection, firefighting services, or emergency medical services for any area within the jurisdiction of such State, Indian tribal government (as so defined), or any political subdivision, or

(II) as a member of the Armed Forces of the United States.

(I) EXEMPTION FOR SURVIVOR AND DISABILITY BENEFITS PROVIDED UNDER GOVERNMENTAL PLANS.—Subparagraph (C) of this paragraph and paragraph (5) shall not apply to—

(i) income received from a governmental plan (as defined in section 414(d)) as a pension, annuity, or simi-

lar allowance as the result of the recipient becoming disabled by reason of personal injuries or sickness, or

(ii) amounts received from a governmental plan by the beneficiaries, survivors, or the estate of an employee as the result of the death of the employee.

(3) AVERAGE COMPENSATION FOR HIGH 3 YEARS.—For purposes of paragraph (1), a participant's high 3 years shall be the period of consecutive calendar years (not more than 3) during which the participant had the greatest aggregate compensation from the employer. In the case of an employee within the meaning of section 401(c)(1), the preceding sentence shall be applied by substituting for "compensation from the employer" the following: "the participant's earned income (within the meaning of section 401(c)(2) but determined without regard to any exclusion under section 911)".

(4) TOTAL ANNUAL BENEFITS NOT IN EXCESS OF $10,000.—Notwithstanding the preceding provisions of this subsection, the benefits payable with respect to a participant under any defined benefit plan shall be deemed not to exceed the limitation of this subsection if—

(A) the retirement benefits payable with respect to such participant under such plan and under all other defined benefit plans of the employer do not exceed $10,000 for the plan year, or for any prior plan year, and

(B) the employer has not at any time maintained a defined contribution plan in which the participant participated.

(5) REDUCTION FOR PARTICIPATION OR SERVICE OF LESS THAN 10 YEARS.—

(A) DOLLAR LIMITATION.—In the case of an employee who has less than 10 years of participation in a defined benefit plan, the limitation referred to in paragraph (1)(A) shall be the limitation determined under such paragraph (without regard to this paragraph) multiplied by a fraction—

(i) the numerator of which is the number of years (or part thereof) of participation in the defined benefit plan of the employer, and

(ii) the denominator of which is 10.

(B) COMPENSATION AND BENEFITS LIMITATIONS.—The provisions of subparagraph (A) shall apply to the limitations under paragraphs (1)(B) and (4), except that such subparagraph shall be applied with respect to years of service with an employer rather than years of participation in a plan.

(C) LIMITATION ON REDUCTION.—In no event shall subparagraph (A) or (B) reduce the limitations referred to in paragraphs (1) and (4) to an amount less than ? of such limitation (determined without regard to this paragraph).

(D) APPLICATION TO CHANGES IN BENEFIT STRUCTURE.—To the extent provided in regulations, subparagraph (A) shall be applied separately with respect to each change in the benefit structure of a plan.

(6) COMPUTATION OF BENEFITS AND CONTRIBUTIONS.—The computation of—

(A) benefits under a defined contribution plan, for purposes of section 401(a)(4),

(B) contributions made on behalf of a participant in a defined benefit plan, for purposes of section 401(a)(4), and

(C) contributions and benefits provided for a participant in a plan described in section 414(k), for purposes of this section

shall not be made on a basis inconsistent with regulations prescribed by the Secretary.

(7) BENEFITS UNDER CERTAIN COLLECTIVELY BARGAINED PLANS.—For a year, the limitation referred to in paragraph (1)(B) shall not apply to benefits with respect to a participant under a defined benefit plan (other than a multiemployer plan)—

(A) which is maintained for such year pursuant to a collective bargaining agreement between employee representatives and one or more employers,

(B) which, at all times during such year, has at least 100 participants,

(C) under which benefits are determined solely by reference to length of service, the particular years during which service was rendered, age at retirement, and date of retirement,

(D) which provides that an employee who has at least 4 years of service has a nonforfeitable right to 100 percent of his accrued benefit derived from employer contributions, and

(E) which requires, as a condition of participation in the plan, that an employee complete a period of not more than 60 consecutive days of service with the employer or employers maintaining the plan.

This paragraph shall not apply to a participant whose compensation for any 3 years during the 10-year period immediately preceding the year in which he separates from service exceeded the average compensation for such 3 years of all participants in such plan. This paragraph shall not apply to a participant for any period for which he is a participant under another plan to which this section applies which is maintained by an employer maintaining this plan. For any year for which the paragraph applies to benefits with respect to a participant, paragraph (1)(A) and subsection (d)(1)(A) shall be applied with respect to such participant by substituting one-half the amount otherwise applicable for such year under paragraph (1)(A) for "$160,000".

(8) SOCIAL SECURITY RETIREMENT AGE DEFINED.—For purposes of this subsection, the term "social security retirement age" means the age used as the retirement age under section 216(*l*) of the Social Security Act, except that such section shall be applied—

(A) without regard to the age increase factor, and

(B) as if the early retirement age under section 216(*l*)(2) of such Act were 62.

(9) SPECIAL RULE FOR COMMERCIAL AIRLINE PILOTS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), in the case of any participant who is a commercial air-

line pilot, if, as of the time of the participant's retirement, regulations prescribed by the Federal Aviation Administration require an individual to separate from service as a commercial airline pilot after attaining any age occurring on or after age 60 and before age 62, paragraph (2)(C) shall be applied by substituting such age for age 62.

(B) INDIVIDUALS WHO SEPARATE FROM SERVICE BEFORE AGE 60.—If a participant described in subparagraph (A) separates from service before age 60, the rules of paragraph (2)(C) shall apply.

(10) SPECIAL RULE FOR STATE, INDIAN TRIBAL, AND LOCAL GOVERNMENT PLANS.—

(A) LIMITATION TO EQUAL ACCRUED BENEFIT.—In the case of a plan maintained for its employees by any State or political subdivision thereof, or by any agency or instrumentality of the foregoing, or a governmental plan described in the last sentence of section 414(d) (relating to plans of Indian tribal governments), the limitation with respect to a qualified participant under this subsection shall not be less than the accrued benefit of the participant under the plan (determined without regard to any amendment of the plan made after October 14, 1987).

(B) QUALIFIED PARTICIPANT.—For purposes of this paragraph, the term "qualified participant" means a participant who first became a participant in the plan maintained by the employer before January 1, 1990.

(C) ELECTION.—

(i) IN GENERAL.—This paragraph shall not apply to any plan unless each employer maintaining the plan elects before the close of the 1st plan year beginning after December 31, 1989, to have this subsection (other than paragraph (2)(G)).

(ii) REVOCATION OF ELECTION.—An election under clause (i) may be revoked not later than the last day of the third plan year beginning after the date of the enactment of this clause. The revocation shall apply to all plan years to which the election applied and to all subsequent plan years. Any amount paid by a plan in a taxable year ending after the revocation shall be includible in income in such taxable year under the rules of this chapter in effect for such taxable year, except that, for purposes of applying the limitations imposed by this section, any portion of such amount which is attributable to any taxable year during which the election was in effect shall be treated as received in such taxable year.

(11) SPECIAL LIMITATION RULE FOR GOVERNMENTAL AND MULTIEMPLOYER PLANS.—In the case of a governmental plan (as defined in section 414(d)) or a multiemployer plan (as defined in section 414(f)), subparagraph (B) of paragraph (1) shall not apply. Subparagraph (B) of paragraph (1) shall not apply to a plan maintained by an organization described in section 3121(w)(3)(A) except with respect to highly compensated benefits. For purposes of this paragraph, the term "highly compensated benefits" means any benefits accrued for an employee

in any year on or after the first year in which such employee is a highly compensated employee (as defined in section 414(q)) of the organization described in section 3121(w)(3)(A). For purposes of applying paragraph (1)(B) to highly compensated benefits, all benefits of the employee otherwise taken into account (without regard to this paragraph) shall be taken into account.

(c) LIMITATION FOR DEFINED CONTRIBUTION PLANS.—

(1) IN GENERAL.—Contributions and other additions with respect to a participant exceed the limitation of this subsection if, when expressed as an annual addition (within the meaning of paragraph (2)) to the participant's account, such annual addition is greater than the lesser of—

(A) $40,000, or

(B) 100 percent of the participant's compensation.

(2) ANNUAL ADDITION.—For purposes of paragraph (1), the term "annual addition" means the sum of any year of—

(A) employer contributions,

(B) the employee contributions, and

(C) forfeitures.

For the purposes of this paragraph, employee contributions under subparagraph (B) are determined without regard to any rollover contributions (as defined in sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16)) without regard to employee contributions to a simplified employee pension which are excludable from gross income under section 408(k)(6). Subparagraph (B) of paragraph (1) shall not apply to any contribution for medical benefits (within the meaning of section 419A(f)(2)) after separation from service which is treated as an annual addition.

(3) PARTICIPANT'S COMPENSATION.—For purposes of paragraph (1)—

(A) IN GENERAL.—The term "participant's compensation" means the compensation of the participant from the employer for the year.

(B) SPECIAL RULE FOR SELF-EMPLOYED INDIVIDUALS.—In the case of an employee within the meaning of section 401(c)(1), subparagraph (A) shall be applied by substituting "the participant's earned income (within the meaning of section 401(c)(2) but determined without regard to any exclusion under section 911)" for "compensation of the participant from the employer".

(C) SPECIAL RULES FOR PERMANENT AND TOTAL DISABILITY.—In the case of a participant in any defined contribution plan—

(i) who is permanently and totally disabled (as defined in section 22(e)(3)),

(ii) who is not a highly compensated employee (within the meaning of section 414(q)), and

(iii) with respect to whom the employer elects, at such time and in such manner as the Secretary may prescribe, to have this subparagraph apply,

the term "participant's compensation" means the compensation the participant would have received for the year if the participant was paid at the rate of compensation paid immediately before becoming permanently and totally

disabled. This subparagraph shall apply only if contributions made with respect to amounts treated as compensation under this subparagraph are nonforfeitable when made. If a defined contribution plan provides for the continuation of contributions on behalf of all participants described in clause (i) for a fixed or determinable period, this subparagraph shall be applied without regard to clauses (ii) and (iii).

(D) CERTAIN DEFERRALS INCLUDED.—The term "participant's compensation" shall include—

(i) any elective deferral (as defined in section 402(g)(3)), and

(ii) any amount which is contributed or deferred by the employer at the election of the employee and which is not includible in the gross income of the employee by reason of section 125, 132(f)(4), or 457.

(E) ANNUITY CONTRACTS.—In the case of an annuity contract described in section 403(b), the term "participant's compensation" means the participant's includible compensation determined under section 403(b)(3).

(6) SPECIAL RULE FOR EMPLOYEE STOCK OWNERSHIP PLANS.—If no more than one-third of the employer contributions to an employee stock ownership plan (as described in section 4975(e)(7)) for a year which are deductible under paragraph (9) of section 404(a) are allocated to highly compensated employees (within the meaning of section 414(q)), the limitations imposed by this section shall not apply to—

(A) forfeitures of employer securities (within the meaning of section 409) under such an employee stock ownership plan if such securities were acquired with the proceeds of a loan (as described in section 404(a)(9)(A)), or

(B) employer contributions to such an employee stock ownership plan which are deductible under section 404(a)(9)(B) and charged against the participant's account.

The amount of any qualified gratuitous transfer (as defined in section 664(g)(1)) allocated to a participant for any limitation year shall not exceed the limitations imposed by this section, but such amount shall not be taken into account in determining whether any other amount exceeds the limitations imposed by this section.

(7) SPECIAL RULES RELATING TO CHURCH PLANS.—

(A) ALTERNATIVE CONTRIBUTION LIMITATION.—

(i) IN GENERAL.—Notwithstanding any other provision of this subsection, at the election of a participant who is an employee of a church or a convention or association of churches, including an organization described in section 414(e)(3)(B)(ii), contributions and other additions for an annuity contract or retirement income account described in section 403(b) with respect to such participant, when expressed as an annual addition to such participant's account, shall be treated as not exceeding the limitation of paragraph (1) if such annual addition is not in excess of $10,000.

(ii) $40,000 AGGREGATE LIMITATION.—The total amount of additions with respect to any participant

which may be taken into account for purposes of this subparagraph for all years may not exceed $40,000.

(B) NUMBER OF YEARS OF SERVICE FOR DULY ORDAINED, COMMISSIONED, OR LICENSED MINISTERS OR LAY EMPLOYEES.—For purposes of this paragraph—

(i) all years of service by—

(I) a duly ordained, commissioned, or licensed minister of a church, or

(II) a lay person,

as an employee of a church, a convention or association of churches, including an organization described in section 414(e)(3)(B)(ii), shall be considered as years of service for 1 employer, and

(ii) all amounts contributed for annuity contracts by each such church (or convention or association of churches) or such organization during such years for such minister or lay person shall be considered to have been contributed by 1 employer.

(C) FOREIGN MISSIONARIES.—In the case of any individual described in subparagraph (B) performing services outside the United States, contributions and other additions for an annuity contract or retirement income account described in section 403(b) with respect to such employee, when expressed as an annual addition to such employee's account, shall not be treated as exceeding the limitation of paragraph (1) if such annual addition is not in excess of $3,000. This subparagraph shall not apply with respect to any taxable year to any individual whose adjusted gross income for such taxable year (determined separately and without regard to community property laws) exceeds $17,000.

(D) ANNUAL ADDITION.—For purposes of this paragraph, the term "annual addition" has the meaning given such term by paragraph (2).

(E) CHURCH, CONVENTION OR ASSOCIATION OF CHURCHES.—For purposes of this paragraph, the terms "church" and "convention or association of churches" have the same meaning as when used in section 414(e).

(d) COST-OF-LIVING ADJUSTMENTS.—

(1) IN GENERAL.—The Secretary shall adjust annually—

(A) the $160,000 amount in subsection (b)(1)(A),

(B) in the case of a participant who is separated from service, the amount taken into account under subsection (b)(1)(B), and

(C) the $40,000 amount in subsection (c)(1)(A),

for increases in the cost-of-living in accordance with regulations prescribed by the Secretary.

(2) METHOD.—The regulations prescribed under paragraph (1) shall provide for—

(A) an adjustment with respect to any calendar year based on the increase in the applicable index for the calendar quarter ending September 30 of the preceding calendar year over such index for the base period, and

(B) adjustment procedures which are similar to the procedures used to adjust benefit amounts under section 215(i)(2)(A) of the Social Security Act.

(3) BASE PERIOD.—For purposes of paragraph (2)—

(A) $160,000 AMOUNT.—The base period taken into account for purposes of paragraph (1)(A) is the calendar quarter beginning July 1, 2001.

(B) SEPARATIONS AFTER DECEMBER 31, 1994.—The base period taken into account for purposes of paragraph (1)(B) with respect to individuals separating from service with the employer after December 31, 1994, is the calendar quarter beginning July 1 of the calendar year preceding the calendar year in which such separation occurs.

(C) SEPARATIONS BEFORE JANUARY 1, 1995.—The base period taken into account for purposes of paragraph (1)(B) with respect to individuals separating from service with the employer before January 1, 1995, is the calendar quarter beginning October 1 of the calendar year preceding the calendar year in which such separation occurs.

(D) $40,000 AMOUNT.—The base period taken into account for purposes of paragraph (1)(C) is the calendar quarter beginning July 1, 2001.

(4) ROUNDING.—

(A) $160,000 AMOUNT.—Any increase under subparagraph (A) of paragraph (1) which is not a multiple of $5,000 shall be rounded to the next lowest multiple of $5,000. This subparagraph shall also apply for purposes of any provision of this title that provides for adjustments in accordance with the method contained in this subsection, except to the extent provided in such provision.

(B) $40,000 AMOUNT.—Any increase under subparagraph (C) of paragraph (1) which is not a multiple of $1,000 shall be rounded to the next lowest multiple of $1,000.

(f) COMBINING OF PLANS.—

(1) IN GENERAL.—For purposes of applying the limitations of subsections (b) and (c)—

(A) all defined benefit plans (whether or not terminated) of an employer are to be treated as one defined benefit plan, and

(B) all defined contribution plans (whether or not terminated) of an employer are to be treated as one defined contribution plan.

(2) EXCEPTION FOR MULTIEMPLOYER PLANS.—Notwithstanding paragraph (1) and subsection (g), a multiemployer plan (as defined in section 414(f)) shall not be combined or aggregated—

(A) with any other plan which is not a multiemployer plan for purposes of applying subsection (b)(1)(B) to such other plan, or

(B) with any other multiemployer plan for purposes of applying the limitations established in this section.

(g) AGGREGATION OF PLANS.—Except as provided in subsection (f)(2), the Secretary, in applying the provisions of this section to benefits or contributions under more than one plan maintained by the same employer, and to any trusts, contracts, accounts, or bonds

referred to in subsection (a)(2), with respect to which the participant has the control required under section 414(b) or (c), as modified by subsection (h), shall, under regulations prescribed by the Secretary, disqualify one or more trusts, plans, contracts, accounts, or bonds, or any combination thereof until such benefits or contributions do not exceed the limitations contained in this section. In addition to taking into account such other factors as may be necessary to carry out the purposes of subsection (f), the regulations prescribed under this paragraph shall provide that no plan which has been terminated shall be disqualified until all other trusts, plans, contracts, accounts, or bonds have been disqualified.

(h) 50 PERCENT CONTROL.—For purposes of applying subsections (b) and (c) of section 414 to this section, the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in section 1563(a)(1).

(i) RECORDS NOT AVAILABLE FOR PAST PERIODS.—Where for the period before January 1, 1976, or (if later) the first day of the first plan year of the plan, the records necessary for the application of this section are not available, the Secretary may by regulations prescribe alternate methods for determining the amounts to be taken into account for such period.

(j) REGULATIONS; DEFINITION OF YEAR.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section, including, but not limited to, regulations defining the term "year" for purposes of any provision of this section.

(k) SPECIAL RULES.—

(1) DEFINED BENEFIT PLAN AND DEFINED CONTRIBUTION PLAN.—For purposes of this title, the term "defined contribution plan" or "defined benefit plan" means a defined contribution plan (within the meaning of section 414(i)) or a defined benefit plan (within the meaning of section 414(j)), whichever applies, which is—

(A) a plan described in section 401(a) which includes a trust which is exempt from tax under section 501(a),

(B) an annuity plan described in section 403(a),

(C) an annuity contract described in section 403(b), or

(D) a simplified employee pension.

(2) CONTRIBUTIONS TO PROVIDE COST-OF-LIVING PROTECTION UNDER DEFINED BENEFIT PLANS.—

(A) IN GENERAL.—In the case of a defined benefit plan which maintains a qualified cost-of-living arrangement—

(i) any contribution made directly by an employee under such an arrangement shall not be treated as an annual addition for purposes of subsection (c), and

(ii) any benefit under such arrangement which is allocable to an employer contribution which was transferred from a defined contribution plan and to which the requirements of subsection (c) were applied shall, for purposes of subsection (b), be treated as a benefit derived from an employee contribution (and subsection (c) shall not again apply to such contribution by reason of such transfer).

(B) QUALIFIED COST-OF-LIVING ARRANGEMENT DEFINED.—For purposes of this paragraph, the term "qualified cost-of-

living arrangement" means an arrangement under a defined benefit plan which—

(i) provides a cost-of-living adjustment to a benefit provided under such plan or a separate plan subject to the requirements of section 412, and

(ii) meets the requirements of subparagraphs (C), (D), (E), and (F) and such other requirements as the Secretary may prescribe.

(C) DETERMINATION OF AMOUNT OF BENEFIT.—An arrangement meets the requirement of this subparagraph only if the cost-of-living adjustment of participants is based—

(i) on increases in the cost-of-living after the annuity starting date, and

(ii) on average cost-of-living increases determined by reference to 1 or more indexes prescribed by the Secretary, except that the arrangement may provide that the increase for any year will not be less than 3 percent of the retirement benefit (determined without regard to such increase).

(D) ARRANGEMENT ELECTIVE; TIME FOR ELECTION.—An arrangement meets the requirements of this subparagraph only if it is elective, it is available under the same terms to all participants, and it provides that such election may at least be made in the year in which the participant—

(i) attains the earliest retirement age under the defined benefit plan (determined without regard to any requirement of separation from service), or

(ii) separates from service.

(E) NONDISCRIMINATION REQUIREMENTS.—An arrangement shall not meet the requirements of this subparagraph if the Secretary finds that a pattern of discrimination exists with respect to participation.

(F) SPECIAL RULES FOR KEY EMPLOYEES.—

(i) IN GENERAL.—An arrangement shall not meet the requirements of this paragraph if any key employee is eligible to participate.

(ii) KEY EMPLOYEE.—For purposes of this subparagraph, the term "key employee" has the meaning given such term by section 416(i)(1), except that in the case of a plan other than a top-heavy plan (within the meaning of section 416(g)), such term shall not include an individual who is a key employee solely by reason of section 416(i)(1)(A)(i).

(3) REPAYMENTS OF CASHOUTS UNDER GOVERNMENTAL PLANS.—In the case of any repayment of contributions (including interest thereon) to the governmental plan with respect to an amount previously refunded upon a forfeiture of service credit under the plan or under another governmental plan maintained by a State or local government employer within the same State, any such repayment shall not be taken into account for purposes of this section.

(4) SPECIAL RULES FOR SECTIONS 403(B) AND 408.—For purposes of this section, any annuity contract described in section 403(b) for the benefit of a participant shall be treated as a de-

fined contribution plan maintained by each employer with respect to which the participant has the control required under subsection (b) or (c) of section 414 (as modified by subsection (h)). For purposes of this section, any contribution by an employer to a simplified employee pension plan for an individual for a taxable year shall be treated as an employer contribution to a defined contribution plan for such individual for such year.

(l) TREATMENT OF CERTAIN MEDICAL BENEFITS.—

(1) IN GENERAL.—For purposes of this section, contributions allocated to any individual medical benefit account which is part of a pension or annuity plan shall be treated as an annual addition to a defined contribution plan for purposes of subsection (c). Subparagraph (B) of subsection (c)(1) shall not apply to any amount treated as an annual addition under the preceding sentence.

(2) INDIVIDUAL MEDICAL BENEFIT ACCOUNT.—For purposes of paragraph (1), the term "individual medical benefit account" means any separate account—

(A) which is established for a participant under a pension or annuity plan, and

(B) from which benefits described in section 401(h) are payable solely to such participant[, his spouse, or his dependents] *or the participant's spouse or dependents*.

(m) TREATMENT OF QUALIFIED GOVERNMENTAL EXCESS BENEFIT ARRANGEMENTS.—

(1) GOVERNMENTAL PLAN NOT AFFECTED.—In determining whether a governmental plan (as defined in section 414(d)) meets the requirements of this section, benefits provided under a qualified governmental excess benefit arrangement shall not be taken into account. Income accruing to a governmental plan (or to a trust that is maintained solely for the purpose of providing benefits under a qualified governmental excess benefit arrangement) in respect of a qualified governmental excess benefit arrangement shall constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) shall be exempt from tax under section 115.

(2) TAXATION OF PARTICIPANT.—For purposes of this chapter—

(A) the taxable year or years for which amounts in respect of a qualified governmental excess benefit arrangement are includible in gross income by a participant, and

(B) the treatment of such amounts when so includible by the participant,

shall be determined as if such qualified governmental excess benefit arrangement were treated as a plan for the deferral of compensation which is maintained by a corporation not exempt from tax under this chapter and which does not meet the requirements for qualification under section 401.

(3) QUALIFIED GOVERNMENTAL EXCESS BENEFIT ARRANGEMENT.—For purposes of this subsection, the term "qualified governmental excess benefit arrangement" means a portion of a governmental plan if—

(A) such portion is maintained solely for the purpose of providing to participants in the plan that part of the par-

ticipant's annual benefit otherwise payable under the terms of the plan that exceeds the limitations on benefits imposed by this section,

(B) under such portion no election is provided at any time to the participant (directly or indirectly) to defer compensation, and

(C) benefits described in subparagraph (A) are not paid from a trust forming a part of such governmental plan unless such trust is maintained solely for the purpose of providing such benefits.

(n) SPECIAL RULES RELATING TO PURCHASE OF PERMISSIVE SERVICE CREDIT.—

(1) IN GENERAL.—If a participant makes 1 or more contributions to a defined benefit governmental plan (within the meaning of section 414(d)) to purchase permissive service credit under such plan, then the requirements of this section shall be treated as met only if—

(A) the requirements of subsection (b) are met, determined by treating the accrued benefit derived from all such contributions as an annual benefit for purposes of subsection (b), or

(B) the requirements of subsection (c) are met, determined by treating all such contributions as annual additions for purposes of subsection (c).

(2) APPLICATION OF LIMIT.—For purposes of—

(A) applying paragraph (1)(A), the plan shall not fail to meet the reduced limit under subsection (b)(2)(C) solely by reason of this subsection, and

(B) applying paragraph (1)(B), the plan shall not fail to meet the percentage limitation under subsection (c)(1)(B) solely by reason of this subsection.

(3) PERMISSIVE SERVICE CREDIT.—For purposes of this subsection—

(A) IN GENERAL.—The term "permissive service credit" means service credit—

(i) recognized by the governmental plan for purposes of calculating a participant's benefit under the plan,

(ii) which such participant has not received under such governmental plan, and

(iii) which such participant may receive only by making a voluntary additional contribution, in an amount determined under such governmental plan, which does not exceed the amount necessary to fund the benefit attributable to such service credit.

Such term may include service credit for periods for which there is no performance of service, and, notwithstanding clause (ii), may include service credited in order to provide an increased benefit for service credit which a participant is receiving under the plan.

(B) LIMITATION ON NONQUALIFIED SERVICE CREDIT.—A plan shall fail to meet the requirements of this section if—

(i) more than 5 years of nonqualified service credit are taken into account for purposes of this subsection, or

(ii) any nonqualified service credit is taken into account under this subsection before the employee has at least 5 years of participation under the plan.

(C) NONQUALIFIED SERVICE CREDIT.—For purposes of subparagraph (B), the term "nonqualified service credit" means permissive service credit other than that allowed with respect to—

(i) service (including parental, medical, sabbatical, and similar leave) as an employee of the Government of the United States, any State or political subdivision thereof, or any agency or instrumentality of any of the foregoing (other than military service or service for credit which was obtained as a result of a repayment described in subsection (k)(3)),

(ii) service (including parental, medical, sabbatical, and similar leave) as an employee (other than as an employee described in clause (i)) of an educational organization described in section 170(b)(1)(A)(ii) which is a public, private, or sectarian school which provides elementary or secondary education (through grade 12), or a comparable level of education, as determined under the applicable law of the jurisdiction in which the service was performed,

(iii) service as an employee of an association of employees who are described in clause (i), or

(iv) military service (other than qualified military service under section 414(u)) recognized by such governmental plan.

In the case of service described in clause (i), (ii), or (iii), such service will be nonqualified service if recognition of such service would cause a participant to receive a retirement benefit for the same service under more than one plan.

(D) SPECIAL RULES FOR TRUSTEE-TO-TRUSTEE TRANSFERS.—In the case of a trustee-to-trustee transfer to which section 403(b)(13)(A) or 457(e)(17)(A) applies (without regard to whether the transfer is made between plans maintained by the same employer)—

(i) the limitations of subparagraph (B) shall not apply in determining whether the transfer is for the purchase of permissive service credit, and

(ii) the distribution rules applicable under this title to the defined benefit governmental plan to which any amounts are so transferred shall apply to such amounts and any benefits attributable to such amounts.

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Subpart E—TREATMENT OF TRANSFERS TO RETIREE HEALTH ACCOUNTS

* * * * * * *

SEC. 420. TRANSFERS OF EXCESS PENSION ASSETS TO RETIREE HEALTH ACCOUNTS.

(a) GENERAL RULE.—If there is a qualified transfer of any excess pension assets of a defined benefit plan to a health benefits account, or an applicable life insurance account, which is part of such plan—

(1) a trust which is part of such plan shall not be treated as failing to meet the requirements of subsection (a) or (h) of section 401 solely by reason of such transfer (or any other action authorized under this section),

(2) no amount shall be includible in the gross income of the employer maintaining the plan solely by reason of such transfer,

(3) such transfer shall not be treated—

(A) as an employer reversion for purposes of section 4980, or

(B) as a prohibited transaction for purposes of section 4975, and

(4) the limitations of subsection (d) shall apply to such employer.

(b) QUALIFIED TRANSFER.—For purposes of this section—

(1) IN GENERAL.—The term "qualified transfer" means a transfer—

(A) of excess pension assets of a defined benefit plan to a health benefits account, or an applicable life insurance account, which is part of such plan,

(B) which does not contravene any other provision of law, and

(C) with respect to which the following requirements are met in connection with the plan—

(i) the use requirements of subsection (c)(1),

(ii) the vesting requirements of subsection (c)(2), and

(iii) the minimum cost requirements of subsection (c)(3).

(2) ONLY 1 TRANSFER PER YEAR.—No more than 1 transfer with respect to any plan during a taxable year may be treated as a qualified transfer for purposes of this section. If there is a transfer from a defined benefit plan to both a health benefits account and an applicable life insurance account during any taxable year, such transfers shall be treated as 1 transfer for purposes of this paragraph.

(3) LIMITATION ON AMOUNT TRANSFERRED.—The amount of excess pension assets which may be transferred to an account in a qualified transfer shall not exceed the amount which is reasonably estimated to be the amount the employer maintaining the plan will pay (whether directly or through reimbursement) out of such account during the taxable year of the transfer for qualified current retiree liabilities.

(4) EXPIRATION.—No transfer made after December 31, 2025, shall be treated as a qualified transfer.

(c) REQUIREMENTS OF PLANS TRANSFERRING ASSETS.—

(1) USE OF TRANSFERRED ASSETS.—

(A) IN GENERAL.—Any assets transferred to a health benefits account, or an applicable life insurance account, in a qualified transfer (and any income allocable thereto)

shall be used only to pay qualified current retiree liabilities (other than liabilities of key employees not taken into account under subsection (e)(1)(E)) for the taxable year of the transfer (whether directly or through reimbursement). In the case of a qualified future transfer or collectively bargained transfer to which subsection (f) applies, any assets so transferred may also be used to pay liabilities described in subsection (f)(2)(C).

(B) AMOUNTS NOT USED TO PAY FOR HEALTH BENEFITS OR LIFE INSURANCE.—

(i) IN GENERAL.—Any assets transferred to a health benefits account, or an applicable life insurance account, in a qualified transfer (and any income allocable thereto) which are not used as provided in subparagraph (A) shall be transferred out of the account to the transferor plan.

(ii) TAX TREATMENT OF AMOUNTS.—Any amount transferred out of an account under clause (i)—

(I) shall not be includible in the gross income of the employer for such taxable year, but

(II) shall be treated as an employer reversion for purposes of section 4980 (without regard to subsection (d) thereof).

(C) ORDERING RULE.—For purposes of this section, any amount paid out of a health benefits account, or an applicable life insurance account, shall be treated as paid first out of the assets and income described in subparagraph (A).

(2) REQUIREMENTS RELATING TO PENSION BENEFITS ACCRUING BEFORE TRANSFER.—The requirements of this paragraph are met if the plan provides that the accrued pension benefits of any participant or beneficiary under the plan become nonforfeitable in the same manner which would be required if the plan had terminated immediately before the qualified transfer (or in the case of a participant who separated during the 1-year period ending on the date of the transfer, immediately before such separation).

(3) MINIMUM COST REQUIREMENTS.—

(A) IN GENERAL.—The requirements of this paragraph are met if each group health plan or arrangement under which applicable health benefits are provided, and each group-term life insurance plan under which applicable life insurance benefits are provided, provides that the applicable employer cost for each taxable year during the cost maintenance period shall not be less than the higher of the applicable employer costs for each of the 2 taxable years immediately preceding the taxable year of the qualified transfer or, in the case of a transfer which involves a plan maintained by an employer described in subsection (f)(2)(E)(i)(III), if the plan meets the requirements of subsection (f)(2)(D)(i)(II).

(B) APPLICABLE EMPLOYER COST.—For purposes of this paragraph, the term "applicable employer cost" means, with respect to any taxable year, the amount determined by dividing—

(i) the qualified current retiree liabilities of the employer for such taxable year determined—

(I) separately with respect to applicable health benefits and applicable life insurance benefits,

(II) without regard to any reduction under subsection (e)(1)(B), and

(III) in the case of a taxable year in which there was no qualified transfer, in the same manner as if there had been such a transfer at the end of the taxable year, by

(ii) the number of individuals to whom coverage was provided during such taxable year for the benefits with respect to which the determination under clause (i) is made.

(C) ELECTION TO COMPUTE COST SEPARATELY.—An employer may elect to have this paragraph applied separately for applicable health benefits with respect to individuals eligible for benefits under title XVIII of the Social Security Act at any time during the taxable year and with respect to individuals not so eligible, and separately for applicable life insurance benefits with respect to individuals age 65 or older at any time during the taxable year and with respect to individuals under age 65 during the taxable year.

(D) COST MAINTENANCE PERIOD.—For purposes of this paragraph, the term "cost maintenance period" means the period of 5 taxable years beginning with the taxable year in which the qualified transfer occurs. If a taxable year is in two or more overlapping cost maintenance periods, this paragraph shall be applied by taking into account the highest applicable employer cost required to be provided under subparagraph (A) for such taxable year.

(E) REGULATIONS.—

(i) IN GENERAL.—The Secretary shall prescribe such regulations as may be necessary to prevent an employer who significantly reduces retiree health coverage or retiree life insurance coverage, as the case may be, during the cost maintenance period from being treated as satisfying the minimum cost requirement of this subsection.

(ii) INSIGNIFICANT COST REDUCTIONS FOR RETIREE HEALTH COVERAGE PERMITTED.—

(I) IN GENERAL.—An eligible employer shall not be treated as failing to meet the requirements of this paragraph for any taxable year if, in lieu of any reduction of retiree health coverage permitted under the regulations prescribed under clause (i), the employer reduces applicable employer cost by an amount not in excess of the reduction in costs which would have occurred if the employer had made the maximum permissible reduction in retiree health coverage under such regulations. In applying such regulations to any subsequent taxable year, any reduction in applicable employer cost under this clause shall be treated as if it were an equivalent reduction in retiree health coverage.

(II) ELIGIBLE EMPLOYER.—For purposes of subclause (I), an employer shall be treated as an eligible employer for any taxable year if, for the preceding taxable year, the qualified current retiree liabilities of the employer with respect to applicable health benefits were at least 5 percent of the gross receipts of the employer. For purposes of this subclause, the rules of paragraphs (2), (3)(B), and (3)(C) of section 448(c) shall apply in determining the amount of an employer's gross receipts.

(d) LIMITATIONS ON EMPLOYER.—For purposes of this title—

(1) DEDUCTION LIMITATIONS.—No deduction shall be allowed—

(A) for the transfer of any amount to a health benefits account, or an applicable life insurance account, in a qualified transfer (or any retransfer to the plan under subsection (c)(1)(B)),

(B) for qualified current retiree liabilities paid out of the assets (and income) described in subsection (c)(1), or

(C) for any amounts to which subparagraph (B) does not apply and which are paid for qualified current retiree liabilities for the taxable year to the extent such amounts are not greater than the excess (if any) of—

(i) the amount determined under subparagraph (A) (and income allocable thereto), over

(ii) the amount determined under subparagraph (B).

(2) NO CONTRIBUTIONS ALLOWED.—An employer may not contribute any amount to a health benefits account or welfare benefit fund (as defined in section 419(e)(1)) with respect to qualified current retiree liabilities for which transferred assets are required to be used under subsection (c)(1).

(e) DEFINITION AND SPECIAL RULES.—For purposes of this section—

(1) QUALIFIED CURRENT RETIREE LIABILITIES.—For purposes of this section—

(A) IN GENERAL.—The term "qualified current retiree liabilities" means, with respect to any taxable year, the aggregate amounts (including administrative expenses) which would have been allowable as a deduction to the employer for such taxable year with respect to applicable health benefits and applicable life insurance benefits provided during such taxable year if—

(i) such benefits were provided directly by the employer, and

(ii) the employer used the cash receipts and disbursements method of accounting.

For purposes of the preceding sentence, the rule of section 419(c)(3)(B) shall apply.

(B) REDUCTIONS FOR AMOUNTS PREVIOUSLY SET ASIDE.—The amount determined under subparagraph (A) shall be reduced by the amount (determined separately for applicable health benefits and applicable life insurance benefits) which bears the same ratio to such amount as—

(i) the value (as of the close of the plan year preceding the year of the qualified transfer) of the assets in all health benefits accounts or applicable life insurance accounts or welfare benefit funds (as defined in section 419(e)(1)) set aside to pay for the qualified current retiree liability, bears to

(ii) the present value of the qualified current retiree liabilities for all plan years (determined without regard to this subparagraph).

(C) APPLICABLE HEALTH BENEFITS.—The term "applicable health benefits" means health benefits or coverage which are provided to—

(i) retired employees who, immediately before the qualified transfer, are entitled to receive such benefits by reason of retirement and who are entitled to pension benefits under the plan, and

(ii) their spouses and dependents.

(D) APPLICABLE LIFE INSURANCE BENEFITS.—The term "applicable life insurance benefits" means group-term life insurance coverage provided to retired employees who, immediately before the qualified transfer, are entitled to receive such coverage by reason of retirement and who are entitled to pension benefits under the plan, but only to the extent that such coverage is provided under a policy for retired employees and the cost of such coverage is excludable from the retired employee's gross income under section 79.

(E) KEY EMPLOYEES EXCLUDED.—If an employee is a key employee (within the meaning of section 416(i)(1)) with respect to any plan year ending in a taxable year, such employee shall not be taken into account in computing qualified current retiree liabilities for such taxable year or in calculating applicable employer cost under subsection (c)(3)(B).

(2) EXCESS PENSION ASSETS.—The term "excess pension assets" means the excess (if any) of—

(A) the lesser of—

(i) the fair market value of the plan's assets (reduced by the prefunding balance and funding standard carryover balance determined under section 430(f)), or

(ii) the value of plan assets as determined under section 430(g)(3) after reduction under section 430(f), over

(B) 125 percent of the sum of the funding target and the target normal cost determined under section 430 for such plan year.

(3) HEALTH BENEFITS ACCOUNT.—The term "health benefits account" means an account established and maintained under section 401(h).

(4) APPLICABLE LIFE INSURANCE ACCOUNT.—The term "applicable life insurance account" means a separate account established and maintained for amounts transferred under this section for qualified current retiree liabilities based on premiums for applicable life insurance benefits.

(5) COORDINATION WITH SECTIONS 430 AND 433.—In the case of a qualified transfer, any assets so transferred shall not, for

purposes of this section and sections 430 and 433, be treated as assets in the plan.

(6) APPLICATION TO MULTIEMPLOYER PLANS.—In the case of a multiemployer plan, this section shall be applied to any such plan—

(A) by treating any reference in this section to an employer as a reference to all employers maintaining the plan (or, if appropriate, the plan sponsor), and

(B) in accordance with such modifications of this section (and the provisions of this title relating to this section) as the Secretary determines appropriate to reflect the fact the plan is not maintained by a single employer.

(f) QUALIFIED TRANSFERS TO COVER FUTURE RETIREE COSTS AND COLLECTIVELY BARGAINED RETIREE BENEFITS.—

(1) IN GENERAL.—An employer maintaining a defined benefit plan (other than a multiemployer plan) may, in lieu of a qualified transfer, elect for any taxable year to have the plan make—

(A) a qualified future transfer, or

(B) a collectively bargained transfer.

Except as provided in this subsection, a qualified future transfer and a collectively bargained transfer shall be treated for purposes of this title and the Employee Retirement Income Security Act of 1974 as if it were a qualified transfer.

(2) QUALIFIED FUTURE AND COLLECTIVELY BARGAINED TRANSFERS.—For purposes of this subsection—

(A) IN GENERAL.—The terms "qualified future transfer" and "collectively bargained transfer" mean a transfer which meets all of the requirements for a qualified transfer, except that—

(i) the determination of excess pension assets shall be made under subparagraph (B),

(ii) the limitation on the amount transferred shall be determined under subparagraph (C),

(iii) the minimum cost requirements of subsection (c)(3) shall be modified as provided under subparagraph (D), and

(iv) in the case of a collectively bargained transfer, the requirements of subparagraph (E) shall be met with respect to the transfer.

(B) EXCESS PENSION ASSETS.—

(i) IN GENERAL.—In determining excess pension assets for purposes of this subsection, subsection (e)(2) shall be applied by substituting "120 percent" for "125 percent".

(ii) REQUIREMENT TO MAINTAIN FUNDED STATUS.—If, as of any valuation date of any plan year in the transfer period, the amount determined under subsection (e)(2)(B) (after application of clause (i)) exceeds the amount determined under subsection (e)(2)(A), either—

(I) the employer maintaining the plan shall make contributions to the plan in an amount not less than the amount required to reduce such excess to zero as of such date, or

(II) there is transferred from the health benefits account or applicable life insurance account, as the case may be, to the plan an amount not less than the amount required to reduce such excess to zero as of such date.

(C) LIMITATION ON AMOUNT TRANSFERRED.—Notwithstanding subsection (b)(3), the amount of the excess pension assets which may be transferred—

(i) in the case of a qualified future transfer shall be equal to the sum of—

(I) if the transfer period includes the taxable year of the transfer, the amount determined under subsection (b)(3) for such taxable year, plus

(II) in the case of all other taxable years in the transfer period, the sum of the qualified current retiree liabilities which the plan reasonably estimates, in accordance with guidance issued by the Secretary, will be incurred for each of such years, and

(ii) in the case of a collectively bargained transfer, shall not exceed the amount which is reasonably estimated, in accordance with the provisions of the collective bargaining agreement and generally accepted accounting principles, to be the amount the employer maintaining the plan will pay (whether directly or through reimbursement) out of such account during the collectively bargained cost maintenance period for collectively bargained retiree liabilities.

(D) MINIMUM COST REQUIREMENTS.—

(i) IN GENERAL.—The requirements of subsection (c)(3) shall be treated as met if—

(I) in the case of a qualified future transfer, each group health plan or arrangement under which applicable health benefits are provided, and each group-term life insurance plan or arrangement under which applicable life insurance benefits are provided, provides applicable health benefits or applicable life insurance benefits, as the case may be, during the period beginning with the first year of the transfer period and ending with the last day of the 4th year following the transfer period such that the annual average amount of the applicable employer cost during such period is not less than the applicable employer cost determined under subsection (c)(3)(A) with respect to the transfer, and

(II) in the case of a collectively bargained transfer, each collectively bargained plan under which collectively bargained health benefits or collectively bargained life insurance benefits are provided provides that the collectively bargained employer cost for each taxable year during the collectively bargained cost maintenance period shall not be less than the amount specified by the collective bargaining agreement.

(ii) ELECTION TO MAINTAIN BENEFITS FOR FUTURE TRANSFERS.—An employer may elect, in lieu of the requirements of clause (i)(I), to meet the requirements of subsection (c)(3) with respect to applicable health benefits or applicable life insurance benefits by meeting the requirements of such subsection (as in effect before the amendments made by section 535 of the Tax Relief Extension Act of 1999) for each of the years described in the period under clause (i)(I). Such election may be made separately with respect to applicable health benefits and applicable life insurance benefits. In the case of an election with respect to applicable life insurance benefits, the first sentence of this clause shall be applied as if subsection (c)(3) as in effect before the amendments made by such Act applied to such benefits.

(iii) COLLECTIVELY BARGAINED EMPLOYER COST.—For purposes of this subparagraph, the term "collectively bargained employer cost" means the average cost per covered individual of providing collectively bargained health benefits, collectively bargained life insurance benefits, or both, as the case may be, as determined in accordance with the applicable collective bargaining agreement. Such agreement may provide for an appropriate reduction in the collectively bargained employer cost to take into account any portion of the collectively bargained health benefits, collectively bargained life insurance benefits, or both, as the case may be, that is provided or financed by a government program or other source.

(E) SPECIAL RULES FOR COLLECTIVELY BARGAINED TRANSFERS.—

(i) IN GENERAL.—A collectively bargained transfer shall only include a transfer which—

(I) is made in accordance with a collective bargaining agreement,

(II) before the transfer, the employer designates, in a written notice delivered to each employee organization that is a party to the collective bargaining agreement, as a collectively bargained transfer in accordance with this section, and

(III) involves a defined benefit plan maintained by an employer which, in its taxable year ending in 2005, provided health benefits or coverage to retirees and their spouses and dependents under all of the health benefit plans maintained by the employer, but only if the aggregate cost (including administrative expenses) of such benefits or coverage which would have been allowable as a deduction to the employer (if such benefits or coverage had been provided directly by the employer and the employer used the cash receipts and disbursements method of accounting) is at least 5 percent of the gross receipts of the employer (determined in accordance with the last sentence of

subsection (c)(3)(E)(ii)(II)) for such taxable year, or a plan maintained by a successor to such employer.

(ii) USE OF ASSETS.—Any assets transferred to a health benefits account, or an applicable life insurance account, in a collectively bargained transfer (and any income allocable thereto) shall be used only to pay collectively bargained retiree liabilities (other than liabilities of key employees not taken into account under paragraph (6)(B)(iii)) for the taxable year of the transfer or for any subsequent taxable year during the collectively bargained cost maintenance period (whether directly or through reimbursement).

(3) COORDINATION WITH OTHER TRANSFERS.—In applying subsection (b)(3) to any subsequent transfer during a taxable year in a transfer period or collectively bargained cost maintenance period, qualified current retiree liabilities shall be reduced by any such liabilities taken into account with respect to the qualified future transfer or collectively bargained transfer to which such period relates.

(4) SPECIAL DEDUCTION RULES FOR COLLECTIVELY BARGAINED TRANSFERS.—In the case of a collectively bargained transfer—

(A) the limitation under subsection (d)(1)(C) shall not apply, and

(B) notwithstanding subsection (d)(2), an employer may contribute an amount to a health benefits account or welfare benefit fund (as defined in section 419(e)(1)) with respect to collectively bargained retiree liabilities for which transferred assets are required to be used under subsection (c)(1)(B), and the deductibility of any such contribution shall be governed by the limits applicable to the deductibility of contributions to a welfare benefit fund under a collective bargaining agreement (as determined under section 419A(f)(5)(A)) without regard to whether such contributions are made to a health benefits account or welfare benefit fund and without regard to the provisions of section 404 or the other provisions of this section.

The Secretary shall provide rules to ensure that the application of this paragraph does not result in a deduction being allowed more than once for the same contribution or for 2 or more contributions or expenditures relating to the same collectively bargained retiree liabilities.

(5) TRANSFER PERIOD.—For purposes of this subsection, the term "transfer period" means, with respect to any transfer, a period of consecutive taxable years (not less than 2) specified in the election under paragraph (1) which begins and ends during the 10-taxable-year period beginning with the taxable year of the transfer.

(6) TERMS RELATING TO COLLECTIVELY BARGAINED TRANSFERS.—For purposes of this subsection—

(A) COLLECTIVELY BARGAINED COST MAINTENANCE PERIOD.—The term "collectively bargained cost maintenance period" means, with respect to each covered retiree and [his covered spouse and dependents] *the covered spouse and dependents of such retiree*, the shorter of—

(i) the remaining lifetime of such covered retiree and, in the case of a transfer to a health benefits account, [his covered spouse and dependents] *the covered spouse and dependents of such retiree*, or

(ii) the period of coverage provided by the collectively bargained plan (determined as of the date of the collectively bargained transfer) with respect to such covered retiree and, in the case of a transfer to a health benefits account, [his covered spouse and dependents] *the covered spouse and dependents of such retiree*.

(B) COLLECTIVELY BARGAINED RETIREE LIABILITIES.—

(i) IN GENERAL.—The term "collectively bargained retiree liabilities" means the present value, as of the beginning of a taxable year and determined in accordance with the applicable collective bargaining agreement, of all collectively bargained health benefits, and collectively bargained life insurance benefits, (including administrative expenses) for such taxable year and all subsequent taxable years during the collectively bargained cost maintenance period.

(ii) REDUCTION FOR AMOUNTS PREVIOUSLY SET ASIDE.—The amount determined under clause (i) shall be reduced by the value (as of the close of the plan year preceding the year of the collectively bargained transfer) of the assets in all health benefits accounts, applicable life insurance accounts, or welfare benefit funds (as defined in section 419(e)(1)) set aside to pay for the collectively bargained retiree liabilities. The preceding sentence shall be applied separately for collectively bargained health benefits and collectively bargained life insurance benefits.

(iii) KEY EMPLOYEES EXCLUDED.—If an employee is a key employee (within the meaning of section 416(i)(1)) with respect to any plan year ending in a taxable year, such employee shall not be taken into account in computing collectively bargained retiree liabilities for such taxable year or in calculating collectively bargained employer cost under subsection (c)(3)(C).

(C) COLLECTIVELY BARGAINED HEALTH BENEFITS.—The term "collectively bargained health benefits" means health benefits or coverage—

(i) which are provided to retired employees who, immediately before the collectively bargained transfer, are entitled to receive such benefits by reason of retirement and who are entitled to pension benefits under the plan, and their spouses and dependents, and

(ii) if specified by the provisions of the collective bargaining agreement governing the collectively bargained transfer, which will be provided at retirement to employees who are not retired employees at the time of the transfer and who are entitled to receive such benefits and who are entitled to pension benefits under the plan, and their spouses and dependents.

(D) COLLECTIVELY BARGAINED LIFE INSURANCE BENEFITS.—The term "collectively bargained life insurance benefits" means, with respect to any collectively bargained transfer—

(i) applicable life insurance benefits which are provided to retired employees who, immediately before the transfer, are entitled to receive such benefits by reason of retirement, and

(ii) if specified by the provisions of the collective bargaining agreement governing the transfer, applicable life insurance benefits which will be provided at retirement to employees who are not retired employees at the time of the transfer.

(E) COLLECTIVELY BARGAINED PLAN.—The term "collectively bargained plan" means a group health plan or arrangement for retired employees and their spouses and dependents, or a group-term life insurance plan or arrangement for retired employees, that is maintained pursuant to 1 or more collective bargaining agreements.

(g) SEGMENT RATES DETERMINED WITHOUT PENSION STABILIZATION.—For purposes of this section, section 430 shall be applied without regard to subsection (h)(2)(C)(iv) thereof.

PART II—CERTAIN STOCK OPTIONS

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SEC. 424. DEFINITIONS AND SPECIAL RULES.

(a) CORPORATE REORGANIZATIONS, LIQUIDATIONS, ETC..—For purposes of this part, the term "issuing or assuming a stock option in a transaction to which section 424(a) applies" means a substitution of a new option for the old option, or an assumption of the old option, by an employer corporation, or a parent or subsidiary of such corporation, by reason of a corporate merger, consolidation, acquisition of property or stock, separation, reorganization, or liquidation, if—

(1) the excess of the aggregate fair market value of the shares subject to the option immediately after the substitution or assumption over the aggregate option price of such shares is not more than the excess of the aggregate fair market value of all shares subject to the option immediately before such substitution or assumption over the aggregate option price of such shares, and

(2) the new option or the assumption of the old option does not give the employee additional benefits which he did not have under the old option.

For purposes of this subsection, the parent-subsidiary relationship shall be determined at the time of any such transaction under this subsection.

(b) ACQUISITION OF NEW STOCK.—For purposes of this part, if stock is received by an individual in a distribution to which section 305, 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applies, and such distribution was made with respect to stock transferred to him upon his exercise of the option, such stock shall be considered as having been transferred to him

on his exercise of such option. A similar rule shall be applied in the case of a series of such distributions.

(c) DISPOSITION.—

(1) IN GENERAL.—Except as provided in paragraphs (2), (3), and (4), for purposes of this part, the term "disposition" includes a sale, exchange, gift, or a transfer of legal title, but does not include—

(A) a transfer from a decedent to an estate or a transfer by bequest or inheritance;

(B) an exchange to which section 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applies; or

(C) a mere pledge or hypothecation.

(2) JOINT TENANCY.—The acquisition of a share of stock in the name of the employee and another jointly with the right of survivorship or a subsequent transfer of a share of stock into such joint ownership shall not be deemed a disposition, but a termination of such joint tenancy (except to the extent such employee acquires ownership of such stock) shall be treated as a disposition by him occurring at the time such joint tenancy is terminated.

(3) SPECIAL RULE WHERE INCENTIVE STOCK IS ACQUIRED THROUGH USE OF OTHER STATUTORY OPTION STOCK.—

(A) NONRECOGNITION SECTIONS NOT TO APPLY.—If—

(i) there is a transfer of statutory option stock in connection with the exercise of any incentive stock option, and

(ii) the applicable holding period requirements (under section 422(a)(1) or 423(a)(1)) are not met before such transfer,

then no section referred to in subparagraph (B) of paragraph (1) shall apply to such transfer.

(B) STATUTORY OPTION STOCK.—For purpose of subparagraph (A), the term "statutory option stock" means any stock acquired through the exercise of an incentive stock option or an option granted under an employee stock purchase plan.

(4) TRANSFERS BETWEEN SPOUSES OR INCIDENT TO DIVORCE.—In the case of any transfer described in subsection (a) of section 1041—

(A) such transfer shall not be treated as a disposition for purposes of this part, and

(B) the same tax treatment under this part with respect to the transferred property shall apply to the transferee as would have applied to the transferor.

(d) ATTRIBUTION OF STOCK OWNERSHIP.—For purposes of this part, in applying the percentage limitations of sections 422(b)(6) and 423(b)(3)—

(1) the individual with respect to whom such limitation is being determined shall be considered as owning the stock owned, directly or indirectly, by or for [his] *the individual's* brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; and

(2) stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust, shall be considered as being

owned proportionately by or for its shareholders, partners, or beneficiaries.

(e) PARENT CORPORATION.—For purposes of this part, the term "parent corporation" means any corporation (other than the employer corporation) in an unbroken chain of corporations ending with the employer corporation if, at the time of the granting of the option, each of the corporations other than the employer corporation owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

(f) SUBSIDIARY CORPORATION.—For purposes of this part, the term "subsidiary corporation" means any corporation (other than the employer corporation) in an unbroken chain of corporations beginning with the employer corporation if, at the time of the granting of the option, each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

(g) SPECIAL RULE FOR APPLYING SUBSECTIONS (E) AND (F).—In applying subsections (e) and (f) for purposes of sections 422(a)(2) and 423(a)(2), there shall be substituted for the term "employer corporation" wherever it appears in subsections (e) and (f) the term "grantor corporation" or the term "corporation issuing or assuming a stock option in a transaction to which section 424(a) applies", as the case may be.

(h) MODIFICATION, EXTENSION, OR RENEWAL OF OPTION.—

(1) IN GENERAL.—For purposes of this part, if the terms of any option to purchase stock are modified, extended, or renewed, such modification, extension, or renewal shall be considered as the granting of a new option.

(2) SPECIAL RULE FOR SECTION 423 OPTIONS.—In the case of the transfer of stock pursuant to the exercise of an option to which section 423 applies and which has been so modified, extended, or renewed, the fair market value of such stock at the time of the granting of the option shall be considered as whichever of the following is the highest—

(A) the fair market value of such stock on the date of the original granting of the option,

(B) the fair market value of such stock on the date of the making of such modification, extension, or renewal, or

(C) the fair market value of such stock at the time of the making of any intervening modification, extension, or renewal.

(3) DEFINITION OF MODIFICATION.—The term "modification" means any change in the terms of the option which gives the employee additional benefits under the option, but such term shall not include a change in the terms of the option—

(A) attributable to the issuance or assumption of an option under subsection (a);

(B) to permit the option to qualify under section 423(b)(9); or

(C) in the case of an option not immediately exercisable in full, to accelerate the time at which the option may be exercised.

(i) STOCKHOLDER APPROVAL.—For purposes of this part, if the grant of an option is subject to approval by stockholders, the date of grant of the option shall be determined as if the option had not been subject to such approval.

(j) CROSS REFERENCES.—For provisions requiring the reporting of certain acts with respect to a qualified stock option, an incentive stock option, options granted under employer stock purchase plans, or a restricted stock option, see section 6039.

Subchapter E—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

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PART II—METHODS OF ACCOUNTING

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Subpart C—TAXABLE YEAR FOR WHICH DEDUCTIONS TAKEN

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SEC. 469. PASSIVE ACTIVITY LOSSES AND CREDITS LIMITED.

(a) DISALLOWANCE.—

(1) IN GENERAL.—If for any taxable year the taxpayer is described in paragraph (2), neither—

(A) the passive activity loss, nor

(B) the passive activity credit,

for the taxable year shall be allowed.

(2) PERSONS DESCRIBED.—The following are described in this paragraph:

(A) any individual, estate, or trust,

(B) any closely held C corporation, and

(C) any personal service corporation.

(b) DISALLOWED LOSS OR CREDIT CARRIED TO NEXT YEAR.—Except as otherwise provided in this section, any loss or credit from an activity which is disallowed under subsection (a) shall be treated as a deduction or credit allocable to such activity in the next taxable year.

(c) PASSIVE ACTIVITY DEFINED.—For purposes of this section—

(1) IN GENERAL.—The term "passive activity" means any activity—

(A) which involves the conduct of any trade or business, and

(B) in which the taxpayer does not materially participate.

(2) PASSIVE ACTIVITY INCLUDES ANY RENTAL ACTIVITY.—Except as provided in paragraph (7), the term "passive activity" includes any rental activity.

(3) WORKING INTERESTS IN OIL AND GAS PROPERTY.—

(A) IN GENERAL.—The term "passive activity" shall not include any working interest in any oil or gas property which the taxpayer holds directly or through an entity which does not limit the liability of the taxpayer with respect to such interest.

(B) INCOME IN SUBSEQUENT YEARS.—If any taxpayer has any loss for any taxable year from a working interest in any oil or gas property which is treated as a loss which is not from a passive activity, then any net income from such property (or any property the basis of which is determined in whole or in part by reference to the basis of such property) for any succeeding taxable year shall be treated as income of the taxpayer which is not from a passive activity. If the preceding sentence applies to the net income from any property for any taxable year, any credits allowable under subpart B (other than section 27) or D of part IV of subchapter A for such taxable year which are attributable to such property shall be treated as credits not from a passive activity to the extent the amount of such credits does not exceed the regular tax liability of the taxpayer for the taxable year which is allocable to such net income.

(4) MATERIAL PARTICIPATION NOT REQUIRED FOR PARAGRAPHS (2) AND (3).—Paragraphs (2) and (3) shall be applied without regard to whether or not the taxpayer materially participates in the activity.

(5) TRADE OR BUSINESS INCLUDES RESEARCH AND EXPERIMENTATION ACTIVITY.—For purposes of paragraph (1)(A), the term "trade or business" includes any activity involving research or experimentation (within the meaning of section 174).

(6) ACTIVITY IN CONNECTION WITH TRADE OR BUSINESS OR PRODUCTION OF INCOME.—To the extent provided in regulations, for purposes of paragraph (1)(A), the term "trade or business" includes—

(A) any activity in connection with a trade or business, or

(B) any activity with respect to which expenses are allowable as a deduction under section 212.

(7) SPECIAL RULES FOR TAXPAYERS IN REAL PROPERTY BUSINESS.—

(A) IN GENERAL.—If this paragraph applies to any taxpayer for a taxable year—

(i) paragraph (2) shall not apply to any rental real estate activity of such taxpayer for such taxable year, and

(ii) this section shall be applied as if each interest of the taxpayer in rental real estate were a separate activity.

Notwithstanding clause (ii), a taxpayer may elect to treat all interests in rental real estate as one activity. Nothing in the preceding provisions of this subparagraph shall be construed as affecting the determination of whether the taxpayer materially participates with respect to any interest in a limited partnership as a limited partner.

(B) TAXPAYERS TO WHOM PARAGRAPH APPLIES.—This paragraph shall apply to a taxpayer for a taxable year if—

(i) more than one-half of the personal services performed in trades or businesses by the taxpayer during such taxable year are performed in real property trades or businesses in which the taxpayer materially participates, and

(ii) such taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates.

In the case of a joint return, the requirements of the preceding sentence are satisfied if and only if either spouse separately satisfies such requirements. For purposes of the preceding sentence, activities in which a spouse materially participates shall be determined under subsection (h).

(C) REAL PROPERTY TRADE OR BUSINESS.—For purposes of this paragraph, the term "real property trade or business" means any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.

(D) SPECIAL RULES FOR SUBPARAGRAPH (B).—

(i) CLOSELY HELD C CORPORATIONS.—In the case of a closely held C corporation, the requirements of subparagraph (B) shall be treated as met for any taxable year if more than 50 percent of the gross receipts of such corporation for such taxable year are derived from real property trades or businesses in which the corporation materially participates.

(ii) PERSONAL SERVICES AS AN EMPLOYEE.—For purposes of subparagraph (B), personal services performed as an employee shall not be treated as performed in real property trades or businesses. The preceding sentence shall not apply if such employee is a 5-percent owner (as defined in section 416(i)(1)(B)) in the employer.

(d) PASSIVE ACTIVITY LOSS AND CREDIT DEFINED.—For purposes of this section—

(1) PASSIVE ACTIVITY LOSS.—The term "passive activity loss" means the amount (if any) by which—

(A) the aggregate losses from all passive activities for the taxable year, exceed

(B) the aggregate income from all passive activities for such year.

(2) PASSIVE ACTIVITY CREDIT.—The term "passive activity credit" means the amount (if any) by which—

(A) the sum of the credits from all passive activities allowable for the taxable year under—

(i) subpart D of part IV of subchapter A, or

(ii) subpart B (other than section 27) of such part IV, exceeds

(B) the regular tax liability of the taxpayer for the taxable year allocable to all passive activities.

(e) SPECIAL RULES FOR DETERMINING INCOME OR LOSS FROM A PASSIVE ACTIVITY.—For purposes of this section—

(1) CERTAIN INCOME NOT TREATED AS INCOME FROM PASSIVE ACTIVITY.—In determining the income or loss from any activity—

(A) IN GENERAL.—There shall not be taken into account—

(i) any—

(I) gross income from interest, dividends, annuities, or royalties not derived in the ordinary course of a trade or business,

(II) expenses (other than interest) which are clearly and directly allocable to such gross income, and

(III) interest expense properly allocable to such gross income, and

(ii) gain or loss not derived in the ordinary course of a trade or business which is attributable to the disposition of property—

(I) producing income of a type described in clause (i), or

(II) held for investment.

For purposes of clause (ii), any interest in a passive activity shall not be treated as property held for investment.

(B) RETURN ON WORKING CAPITAL.—For purposes of subparagraph (A), any income, gain, or loss which is attributable to an investment of working capital shall be treated as not derived in the ordinary course of a trade or business.

(2) PASSIVE LOSSES OF CERTAIN CLOSELY HELD CORPORATIONS MAY OFFSET ACTIVE INCOME.—

(A) IN GENERAL.—If a closely held C corporation (other than a personal service corporation) has net active income for any taxable year, the passive activity loss of such taxpayer for such taxable year (determined without regard to this paragraph)—

(i) shall be allowable as a deduction against net active income, and

(ii) shall not be taken into account under subsection (a) to the extent so allowable as a deduction.

A similar rule shall apply in the case of any passive activity credit of the taxpayer.

(B) NET ACTIVE INCOME.—For purposes of this paragraph, the term "net active income" means the taxable income of the taxpayer for the taxable year determined without regard to—

(i) any income or loss from a passive activity, and

(ii) any item of gross income, expense, gain, or loss described in paragraph (1)(A).

(3) COMPENSATION FOR PERSONAL SERVICES.—Earned income (within the meaning of section 911(d)(2)(A)) shall not be taken into account in computing the income or loss from a passive activity for any taxable year.

(4) DIVIDENDS REDUCED BY DIVIDENDS RECEIVED DEDUCTION.—For purposes of paragraphs (1) and (2), income from dividends shall be reduced by the amount of any dividends received deduction under section 243 or 245.

(f) TREATMENT OF FORMER PASSIVE ACTIVITIES.—For purposes of this section—

(1) IN GENERAL.—If an activity is a former passive activity for any taxable year—

(A) any unused deduction allocable to such activity under subsection (b) shall be offset against the income from such activity for the taxable year,

(B) any unused credit allocable to such activity under subsection (b) shall be offset against the regular tax liability (computed after the application of paragraph (1)) allocable to such activity for the taxable year, and

(C) any such deduction or credit remaining after the application of subparagraphs (A) and (B) shall continue to be treated as arising from a passive activity.

(2) CHANGE IN STATUS OF CLOSELY HELD C CORPORATION OR PERSONAL SERVICE CORPORATION.—If a taxpayer ceases for any taxable year to be a closely held C corporation or personal service corporation, this section shall continue to apply to losses and credits to which this section applied for any preceding taxable year in the same manner as if such taxpayer continued to be a closely held C corporation or personal service corporation, whichever is applicable.

(3) FORMER PASSIVE ACTIVITY.—The term "former passive activity" means any activity which, with respect to the taxpayer—

(A) is not a passive activity for the taxable year, but

(B) was a passive activity for any prior taxable year.

(g) DISPOSITIONS OF ENTIRE INTEREST IN PASSIVE ACTIVITY.—If during the taxable year a taxpayer disposes of his entire interest in any passive activity (or former passive activity), the following rules shall apply:

(1) FULLY TAXABLE TRANSACTION.—

(A) IN GENERAL.—If all gain or loss realized on such disposition is recognized, the excess of—

(i) any loss from such activity for such taxable year (determined after the application of subsection (b)), over

(ii) any net income or gain for such taxable year from all other passive activities (determined after the application of subsection (b)),

shall be treated as a loss which is not from a passive activity.

(B) SUBPARAGRAPH (A) NOT TO APPLY TO DISPOSITION INVOLVING RELATED PARTY.—If the taxpayer and the person acquiring the interest bear a relationship to each other described in section 267(b) or section 707(b)(1), then subparagraph (A) shall not apply to any loss of the taxpayer until the taxable year in which such interest is acquired (in a transaction described in subparagraph (A)) by another person who does not bear such a relationship to the taxpayer.

(C) INCOME FROM PRIOR YEARS.—To the extent provided in regulations, income or gain from the activity for preceding taxable years shall be taken into account under subparagraph (A)(ii) for the taxable year to the extent necessary to prevent the avoidance of this section.

(2) DISPOSITION BY DEATH.—If an interest in the activity is transferred by reason of the death of the taxpayer—

(A) paragraph (1)(A) shall apply to losses described in paragraph (1)(A) to the extent such losses are greater than the excess (if any) of—

(i) the basis of such property in the hands of the transferee, over

(ii) the adjusted basis of such property immediately before the death of the taxpayer, and

(B) any losses to the extent of the excess described in subparagraph (A) shall not be allowed as a deduction for any taxable year.

(3) INSTALLMENT SALE OF ENTIRE INTEREST.—In the case of an installment sale of an entire interest in an activity to which section 453 applies, paragraph (1) shall apply to the portion of such losses for each taxable year which bears the same ratio to all such losses as the gain recognized on such sale during such taxable year bears to the gross profit from such sale (realized or to be realized when payment is completed).

(h) MATERIAL PARTICIPATION DEFINED.—For purposes of this section—

(1) IN GENERAL.—A taxpayer shall be treated as materially participating in an activity only if the taxpayer is involved in the operations of the activity on a basis which is—

(A) regular,

(B) continuous, and

(C) substantial.

(2) INTERESTS IN LIMITED PARTNERSHIPS.—Except as provided in regulations, no interest in a limited partnership as a limited partner shall be treated as an interest with respect to which a taxpayer materially participates.

(3) TREATMENT OF CERTAIN RETIRED INDIVIDUALS AND SURVIVING SPOUSES.—A taxpayer shall be treated as materially participating in any farming activity for a taxable year if paragraph (4) or (5) of section 2032A(b) would cause the requirements of section 2032A(b)(1)(C)(ii) to be met with respect to real property used in such activity if such taxpayer had died during the taxable year.

(4) CERTAIN CLOSELY HELD C CORPORATIONS AND PERSONAL SERVICE CORPORATIONS.—A closely held C corporation or personal service corporation shall be treated as materially participating in an activity only if—

(A) 1 or more shareholders holding stock representing more than 50 percent (by value) of the outstanding stock of such corporation materially participate in such activity, or

(B) in the case of a closely held C corporation (other than a personal service corporation), the requirements of section 465(c)(7)(C) (without regard to clause (iv)) are met with respect to such activity.

(5) PARTICIPATION BY SPOUSE.—In determining whether a taxpayer materially participates, the participation of the spouse of the taxpayer shall be taken into account.

(i) $25,000 OFFSET FOR RENTAL REAL ESTATE ACTIVITIES.—

(1) IN GENERAL.—In the case of any natural person, subsection (a) shall not apply to that portion of the passive activity loss or the deduction equivalent (within the meaning of sub-

section (j)(5)) of the passive activity credit for any taxable year which is attributable to all rental real estate activities with respect to which such individual actively participated in such taxable year (and if any portion of such loss or credit arose in another taxable year, in such other taxable year).

(2) DOLLAR LIMITATION.—The aggregate amount to which paragraph (1) applies for any taxable year shall not exceed $25,000.

(3) PHASE-OUT OF EXEMPTION.—

(A) IN GENERAL.—In the case of any taxpayer, the $25,000 amount under paragraph (2) shall be reduced (but not below zero) by 50 percent of the amount by which the adjusted gross income of the taxpayer for the taxable year exceeds $100,000.

(B) SPECIAL PHASE-OUT OF REHABILITATION CREDIT.—In the case of any portion of the passive activity credit for any taxable year which is attributable to the rehabilitation credit determined under section 47, subparagraph (A) shall be applied by substituting "$200,000" for "$100,000".

(C) EXCEPTION FOR LOW-INCOME HOUSING CREDIT.—Subparagraph (A) shall not apply to any portion of the passive activity credit for any taxable year which is attributable to any credit determined under section 42.

(D) ORDERING RULE.—Paragraph (1) shall be applied for any taxable year—

(i) first, to the passive activity loss,

(ii) second, to the portion of the passive activity credit to which subparagraph (B) and (C) does not apply,

(iii) third, to the portion of such credit to which subparagraph (B) applies, and

(iv) then, to the portion of such credit to which subparagraph (C) applies.

(E) ADJUSTED GROSS INCOME.—For purposes of this paragraph, adjusted gross income shall be determined without regard to—

(i) any amount includible in gross income under section 86,

(ii) the amounts excludable from gross income under sections 135 and 137,

(iii) the amounts allowable as a deduction under sections 219, 221, 222, and 250, and

(iv) any passive activity loss or any loss allowable by reason of subsection (c)(7).

(4) SPECIAL RULE FOR ESTATES.—

(A) IN GENERAL.—In the case of taxable years of an estate ending less than 2 years after the date of the death of the decedent, this subsection shall apply to all rental real estate activities with respect to which such decedent actively participated before his death.

(B) REDUCTION FOR SURVIVING SPOUSE'S EXEMPTION.—For purposes of subparagraph (A), the $25,000 amount under paragraph (2) shall be reduced by the amount of the exemption under paragraph (1) (without regard to paragraph (3)) allowable to the surviving spouse of the dece-

dent for the taxable year ending with or within the taxable year of the estate.

(5) MARRIED INDIVIDUALS FILING SEPARATELY.—

(A) IN GENERAL.—Except as provided in subparagraph (B), in the case of any married individual filing a separate return, this subsection shall be applied by substituting—

(i) "$12,500" for "$25,000" each place it appears,

(ii) "$50,000" for "$100,000" in paragraph (3)(A), and

(iii) "$100,000" for "$200,000" in paragraph (3)(B).

(B) TAXPAYERS NOT LIVING APART.—This subsection shall not apply to a taxpayer who—

(i) is a married individual filing a separate return for any taxable year, and

(ii) does not live apart from [his spouse] *the individual's spouse* at all times during such taxable year.

(6) ACTIVE PARTICIPATION.—

(A) IN GENERAL.—An individual shall not be treated as actively participating with respect to any interest in any rental real estate activity for any period if, at any time during such period, such interest (including any interest of the spouse of the individual) is less than 10 percent (by value) of all interests in such activity.

(B) NO PARTICIPATION REQUIREMENT FOR LOW-INCOME HOUSING OR REHABILITATION CREDIT.—Paragraphs (1) and (4)(A) shall be applied without regard to the active participation requirement in the case of—

(i) any credit determined under section 42 for any taxable year, or

(ii) any rehabilitation credit determined under section 47,

(C) INTEREST AS A LIMITED PARTNER.—Except as provided in regulations, no interest as a limited partner in a limited partnership shall be treated as an interest with respect to which the taxpayer actively participates.

(D) PARTICIPATION BY SPOUSE.—In determining whether a taxpayer actively participates, the participation of the spouse of the taxpayer shall be taken into account.

(j) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) CLOSELY HELD C CORPORATION.—The term "closely held C corporation" means any C corporation described in section 465(a)(1)(B).

(2) PERSONAL SERVICE CORPORATION.—The term "personal service corporation" has the meaning given such term by section 269A(b)(1), except that section 269A(b)(2) shall be applied—

(A) by substituting "any" for "more than 10 percent", and

(B) by substituting "any" for "50 percent or more in value" in section 318(a)(2)(C).

A corporation shall not be treated as a personal service corporation unless more than 10 percent of the stock (by value) in such corporation is held by employee-owners (within the meaning of section 269A(b)(2), as modified by the preceding sentence).

(3) REGULAR TAX LIABILITY.—The term "regular tax liability" has the meaning given such term by section 26(b).

(4) ALLOCATION OF PASSIVE ACTIVITY LOSS AND CREDIT.—The passive activity loss and the passive activity credit (and the $25,000 amount under subsection (i)) shall be allocated to activities, and within activities, on a pro rata basis in such manner as the Secretary may prescribe.

(5) DEDUCTION EQUIVALENT.—The deduction equivalent of credits from a passive activity for any taxable year is the amount which (if allowed as a deduction) would reduce the regular tax liability for such taxable year by an amount equal to such credits.

(6) SPECIAL RULE FOR GIFTS.—In the case of a disposition of any interest in a passive activity by gift—

(A) the basis of such interest immediately before the transfer shall be increased by the amount of any passive activity losses allocable to such interest with respect to which a deduction has not been allowed by reason of subsection (a), and

(B) such losses shall not be allowable as a deduction for any taxable year.

(7) QUALIFIED RESIDENCE INTEREST.—The passive activity loss of a taxpayer shall be computed without regard to qualified residence interest (within the meaning of section 163(h)(3)).

(8) RENTAL ACTIVITY.—The term "rental activity" means any activity where payments are principally for the use of tangible property.

(9) ELECTION TO INCREASE BASIS OF PROPERTY BY AMOUNT OF DISALLOWED CREDIT.—For purposes of determining gain or loss from a disposition of any property to which subsection (g)(1) applies, the transferor may elect to increase the basis of such property immediately before the transfer by an amount equal to the portion of any unused credit allowable under this chapter which reduced the basis of such property for the taxable year in which such credit arose. If the taxpayer elects the application of this paragraph, such portion of the passive activity credit of such taxpayer shall not be allowed for any taxable year.

(10) COORDINATION WITH SECTION 280A.—If a passive activity involves the use of a dwelling unit to which section 280A(c)(5) applies for any taxable year, any income, deduction, gain, or loss allocable to such use shall not be taken into account for purposes of this section for such taxable year.

(11) AGGREGATION OF MEMBERS OF AFFILIATED GROUPS.—Except as provided in regulations, all members of an affiliated group which files a consolidated return shall be treated as 1 corporation.

(12) SPECIAL RULE FOR DISTRIBUTIONS BY ESTATES OR TRUSTS.—If any interest in a passive activity is distributed by an estate or trust—

(A) the basis of such interest immediately before such distribution shall be increased by the amount of any passive activity losses allocable to such interest, and

(B) such losses shall not be allowable as a deduction for any taxable year.

(k) SEPARATE APPLICATION OF SECTION IN CASE OF PUBLICLY TRADED PARTNERSHIPS.—

(1) IN GENERAL.—This section shall be applied separately with respect to items attributable to each publicly traded partnership (and subsection (i) shall not apply with respect to items attributable to any such partnership). The preceding sentence shall not apply to any credit determined under section 42, or any rehabilitation credit determined under section 47, attributable to a publicly traded partnership to the extent the amount of any such credits exceeds the regular tax liability attributable to income from such partnership.

(2) PUBLICLY TRADED PARTNERSHIP.—For purposes of this section, the term "publicly traded partnership" means any partnership if—

(A) interests in such partnership are traded on an established securities market, or

(B) interests in such partnership are readily tradable on a secondary market (or the substantial equivalent thereof).

(3) COORDINATION WITH SUBSECTION (G).—For purposes of subsection (g), a taxpayer shall not be treated as having disposed of his entire interest in an activity of a publicly traded partnership until he disposes of his entire interest in such partnership.

(4) APPLICATION TO REGULATED INVESTMENT COMPANIES.—For purposes of this section, a regulated investment company (as defined in section 851) holding an interest in a qualified publicly traded partnership (as defined in section 851(h)) shall be treated as a taxpayer described in subsection (a)(2) with respect to items attributable to such interest.

(l) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out provisions of this section, including regulations—

(1) which specify what constitutes an activity, material participation, or active participation for purposes of this section,

(2) which provide that certain items of gross income will not be taken into account in determining income or loss from any activity (and the treatment of expenses allocable to such income),

(3) requiring net income or gain from a limited partnership or other passive activity to be treated as not from a passive activity,

(4) which provide for the determination of the allocation of interest expense for purposes of this section, and

(5) which deal with changes in marital status and changes between joint returns and separate returns.

Subchapter F—EXEMPT ORGANIZATIONS

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PART II—PRIVATE FOUNDATIONS

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SEC. 507. TERMINATION OF PRIVATE FOUNDATION STATUS.

(a) GENERAL RULE.—Except as provided in subsection (b), the status of any organization as a private foundation shall be terminated only if—

(1) such organization notifies the Secretary (at such time and in such manner as the Secretary may by regulations prescribe) of its intent to accomplish such termination, or

(2)(A) with respect to such organization, there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act), giving rise to liability for tax under chapter 42, and

(B) the Secretary notifies such organization that, by reason of subparagraph (A), such organization is liable for the tax imposed by subsection (c),

and either such organization pays the tax imposed by subsection (c) (or any portion not abated under subsection (g)) or the entire amount of such tax is abated under subsection (g).

(b) SPECIAL RULES.—

(1) TRANSFER TO, OR OPERATION AS, PUBLIC CHARITY.—The status as a private foundation of any organization, with respect to which there have not been either willful repeated acts (or failures to act) or a willful and flagrant act (or failure to act) giving rise to liability for tax under chapter 42, shall be terminated if—

(A) such organization distributes all of its net assets to one or more organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)) each of which has been in existence and so described for a continuous period of at least 60 calendar months immediately preceding such distribution, or

(B)(i) such organization meets the requirements of paragraph (1), (2), or (3) of section 509(a) by the end of the 12-month period beginning with its first taxable year which begins after December 31, 1969, or for a continuous period of 60 calendar months beginning with the first day of any taxable year which begins after December 31, 1969,

(ii) such organization notifies the Secretary (in such manner as the Secretary may by regulations prescribe) before the commencement of such 12-month or 60-month period (or before the 90th day after the day on which regulations first prescribed under this subsection become final) that it is terminating its private foundation status, and

(iii) such organization establishes to the satisfaction of the Secretary (in such manner as the Secretary may by regulations prescribe) immediately after the expiration of such 12-month or 60-month period that such organization has complied with clause (i).

If an organization gives notice under subparagraph (B)(ii) of the commencement of a 60-month period and such organization fails to meet the requirements of paragraph (1), (2), or (3) of section 509(a) for the entire 60-month period, this part and chapter 42 shall not apply to such organization for any taxable year within such 60-month period for which it does meet such requirements.

(2) TRANSFEREE FOUNDATIONS.—For purposes of this part, in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee foundation shall not be treated as a newly created organization.

(c) IMPOSITION OF TAX.—There is hereby imposed on each organization which is referred to in subsection (a) a tax equal to the lower of—

(1) the amount which the private foundation substantiates by adequate records or other corroborating evidence as the aggregate tax benefit resulting from the section 501(c)(3) status of such foundation, or

(2) the value of the net assets of such foundation.

(d) AGGREGATE TAX BENEFIT.—

(1) IN GENERAL.—For purposes of subsection (c), the aggregate tax benefit resulting from the section 501(c)(3) status of any private foundation is the sum of—

(A) the aggregate increases in tax under chapters 1, 11, and 12 (or the corresponding provisions of prior law) which would have been imposed with respect to all substantial contributors to the foundation if deductions for all contributions made by such contributors to the foundation after February 28, 1913, had been disallowed, and

(B) the aggregate increases in tax under chapter 1 (or the corresponding provisions of prior law) which would have been imposed with respect to the income of the private foundation for taxable years beginning after December 31, 1912, if (i) it had not been exempt from tax under section 501(a) (or the corresponding provisions of prior law), and (ii) in the case of a trust, deductions under section 642(c) (or the corresponding provisions of prior law) had been limited to 20 percent of the taxable income of the trust (computed without the benefit of section 642(c) but with the benefit of section 170(b)(1)(A)), and

(C) interest on the increases in tax determined under subparagraphs (A) and (B) from the first date on which each such increase would have been due and payable to the date on which the organization ceases to be a private foundation.

(2) SUBSTANTIAL CONTRIBUTOR.—

(A) DEFINITION.—For purposes of paragraph (1), the term "substantial contributor" means any person who contributed or bequeathed an aggregate amount of more than $5,000 to the private foundation, if such amount is more than 2 percent of the total contributions and bequests received by the foundation before the close of the taxable year of the foundation in which the contribution or bequest is received by the foundation from such person. In the case of a trust, the term "substantial contributor" also means the creator of the trust.

(B) SPECIAL RULES.—For purposes of subparagraph (A)—

(i) each contribution or bequest shall be valued at fair market value on the date it was received,

(ii) in the case of a foundation which is in existence on October 9, 1969, all contributions and bequests received on or before such date shall be treated (except for purposes of clause (i)) as if received on such date,

(iii) an individual shall be treated as making all contributions and bequests made by [his spouse] *the individual's spouse*, and

(iv) any person who is a substantial contributor on any date shall remain a substantial contributor for all subsequent periods.

(C) PERSON CEASES TO BE SUBSTANTIAL CONTRIBUTOR IN CERTAIN CASES.—

(i) IN GENERAL.—A person shall cease to be treated as a substantial contributor with respect to any private foundation as of the close of any taxable year of such foundation if—

(I) during the 10-year period ending at the close of such taxable year such person (and all related persons) have not made any contribution to such private foundation,

(II) at no time during such 10-year period was such person (or any related person) a foundation manager of such private foundation, and

(III) the aggregate contributions made by such person (and related persons) are determined by the Secretary to be insignificant when compared to the aggregate amount of contributions to such foundation by one other person.

For purposes of subclause (III), appreciation on contributions while held by the foundation shall be taken into account.

(ii) RELATED PERSON.—For purposes of clause (i), the term "related person" means, with respect to any person, any other person who would be a disqualified person (within the meaning of section 4946) by reason of his relationship to such person. In the case of a contributor which is a corporation, the term also includes any officer or director of such corporation.

(3) REGULATIONS.—For purposes of this section, the determination as to whether and to what extent there would have been any increase in tax shall be made in accordance with regulations prescribed by the Secretary.

(e) VALUE OF ASSETS.—For purposes of subsection (c), the value of the net assets shall be determined at whichever time such value is higher: (1) the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation, or (2) the date on which it ceases to be a private foundation.

(f) LIABILITY IN CASE OF TRANSFERS OF ASSETS FROM PRIVATE FOUNDATION.—For purposes of determining liability for the tax imposed by subsection (c) in the case of assets transferred by the private foundation, such tax shall be deemed to have been imposed on the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation.

(g) ABATEMENT OF TAXES.—The Secretary may abate the unpaid portion of the assessment of any tax imposed by subsection (c), or any liability in respect thereof, if—

(1) the private foundation distributes all of its net assets to one or more organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)) each of which has been in existence and so described for a continuous period of at least 60 calendar months, or

(2) following the notification prescribed in section 6104(c) to the appropriate State officer, such State officer within one year notifies the Secretary, in such manner as the Secretary may by regulations prescribe, that corrective action has been initiated pursuant to State law to insure that the assets of such private foundation are preserved for such charitable or other purposes specified in section 501(c)(3) as may be ordered or approved by a court of competent jurisdiction, and upon completion of the corrective action, the Secretary receives certification from the appropriate State officer that such action has resulted in such preservation of assets.

Subchapter G—CORPORATIONS USED TO AVOID INCOME TAX ON SHAREHOLDERS

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PART II—PERSONAL HOLDING COMPANIES

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SEC. 544. RULES FOR DETERMINING STOCK OWNERSHIP.

(a) CONSTRUCTIVE OWNERSHIP.—For purposes of determining whether a corporation is a personal holding company, insofar as such determination is based on stock ownership under section 542(a)(2), section 543(a)(7), section 543(a)(6), or section 543(a)(4)—

(1) STOCK NOT OWNED BY INDIVIDUAL.—Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries.

(2) FAMILY AND PARTNERSHIP OWNERSHIP.—An individual shall be considered as owning the stock owned, directly or indirectly, by or for [his] *the individual's* family or by or for [his] *the individual's* partner. For purposes of this paragraph, the family of an individual includes only [his] *the individual's* brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

(3) OPTIONS.—If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

(4) APPLICATION OF FAMILY-PARTNERSHIP AND OPTION RULES.—Paragraphs (2) and (3) shall be applied—

(A) for purposes of the stock ownership requirement provided in section 542(a)(2), if, but only if, the effect is to make the corporation a personal holding company;

(B) for purposes of section 543(a)(7) (relating to personal service contracts), of section 543(a)(6) (relating to use of property by shareholders), or of section 543(a)(4) (relating to copyright royalties), if, but only if, the effect is to make the amounts therein referred to includible under such paragraph as personal holding company income.

(5) CONSTRUCTIVE OWNERSHIP AS ACTUAL OWNERSHIP.—Stock constructively owned by a person by reason of the application of paragraph (1) or (3), shall, for purposes of applying paragraph (1) or (2), be treated as actually owned by such person; but stock constructively owned by an individual by reason of the application of paragraph (2) shall not be treated as owned by him for purposes of again applying such paragraph in order to make another the constructive owner of such stock.

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

(b) CONVERTIBLE SECURITIES.—Outstanding securities convertible into stock (whether or not convertible during the taxable year) shall be considered as outstanding stock—

(1) for purposes of the stock ownership requirement provided in section 542(a)(2), but only if the effect of the inclusion of all such securities is to make the corporation a personal holding company;

(2) for purposes of section 543(a)(7) (relating to personal service contracts), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such paragraph as personal holding company income;

(3) for purposes of section 543(a)(6) (relating to the use of property by shareholders), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such paragraph as personal holding company income; and

(4) for purposes of section 543(a)(4) (relating to copyright royalties), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such paragraph as personal holding company income.

The requirement in paragraphs (1), (2), (3), and (4) that all convertible securities must be included if any are to be included shall be subject to the exception that, where some of the outstanding securities are convertible only after a later date than in the case of others, the class having the earlier conversion date may be included although the others are not included, but no convertible securities shall be included unless all outstanding securities having a prior conversion date are also included.

Subchapter I—NATURAL RESOURCES

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PART I—DEDUCTIONS

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SEC. 613A. LIMITATIONS ON PERCENTAGE DEPLETION IN CASE OF OIL AND GAS WELLS.

(a) GENERAL RULE.—Except as otherwise provided in this section, the allowance for depletion under section 611 with respect to any oil or gas well shall be computed without regard to section 613.

(b) EXEMPTION FOR CERTAIN DOMESTIC GAS WELLS.—

(1) IN GENERAL.—The allowance for depletion under section 611 shall be computed in accordance with section 613 with respect to—

(A) regulated natural gas, and

(B) natural gas sold under a fixed contract,

and 22 percent shall be deemed to be specified in subsection (b) of section 613 for purposes of subsection (a) of that section.

(2) NATURAL GAS FROM GEOPRESSURED BRINE.—The allowance for depletion under section 611 shall be computed in accordance with section 613 with respect to any qualified natural gas from geopressured brine, and 10 percent shall be deemed to be specified in subsection (b) of section 613 for purposes of subsection (a) of such section.

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

(A) NATURAL GAS SOLD UNDER A FIXED CONTRACT.—The term "natural gas sold under a fixed contract" means domestic natural gas sold by the producer under a contract, in effect on February 1, 1975, and at all times thereafter before such sale, under which the price for such gas cannot be adjusted to reflect to any extent the increase in liabilities of the seller for tax under this chapter by reason of the repeal of percentage depletion for gas. Price increases after February 1, 1975, shall be presumed to take increases in tax liabilities into account unless the taxpayer demonstrates to the contrary by clear and convincing evidence.

(B) REGULATED NATURAL GAS.—The term "regulated natural gas" means domestic natural gas produced and sold by the producer, before July 1, 1976, subject to the jurisdiction of the Federal Power Commission, the price for which has not been adjusted to reflect to any extent the increase in liability of the seller for tax under this chapter by reason of the repeal of percentage depletion for gas. Price increases after February 1, 1975, shall be presumed to take increases in tax liabilities into account unless the taxpayer demonstrates the contrary by clear and convincing evidence.

(C) QUALIFIED NATURAL GAS FROM GEOPRESSURED BRINE.—The term "qualified natural gas from geopressured brine" means any natural gas—

(i) which is determined in accordance with section 503 of the Natural Gas Policy Act of 1978 to be produced from geopressured brine, and

(ii) which is produced from any well the drilling of which began after September 30, 1978, and before January 1, 1984.

(c) EXEMPTION FOR INDEPENDENT PRODUCERS AND ROYALTY OWNERS.—

(1) IN GENERAL.—Except as provided in subsection (d), the allowance for depletion under section 611 shall be computed in accordance with section 613 with respect to—

(A) so much of the taxpayer's average daily production of domestic crude oil as does not exceed the taxpayer's depletable oil quantity; and

(B) so much of the taxpayer's average daily production of domestic natural gas as does not exceed the taxpayer's depletable natural gas quantity;

and 15 percent shall be deemed to be specified in subsection (b) of section 613 for purposes of subsection (a) of that section.

(2) AVERAGE DAILY PRODUCTION.—For purposes of paragraph (1)—

(A) the taxpayer's average daily production of domestic crude oil or natural gas for any taxable year, shall be determined by dividing his aggregate production of domestic crude oil or natural gas, as the case may be, during the taxable year by the number of days in such taxable year, and

(B) in the case of a taxpayer holding a partial interest in the production from any property (including an interest held in a partnership) such taxpayer's production shall be considered to be that amount of such production determined by multiplying the total production of such property by the taxpayer's percentage participation in the revenues from such property.

(3) DEPLETABLE OIL QUANTITY.—

(A) IN GENERAL.—For purposes of paragraph (1), the taxpayer's depletable oil quantity shall be equal to—

(i) the tentative quantity determined under subparagraph (B), reduced (but not below zero) by

(ii) except in the case of a taxpayer making an election under paragraph (6)(B), the taxpayer's average daily marginal production for the taxable year.

(B) TENTATIVE QUANTITY.—For purposes of subparagraph (A), the tentative quantity is 1,000 barrels.

(4) DAILY DEPLETABLE NATURAL GAS QUANTITY.—For purposes of paragraph (1), the depletable natural gas quantity of any taxpayer for any taxable year shall be equal to 6,000 cubic feet multiplied by the number of barrels of the taxpayer's depletable oil quantity to which the taxpayer elects to have this paragraph apply. The taxpayer's depletable oil quantity for any taxable year shall be reduced by the number of barrels with respect to which an election under this paragraph applies. Such election shall be made at such time and in such manner as the Secretary shall by regulations prescribe.

(6) OIL AND NATURAL GAS PRODUCED FROM MARGINAL PROPERTIES.—

(A) IN GENERAL.—Except as provided in subsection (d) and subparagraph (B), the allowance for depletion under section 611 shall be computed in accordance with section 613 with respect to—

(i) so much of the taxpayer's average daily marginal production of domestic crude oil as does not exceed the

taxpayer's depletable oil quantity (determined without regard to paragraph (3)(A)(ii)), and

(ii) so much of the taxpayer's average daily marginal production of domestic natural gas as does not exceed the taxpayer's depletable natural gas quantity (determined without regard to paragraph (3)(A)(ii)),

and the applicable percentage shall be deemed to be specified in subsection (b) of section 613 for purposes of subsection (a) of that section.

(B) ELECTION TO HAVE PARAGRAPH APPLY TO PRO RATA PORTION OF MARGINAL PRODUCTION.—If the taxpayer elects to have this subparagraph apply for any taxable year, the rules of subparagraph (A) shall apply to the average daily marginal production of domestic crude oil or domestic natural gas of the taxpayer to which paragraph (1) would have applied without regard to this paragraph.

(C) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A), the term "applicable percentage" means the percentage (not greater than 25 percent) equal to the sum of—

(i) 15 percent, plus

(ii) 1 percentage point for each whole dollar by which $20 exceeds the reference price for crude oil for the calendar year preceding the calendar year in which the taxable year begins.

For purposes of this paragraph, the term "reference price" means, with respect to any calendar year, the reference price determined for such calendar year under section 45K(d)(2)(C).

(D) MARGINAL PRODUCTION.—The term "marginal production" means domestic crude oil or domestic natural gas which is produced during any taxable year from a property which—

(i) is a stripper well property for the calendar year in which the taxable year begins, or

(ii) is a property substantially all of the production of which during such calendar year is heavy oil.

(E) STRIPPER WELL PROPERTY.—For purposes of this paragraph, the term "stripper well property" means, with respect to any calendar year, any property with respect to which the amount determined by dividing—

(i) the average daily production of domestic crude oil and domestic natural gas from producing wells on such property for such calendar year, by

(ii) the number of such wells,

is 15 barrel equivalents or less.

(F) HEAVY OIL.—For purposes of this paragraph, the term "heavy oil" means domestic crude oil produced from any property if such crude oil had a weighted average gravity of 20 degrees API or less (corrected to 60 degrees Fahrenheit).

(G) AVERAGE DAILY MARGINAL PRODUCTION.—For purposes of this subsection—

(i) the taxpayer's average daily marginal production of domestic crude oil or natural gas for any taxable

year shall be determined by dividing the taxpayer's aggregate marginal production of domestic crude oil or natural gas, as the case may be, during the taxable year by the number of days in such taxable year, and

(ii) in the case of a taxpayer holding a partial interest in the production from any property (including any interest held in any partnership), such taxpayer's production shall be considered to be that amount of such production determined by multiplying the total production of such property by the taxpayer's percentage participation in the revenues from such property.

(7) SPECIAL RULES.—

(A) PRODUCTION OF CRUDE OIL IN EXCESS OF DEPLETABLE OIL QUANTITY.—If the taxpayer's average daily production of domestic crude oil exceeds his depletable oil quantity, the allowance under paragraph (1)(A) with respect to oil produced during the taxable year from each property in the United States shall be that amount which bears the same ratio to the amount of depletion which would have been allowable under section 613(a) for all of the taxpayer's oil produced from such property during the taxable year (computed as if section 613 applied to all of such production at the rate specified in paragraph (1) or (6), as the case may be) as his depletable oil quantity bears to the aggregate number of barrels representing the average daily production of domestic crude oil of the taxpayer for such year.

(B) PRODUCTION OF NATURAL GAS IN EXCESS OF DEPLETABLE NATURAL GAS QUANTITY.—If the taxpayer's average daily production of domestic natural gas exceeds his depletable natural gas quantity, the allowance under paragraph (1)(B) with respect to natural gas produced during the taxable year from each property in the United States shall be that amount which bears the same ratio to the amount of depletion which would have been allowable under section 613(a) for all of the taxpayer's natural gas produced from such property during the taxable year (computed as if section 613 applied to all of such production at the rate specified in paragraph (1) or (6), as the case may be) as the amount of his depletable natural gas quantity in cubic feet bears to the aggregate number of cubic feet representing the average daily production of domestic natural gas of the taxpayer for such year.

(C) TAXABLE INCOME FROM THE PROPERTY.—If both oil and gas are produced from the property during the taxable year, for purposes of subparagraphs (A) and (B) the taxable income from the property, in applying the taxable income limitation in section 613(a), shall be allocated between the oil production and the gas production in proportion to the gross income during the taxable year from each.

(D) PARTNERSHIPS.—In the case of a partnership, the depletion allowance shall be computed separately by the partners and not by the partnership. The partnership shall allocate to each partner his proportionate share of the adjusted basis of each partnership oil or gas property. The al-

location is to be made as of the later of the date of acquisition of the oil or gas property by the partnership, or January 1, 1975. A partner's proportionate share of the adjusted basis of partnership property shall be determined in accordance with his interest in partnership capital or income and, in the case of property contributed to the partnership by a partner, section 704(c) (relating to contributed property) shall apply in determining such share. Each partner shall separately keep records of his share of the adjusted basis in each oil and gas property of the partnership, adjust such share of the adjusted basis for any depletion taken on such property, and use such adjusted basis each year in the computation of his cost depletion or in the computation of his gain or loss on the disposition of such property by the partnership. For purposes of section 732 (relating to basis of distributed property other than money), the partnership's adjusted basis in mineral property shall be an amount equal to the sum of the partners' adjusted basis in such property as determined under this paragraph.

(8) BUSINESS UNDER COMMON CONTROL; MEMBERS OF THE SAME FAMILY.—

(A) COMPONENT MEMBERS OF CONTROLLED GROUP TREATED AS ONE TAXPAYER.—For purposes of this subsection, persons who are members of the same controlled group of corporations shall be treated as one taxpayer.

(B) AGGREGATION OF BUSINESS ENTITIES UNDER COMMON CONTROL.—If 50 percent or more of the beneficial interest in two or more corporations, trusts, or estates is owned by the same or related persons (taking into account only persons who own at least 5 percent of such beneficial interest), the tentative quantity determined under paragraph (3)(B) shall be allocated among all such entities in proportion to the respective production of domestic crude oil during the period in question by such entities.

(C) ALLOCATION AMONG MEMBERS OF THE SAME FAMILY.—In the case of individuals who are members of the same family, the tentative quantity determined under paragraph (3)(B) shall be allocated among such individuals in proportion to the respective production of domestic crude oil during the period in question by such individuals.

(D) DEFINITION AND SPECIAL RULES.—For purposes of this paragraph—

(i) the term "controlled group of corporations" has the meaning given to such term by section 1563(a), except that section 1563(b)(2) shall not apply and except that "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears in section 1563(a),

(ii) a person is a related person to another person if such persons are members of the same controlled group of corporations or if the relationship between such persons would result in a disallowance of losses under section 267 or 707(b), except that for this pur-

pose the family of an individual includes only [his spouse] *the individual's spouse* and minor children.

(iii) the family of an individual includes only [his spouse] *the individual's spouse* and minor children, and

(iv) each 6,000 cubic feet of domestic natural gas shall be treated as 1 barrel of domestic crude oil.

(9) SPECIAL RULE FOR FISCAL YEAR TAXPAYERS.—In applying this subsection to a taxable year which is not a calendar year, each portion of such taxable year which occurs during a single calendar year shall be treated as if it were a short taxable year.

(10) CERTAIN PRODUCTION NOT TAKEN INTO ACCOUNT.—In applying this subsection, there shall not be taken into account the production of natural gas with respect to which subsection (b) applies.

(11) SUBCHAPTER S CORPORATIONS.—

(A) COMPUTATION OF DEPLETION ALLOWANCE AT SHAREHOLDER LEVEL.—In the case of an S corporation, the allowance for depletion with respect to any oil or gas property shall be computed separately by each shareholder.

(B) ALLOCATION OF BASIS.—The S corporation shall allocate to each shareholder his pro rata share of the adjusted basis of the S corporation in each oil or gas property held by the S corporation. The allocation shall be made as of the later of the date of acquisition of the property by the S corporation, or the first day of the first taxable year of the S corporation to which the Subchapter S Revision Act of 1982 applies. Each shareholder shall separately keep records of his share of the adjusted basis in each oil and gas property of the S corporation, adjust such share of the adjusted basis for any depletion taken on such property, and use such adjusted basis each year in the computation of his cost depletion or in the computation of his gain or loss on the disposition of such property by the S corporation. In the case of any distribution of oil or gas property to its shareholders by the S corporation, the corporation's adjusted basis in the property shall be an amount equal to the sum of the shareholders' adjusted bases in such property, as determined under this subparagraph.

(d) LIMITATIONS ON APPLICATION OF SUBSECTION (C).—

(1) LIMITATION BASED ON TAXABLE INCOME.—The deduction for the taxable year attributable to the application of subsection (c) shall not exceed 65 percent of the taxpayer's taxable income for the year computed without regard to—

(A) any depletion on production from an oil or gas property which is subject to the provisions of subsection (c),

(B) any deduction allowable under section 199A,

(C) any net operating loss carryback to the taxable year under section 172,

(D) any capital loss carryback to the taxable year under section 1212, and

(E) in the case of a trust, any distributions to its beneficiary, except in the case of any trust where any beneficiary of such trust is a member of the family (as defined

in section 267(c)(4)) of a settlor who created inter vivos and testamentary trusts for members of the family and such settlor died within the last six days of the fifth month in 1970, and the law in the jurisdiction in which such trust was created requires all or a portion of the gross or net proceeds of any royalty or other interest in oil, gas, or other mineral representing any percentage depletion allowance to be allocated to the principal of the trust.

If an amount is disallowed as a deduction for the taxable year by reason of application of the preceding sentence, the disallowed amount shall be treated as an amount allowable as a deduction under subsection (c) for the following taxable year, subject to the application of the preceding sentence to such taxable year. For purposes of basis adjustments and determining whether cost depletion exceeds percentage depletion with respect to the production from a property, any amount disallowed as a deduction on the application of this paragraph shall be allocated to the respective properties from which the oil or gas was produced in proportion to the percentage depletion otherwise allowable to such properties under subsection (c).

(2) RETAILERS EXCLUDED.—Subsection (c) shall not apply in the case of any taxpayer who directly, or through a related person, sells oil or natural gas (excluding bulk sales of such items to commercial or industrial users), or any product derived from oil or natural gas (excluding bulk sales of aviation fuels to the Department of Defense)—

(A) through any retail outlet operated by the taxpayer or a related person, or

(B) to any person—

(i) obligated under an agreement or contract with the taxpayer or a related person to use a trademark, trade name, or service mark or name owned by such taxpayer or a related person, in marketing or distributing oil or natural gas or any product derived from oil or natural gas, or

(ii) given authority, pursuant to an agreement or contract with the taxpayer or a related person, to occupy any retail outlet owned, leased, or in any way controlled by the taxpayer or a related person.

Notwithstanding the preceding sentence this paragraph shall not apply in any case where the combined gross receipts from the sale of such oil, natural gas, or any product derived therefrom, for the taxable year of all retail outlets taken into account for purposes of this paragraph do not exceed $5,000,000. For purposes of this paragraph, sales of oil, natural gas, or any product derived from oil or natural gas shall not include sales made of such items outside the United States, if no domestic production of the taxpayer or a related person is exported during the taxable year or the immediately preceding taxable year.

(3) RELATED PERSON.—For purposes of this subsection, a person is a related person with respect to the taxpayer if a significant ownership interest in either the taxpayer or such person is held by the other, or if a third person has a significant own-

ership interest in both the taxpayer and such person. For purposes of the preceding sentence, the term "significant ownership interest" means—

(A) with respect to any corporation, 5 percent or more in value of the outstanding stock of such corporation,

(B) with respect to a partnership, 5 percent or more interest in the profits or capital of such partnership, and

(C) with respect to an estate or trust, 5 percent or more of the beneficial interests in such estate or trust.

For purposes of determining a significant ownership interest, an interest owned by or for a corporation, partnership, trust, or estate shall be considered as owned directly both by itself and proportionately by its shareholders, partners, or beneficiaries, as the case may be.

(4) CERTAIN REFINERS EXCLUDED.—If the taxpayer or one or more related persons engages in the refining of crude oil, subsection (c) shall not apply to the taxpayer for a taxable year if the average daily refinery runs of the taxpayer and such persons for the taxable year exceed 75,000 barrels. For purposes of this paragraph, the average daily refinery runs for any taxable year shall be determined by dividing the aggregate refinery runs for the taxable year by the number of days in the taxable year.

(5) PERCENTAGE DEPLETION NOT ALLOWED FOR LEASE BONUSES, ETC..—In the case of any oil or gas property to which subsection (c) applies, for purposes of section 613, the term "gross income from the property" shall not include any lease bonus, advance royalty, or other amount payable without regard to production from property.

(e) DEFINITIONS.—For purposes of this section—

(1) CRUDE OIL.—The term "crude oil" includes a natural gas liquid recovered from a gas well in lease separators or field facilities.

(2) NATURAL GAS.—The term "natural gas" means any product (other than crude oil) of an oil or gas well if a deduction for depletion is allowable under section 611 with respect to such product.

(3) DOMESTIC.—The term "domestic" refers to production from an oil or gas well located in the United States or in a possession of the United States.

(4) BARREL.—The term "barrel" means 42 United States gallons.

Subchapter J—ESTATES, TRUSTS, BENEFICIARIES, AND DECEDENTS

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PART I—ESTATES, TRUSTS, AND BENEFICIARIES

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Subpart A—GENERAL RULES FOR TAXATION OF ESTATES AND TRUSTS

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SEC. 643. DEFINITIONS APPLICABLE TO SUBPARTS A, B, C, AND D.

(a) DISTRIBUTABLE NET INCOME.—For purposes of this part, the term "distributable net income" means, with respect to any taxable year, the taxable income of the estate or trust computed with the following modifications—

(1) DEDUCTION FOR DISTRIBUTIONS.—No deduction shall be taken under sections 651 and 661 (relating to additional deductions).

(2) DEDUCTION FOR PERSONAL EXEMPTION.—No deduction shall be taken under section 642(b) (relating to deduction for personal exemptions).

(3) CAPITAL GAINS AND LOSSES.—Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year, or (B) paid, permanently set aside, or to be used for the purposes specified in section 642(c). Losses from the sale or exchange of capital assets shall be excluded, except to the extent such losses are taken into account in determining the amount of gains from the sale or exchange of capital assets which are paid, credited, or required to be distributed to any beneficiary during the taxable year. The exclusion under section 1202 shall not be taken into account.

(4) EXTRAORDINARY DIVIDENDS AND TAXABLE STOCK DIVIDENDS.—For purposes only of subpart B (relating to trusts which distribute current income only), there shall be excluded those items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, does not pay or credit to any beneficiary by reason of his determination that such dividends are allocable to corpus under the terms of the governing instrument and applicable local law.

(5) TAX-EXEMPT INTEREST.—There shall be included any tax-exempt interest to which section 103 applies, reduced by any amounts which would be deductible in respect of disbursements allocable to such interest but for the provisions of section 265 (relating to disallowance of certain deductions).

(6) INCOME OF FOREIGN TRUST.—In the case of a foreign trust—

(A) There shall be included the amounts of gross income from sources without the United States, reduced by any amounts which would be deductible in respect of disbursements allocable to such income but for the provisions of section 265(a)(1) (relating to disallowance of certain deductions).

(B) Gross income from sources within the United States shall be determined without regard to section 894 (relating to income exempt under treaty).

(C) Paragraph (3) shall not apply to a foreign trust. In the case of such a trust, there shall be included gains from the sale or exchange of capital assets, reduced by losses from such sales or exchanges to the extent such losses do not exceed gains from such sales or exchanges.

(7) ABUSIVE TRANSACTIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry

out the purposes of this part, including regulations to prevent avoidance of such purposes.

If the estate or trust is allowed a deduction under section 642(c), the amount of the modifications specified in paragraphs (5) and (6) shall be reduced to the extent that the amount of income which is paid, permanently set aside, or to be used for the purposes specified in section 642(c) is deemed to consist of items specified in those paragraphs. For this purpose, such amount shall (in the absence of specific provisions in the governing instrument) be deemed to consist of the same proportion of each class of items of income of the estate or trust as the total of each class bears to the total of all classes.

(b) INCOME.—For purposes of this subpart and subparts B, C, and D, the term "income", when not preceded by the words "taxable", "distributable net", "undistributed net", or "gross", means the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. Items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, determines to be allocable to corpus under the terms of the governing instrument and applicable local law shall not be considered income.

(c) BENEFICIARY.—For purposes of this part, the term "beneficiary" includes heir, legatee, devisee.

(d) COORDINATION WITH BACK-UP WITHHOLDING.—Except to the extent otherwise provided in regulations, this subchapter shall be applied with respect to payments subject to withholding under section 3406—

(1) by allocating between the estate or trust and its beneficiaries any credit allowable under section 31(c) (on the basis of their respective shares of any such payment taken into account under this subchapter),

(2) by treating each beneficiary to whom such credit is allocated as if an amount equal to such credit has been paid to him by the estate or trust, and

(3) by allowing the estate or trust a deduction in an amount equal to the credit so allocated to beneficiaries.

(e) TREATMENT OF PROPERTY DISTRIBUTED IN KIND.—

(1) BASIS OF BENEFICIARY.—The basis of any property received by a beneficiary in a distribution from an estate or trust shall be—

(A) the adjusted basis of such property in the hands of the estate or trust immediately before the distribution, adjusted for

(B) any gain or loss recognized to the estate or trust on the distribution.

(2) AMOUNT OF DISTRIBUTION.—In the case of any distribution of property (other than cash), the amount taken into account under sections 661(a)(2) and 662(a)(2) shall be the lesser of—

(A) the basis of such property in the hands of the beneficiary (as determined under paragraph (1)), or

(B) the fair market value of such property.

(3) ELECTION TO RECOGNIZE GAIN.—

(A) IN GENERAL.—In the case of any distribution of property (other than cash) to which an election under this paragraph applies—

(i) paragraph (2) shall not apply,

(ii) gain or loss shall be recognized by the estate or trust in the same manner as if such property had been sold to the distributee at its fair market value, and

(iii) the amount taken into account under sections 661(a)(2) and 662(a)(2) shall be the fair market value of such property.

(B) ELECTION.—Any election under this paragraph shall apply to all distributions made by the estate or trust during a taxable year and shall be made on the return of such estate or trust for such taxable year.

Any such election, once made, may be revoked only with the consent of the Secretary.

(4) EXCEPTION FOR DISTRIBUTIONS DESCRIBED IN SECTION 663(A).—This subsection shall not apply to any distribution described in section 663(a).

(f) TREATMENT OF MULTIPLE TRUSTS.—For purposes of this subchapter, under regulations prescribed by the Secretary, 2 or more trusts shall be treated as 1 trust if—

(1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and

(2) a principal purpose of such trusts is the avoidance of the tax imposed by this chapter.

For purposes of the preceding sentence, a [husband and wife] *married couple* shall be treated as 1 person.

(g) CERTAIN PAYMENTS OF ESTIMATED TAX TREATED AS PAID BY BENEFICIARY.—

(1) IN GENERAL.—In the case of a trust—

(A) the trustee may elect to treat any portion of a payment of estimated tax made by such trust for any taxable year of the trust as a payment made by a beneficiary of such trust,

(B) any amount so treated shall be treated as paid or credited to the beneficiary on the last day of such taxable year, and

(C) for purposes of subtitle F, the amount so treated—

(i) shall not be treated as a payment of estimated tax made by the trust, but

(ii) shall be treated as a payment of estimated tax made by such beneficiary on January 15 following the taxable year.

(2) TIME FOR MAKING ELECTION.—An election under paragraph (1) shall be made on or before the 65th day after the close of the taxable year of the trust and in such manner as the Secretary may prescribe.

(3) EXTENSION TO LAST YEAR OF ESTATE.—In the case of a taxable year reasonably expected to be the last taxable year of an estate—

(A) any reference in this subsection to a trust shall be treated as including a reference to an estate, and

(B) the fiduciary of the estate shall be treated as the trustee.

(h) DISTRIBUTIONS BY CERTAIN FOREIGN TRUSTS THROUGH NOMINEES.—For purposes of this part, any amount paid to a United States person which is derived directly or indirectly from a foreign trust of which the payor is not the grantor shall be deemed in the year of payment to have been directly paid by the foreign trust to such United States person.

(i) LOANS FROM FOREIGN TRUSTS.—For purposes of subparts B, C, and D—

(1) GENERAL RULE.—Except as provided in regulations, if a foreign trust makes a loan of cash or marketable securities (or permits the use of any other trust property) directly or indirectly to or by—

(A) any grantor or beneficiary of such trust who is a United States person, or

(B) any United States person not described in subparagraph (A) who is related to such grantor or beneficiary,

the amount of such loan (or the fair market value of the use of such property) shall be treated as a distribution by such trust to such grantor or beneficiary (as the case may be).

(2) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

(A) CASH.—The term "cash" includes foreign currencies and cash equivalents.

(B) RELATED PERSON.—

(i) IN GENERAL.—A person is related to another person if the relationship between such persons would result in a disallowance of losses under section 267 or 707(b). In applying section 267 for purposes of the preceding sentence, section 267(c)(4) shall be applied as if the family of an individual includes the spouses of the members of the family.

(ii) ALLOCATION.—If any person described in paragraph (1)(B) is related to more than one person, the grantor or beneficiary to whom the treatment under this subsection applies shall be determined under regulations prescribed by the Secretary.

(C) EXCLUSION OF TAX-EXEMPTS.—The term "United States person" does not include any entity exempt from tax under this chapter.

(D) TRUST NOT TREATED AS SIMPLE TRUST.—Any trust which is treated under this subsection as making a distribution shall be treated as not described in section 651.

(E) EXCEPTION FOR COMPENSATED USE OF PROPERTY.—In the case of the use of any trust property other than a loan of cash or marketable securities, paragraph (1) shall not apply to the extent that the trust is paid the fair market value of such use within a reasonable period of time of such use.

(3) SUBSEQUENT TRANSACTIONS.—If any loan (or use of property) is taken into account under paragraph (1), any subsequent transaction between the trust and the original borrower regarding the principal of the loan (by way of complete or partial repayment, satisfaction, cancellation, discharge, or other-

wise) or the return of such property shall be disregarded for purposes of this title.

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Subpart E—GRANTORS AND OTHERS TREATED AS SUBSTANTIAL OWNERS

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SEC. 672. DEFINITIONS AND RULES.

(a) ADVERSE PARTY.—For purposes of this subpart, the term "adverse party" means any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust. A person having a general power of appointment over the trust property shall be deemed to have a beneficial interest in the trust.

(b) NONADVERSE PARTY.—For purposes of this subpart, the term "nonadverse party" means any person who is not an adverse party.

(c) RELATED OR SUBORDINATE PARTY.—For purposes of this subpart, the term "related or subordinate party" means any nonadverse party who is—

(1) the grantor's spouse if living with the grantor;

(2) any one of the following: The grantor's father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive.

For purposes of subsection (f) and sections 674 and 675, a related or subordinate party shall be presumed to be subservient to the grantor in respect of the exercise or nonexercise of the powers conferred on him unless such party is shown not to be subservient by a preponderance of the evidence.

(d) RULE WHERE POWER IS SUBJECT TO CONDITION PRECEDENT.—A person shall be considered to have a power described in this subpart even though the exercise of the power is subject to a precedent giving of notice or takes effect only on the expiration of a certain period after the exercise of the power.

(e) GRANTOR TREATED AS HOLDING ANY POWER OR INTEREST OF GRANTOR'S SPOUSE.—

(1) IN GENERAL.—For purposes of this subpart, a grantor shall be treated as holding any power or interest held by—

(A) any individual who was the spouse of the grantor at the time of the creation of such power or interest, or

(B) any individual who became the spouse of the grantor after the creation of such power or interest, but only with respect to periods after such individual became the spouse of the grantor.

(2) MARITAL STATUS.—For purposes of paragraph (1)(A), an individual legally separated from [his spouse] *the individual's spouse* under a decree of divorce or of separate maintenance shall not be considered as married.

(f) SUBPART NOT TO RESULT IN FOREIGN OWNERSHIP.—

(1) IN GENERAL.—Notwithstanding any other provision of this subpart, this subpart shall apply only to the extent such

application results in an amount (if any) being currently taken into account (directly or through 1 or more entities) under this chapter in computing the income of a citizen or resident of the United States or a domestic corporation.

(2) EXCEPTIONS.—

(A) CERTAIN REVOCABLE AND IRREVOCABLE TRUSTS.—Paragraph (1) shall not apply to any portion of a trust if—

(i) the power to revest absolutely in the grantor title to the trust property to which such portion is attributable is exercisable solely by the grantor without the approval or consent of any other person or with the consent of a related or subordinate party who is subservient to the grantor, or

(ii) the only amounts distributable from such portion (whether income or corpus) during the lifetime of the grantor are amounts distributable to the grantor or the spouse of the grantor.

(B) COMPENSATORY TRUSTS.—Except as provided in regulations, paragraph (1) shall not apply to any portion of a trust distributions from which are taxable as compensation for services rendered.

(3) SPECIAL RULES.—Except as otherwise provided in regulations prescribed by the Secretary—

(A) a controlled foreign corporation (as defined in section 957) shall be treated as a domestic corporation for purposes of paragraph (1), and

(B) paragraph (1) shall not apply for purposes of applying section 1297.

(4) RECHARACTERIZATION OF PURPORTED GIFTS.—In the case of any transfer directly or indirectly from a partnership or foreign corporation which the transferee treats as a gift or bequest, the Secretary may recharacterize such transfer in such circumstances as the Secretary determines to be appropriate to prevent the avoidance of the purposes of this subsection.

(5) SPECIAL RULE WHERE GRANTOR IS FOREIGN PERSON.—If—

(A) but for this subsection, a foreign person would be treated as the owner of any portion of a trust, and

(B) such trust has a beneficiary who is a United States person,

such beneficiary shall be treated as the grantor of such portion to the extent such beneficiary has made (directly or indirectly) transfers of property (other than in a sale for full and adequate consideration) to such foreign person. For purposes of the preceding sentence, any gift shall not be taken into account to the extent such gift would be excluded from taxable gifts under section 2503(b).

(6) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection, including regulations providing that paragraph (1) shall not apply in appropriate cases.

Subchapter K—PARTNERS AND PARTNERSHIPS

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PART I—DETERMINATION OF TAX LIABILITY

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SEC. 704. PARTNER'S DISTRIBUTIVE SHARE.

(a) EFFECT OF PARTNERSHIP AGREEMENT.—A partner's distributive share of income, gain, loss, deduction, or credit shall, except as otherwise provided in this chapter, be determined by the partnership agreement.

(b) DETERMINATION OF DISTRIBUTIVE SHARE.—A partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) shall be determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances), if—

(1) the partnership agreement does not provide as to the partner's distributive share of income, gain, loss, deduction, or credit (or item thereof), or

(2) the allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item thereof) does not have substantial economic effect.

(c) CONTRIBUTED PROPERTY.—

(1) IN GENERAL.—Under regulations prescribed by the Secretary—

(A) income, gain, loss, and deduction with respect to property contributed to the partnership by a partner shall be shared among the partners so as to take account of the variation between the basis of the property to the partnership and its fair market value at the time of contribution,

(B) if any property so contributed is distributed (directly or indirectly) by the partnership (other than to the contributing partner) within 7 years of being contributed—

(i) the contributing partner shall be treated as recognizing gain or loss (as the case may be) from the sale of such property in an amount equal to the gain or loss which would have been allocated to such partner under subparagraph (A) by reason of the variation described in subparagraph (A) if the property had been sold at its fair market value at the time of the distribution,

(ii) the character of such gain or loss shall be determined by reference to the character of the gain or loss which would have resulted if such property had been sold by the partnership to the distributee, and

(iii) appropriate adjustments shall be made to the adjusted basis of the contributing partner's interest in the partnership and to the adjusted basis of the property distributed to reflect any gain or loss recognized under this subparagraph, and

(C) if any property so contributed has a built-in loss—

(i) such built-in loss shall be taken into account only in determining the amount of items allocated to the contributing partner, and

(ii) except as provided in regulations, in determining the amount of items allocated to other partners, the basis of the contributed property in the hands of the

partnership shall be treated as being equal to its fair market value at the time of contribution.

For purposes of subparagraph (C), the term "built-in loss" means the excess of the adjusted basis of the property (determined without regard to subparagraph (C)(ii)) over its fair market value at the time of contribution.

(2) SPECIAL RULE FOR DISTRIBUTIONS WHERE GAIN OR LOSS WOULD NOT BE RECOGNIZED OUTSIDE PARTNERSHIPS.—Under regulations prescribed by the Secretary, if—

(A) property contributed by a partner (hereinafter referred to as the "contributing partner") is distributed by the partnership to another partner, and

(B) other property of a like kind (within the meaning of section 1031) is distributed by the partnership to the contributing partner not later than the earlier of—

(i) the 180th day after the date of the distribution described in subparagraph (A), or

(ii) the due date (determined with regard to extensions) for the contributing partner's return of the tax imposed by this chapter for the taxable year in which the distribution described in subparagraph (A) occurs,

then to the extent of the value of the property described in subparagraph (B), paragraph (1)(B) shall be applied as if the contributing partner had contributed to the partnership the property described in subparagraph (B).

(3) OTHER RULES.—Under regulations prescribed by the Secretary, rules similar to the rules of paragraph (1) shall apply to contributions by a partner (using the cash receipts and disbursements method of accounting) of accounts payable and other accrued but unpaid items. Any reference in paragraph (1) or (2) to the contributing partner shall be treated as including a reference to any successor of such partner.

(d) LIMITATION ON ALLOWANCE OF LOSSES.—

(1) IN GENERAL.—A partner's distributive share of partnership loss (including capital loss) shall be allowed only to the extent of the adjusted basis of such partner's interest in the partnership at the end of the partnership year in which such loss occurred.

(2) CARRYOVER.—Any excess of such loss over such basis shall be allowed as a deduction at the end of the partnership year in which such excess is repaid to the partnership.

(3) SPECIAL RULES.—

(A) IN GENERAL.—In determining the amount of any loss under paragraph (1), there shall be taken into account the partner's distributive share of amounts described in paragraphs (4) and (6) of section 702(a).

(B) EXCEPTION.—In the case of a charitable contribution of property whose fair market value exceeds its adjusted basis, subparagraph (A) shall not apply to the extent of the partner's distributive share of such excess.

(e) PARTNERSHIP INTERESTS CREATED BY GIFT.—

(1) DISTRIBUTIVE SHARE OF DONEE INCLUDIBLE IN GROSS INCOME.—In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the

extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service.

(2) PURCHASE OF INTEREST BY MEMBER OF FAMILY.—For purposes of this subsection, an interest purchased by one member of a family from another shall be considered to be created by gift from the seller, and the fair market value of the purchased interest shall be considered to be donated capital. The "family" of any individual shall include only [his spouse] *the individual's spouse*, ancestors, and lineal descendants, and any trusts for the primary benefit of such persons.

(f) CROSS REFERENCE.—For rules in the case of the sale, exchange, liquidation, or reduction of a partner's interest, see section 706(c)(2).

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PART III—DEFINITIONS

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SEC. 761. TERMS DEFINED.

(a) PARTNERSHIP.—For purposes of this subtitle, the term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a corporation or a trust or estate. Under regulations the Secretary may, at the election of all the members of an unincorporated organization, exclude such organization from the application of all or part of this subchapter, if it is availed of—

(1) for investment purposes only and not for the active conduct of a business,

(2) for the joint production, extraction, or use of property, but not for the purpose of selling services or property produced or extracted, or

(3) by dealers in securities for a short period for the purpose of underwriting, selling, or distributing a particular issue of securities,

if the income of the members of the organization may be adequately determined without the computation of partnership taxable income.

(b) PARTNER.—For purposes of this subtitle, the term "partner" means a member of a partnership. In the case of a capital interest in a partnership in which capital is a material income-producing factor, whether a person is a partner with respect to such interest shall be determined without regard to whether such interest was derived by gift from any other person.

(c) PARTNERSHIP AGREEMENT.—For purposes of this subchapter, a partnership agreement includes any modifications of the partnership agreement made prior to, or at, the time prescribed by law for the filing of the partnership return for the taxable year (not includ-

ing extensions) which are agreed to by all the partners, or which are adopted in such other manner as may be provided by the partnership agreement.

(d) LIQUIDATION OF A PARTNER'S INTEREST.—For purposes of this subchapter, the term "liquidation of a partner's interest" means the termination of a partner's entire interest in a partnership by means of a distribution, or a series of distributions, to the partner by the partnership.

(e) DISTRIBUTIONS OF PARTNERSHIP INTERESTS TREATED AS EXCHANGES.—Except as otherwise provided in regulations, for purposes of—

(1) section 708 (relating to continuation of partnership),

(2) section 743 (relating to optional adjustment to basis of partnership property), and

(3) any other provision of this subchapter specified in regulations prescribed by the Secretary,

any distribution of an interest in a partnership (not otherwise treated as an exchange) shall be treated as an exchange.

(f) QUALIFIED JOINT VENTURE.—

(1) IN GENERAL.—In the case of a qualified joint venture conducted by a [husband and wife] *married couple* who file a joint return for the taxable year, for purposes of this title—

(A) such joint venture shall not be treated as a partnership,

(B) all items of income, gain, loss, deduction, and credit shall be divided between the spouses in accordance with their respective interests in the venture, and

(C) each spouse shall take into account such spouse's respective share of such items as if they were attributable to a trade or business conducted by such spouse as a sole proprietor.

(2) QUALIFIED JOINT VENTURE.—For purposes of paragraph (1), the term "qualified joint venture" means any joint venture involving the conduct of a trade or business if—

(A) the only members of such joint venture are a [husband and wife] *married couple*,

(B) both spouses materially participate (within the meaning of section 469(h) without regard to paragraph (5) thereof) in such trade or business, and

(C) both spouses elect the application of this subsection.

(g) CROSS REFERENCE.—For rules in the case of the sale, exchange, liquidation, or reduction of a partner's interest, see sections 704(b) and 706(c)(2).

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Subchapter N—TAX BASED ON INCOME FROM SOURCES WITHIN OR WITHOUT THE UNITED STATES

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PART III—INCOME FROM SOURCES WITHOUT THE UNITED STATES

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Subpart B—EARNED INCOME OF CITIZENS OR RESIDENTS OF UNITED STATES

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SEC. 911. CITIZENS OR RESIDENTS OF THE UNITED STATES LIVING ABROAD.

(a) EXCLUSION FROM GROSS INCOME.—At the election of a qualified individual (made separately with respect to paragraphs (1) and (2)), there shall be excluded from the gross income of such individual, and exempt from taxation under this subtitle, for any taxable year—

(1) the foreign earned income of such individual, and

(2) the housing cost amount of such individual.

(b) FOREIGN EARNED INCOME.—

(1) DEFINITION.—For purposes of this section—

(A) IN GENERAL.—The term "foreign earned income" with respect to any individual means the amount received by such individual from sources within a foreign country or countries which constitute earned income attributable to services performed by such individual during the period described in subparagraph (A) or (B) of subsection (d)(1), whichever is applicable.

(B) CERTAIN AMOUNTS NOT INCLUDED IN FOREIGN EARNED INCOME.—The foreign earned income for an individual shall not include amounts—

(i) received as a pension or annuity,

(ii) paid by the United States or an agency thereof to an employee of the United States or an agency thereof,

(iii) included in gross income by reason of section 402(b) (relating to taxability of beneficiary of nonexempt trust) or section 403(c) (relating to taxability of beneficiary under a nonqualified annuity), or

(iv) received after the close of the taxable year following the taxable year in which the services to which the amounts are attributable are performed.

(2) LIMITATION ON FOREIGN EARNED INCOME.—

(A) IN GENERAL.—The foreign earned income of an individual which may be excluded under subsection (a)(1) for any taxable year shall not exceed the amount of foreign earned income computed on a daily basis at an annual rate equal to the exclusion amount for the calendar year in which such taxable year begins.

(B) ATTRIBUTION TO YEAR IN WHICH SERVICES ARE PERFORMED.—For purposes of applying subparagraph (A), amounts received shall be considered received in the taxable year in which the services to which the amounts are attributable are performed.

[(C) TREATMENT OF COMMUNITY INCOME.—In applying subparagraph (A) with respect to amounts received from services performed by a husband or wife which are community income under community property laws applicable to such income, the aggregate amount which may be excludable from the gross income of such husband and wife under subsection (a)(1) for any taxable year shall equal the

amount which would be so excludable if such amounts did not constitute community income.]

(C) TREATMENT OF COMMUNITY INCOME.—In applying subparagraph (A) with respect to amounts received from services performed by a married individual which are community income under community property laws applicable to such income, the aggregate amount which may be excludable from the gross income of such individual and such individual's spouse under subsection (a)(1) for any taxable year shall equal the amount which would be so excludable if such amounts did not constitute community income.

(D) EXCLUSION AMOUNT.—

(i) IN GENERAL.—The exclusion amount for any calendar year is $80,000.

(ii) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 2005, the $80,000 amount in clause (i) shall be increased by an amount equal to the product of—

(I) such dollar amount, and

(II) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting "2004" for "2016" in subparagraph (A)(ii) thereof.

If any increase determined under the preceding sentence is not a multiple of $100, such increase shall be rounded to the next lowest multiple of $100.

(c) HOUSING COST AMOUNT.—For purposes of this section—

(1) IN GENERAL.—The term "housing cost amount" means an amount equal to the excess of—

(A) the housing expenses of an individual for the taxable year to the extent such expenses do not exceed the amount determined under paragraph (2), over

(B) an amount equal to the product of—

(i) 16 percent of the amount (computed on a daily basis) in effect under subsection (b)(2)(D) for the calendar year in which such taxable year begins, multiplied by

(ii) the number of days of such taxable year within the applicable period described in subparagraph (A) or (B) of subsection (d)(1).

(2) LIMITATION.—

(A) IN GENERAL.—The amount determined under this paragraph is an amount equal to the product of—

(i) 30 percent (adjusted as may be provided under subparagraph (B)) of the amount (computed on a daily basis) in effect under subsection (b)(2)(D) for the calendar year in which the taxable year of the individual begins, multiplied by

(ii) the number of days of such taxable year within the applicable period described in subparagraph (A) or (B) of subsection (d)(1).

(B) REGULATIONS.—The Secretary may issue regulations or other guidance providing for the adjustment of the percentage under subparagraph (A)(i) on the basis of geo-

graphic differences in housing costs relative to housing costs in the United States.

(3) HOUSING EXPENSES.—

(A) IN GENERAL.—The term "housing expenses" means the reasonable expenses paid or incurred during the taxable year by or on behalf of an individual for housing for the individual (and, if they reside with [him] *the individual*, for [his spouse] *the individual's spouse* and dependents) in a foreign country. The term—

(i) includes expenses attributable to the housing (such as utilities and insurance), but

(ii) does not include interest and taxes of the kind deductible under section 163 or 164 or any amount allowable as a deduction under section 216(a).

Housing expenses shall not be treated as reasonable to the extent such expenses are lavish or extravagant under the circumstances.

(B) SECOND FOREIGN HOUSEHOLD.—

(i) IN GENERAL.—Except as provided in clause (ii), only housing expenses incurred with respect to that abode which bears the closest relationship to the tax home of the individual shall be taken into account under paragraph (1).

(ii) SEPARATE HOUSEHOLD FOR SPOUSE AND DEPENDENTS.—If an individual maintains a separate abode outside the United States for [his spouse] *the individual's spouse* and dependents and they do not reside with [him] *the individual* because of living conditions which are dangerous, unhealthful, or otherwise adverse, then—

(I) the words "if they reside with [him] *the individual*" in subparagraph (A) shall be disregarded, and

(II) the housing expenses incurred with respect to such abode shall be taken into account under paragraph (1).

(4) SPECIAL RULES WHERE HOUSING EXPENSES NOT PROVIDED BY EMPLOYER.—

(A) IN GENERAL.—To the extent the housing cost amount of any individual for any taxable year is not attributable to employer provided amounts, such amount shall be treated as a deduction allowable in computing adjusted gross income to the extent of the limitation of subparagraph (B).

(B) LIMITATION.—For purposes of subparagraph (A), the limitation of this subparagraph is the excess of—

(i) the foreign earned income of the individual for the taxable year, over

(ii) the amount of such income excluded from gross income under subsection (a) for the taxable year.

(C) 1-YEAR CARRYOVER OF HOUSING AMOUNTS NOT ALLOWED BY REASON OF SUBPARAGRAPH (B).—

(i) IN GENERAL.—The amount not allowable as a deduction for any taxable year under subparagraph (A) by reason of the limitation of subparagraph (B) shall be treated as a deduction allowable in computing ad-

justed gross income for the succeeding taxable year (and only for the succeeding taxable year) to the extent of the limitation of clause (ii) for such succeeding taxable year.

(ii) LIMITATION.—For purposes of clause (i), the limitation of this clause for any taxable year is the excess of—

(I) the limitation of subparagraph (B) for such taxable year, over

(II) amounts treated as a deduction under subparagraph (A) for such taxable year.

(D) EMPLOYER PROVIDED AMOUNTS.—For purposes of this paragraph, the term "employer provided amounts" means any amount paid or incurred on behalf of the individual by the individual's employer which is foreign earned income included in the individual's gross income for the taxable year (without regard to this section).

(E) FOREIGN EARNED INCOME.—For purposes of this paragraph, an individual's foreign earned income for any taxable year shall be determined without regard to the limitation of subparagraph (A) of subsection (b)(2).

(d) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) QUALIFIED INDIVIDUAL.—The term "qualified individual" means an individual whose tax home is in a foreign country and who is—

(A) a citizen of the United States and establishes to the satisfaction of the Secretary that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, or

(B) a citizen or resident of the United States and who, during any period of 12 consecutive months, is present in a foreign country or countries during at least 330 full days in such period.

(2) EARNED INCOME.—

(A) IN GENERAL.—The term "earned income" means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered.

(B) TAXPAYER ENGAGED IN TRADE OR BUSINESS.—In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income.

(3) TAX HOME.—The term "tax home" means, with respect to any individual, such individual's home for purposes of section 162(a)(2) (relating to traveling expenses while away from home). An individual shall not be treated as having a tax home

in a foreign country for any period for which his abode is within the United States, unless such individual is serving in an area designated by the President of the United States by Executive order as a combat zone for purposes of section 112 in support of the Armed Forces of the United States.

(4) WAIVER OF PERIOD OF STAY IN FOREIGN COUNTRY.—Notwithstanding paragraph (1), an individual who—

(A) is a bona fide resident of, or is present in, a foreign country for any period,

(B) leaves such foreign country after August 31, 1978—

(i) during any period during which the Secretary determines, after consultation with the Secretary of State or his delegate, that individuals were required to leave such foreign country because of war, civil unrest, or similar adverse conditions in such foreign country which precluded the normal conduct of business by such individuals, and

(ii) before meeting the requirements of such paragraph (1), and

(C) establishes to the satisfaction of the Secretary that such individual could reasonably have been expected to have met such requirements but for the conditions referred to in clause (i) of subparagraph (B),

shall be treated as a qualified individual with respect to the period described in subparagraph (A) during which he was a bona fide resident of, or was present in, the foreign country, and in applying subsections (b)(2)(A), (c)(1)(B)(ii), and (c)(2)(A)(ii) with respect to such individual, only the days within such period shall be taken into account.

(5) TEST OF BONA FIDE RESIDENCE.—If—

(A) an individual who has earned income from sources within a foreign country submits a statement to the authorities of that country that he is not a resident of that country, and

(B) such individual is held not subject as a resident of that country to the income tax of that country by its authorities with respect to such earnings,

then such individual shall not be considered a bona fide resident of that country for purposes of paragraph (1)(A).

(6) DENIAL OF DOUBLE BENEFITS.—No deduction or exclusion from gross income under this subtitle or credit against the tax imposed by this chapter (including any credit or deduction for the amount of taxes paid or accrued to a foreign country or possession of the United States) shall be allowed to the extent such deduction, exclusion, or credit is properly allocable to or chargeable against amounts excluded from gross income under subsection (a).

(7) AGGREGATE BENEFIT CANNOT EXCEED FOREIGN EARNED INCOME.—The sum of the amount excluded under subsection (a) and the amount deducted under subsection (c)(4)(A) for the taxable year shall not exceed the individual's foreign earned income for such year.

(8) LIMITATION ON INCOME EARNED IN RESTRICTED COUNTRY.—

(A) IN GENERAL.—If travel (or any transaction in connection with such travel) with respect to any foreign country is subject to the regulations described in subparagraph (B) during any period—

(i) the term "foreign earned income" shall not include any income from sources within such country attributable to services performed during such period,

(ii) the term "housing expenses" shall not include any expenses allocable to such period for housing in such country or for housing of the spouse or dependents of the taxpayer in another country while the taxpayer is present in such country, and

(iii) an individual shall not be treated as a bona fide resident of, or as present in, a foreign country for any day during which such individual was present in such country during such period.

(B) REGULATIONS.—For purposes of this paragraph, regulations are described in this subparagraph if such regulations—

(i) have been adopted pursuant to the Trading With the Enemy Act (50 U.S.C. 4301 et seq.) or the International Emergency Economic Powers Act (50 U.S.C. 1701 et seq.), and

(ii) include provisions generally prohibiting citizens and residents of the United States from engaging in transactions related to travel to, from, or within a foreign country.

(C) EXCEPTION.—Subparagraph (A) shall not apply to any individual during any period in which such individual's activities are not in violation of the regulations described in subparagraph (B).

(9) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations providing rules—

(A) for cases [where a husband and wife each have] *where both spouses have* earned income from sources outside the United States, and

(B) for married individuals filing separate returns.

(e) ELECTION.—

(1) IN GENERAL.—An election under subsection (a) shall apply to the taxable year for which made and to all subsequent taxable years unless revoked under paragraph (2).

(2) REVOCATION.—A taxpayer may revoke an election made under paragraph (1) for any taxable year after the taxable year for which such election was made. Except with the consent of the Secretary, any taxpayer who makes such a revocation for any taxable year may not make another election under this section for any subsequent taxable year before the 6th taxable year after the taxable year for which such revocation was made.

(f) DETERMINATION OF TAX LIABILITY.—

(1) IN GENERAL.—If, for any taxable year, any amount is excluded from gross income of a taxpayer under subsection (a), then, notwithstanding sections 1 and 55—

(A) if such taxpayer has taxable income for such taxable year, the tax imposed by section 1 for such taxable year shall be equal to the excess (if any) of—

(i) the tax which would be imposed by section 1 for such taxable year if the taxpayer's taxable income were increased by the amount excluded under subsection (a) for such taxable year, over

(ii) the tax which would be imposed by section 1 for such taxable year if the taxpayer's taxable income were equal to the amount excluded under subsection (a) for such taxable year, and

(B) if such taxpayer has a taxable excess (as defined in section 55(b)(1)(B)) for such taxable year, the amount determined under the first sentence of section 55(b)(1)(A) for such taxable year shall be equal to the excess (if any) of—

(i) the amount which would be determined under such sentence for such taxable year (subject to the limitation of section 55(b)(3)) if the taxpayer's taxable excess (as so defined) were increased by the amount excluded under subsection (a) for such taxable year, over

(ii) the amount which would be determined under such sentence for such taxable year if the taxpayer's taxable excess (as so defined) were equal to the amount excluded under subsection (a) for such taxable year.

For purposes of this paragraph, the amount excluded under subsection (a) shall be reduced by the aggregate amount of any deductions or exclusions disallowed under subsection (d)(6) with respect to such excluded amount.

(2) SPECIAL RULES.—

(A) REGULAR TAX.—In applying section 1(h) for purposes of determining the tax under paragraph (1)(A)(i) for any taxable year in which, without regard to this subsection, the taxpayer's net capital gain exceeds taxable income (hereafter in this subparagraph referred to as the capital gain excess)—

(i) the taxpayer's net capital gain (determined without regard to section 1(h)(11)) shall be reduced (but not below zero) by such capital gain excess,

(ii) the taxpayer's qualified dividend income shall be reduced by so much of such capital gain excess as exceeds the taxpayer's net capital gain (determined without regard to section 1(h)(11) and the reduction under clause (i)), and

(iii) adjusted net capital gain, unrecaptured section 1250 gain, and 28-percent rate gain shall each be determined after increasing the amount described in section 1(h)(4)(B) by such capital gain excess.

(B) ALTERNATIVE MINIMUM TAX.—In applying section 55(b)(3) for purposes of determining the tax under paragraph (1)(B)(i) for any taxable year in which, without regard to this subsection, the taxpayer's net capital gain exceeds the taxable excess (as defined in section 55(b)(1)(B))—

(i) the rules of subparagraph (A) shall apply, except that such subparagraph shall be applied by substituting "the taxable excess (as defined in section 55(b)(1)(B))" for "taxable income", and

(ii) the reference in section 55(b)(3)(B) to the excess described in section 1(h)(1)(B), and the reference in section 55(b)(3)(C)(ii) to the excess described in section 1(h)(1)(C)(ii), shall each be treated as a reference to each such excess as determined under the rules of subparagraph (A) for purposes of determining the tax under paragraph (1)(A)(i).

(C) DEFINITIONS.—Terms used in this paragraph which are also used in section 1(h) shall have the respective meanings given such terms by section 1(h), except that in applying subparagraph (B) the adjustments under part VI of subchapter A shall be taken into account.

(g) CROSS REFERENCES.—For administrative and penal provisions relating to the exclusions provided for in this section, see sections 6001, 6011, 6012(c), and the other provisions of subtitle F.

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Subchapter O—GAIN OR LOSS ON DISPOSITION OF PROPERTY

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PART II—BASIS RULES OF GENERAL APPLICATION

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SEC. 1015. BASIS OF PROPERTY ACQUIRED BY GIFTS AND TRANSFERS IN TRUST.

(a) GIFTS AFTER DECEMBER 31, 1920.—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in section 1016) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss the basis shall be such fair market value. If the facts necessary to determine the basis in the hands of the donor or the last preceding owner are unknown to the donee, the Secretary shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Secretary finds it impossible to obtain such facts, the basis in the hands of such donor or last preceding owner shall be the fair market value of such property as found by the Secretary as of the date or approximate date at which, according to the best information that the Secretary is able to obtain, such property was acquired by such donor or last preceding owner.

(b) TRANSFER IN TRUST AFTER DECEMBER 31, 1920.—If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a gift, bequest, or devise), the basis shall be the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss

recognized to the grantor on such transfer under the law applicable to the year in which the transfer was made.

(c) GIFT OR TRANSFER IN TRUST BEFORE JANUARY 1, 1921.—If the property was acquired by gift or transfer in trust on or before December 31, 1920, the basis shall be the fair market value of such property at the time of such acquisition.

(d) INCREASED BASIS FOR GIFT TAX PAID.—

(1) IN GENERAL.—If—

(A) the property is acquired by gift on or after September 2, 1958, the basis shall be the basis determined under subsection (a), increased (but not above the fair market value of the property at the time of the gift) by the amount of gift tax paid with respect to such gift, or

(B) the property was acquired by gift before September 2, 1958, and has not been sold, exchanged, or otherwise disposed of before such date, the basis of the property shall be increased on such date by the amount of gift tax paid with respect to such gift, but such increase shall not exceed an amount equal to the amount by which the fair market value of the property at the time of the gift exceeded the basis of the property in the hands of the donor at the time of the gift.

(2) AMOUNT OF TAX PAID WITH RESPECT TO GIFT.—For purposes of paragraph (1), the amount of gift tax paid with respect to any gift is an amount which bears the same ratio to the amount of gift tax paid under chapter 12 with respect to all gifts made by the donor for the calendar year (or preceding calendar period) in which such gift is made as the amount of such gift bears to the taxable gifts (as defined in section 2503(a) but computed without the deduction allowed by section 2521) made by the donor during such calendar year or period. For purposes of the preceding sentence, the amount of any gift shall be the amount included with respect to such gift in determining (for the purposes of section 2503(a)) the total amount of gifts made during the calendar year or period, reduced by the amount of any deduction allowed with respect to such gift under section 2522 (relating to charitable deduction) or under section 2523 (relating to marital deduction).

(3) GIFTS TREATED AS MADE ONE-HALF BY EACH SPOUSE.—For purposes of paragraph (1), where the donor and [his spouse] *the donor's spouse* elected, under section 2513 to have the gift considered as made one-half by each, the amount of gift tax paid with respect to such gift under chapter 12 shall be the sum of the amounts of tax paid with respect to each half of such gift (computed in the manner provided in paragraph (2)).

(4) TREATMENT AS ADJUSTMENT TO BASIS.—For purposes of section 1016(b), an increase in basis under paragraph (1) shall be treated as an adjustment under section 1016(a).

(5) APPLICATION TO GIFTS BEFORE 1955.—With respect to any property acquired by gift before 1955, references in this subsection to any provision of this title shall be deemed to refer to the corresponding provision of the Internal Revenue Code of 1939 or prior revenue laws which was effective for the year in which such gift was made.

(6) SPECIAL RULE FOR GIFTS MADE AFTER DECEMBER 31, 1976.—

(A) IN GENERAL.—In the case of any gift made after December 31, 1976, the increase in basis provided by this subsection with respect to any gift for the gift tax paid under chapter 12 shall be an amount (not in excess of the amount of tax so paid) which bears the same ratio to the amount of tax so paid as—

(i) the net appreciation in value of the gift, bears to

(ii) the amount of the gift.

(B) NET APPRECIATION.—For purposes of paragraph (1), the net appreciation in value of any gift is the amount by which the fair market value of the gift exceeds the donor's adjusted basis immediately before the gift.

(e) GIFTS BETWEEN SPOUSES.—In the case of any property acquired by gift in a transfer described in section 1041(a), the basis of such property in the hands of the transferee shall be determined under section 1041(b)(2) and not this section.

Subchapter P—CAPITAL GAINS AND LOSSES

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PART IV—SPECIAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

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SEC. 1233. GAINS AND LOSSES FROM SHORT SALES.

(a) CAPITAL ASSETS.—For purposes of this subtitle, gain or loss from the short sale of property shall be considered as gain or loss from the sale or exchange of a capital asset to the extent that the property, including a commodity future, used to close the short sale constitutes a capital asset in the hands of the taxpayer.

(b) SHORT-TERM GAINS AND HOLDING PERIODS.—If gain or loss from a short sale is considered as gain or loss from the sale or exchange of a capital asset under subsection (a) and if on the date of such short sale substantially identical property has been held by the taxpayer for not more than 1 year (determined without regard to the effect, under paragraph (2) of this subsection, of such short sale on the holding period), or if substantially identical property is acquired by the taxpayer after such short sale and on or before the date of the closing thereof—

(1) any gain on the closing of such short sale shall be considered as a gain on the sale or exchange of a capital asset held for not more than 1 year (notwithstanding the period of time any property used to close such short sale has been held); and

(2) the holding period of such substantially identical property shall be considered to begin (notwithstanding section 1223, relating to the holding period of property) on the date of the closing of the short sale, or on the date of a sale, gift, or other disposition of such property, whichever date occurs first. This paragraph shall apply to such substantially identical property in the order of the dates of the acquisition of such property, but only to so much of such property as does not exceed the quantity sold short.

For purposes of this subsection, the acquisition of an option to sell property at a fixed price shall be considered as a short sale, and the exercise or failure to exercise such option shall be considered as a closing of such short sale.

(c) CERTAIN OPTIONS TO SELL.—Subsection (b) shall not include an option to sell property at a fixed price acquired on the same day on which the property identified as intended to be used in exercising such option is acquired and which, if exercised, is exercised through the sale of the property so identified. If the option is not exercised, the cost of the option shall be added to the basis of the property with which the option is identified. This subsection shall apply only to options acquired after August 16, 1954.

(d) LONG-TERM LOSSES.—If on the date of such short sale substantially identical property has been held by the taxpayer for more than 1 year, any loss on the closing of such short sale shall be considered as a loss on the sale or exchange of a capital asset held for more than 1 year (notwithstanding the period of time any property used to close such short sale has been held, and notwithstanding section 1234).

(e) RULES FOR APPLICATION OF SECTION.—(1) Subsection (b)(1) or (d) shall not apply to the gain or loss, respectively, on any quantity of property used to close such short sale which is in excess of the quantity of the substantially identical property referred to in the applicable subsection.

(2) For purposes of subsections (b) and (d)—

(A) the term "property" includes only stocks and securities (including stocks and securities dealt with on a "when issued" basis), and commodity futures, which are capital assets in the hands of the taxpayer, but does not include any position to which section 1092(b) applies;

(B) in the case of futures transactions in any commodity on or subject to the rules of a board of trade or commodity exchange, a commodity future requiring delivery in 1 calendar month shall not be considered as property substantially identical to another commodity future requiring delivery in a different calendar month;

(C) in the case of a short sale of property by an individual, the term "taxpayer", in the application of this subsection and subsections (b) and (d), shall be read as "taxpayer or [his spouse] *the taxpayer's spouse*"; but an individual who is legally separated from the taxpayer under a decree of divorce or of separate maintenance shall not be considered as the spouse of the taxpayer;

(D) a securities futures contract (as defined in section 1234B) to acquire substantially identical property shall be treated as substantially identical property; and

(E) entering into a securities futures contract (as so defined) to sell shall be considered to be a short sale, and the settlement of such contract shall be considered to be the closing of such short sale.

(3) Where the taxpayer enters into 2 commodity futures transactions on the same day, one requiring delivery by him in one market and the other requiring delivery to him of the same (or substantially identical) commodity in the same calendar month in a different market, and the taxpayer subsequently closes both such

transactions on the same day, subsections (b) and (d) shall have no application to so much of the commodity involved in either such transaction as does not exceed in quantity the commodity involved in the other.

(4)(A) In the case of a taxpayer who is a dealer in securities (within the meaning of section 1236)—

(i) if, on the date of a short sale of stock, substantially identical property which is a capital asset in the hands of the taxpayer has been held for not more than 1 year, and

(ii) if such short sale is closed more than 20 days after the date on which it was made,

subsection (b)(2) shall apply in respect of the holding period of such substantially identical property.

(B) For purposes of subparagraph (A)—

(i) the last sentence of subsection (b) applies; and

(ii) the term "stock" means any share or certificate of stock in a corporation, any bond or other evidence of indebtedness which is convertible into any such share or certificate, or any evidence of an interest in, or right to subscribe to or purchase, any of the foregoing.

(f) ARBITRAGE OPERATIONS IN SECURITIES.—In the case of a short sale which had been entered into as an arbitrage operation, to which sale the rule of subsection (b)(2) would apply except as otherwise provided in this subsection—

(1) subsection (b)(2) shall apply first to substantially identical assets acquired for arbitrage operations held at the close of business on the day such sale is made, and only to the extent that the quantity sold short exceeds the substantially identical assets acquired for arbitrage operations held at the close of business on the day such sale is made, shall the holding period of any other such identical assets held by the taxpayer be affected;

(2) in the event that assets acquired for arbitrage operations are disposed of in such manner as to create a net short position in assets acquired for arbitrage operations, such net short position shall be deemed to constitute a short sale made on that day;

(3) for the purpose of paragraphs (1) and (2) of this subsection the taxpayer will be deemed as of the close of any business day to hold property which he is or will be entitled to receive or acquire by virtue of any other asset acquired for arbitrage operations or by virtue of any contract he has entered into in an arbitrage operation; and

(4) for the purpose of this subsection arbitrage operations are transactions involving the purchase and sale of assets for the purpose of profiting from a current difference between the price of the asset purchased and the price of the asset sold, and in which the asset purchased, if not identical to the asset sold, is such that by virtue thereof the taxpayer is, or will be, entitled to acquire assets identical to the assets sold. Such operations must be clearly identified by the taxpayer in his records as arbitrage operations on the day of the transaction or as soon thereafter as may be practicable. Assets acquired for arbitrage operations will include stocks and securities and the right to acquire stocks and securities.

(g) HEDGING TRANSACTIONS.—This section shall not apply in the case of a hedging transaction in commodity futures.

(h) SHORT SALES OF PROPERTY WHICH BECOMES SUBSTANTIALLY WORTHLESS.—

(1) IN GENERAL.—If—

(A) the taxpayer enters into a short sale of property, and

(B) such property becomes substantially worthless,

the taxpayer shall recognize gain in the same manner as if the short sale were closed when the property becomes substantially worthless. To the extent provided in regulations prescribed by the Secretary, the preceding sentence also shall apply with respect to any option with respect to property, any offsetting notional principal contract with respect to property, any futures or forward contract to deliver any property, and any other similar transaction.

(2) STATUTE OF LIMITATIONS.—If property becomes substantially worthless during a taxable year and any short sale of such property remains open at the time such property becomes substantially worthless, then—

(A) the statutory period for the assessment of any deficiency attributable to any part of the gain on such transaction shall not expire before the earlier of—

(i) the date which is 3 years after the date the Secretary is notified by the taxpayer (in such manner as the Secretary may by regulations prescribe) of the substantial worthlessness of such property, or

(ii) the date which is 6 years after the date the return for such taxable year is filed, and

(B) such deficiency may be assessed before the date applicable under subparagraph (A) notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

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SEC. 1235. SALE OR EXCHANGE OF PATENTS.

(a) GENERAL.—A transfer (other than by gift, inheritance, or devise) of property consisting of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than 1 year, regardless of whether or not payments in consideration of such transfer are—

(1) payable periodically over a period generally coterminous with the transferee's use of the patent, or

(2) contingent on the productivity, use, or disposition of the property transferred.

(b) "HOLDER" DEFINED.—For purposes of this section, the term "holder" means—

(1) any individual whose efforts created such property, or

(2) any other individual who has acquired his interest in such property in exchange for consideration in money or money's worth paid to such creator prior to actual reduction to practice of the invention covered by the patent, if such individual is neither—

(A) the employer of such creator, nor

(B) related to such creator (within the meaning of subsection (c)).

(c) RELATED PERSONS.—Subsection (a) shall not apply to any transfer, directly or indirectly, between persons specified within any one of the paragraphs of section 267(b) or persons described in section 707(b); except that, in applying section 267(b) and (c) and section 707(b) for purposes of this section—

(1) the phrase "25 percent or more" shall be substituted for the phrase "more than 50 percent" each place it appears in section 267(b) or 707(b), and

(2) paragraph (4) of section 267(c) shall be treated as providing that the family of an individual shall include only [his spouse] *the individual's spouse*, ancestors, and lineal descendants.

(d) CROSS REFERENCE.—For special rule relating to nonresident aliens, see section 871(a).

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SEC. 1239. GAIN FROM SALE OF DEPRECIABLE PROPERTY BETWEEN CERTAIN RELATED TAXPAYERS.

(a) TREATMENT OF GAIN AS ORDINARY INCOME.—In the case of a sale or exchange of property, directly or indirectly, between related persons, any gain recognized to the transferor shall be treated as ordinary income if such property is, in the hands of the transferee, of a character which is subject to the allowance for depreciation provided in section 167.

(b) RELATED PERSONS.—For purposes of subsection (a), the term "related persons" means—

(1) a person and all entities which are controlled entities with respect to such person,

(2) a taxpayer and any trust in which such taxpayer (or [his spouse] *the taxpayer's spouse*) is a beneficiary, unless such beneficiary's interest in the trust is a remote contingent interest (within the meaning of section 318(a)(3)(B)(i)), and

(3) except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate.

(c) CONTROLLED ENTITY DEFINED.—

(1) GENERAL RULE.—For purposes of this section, the term "controlled entity" means, with respect to any person—

(A) a corporation more than 50 percent of the value of the outstanding stock of which is owned (directly or indirectly) by or for such person,

(B) a partnership more than 50 percent of the capital interest or profits interest in which is owned (directly or indirectly) by or for such person, and

(C) any entity which is a related person to such person under paragraph (3), (10), (11), or (12) of section 267(b).

(2) CONSTRUCTIVE OWNERSHIP.—For purposes of this section, ownership shall be determined in accordance with rules similar to the rules under section 267(c) (other than paragraph (3) thereof).

(d) EMPLOYER AND RELATED EMPLOYEE ASSOCIATION.—For purposes of subsection (a), the term "related person" also includes—

(1) an employer and any person related to the employer (within the meaning of subsection (b)), and

(2) a welfare benefit fund (within the meaning of section 419(e)) which is controlled directly or indirectly by persons referred to in paragraph (1).

(e) PATENT APPLICATIONS TREATED AS DEPRECIABLE PROPERTY.—For purposes of this section, a patent application shall be treated as property which, in the hands of the transferee, is of a character which is subject to the allowance for depreciation provided in section 167.

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SEC. 1244. LOSSES ON SMALL BUSINESS STOCK.

(a) GENERAL RULE.—In the case of an individual, a loss on section 1244 stock issued to such individual or to a partnership which would (but for this section) be treated as a loss from the sale or exchange of a capital asset shall, to the extent provided in this section, be treated as an ordinary loss.

(b) MAXIMUM AMOUNT FOR ANY TAXABLE YEAR.—For any taxable year the aggregate amount treated by the taxpayer by reason of this section as an ordinary loss shall not exceed—

(1) $50,000, or

(2) $100,000, in the case of [a husband and wife filing] a joint return for such year under section 6013.

(c) SECTION 1244 STOCK DEFINED.—

(1) IN GENERAL.—For purposes of this section, the term "section 1244 stock" means stock in a domestic corporation if—

(A) at the time such stock is issued, such corporation was a small business corporation,

(B) such stock was issued by such corporation for money or other property (other than stock and securities), and

(C) such corporation, during the period of its 5 most recent taxable years ending before the date the loss on such stock was sustained, derived more than 50 percent of its aggregate gross receipts from sources other than royalties, rents, dividends, interests, annuities, and sales or exchanges of stocks or securities.

(2) RULES FOR APPLICATION OF PARAGRAPH (1)(C).—

(A) PERIOD TAKEN INTO ACCOUNT WITH RESPECT TO NEW CORPORATIONS.—For purposes of paragraph (1)(C), if the corporation has not been in existence for 5 taxable years ending before the date the loss on the stock was sustained, there shall be substituted for such 5-year period—

(i) the period of the corporation's taxable years ending before such date, or

(ii) if the corporation has not been in existence for 1 taxable year ending before such date, the period such corporation has been in existence before such date.

(B) GROSS RECEIPTS FROM SALES OF SECURITIES.—For purposes of paragraph (1)(C), gross receipts from the sales or exchanges of stock or securities shall be taken into account only to the extent of gains therefrom.

(C) NONAPPLICATION WHERE DEDUCTIONS EXCEED GROSS INCOME.—Paragraph (1)(C) shall not apply with respect to

any corporation if, for the period taken into account for purposes of paragraph (1)(C), the amount of the deductions allowed by this chapter (other than by sections 172, 243, and 245) exceeds the amount of gross income.

(3) SMALL BUSINESS CORPORATION DEFINED.—

(A) IN GENERAL.—For purposes of this section, a corporation shall be treated as a small business corporation if the aggregate amount of money and other property received by the corporation for stock, as a contribution to capital, and as paid-in surplus, does not exceed $1,000,000. The determination under the preceding sentence shall be made as of the time of the issuance of the stock in question but shall include amounts received for such stock and for all stock theretofore issued.

(B) AMOUNT TAKEN INTO ACCOUNT WITH RESPECT TO PROPERTY.—For purposes of subparagraph (A), the amount taken into account with respect to any property other than money shall be the amount equal to the adjusted basis to the corporation of such property for determining gain, reduced by any liability to which the property was subject or which was assumed by the corporation. The determination under the preceding sentence shall be made as of the time the property was received by the corporation.

(d) SPECIAL RULES.—

(1) LIMITATIONS ON AMOUNT OF ORDINARY LOSS.—

(A) CONTRIBUTIONS OF PROPERTY HAVING BASIS IN EXCESS OF VALUE.—If—

(i) section 1244 stock was issued in exchange for property,

(ii) the basis of such stock in the hands of the taxpayer is determined by reference to the basis in his hands of such property, and

(iii) the adjusted basis (for determining loss) of such property immediately before the exchange exceeded its fair market value at such time,

then in computing the amount of the loss on such stock for purposes of this section the basis of such stock shall be reduced by an amount equal to the excess described in clause (iii).

(B) INCREASES IN BASIS.—In computing the amount of the loss on stock for purposes of this section, any increase in the basis of such stock (through contributions to the capital of the corporation, or otherwise) shall be treated as allocable to stock which is not section 1244 stock.

(2) RECAPITALIZATIONS, CHANGES IN NAME, ETC..—To the extent provided in regulations prescribed by the Secretary, stock in a corporation, the basis of which (in the hands of a taxpayer) is determined in whole or in part by reference to the basis in his hands of stock in such corporation which meets the requirements of subsection (c)(1) (other than subparagraph (C) thereof), or which is received in a reorganization described in section 368(a)(1)(F) in exchange for stock which meets such requirements, shall be treated as meeting such requirements. For purposes of paragraphs (1)(C) and (3)(A) of subsection (c), a successor corporation in a reorganization described in section

368(a)(1)(F) shall be treated as the same corporation as its predecessor.

(3) RELATIONSHIP TO NET OPERATING LOSS DEDUCTION.—For purposes of section 172 (relating to the net operating loss deduction), any amount of loss treated by reason of this section as an ordinary loss shall be treated as attributable to a trade or business of the taxpayer.

(4) INDIVIDUAL DEFINED.—For purposes of this section, the term "individual" does not include a trust or estate.

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

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PART V—SPECIAL RULES FOR BONDS AND OTHER DEBT INSTRUMENTS

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Subpart A—ORIGINAL ISSUE DISCOUNT

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SEC. 1272. CURRENT INCLUSION IN INCOME OF ORIGINAL ISSUE DISCOUNT.

(a) ORIGINAL ISSUE DISCOUNT INCLUDED IN INCOME ON BASIS OF CONSTANT INTEREST RATE.—

(1) GENERAL RULE.—For purposes of this title, there shall be included in the gross income of the holder of any debt instrument having original issue discount, an amount equal to the sum of the daily portions of the original issue discount for each day during the taxable year on which such holder held such debt instrument.

(2) EXCEPTIONS.—Paragraph (1) shall not apply to—

(A) TAX-EXEMPT OBLIGATIONS.—Any tax-exempt obligation.

(B) UNITED STATES SAVINGS BONDS.—Any United States savings bond.

(C) SHORT-TERM OBLIGATIONS.—Any debt instrument which has a fixed maturity date not more than 1 year from the date of issue.

(D) LOANS BETWEEN NATURAL PERSONS.—

(i) IN GENERAL.—Any loan made by a natural person to another natural person if—

(I) such loan is not made in the course of a trade or business of the lender, and

(II) the amount of such loan (when increased by the outstanding amount of prior loans by such natural person to such other natural person) does not exceed $10,000.

(ii) CLAUSE (I) NOT TO APPLY WHERE TAX AVOIDANCE A PRINCIPAL PURPOSE.—Clause (i) shall not apply if the loan has as 1 of its principal purposes the avoidance of any Federal tax.

[(iii) TREATMENT OF HUSBAND AND WIFE.—For purposes of this subparagraph, a husband and wife shall be treated as 1 person. The preceding sentence shall

not apply where the spouses lived apart at all times during the taxable year in which the loan is made.]

(iii) TREATMENT OF A MARRIED COUPLE.—For purposes of this subparagraph, a married couple shall be treated as 1 person. The preceding sentence shall not apply where the spouses lived apart at all times during the taxable year in which the loan is made.

(3) DETERMINATION OF DAILY PORTIONS.—For purposes of paragraph (1), the daily portion of the original issue discount on any debt instrument shall be determined by allocating to each day in any accrual period its ratable portion of the increase during such accrual period in the adjusted issue price of the debt instrument. For purposes of the preceding sentence, the increase in the adjusted issue price for any accrual period shall be an amount equal to the excess (if any) of—

(A) the product of—

(i) the adjusted issue price of the debt instrument at the beginning of such accrual period, and

(ii) the yield to maturity (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period), over

(B) the sum of the amounts payable as interest on such debt instrument during such accrual period.

(4) ADJUSTED ISSUE PRICE.—For purposes of this subsection, the adjusted issue price of any debt instrument at the beginning of any accrual period is the sum of—

(A) the issue price of such debt instrument, plus

(B) the adjustments under this subsection to such issue price for all periods before the first day of such accrual period.

(5) ACCRUAL PERIOD.—Except as otherwise provided in regulations prescribed by the Secretary, the term "accrual period" means a 6-month period (or shorter period from the date of original issue of the debt instrument) which ends on a day in the calendar year corresponding to the maturity date of the debt instrument or the date 6 months before such maturity date.

(6) DETERMINATION OF DAILY PORTIONS WHERE PRINCIPAL SUBJECT TO ACCELERATION.—

(A) IN GENERAL.—In the case of any debt instrument to which this paragraph applies, the daily portion of the original issue discount shall be determined by allocating to each day in any accrual period its ratable portion of the excess (if any) of—

(i) the sum of (I) the present value determined under subparagraph (B) of all remaining payments under the debt instrument as of the close of such period, and (II) the payments during the accrual period of amounts included in the stated redemption price of the debt instrument, over

(ii) the adjusted issue price of such debt instrument at the beginning of such period.

(B) DETERMINATION OF PRESENT VALUE.—For purposes of subparagraph (A), the present value shall be determined on the basis of—

(i) the original yield to maturity (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period),

(ii) events which have occurred before the close of the accrual period, and

(iii) a prepayment assumption determined in the manner prescribed by regulations.

(C) DEBT INSTRUMENTS TO WHICH PARAGRAPH APPLIES.—This paragraph applies to—

(i) any regular interest in a REMIC or qualified mortgage held by a REMIC,

(ii) any other debt instrument if payments under such debt instrument may be accelerated by reason of prepayments of other obligations securing such debt instrument (or, to the extent provided in regulations, by reason of other events), or

(iii) any pool of debt instruments the yield on which may be affected by reason of prepayments (or to the extent provided in regulations, by reason of other events).

To the extent provided in regulations prescribed by the Secretary, in the case of a small business engaged in the trade or business of selling tangible personal property at retail, clause (iii) shall not apply to debt instruments incurred in the ordinary course of such trade or business while held by such business.

(7) REDUCTION WHERE SUBSEQUENT HOLDER PAYS ACQUISITION PREMIUM.—

(A) REDUCTION.—For purposes of this subsection, in the case of any purchase after its original issue of a debt instrument to which this subsection applies, the daily portion for any day shall be reduced by an amount equal to the amount which would be the daily portion for such day (without regard to this paragraph) multiplied by the fraction determined under subparagraph (B).

(B) DETERMINATION OF FRACTION.—For purposes of subparagraph (A), the fraction determined under this subparagraph is a fraction—

(i) the numerator of which is the excess (if any) of—

(I) the cost of such debt instrument incurred by the purchaser, over

(II) the issue price of such debt instrument, increased by the portion of original issue discount previously includible in the gross income of any holder (computed without regard to this paragraph), and

(ii) the denominator of which is the sum of the daily portions for such debt instrument for all days after the date of such purchase and ending on the stated maturity date (computed without regard to this paragraph).

(b) EXCEPTIONS.—This section shall not apply to any holder—

(1) who has purchased the debt instrument at a premium, or

(2) which is a life insurance company to which section 811(b) applies.

(c) DEFINITION AND SPECIAL RULE.—

(1) PURCHASE DEFINED.—For purposes of this section, the term "purchase" means—

(A) any acquisition of a debt instrument, where

(B) the basis of the debt instrument is not determined in whole or in part by reference to the adjusted basis of such debt instrument in the hands of the person from whom acquired.

(2) BASIS ADJUSTMENT.—The basis of any debt instrument in the hands of the holder thereof shall be increased by the amount included in his gross income pursuant to this section.

Subchapter Q—READJUSTMENT OF TAX BETWEEN YEARS AND SPECIAL LIMITATIONS

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PART II—MITIGATION OF EFFECT OF LIMITATIONS AND OTHER PROVISIONS

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SEC. 1313. DEFINITIONS.

(a) DETERMINATION.—For purposes of this part, the term "determination" means—

(1) a decision by the Tax Court or a judgment, decree, or other order by any court of competent jurisdiction, which has become final;

(2) a closing agreement made under section 7121;

(3) a final disposition by the Secretary of a claim for refund. For purposes of this part, a claim for refund shall be deemed finally disposed of by the Secretary—

(A) as to items with respect to which the claim was allowed, on the date of allowance of refund or credit or on the date of mailing notice of disallowance (by reason of offsetting items) of the claim for refund, and

(B) as to items with respect to which the claim was disallowed, in whole or in part, or as to items applied by the Secretary in reduction of the refund or credit, on expiration of the time for instituting suit with respect thereto (unless suit is instituted before the expiration of such time); or

(4) under regulations prescribed by the Secretary, an agreement for purposes of this part, signed by the Secretary and by any person, relating to the liability of such person (or the person for whom he acts) in respect of a tax under this subtitle for any taxable period.

(b) TAXPAYER.—Notwithstanding section 7701(a)(14), the term "taxpayer" means any person subject to a tax under the applicable revenue law.

(c) RELATED TAXPAYER.—For purposes of this part, the term "related taxpayer" means a taxpayer who, with the taxpayer with respect to whom a determination is made, stood, in the taxable year

with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance was made, in one of the following relationships:

(1) [husband and wife] *spouses* ,

(2) grantor and fiduciary,

(3) grantor and beneficiary,

(4) fiduciary and beneficiary, legatee, or heir,

(5) decedent and decedent's estate,

(6) partner, or

(7) member of an affiliated group of corporations (as defined in section 1504).

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Subchapter S—TAX TREATMENT OF S CORPORATIONS AND THEIR SHAREHOLDERS

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PART I—IN GENERAL

* * * * * * *

SEC. 1361. S CORPORATION DEFINED.

(a) S CORPORATION DEFINED.—

(1) IN GENERAL.—For purposes of this title, the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under section 1362(a) is in effect for such year.

(2) C CORPORATION.—For purposes of this title, the term "C corporation" means, with respect to any taxable year, a corporation which is not an S corporation for such year.

(b) SMALL BUSINESS CORPORATION.—

(1) IN GENERAL.—For purposes of this subchapter, the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not—

(A) have more than 100 shareholders,

(B) have as a shareholder a person (other than an estate, a trust described in subsection (c)(2), or an organization described in subsection (c)(6)) who is not an individual,

(C) have a nonresident alien as a shareholder, and

(D) have more than 1 class of stock.

(2) INELIGIBLE CORPORATION DEFINED.—For purposes of paragraph (1), the term "ineligible corporation" means any corporation which is—

(A) a financial institution which uses the reserve method of accounting for bad debts described in section 585,

(B) an insurance company subject to tax under subchapter L, or

(C) a DISC or former DISC.

(3) TREATMENT OF CERTAIN WHOLLY OWNED SUBSIDIARIES.—

(A) IN GENERAL.—Except as provided in regulations prescribed by the Secretary, for purposes of this title—

(i) a corporation which is a qualified subchapter S subsidiary shall not be treated as a separate corporation, and

(ii) all assets, liabilities, and items of income, deduction, and credit of a qualified subchapter S subsidiary shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

(B) QUALIFIED SUBCHAPTER S SUBSIDIARY.—For purposes of this paragraph, the term "qualified subchapter S subsidiary" means any domestic corporation which is not an ineligible corporation (as defined in paragraph (2)), if—

(i) 100 percent of the stock of such corporation is held by the S corporation, and

(ii) the S corporation elects to treat such corporation as a qualified subchapter S subsidiary.

(C) TREATMENT OF TERMINATIONS OF QUALIFIED SUBCHAPTER S SUBSIDIARY STATUS.—

(i) IN GENERAL.—For purposes of this title, if any corporation which was a qualified subchapter S subsidiary ceases to meet the requirements of subparagraph (B), such corporation shall be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before such cessation from the S corporation in exchange for its stock.

(ii) TERMINATION BY REASON OF SALE OF STOCK.—If the failure to meet the requirements of subparagraph (B) is by reason of the sale of stock of a corporation which is a qualified subchapter S subsidiary, the sale of such stock shall be treated as if—

(I) the sale were a sale of an undivided interest in the assets of such corporation (based on the percentage of the corporation's stock sold), and

(II) the sale were followed by an acquisition by such corporation of all of its assets (and the assumption by such corporation of all of its liabilities) in a transaction to which section 351 applies.

(D) ELECTION AFTER TERMINATION.—If a corporation's status as a qualified subchapter S subsidiary terminates, such corporation (and any successor corporation) shall not be eligible to make—

(i) an election under subparagraph (B)(ii) to be treated as a qualified subchapter S subsidiary, or

(ii) an election under section 1362(a) to be treated as an S corporation,

before its 5th taxable year which begins after the 1st taxable year for which such termination was effective, unless the Secretary consents to such election.

(E) INFORMATION RETURNS.—Except to the extent provided by the Secretary, this paragraph shall not apply to part III of subchapter A of chapter 61 (relating to information returns).

(c) SPECIAL RULES FOR APPLYING SUBSECTION (B).—

(1) MEMBERS OF A FAMILY TREATED AS 1 SHAREHOLDER.—

(A) IN GENERAL.—For purposes of subsection (b)(1)(A), there shall be treated as one shareholder—

(i) [a husband and wife] *a married couple* (and their estates), and

(ii) all members of a family (and their estates).

(B) MEMBERS OF A FAMILY.—For purposes of this paragraph—

(i) IN GENERAL.—The term "members of a family" means a common ancestor, any lineal descendant of such common ancestor, and any spouse or former spouse of such common ancestor or any such lineal descendant.

(ii) COMMON ANCESTOR.—An individual shall not be considered to be a common ancestor if, on the applicable date, the individual is more than 6 generations removed from the youngest generation of shareholders who would (but for this subparagraph) be members of the family. For purposes of the preceding sentence, a spouse (or former spouse) shall be treated as being of the same generation as the individual to whom such spouse is (or was) married.

(iii) APPLICABLE DATE.—The term "applicable date" means the latest of—

(I) the date the election under section 1362(a) is made,

(II) the earliest date that an individual described in clause (i) holds stock in the S corporation, or

(III) October 22, 2004.

(C) EFFECT OF ADOPTION, ETC..—Any legally adopted child of an individual, any child who is lawfully placed with an individual for legal adoption by the individual, and any eligible foster child of an individual (within the meaning of section 152(f)(1)(C)), shall be treated as a child of such individual by blood.

(2) CERTAIN TRUSTS PERMITTED AS SHAREHOLDERS.—

(A) IN GENERAL.—For purposes of subsection (b)(1)(B), the following trusts may be shareholders:

(i) A trust all of which is treated (under subpart E of part I of subchapter J of this chapter) as owned by an individual who is a citizen or resident of the United States.

(ii) A trust which was described in clause (i) immediately before the death of the deemed owner and which continues in existence after such death, but only for the 2-year period beginning on the day of the deemed owner's death.

(iii) A trust with respect to stock transferred to it pursuant to the terms of a will, but only for the 2-year period beginning on the day on which such stock is transferred to it.

(iv) A trust created primarily to exercise the voting power of stock transferred to it.

(v) An electing small business trust.

(vi) In the case of a corporation which is a bank (as defined in section 581) or a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(1)), a trust which constitutes an individual retirement account under section 408(a), including one designated as a Roth IRA under section 408A, but only to the extent of the stock held by such trust in such bank or company as of the date of the enactment of this clause.

This subparagraph shall not apply to any foreign trust.

(B) TREATMENT AS SHAREHOLDERS.—For purposes of subsection (b)(1)—

(i) In the case of a trust described in clause (i) of subparagraph (A), the deemed owner shall be treated as the shareholder.

(ii) In the case of a trust described in clause (ii) of subparagraph (A), the estate of the deemed owner shall be treated as the shareholder.

(iii) In the case of a trust described in clause (iii) of subparagraph (A), the estate of the testator shall be treated as the shareholder.

(iv) In the case of a trust described in clause (iv) of subparagraph (A), each beneficiary of the trust shall be treated as a shareholder.

(v) In the case of a trust described in clause (v) of subparagraph (A), each potential current beneficiary of such trust shall be treated as a shareholder; except that, if for any period there is no potential current beneficiary of such trust, such trust shall be treated as the shareholder during such period. This clause shall not apply for purposes of subsection (b)(1)(C).

(vi) In the case of a trust described in clause (vi) of subparagraph (A), the individual for whose benefit the trust was created shall be treated as the shareholder.

(3) ESTATE OF INDIVIDUAL IN BANKRUPTCY MAY BE SHAREHOLDER.—For purposes of subsection (b)(1)(B), the term "estate" includes the estate of an individual in a case under title 11 of the United States Code.

(4) DIFFERENCES IN COMMON STOCK VOTING RIGHTS DISREGARDED.—For purposes of subsection (b)(1)(D), a corporation shall not be treated as having more than 1 class of stock solely because there are differences in voting rights among the shares of common stock.

(5) STRAIGHT DEBT SAFE HARBOR.—

(A) IN GENERAL.—For purposes of subsection (b)(1)(D), straight debt shall not be treated as a second class of stock.

(B) STRAIGHT DEBT DEFINED.—For purposes of this paragraph, the term "straight debt" means any written unconditional promise to pay on demand or on a specified date a sum certain in money if—

(i) the interest rate (and interest payment dates) are not contingent on profits, the borrower's discretion, or similar factors,

(ii) there is no convertibility (directly or indirectly) into stock, and

(iii) the creditor is an individual (other than a nonresident alien), an estate, a trust described in paragraph (2), or a person which is actively and regularly engaged in the business of lending money.

(C) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to provide for the proper treatment of straight debt under this subchapter and for the coordination of such treatment with other provisions of this title.

(6) CERTAIN EXEMPT ORGANIZATIONS PERMITTED AS SHAREHOLDERS.—For purposes of subsection (b)(1)(B), an organization which is—

(A) described in section 401(a) or 501(c)(3), and

(B) exempt from taxation under section 501(a),

may be a shareholder in an S corporation.

(d) SPECIAL RULE FOR QUALIFIED SUBCHAPTER S TRUST.—

(1) IN GENERAL.—In the case of a qualified subchapter S trust with respect to which a beneficiary makes an election under paragraph (2)—

(A) such trust shall be treated as a trust described in subsection (c)(2)(A)(i),

(B) for purposes of section 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under paragraph (2) is made, and

(C) for purposes of applying sections 465 and 469 to the beneficiary of the trust, the disposition of the S corporation stock by the trust shall be treated as a disposition by such beneficiary.

(2) ELECTION.—

(A) IN GENERAL.—A beneficiary of a qualified subchapter S trust (or his legal representative) may elect to have this subsection apply.

(B) MANNER AND TIME OF ELECTION.—

(i) SEPARATE ELECTION WITH RESPECT TO EACH CORPORATION.—An election under this paragraph shall be made separately with respect to each corporation the stock of which is held by the trust.

(ii) ELECTIONS WITH RESPECT TO SUCCESSIVE INCOME BENEFICIARIES.—If there is an election under this paragraph with respect to any beneficiary, an election under this paragraph shall be treated as made by each successive beneficiary unless such beneficiary affirmatively refuses to consent to such election.

(iii) TIME, MANNER, AND FORM OF ELECTION.—Any election, or refusal, under this paragraph shall be made in such manner and form, and at such time, as the Secretary may prescribe.

(C) ELECTION IRREVOCABLE.—An election under this paragraph, once made, may be revoked only with the consent of the Secretary.

(D) GRACE PERIOD.—An election under this paragraph shall be effective up to 15 days and 2 months before the date of the election.

(3) QUALIFIED SUBCHAPTER S TRUST.—For purposes of this subsection, the term "qualified subchapter S trust" means a trust—

(A) the terms of which require that—

(i) during the life of the current income beneficiary, there shall be only 1 income beneficiary of the trust,

(ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary,

(iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust, and

(iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary, and

(B) all of the income (within the meaning of section 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

A substantially separate and independent share of a trust within the meaning of section 663(c) shall be treated as a separate trust for purposes of this subsection and subsection (c).

(4) TRUST CEASING TO BE QUALIFIED.—

(A) FAILURE TO MEET REQUIREMENTS OF PARAGRAPH (3)(A).—If a qualified subchapter S trust ceases to meet any requirement of paragraph (3)(A), the provisions of this subsection shall not apply to such trust as of the date it ceases to meet such requirement.

(B) FAILURE TO MEET REQUIREMENTS OF PARAGRAPH (3)(B).—If any qualified subchapter S trust ceases to meet any requirement of paragraph (3)(B) but continues to meet the requirements of paragraph (3)(A), the provisions of this subsection shall not apply to such trust as of the first day of the first taxable year beginning after the first taxable year for which it failed to meet the requirements of paragraph (3)(B).

(e) ELECTING SMALL BUSINESS TRUST DEFINED.—

(1) ELECTING SMALL BUSINESS TRUST.—For purposes of this section—

(A) IN GENERAL.—Except as provided in subparagraph (B), the term "electing small business trust" means any trust if—

(i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in paragraph (2), (3), (4), or (5) of section 170(c), or (IV) an organization described in section 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary,

(ii) no interest in such trust was acquired by purchase, and

(iii) an election under this subsection applies to such trust.

(B) CERTAIN TRUSTS NOT ELIGIBLE.—The term "electing small business trust" shall not include—

(i) any qualified subchapter S trust (as defined in subsection (d)(3)) if an election under subsection (d)(2) applies to any corporation the stock of which is held by such trust,

(ii) any trust exempt from tax under this subtitle, and

(iii) any charitable remainder annuity trust or charitable remainder unitrust (as defined in section 664(d)).

(C) PURCHASE.—For purposes of subparagraph (A), the term "purchase" means any acquisition if the basis of the property acquired is determined under section 1012.

(2) POTENTIAL CURRENT BENEFICIARY.—For purposes of this section, the term "potential current beneficiary" means, with respect to any period, any person who at any time during such period is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust (determined without regard to any power of appointment to the extent such power remains unexercised at the end of such period). If a trust disposes of all of the stock which it holds in an S corporation, then, with respect to such corporation, the term "potential current beneficiary" does not include any person who first met the requirements of the preceding sentence during the 1-year period ending on the date of such disposition.

(3) ELECTION.—An election under this subsection shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

(4) CROSS REFERENCE.—For special treatment of electing small business trusts, see section 641(c).

(f) RESTRICTED BANK DIRECTOR STOCK.—

(1) IN GENERAL.—Restricted bank director stock shall not be taken into account as outstanding stock of the S corporation in applying this subchapter (other than section 1368(f)).

(2) RESTRICTED BANK DIRECTOR STOCK.—For purposes of this subsection, the term "restricted bank director stock" means stock in a bank (as defined in section 581) or a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(1))), if such stock—

(A) is required to be held by an individual under applicable Federal or State law in order to permit such individual to serve as a director, and

(B) is subject to an agreement with such bank or company (or a corporation which controls (within the meaning of section 368(c)) such bank or company) pursuant to which the holder is required to sell back such stock (at the same price as the individual acquired such stock) upon ceasing to hold the office of director.

(3) CROSS REFERENCE.—For treatment of certain distributions with respect to restricted bank director stock, see section 1368(f).

(g) SPECIAL RULE FOR BANK REQUIRED TO CHANGE FROM THE RESERVE METHOD OF ACCOUNTING ON BECOMING S CORPORATION.—In the case of a bank which changes from the reserve method of accounting for bad debts described in section 585 or 593 for its first taxable year for which an election under section 1362(a) is in effect, the bank may elect to take into account any adjustments under section 481 by reason of such change for the taxable year immediately preceding such first taxable year.

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CHAPTER 6—CONSOLIDATED RETURNS

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Subchapter B—RELATED RULES

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PART II—CERTAIN CONTROLLED CORPORATIONS

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SEC. 1563. DEFINITIONS AND SPECIAL RULES.

(a) CONTROLLED GROUP OF CORPORATIONS.—For purposes of this part, the term "controlled group of corporations" means any group of—

(1) PARENT-SUBSIDIARY CONTROLLED GROUP.—One or more chains of corporations connected through stock ownership with a common parent corporation if—

(A) stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of each of the corporations, except the common parent corporation, is owned (within the meaning of subsection (d)(1)) by one or more of the other corporations; and

(B) the common parent corporation owns (within the meaning of subsection (d)(1)) stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of at least one of the other corporations, excluding, in computing such voting power or value, stock owned directly by such other corporations.

(2) BROTHER-SISTER CONTROLLED GROUP.—Two or more corporations if 5 or fewer persons who are individuals, estates, or trusts own (within the meaning of subsection (d)(2)) stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock of each corporation, taking into account the stock ownership of

each such person only to the extent such stock ownership is identical with respect to each such corporation.

(3) COMBINED GROUP.—Three or more corporations each of which is a member of a group of corporations described in paragraph (1) or (2), and one of which—

(A) is a common parent corporation included in a group of corporations described in paragraph (1), and also

(B) is included in a group of corporations described in paragraph (2).

(4) CERTAIN INSURANCE COMPANIES.—Two or more insurance companies subject to taxation under section 801 which are members of a controlled group of corporations described in paragraph (1), (2), or (3). Such insurance companies shall be treated as a controlled group of corporations separate from any other corporations which are members of the controlled group of corporations described in paragraph (1), (2), or (3).

(b) COMPONENT MEMBER.—

(1) GENERAL RULE.—For purposes of this part, a corporation is a component member of a controlled group of corporations on a December 31 of any taxable year (and with respect to the taxable year which includes such December 31) if such corporation—

(A) is a member of such controlled group of corporations on the December 31 included in such year and is not treated as an excluded member under paragraph (2), or

(B) is not a member of such controlled group of corporations on the December 31 included in such year but is treated as an additional member under paragraph (3).

(2) EXCLUDED MEMBERS.—A corporation which is a member of a controlled group of corporations on December 31 of any taxable year shall be treated as an excluded member of such group for the taxable year including such December 31 if such corporation—

(A) is a member of such group for less than one-half the number of days in such taxable year which precede such December 31,

(B) is exempt from taxation under section 501(a) (except a corporation which is subject to tax on its unrelated business taxable income under section 511) for such taxable year,

(C) is a foreign corporation subject to tax under section 881 for such taxable year,

(D) is an insurance company subject to taxation under section 801 (other than an insurance company which is a member of a controlled group described in subsection (a)(4)), or

(E) is a franchised corporation, as defined in subsection (f)(4).

(3) ADDITIONAL MEMBERS.—A corporation which—

(A) was a member of a controlled group of corporations at any time during a calendar year,

(B) is not a member of such group on December 31 of such calendar year, and

(C) is not described, with respect to such group, in subparagraph (B), (C), (D), or (E) of paragraph (2),

shall be treated as an additional member of such group on December 31 for its taxable year including such December 31 if it was a member of such group for one-half (or more) of the number of days in such taxable year which precede such December 31.

(4) OVERLAPPING GROUPS.—If a corporation is a component member of more than one controlled group of corporations with respect to any taxable year, such corporation shall be treated as a component member of only one controlled group. The determination as to the group of which such corporation is a component member shall be made under regulations prescribed by the Secretary which are consistent with the purposes of this part.

(c) CERTAIN STOCK EXCLUDED.—

(1) GENERAL RULE.—For purposes of this part, the term "stock" does not include—

(A) nonvoting stock which is limited and preferred as to dividends,

(B) treasury stock, and

(C) stock which is treated as "excluded stock" under paragraph (2).

(2) STOCK TREATED AS "EXCLUDED STOCK".—

(A) PARENT-SUBSIDIARY CONTROLLED GROUP.—For purposes of subsection (a)(1), if a corporation (referred to in this paragraph as "parent corporation") owns (within the meaning of subsections (d)(1) and (e)(4)), 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock in another corporation (referred to in this paragraph as "subsidiary corporation"), the following stock of the subsidiary corporation shall be treated as excluded stock—

(i) stock in the subsidiary corporation held by a trust which is part of a plan of deferred compensation for the benefit of the employees of the parent corporation or the subsidiary corporation,

(ii) stock in the subsidiary corporation owned by an individual (within the meaning of subsection (d)(2)) who is a principal stockholder or officer of the parent corporation. For purposes of this clause, the term "principal stockholder" of a corporation means an individual who owns (within the meaning of subsection (d)(2)) 5 percent or more of the total combined voting power of all classes of stock entitled to vote or 5 percent or more of the total value of shares of all classes of stock in such corporation,

(iii) stock in the subsidiary corporation owned (within the meaning of subsection (d)(2)) by an employee of the subsidiary corporation if such stock is subject to conditions which run in favor of such parent (or subsidiary) corporation and which substantially restrict or limit the employee's right (or if the employee constructively owns such stock, the direct owner's right) to dispose of such stock, or

(iv) stock in the subsidiary corporation owned (within the meaning of subsection (d)(2)) by an organization (other than the parent corporation) to which section 501 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by the parent corporation or subsidiary corporation, by an individual, estate, or trust that is a principal stockholder (within the meaning of clause (ii)) of the parent corporation, by an officer of the parent corporation, or by any combination thereof.

(B) BROTHER-SISTER CONTROLLED GROUP.—For purposes of subsection (a)(2), if 5 or fewer persons who are individuals, estates, or trusts (referred to in this subparagraph as "common owners") own (within the meaning of subsection (d)(2)), 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock in a corporation, the following stock of such corporation shall be treated as excluded stock—

(i) stock in such corporation held by an employees' trust described in section 401(a) which is exempt from tax under section 501(a), if such trust is for the benefit of the employees of such corporation,

(ii) stock in such corporation owned (within the meaning of subsection (d)(2)) by an employee of the corporation if such stock is subject to conditions which run in favor of any of such common owners (or such corporation) and which substantially restrict or limit the employee's right (or if the employee constructively owns such stock, the direct owner's right) to dispose of such stock. If a condition which limits or restricts the employee's right (or the direct owner's right) to dispose of such stock also applies to the stock held by any of the common owners pursuant to a bona fide reciprocal stock purchase arrangement, such condition shall not be treated as one which restricts or limits the employee's right to dispose of such stock, or

(iii) stock in such corporation owned (within the meaning of subsection (d)(2)) by an organization to which section 501 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such corporation, by an individual, estate, or trust that is a principal stockholder (within the meaning of subparagraph (A)(ii)) of such corporation, by an officer of such corporation, or by any combination thereof.

(d) RULES FOR DETERMINING STOCK OWNERSHIP.—

(1) PARENT-SUBSIDIARY CONTROLLED GROUP.—For purposes of determining whether a corporation is a member of a parent-subsidiary controlled group of corporations (within the meaning of subsection (a)(1)), stock owned by a corporation means—

(A) stock owned directly by such corporation, and

(B) stock owned with the application of paragraphs (1), (2), and (3) of subsection (e).

(2) BROTHER-SISTER CONTROLLED GROUP.—For purposes of determining whether a corporation is a member of a brother-sister controlled group of corporations (within the meaning of subsection (a)(2)), stock owned by a person who is an individual, estate, or trust means—

(A) stock owned directly by such person, and

(B) stock owned with the application of subsection (e).

(e) CONSTRUCTIVE OWNERSHIP.—

(1) OPTIONS.—If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

(2) ATTRIBUTION FROM PARTNERSHIPS.—Stock owned, directly or indirectly, by or for a partnership shall be considered as owned by any partner having an interest of 5 percent or more in either the capital or profits of the partnership in proportion to his interest in capital or profits, whichever such proportion is the greater.

(3) ATTRIBUTION FROM ESTATES OR TRUSTS.—(A) Stock owned, directly or indirectly, by or for an estate or trust shall be considered as owned by any beneficiary who has an actuarial interest of 5 percent or more in such stock, to the extent of such actuarial interest. For purposes of this subparagraph, the actuarial interest of each beneficiary shall be determined by assuming the maximum exercise of discretion by the fiduciary in favor of such beneficiary and the maximum use of such stock to satisfy his rights as a beneficiary.

(B) Stock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as owned by such person.

(C) This paragraph shall not apply to stock owned by any employees' trust described in section 401(a) which is exempt from tax under section 501(a).

(4) ATTRIBUTION FROM CORPORATIONS.—Stock owned, directly or indirectly, by or for a corporation shall be considered as owned by any person who owns (within the meaning of subsection (d)) 5 percent or more in value of its stock in that proportion which the value of the stock which such person so owns bears to the value of all the stock in such corporation.

(5) SPOUSE.—An individual shall be considered as owning stock in a corporation owned, directly or indirectly, by or for [his spouse] *the individual's spouse* (other than a spouse who is legally separated from the individual under a decree of divorce whether interlocutory or final, or a decree of separate maintenance), except in the case of a corporation with respect to which each of the following conditions is satisfied for its taxable year—

(A) The individual does not, at any time during such taxable year, own directly any stock in such corporation;

(B) The individual is not a director or employee and does not participate in the management of such corporation at any time during such taxable year;

(C) Not more than 50 percent of such corporation's gross income for such taxable year was derived from royalties, rents, dividends, interest, and annuities; and

(D) Such stock in such corporation is not, at any time during such taxable year, subject to conditions which substantially restrict or limit the spouse's right to dispose of such stock and which run in favor of the individual or [his children] *the individual's children* who have not attained the age of 21 years.

(6) CHILDREN, GRANDCHILDREN, PARENTS, AND GRANDPARENTS.—

(A) MINOR CHILDREN.—An individual shall be considered as owning stock owned, directly or indirectly, by or for [his children] *the individual's children* who have not attained the age of 21 years, and, if the individual has not attained the age of 21 years, the stock owned, directly or indirectly, by or for [his parents] *the individual's parents* .

(B) ADULT CHILDREN AND GRANDCHILDREN.—An individual who owns (within the meaning of subsection (d)(2), but without regard to this subparagraph) more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock in a corporation shall be considered as owning the stock in such corporation owned, directly or indirectly, by or for [his parents] *the individual's parents* , grandparents, grandchildren, and children who have attained the age of 21 years.

(C) ADOPTED CHILD.—For purposes of this section, a legally adopted child of an individual shall be treated as a child of such individual by blood.

(f) OTHER DEFINITIONS AND RULES.—

(1) EMPLOYEE DEFINED.—For purposes of this section the term "employee" has the same meaning such term is given by paragraphs (1) and (2) of section 3121(d).

(2) OPERATING RULES.—

(A) IN GENERAL.—Except as provided in subparagraph (B), stock constructively owned by a person by reason of the application of paragraph (1), (2), (3), (4), (5), or (6) of subsection (e) shall, for purposes of applying such paragraphs, be treated as actually owned by such person.

(B) MEMBERS OF FAMILY.—Stock constructively owned by an individual by reason of the application of paragraph (5) or (6) of subsection (e) shall not be treated as owned by [him] *the individual* for purposes of again applying such paragraphs in order to make another the constructive owner of such stock.

(3) SPECIAL RULES.—For purposes of this section—

(A) If stock may be considered as owned by a person under subsection (e)(1) and under any other paragraph of subsection (e), it shall be considered as owned by him under subsection (e)(1).

(B) If stock is owned (within the meaning of subsection (d)) by two or more persons, such stock shall be considered as owned by the person whose ownership of such stock results in the corporation being a component member of a

controlled group. If by reason of the preceding sentence, a corporation would (but for this sentence) become a component member of two controlled groups, it shall be treated as a component member of one controlled group. The determination as to the group of which such corporation is a component member shall be made under regulations prescribed by the Secretary which are consistent with the purposes of this part.

(C) If stock is owned by a person within the meaning of subsection (d) and such ownership results in the corporation being a component member of a controlled group, such stock shall not be treated as excluded stock under subsection (c)(2), if by reason of treating such stock as excluded stock the result is that such corporation is not a component member of a controlled group of corporations.

(4) FRANCHISED CORPORATION.—If—

(A) a parent corporation (as defined in subsection (c)(2)(A)), or a common owner (as defined in subsection (c)(2)(B)), of a corporation which is a member of a controlled group of corporations is under a duty (arising out of a written agreement) to sell stock of such corporation (referred to in this paragraph as "franchised corporation") which is franchised to sell the products of another member, or the common owner, of such controlled group;

(B) such stock is to be sold to an employee (or employees) of such franchised corporation pursuant to a bona fide plan designed to eliminate the stock ownership of the parent corporation or of the common owner in the franchised corporation;

(C) such plan—

(i) provides a reasonable selling price for such stock, and

(ii) requires that a portion of the employee's share of the profits of such corporation (whether received as compensation or as a dividend) be applied to the purchase of such stock (or the purchase of notes, bonds, debentures or other similar evidence of indebtedness of such franchised corporation held by such parent corporation or common owner);

(D) such employee (or employees) owns directly more than 20 percent of the total value of shares of all classes of stock in such franchised corporation;

(E) more than 50 percent of the inventory of such franchised corporation is acquired from members of the controlled group, the common owner, or both; and

(F) all of the conditions contained in subparagraphs (A), (B), (C), (D), and (E) have been met for one-half (or more) of the number of days preceding the December 31 included within the taxable year (or if the taxable year does not include December 31, the last day of such year) of the franchised corporation,

then such franchised corporation shall be treated as an excluded member of such group, under subsection (b)(2), for such taxable year.

(5) BROTHER-SISTER CONTROLLED GROUP DEFINITION FOR PROVISIONS OTHER THAN THIS PART.—

(A) IN GENERAL.—Except as specifically provided in an applicable provision, subsection (a)(2) shall be applied to an applicable provision as if it read as follows:

"(2) BROTHER-SISTER CONTROLLED GROUP.—"Two or more corporations if 5 or fewer persons who are individuals, estates, or trusts own (within the meaning of subsection (d)(2) stock possessing—

"(A) at least 80 percent of the total combined voting power of all classes of stock entitled to vote, or at least 80 percent of the total value of shares of all classes of stock, of each corporation, and

"(B) more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock of each corporation, taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation."

(B) APPLICABLE PROVISION.—For purposes of this paragraph, an applicable provision is any provision of law (other than this part) which incorporates the definition of controlled group of corporations under subsection (a).

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Subtitle B—Estate and Gift Taxes

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CHAPTER 11—ESTATE TAX

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Subchapter A—ESTATES OF CITIZENS OR RESIDENTS

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PART II—CREDITS AGAINST TAX

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SEC. 2012. CREDIT FOR GIFT TAX.

(a) IN GENERAL.—If a tax on a gift has been paid under chapter 12 (sec. 2501 and following), or under corresponding provisions of prior laws, and thereafter on the death of the donor any amount in respect of such gift is required to be included in the value of the gross estate of the decedent for purposes of this chapter, then there shall be credited against the tax imposed by section 2001 the amount of the tax paid on a gift under chapter 12, or under corresponding provisions of prior laws, with respect to so much of the property which constituted the gift as is included in the gross estate, except that the amount of such credit shall not exceed an amount which bears the same ratio to the tax imposed by section

2001 (after deducting from such tax the unified credit provided by section 2010) as the value (at the time of the gift or at the time of the death, whichever is lower) of so much of the property which constituted the gift as is included in the gross estate bears to the value of the entire gross estate reduced by the aggregate amount of the charitable and marital deductions allowed under sections 2055, 2056, and 2106(a)(2).

(b) VALUATION REDUCTIONS.—In applying, with respect to any gift, the ratio stated in subsection (a), the value at the time of the gift or at the time of the death, referred to in such ratio, shall be reduced—

(1) by such amount as will properly reflect the amount of such gift which was excluded in determining (for purposes of section 2503(a)), or of corresponding provisions of prior laws, the total amount of gifts made during the calendar quarter (or calendar year if the gift was made before January 1, 1971) in which the gift was made;

(2) if a deduction with respect to such gift is allowed under section 2056(a) (relating to marital deduction), then by the amount of such value, reduced as provided in paragraph (1); and

(3) if a deduction with respect to such gift is allowed under sections 2055 or 2106(a)(2) (relating to charitable deduction), then by the amount of such value, reduced as provided in paragraph (1) of this subsection.

(c) WHERE GIFT CONSIDERED MADE ONE-HALF BY SPOUSE.—Where the decedent was the donor of the gift but, under the provisions of section 2513, or corresponding provisions of prior laws, the gift was considered as made one-half by [his spouse] *the decedent's spouse* —

(1) the term "the amount of the tax paid on a gift under chapter 12", as used in subsection (a), includes the amounts paid with respect to each half of such gift, the amount paid with respect to each being computed in the manner provided in subsection (d); and

(2) in applying, with respect to such gift, the ratio stated in subsection (a), the value at the time of the gift or at the time of the death, referred to in such ratio, includes such value with respect to each half of such gift, each such value being reduced as provided in paragraph (1) of subsection (b).

(d) COMPUTATION OF AMOUNT OF GIFT TAX PAID.—

(1) AMOUNT OF TAX.—For purposes of subsection (a), the amount of tax paid on a gift under chapter 12, or under corresponding provisions of prior laws, with respect to any gift shall be an amount which bears the same ratio to the total tax paid for the calendar quarter (or calendar year if the gift was made before January 1, 1971) in which the gift was made as the amount of such gift bears to the total amount of taxable gifts (computed without deduction of the specific exemption) for such quarter or year.

(2) AMOUNT OF GIFT.—For purposes of paragraph (1), the "amount of such gift" shall be the amount included with respect to such gift in determining (for the purposes of section 2503(a), or of corresponding provisions of prior laws) the total amount of gifts made during such quarter or year, reduced by

the amount of any deduction allowed with respect to such gift under section 2522, or under corresponding provisions of prior laws (relating to charitable deduction), or under section 2523 (relating to marital deduction).

(e) SECTION INAPPLICABLE TO GIFTS MADE AFTER DECEMBER 31, 1976.—No credit shall be allowed under this section with respect to the amount of any tax paid under chapter 12 on any gift made after December 31, 1976.

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PART III—GROSS ESTATE

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SEC. 2032A. VALUATION OF CERTAIN FARM, ETC., REAL PROPERTY.

(a) VALUE BASED ON USE UNDER WHICH PROPERTY QUALIFIES.—

(1) GENERAL RULE.—If—

(A) the decedent was (at the time of his death) a citizen or resident of the United States, and

(B) the executor elects the application of this section and files the agreement referred to in subsection (d)(2),

then, for purposes of this chapter, the value of qualified real property shall be its value for the use under which it qualifies, under subsection (b), as qualified real property.

(2) LIMITATION ON AGGREGATE REDUCTION IN FAIR MARKET VALUE.—The aggregate decrease in the value of qualified real property taken into account for purposes of this chapter which results from the application of paragraph (1) with respect to any decedent shall not exceed $750,000.

(3) INFLATION ADJUSTMENT.—In the case of estates of decedents dying in a calendar year after 1998, the $750,000 amount contained in paragraph (2) shall be increased by an amount equal to—

(A) $750,000, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar year 1997" for "calendar year 2016" in subparagraph (A)(ii) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of $10,000, such amount shall be rounded to the next lowest multiple of $10,000.

(b) QUALIFIED REAL PROPERTY.—

(1) IN GENERAL.—For purposes of this section, the term "qualified real property" means real property located in the United States which was acquired from or passed from the decedent to a qualified heir of the decedent and which, on the date of the decedent's death, was being used for a qualified use by the decedent or a member of the decedent's family, but only if—

(A) 50 percent or more of the adjusted value of the gross estate consists of the adjusted value of real or personal property which—

(i) on the date of the decedent's death, was being used for a qualified use by the decedent or a member of the decedent's family, and

(ii) was acquired from or passed from the decedent to a qualified heir of the decedent.

(B) 25 percent or more of the adjusted value of the gross estate consists of the adjusted value of real property which meets the requirements of subparagraphs (A)(ii) and (C),

(C) during the 8-year period ending on the date of the decedent's death there have been periods aggregating 5 years or more during which—

(i) such real property was owned by the decedent or a member of the decedent's family and used for a qualified use by the decedent or a member of the decedent's family, and

(ii) there was material participation by the decedent or a member of the decedent's family in the operation of the farm or other business, and

(D) such real property is designated in the agreement referred to in subsection (d)(2).

(2) QUALIFIED USE.—For purposes of this section, the term "qualified use" means the devotion of the property to any of the following:

(A) use as a farm for farming purposes, or

(B) use in a trade or business other than the trade or business of farming.

(3) ADJUSTED VALUE.—For purposes of paragraph (1), the term "adjusted value" means—

(A) in the case of the gross estate, the value of the gross estate for purposes of this chapter (determined without regard to this section), reduced by any amounts allowable as a deduction under paragraph (4) of section 2053(a), or

(B) in the case of any real or personal property, the value of such property for purposes of this chapter (determined without regard to this section), reduced by any amounts allowable as a deduction in respect of such property under paragraph (4) of section 2053(a).

(4) DECEDENTS WHO ARE RETIRED OR DISABLED.—

(A) IN GENERAL.—If, on the date of the decedent's death, the requirements of paragraph (1)(C)(ii) with respect to the decedent for any property are not met, and the decedent—

(i) was receiving old-age benefits under title II of the Social Security Act for a continuous period ending on such date, or

(ii) was disabled for a continuous period ending on such date,

then paragraph (1)(C)(ii) shall be applied with respect to such property by substituting "the date on which the longer of such continuous periods began" for "the date of the decedent's death" in paragraph (1)(C).

(B) DISABLED DEFINED.—For purposes of subparagraph (A), an individual shall be disabled if such individual has a mental or physical impairment which renders him unable to materially participate in the operation of the farm or other business.

(C) COORDINATION WITH RECAPTURE.—For purposes of subsection (c)(6)(B)(i), if the requirements of paragraph (1)(C)(ii) are met with respect to any decedent by reason

of subparagraph (A), the period ending on the date on which the continuous period taken into account under subparagraph (A) began shall be treated as the period immediately before the decedent's death.

(5) SPECIAL RULES FOR SURVIVING SPOUSES.—

(A) IN GENERAL.—If property is qualified real property with respect to a decedent (hereinafter in this paragraph referred to as the "first decedent") and such property was acquired from or passed from the first decedent to the surviving spouse of the first decedent, for purposes of applying this subsection and subsection (c) in the case of the estate of such surviving spouse, active management of the farm or other business by the surviving spouse shall be treated as material participation by such surviving spouse in the operation of such farm or business.

(B) SPECIAL RULE.—For the purposes of subparagraph (A), the determination of whether property is qualified real property with respect to the first decedent shall be made without regard to subparagraph (D) of paragraph (1) and without regard to whether an election under this section was made.

(C) COORDINATION WITH PARAGRAPH (4).—In any case in which to do so will enable the requirements of paragraph (1)(C)(ii) to be met with respect to the surviving spouse, this subsection and subsection (c) shall be applied by taking into account any application of paragraph (4).

(c) TAX TREATMENT OF DISPOSITIONS AND FAILURES TO USE FOR QUALIFIED USE.—

(1) IMPOSITION OF ADDITIONAL ESTATE TAX.—If, within 10 years after the decedent's death and before the death of the qualified heir—

(A) the qualified heir disposes of any interest in qualified real property (other than by a disposition to a member of his family), or

(B) the qualified heir ceases to use for the qualified use the qualified real property which was acquired (or passed) from the decedent,

then, there is hereby imposed an additional estate tax.

(2) AMOUNT OF ADDITIONAL TAX.—

(A) IN GENERAL.—The amount of the additional tax imposed by paragraph (1) with respect to any interest shall be the amount equal to the lesser of—

(i) the adjusted tax difference attributable to such interest, or

(ii) the excess of the amount realized with respect to the interest (or, in any case other than a sale or exchange at arm's length, the fair market value of the interest) over the value of the interest determined under subsection (a).

(B) ADJUSTED TAX DIFFERENCE ATTRIBUTABLE TO INTEREST.—For purposes of subparagraph (A), the adjusted tax difference attributable to an interest is the amount which bears the same ratio to the adjusted tax difference with respect to the estate (determined under subparagraph (C)) as—

(i) the excess of the value of such interest for purposes of this chapter (determined without regard to subsection (a)) over the value of such interest determined under subsection (a), bears to

(ii) a similar excess determined for all qualified real property.

(C) ADJUSTED TAX DIFFERENCE WITH RESPECT TO THE ESTATE.—For purposes of subparagraph (B), the term "adjusted tax difference with respect to the estate" means the excess of what would have been the estate tax liability but for subsection (a) over the estate tax liability. For purposes of this subparagraph, the term "estate tax liability" means the tax imposed by section 2001 reduced by the credits allowable against such tax.

(D) PARTIAL DISPOSITIONS.—For purposes of this paragraph, where the qualified heir disposes of a portion of the interest acquired by (or passing to) such heir (or a predecessor qualified heir) or there is a cessation of use of such a portion—

(i) the value determined under subsection (a) taken into account under subparagraph (A)(ii) with respect to such portion shall be its pro rata share of such value of such interest, and

(ii) the adjusted tax difference attributable to the interest taken into account with respect to the transaction involving the second or any succeeding portion shall be reduced by the amount of the tax imposed by this subsection with respect to all prior transactions involving portions of such interest.

(E) SPECIAL RULE FOR DISPOSITION OF TIMBER.—In the case of qualified woodland to which an election under subsection (e)(13)(A) applies, if the qualified heir disposes of (or severs) any standing timber on such qualified woodland—

(i) such disposition (or severance) shall be treated as a disposition of a portion of the interest of the qualified heir in such property, and

(ii) the amount of the additional tax imposed by paragraph (1) with respect to such disposition shall be an amount equal to the lesser of—

(I) the amount realized on such disposition (or, in any case other than a sale or exchange at arm's length, the fair market value of the portion of the interest disposed or severed), or

(II) the amount of additional tax determined under this paragraph (without regard to this subparagraph) if the entire interest of the qualified heir in the qualified woodland had been disposed of, less the sum of the amount of the additional tax imposed with respect to all prior transactions involving such woodland to which this subparagraph applied.

For purposes of the preceding sentence, the disposition of a right to sever shall be treated as the disposition of the standing timber. The amount of additional tax imposed

under paragraph (1) in any case in which a qualified heir disposes of his entire interest in the qualified woodland shall be reduced by any amount determined under this subparagraph with respect to such woodland.

(3) ONLY 1 ADDITIONAL TAX IMPOSED WITH RESPECT TO ANY 1 PORTION.—In the case of an interest acquired from (or passing from) any decedent, if subparagraph (A) or (B) of paragraph (1) applies to any portion of an interest, subparagraph (B) or (A), as the case may be, of paragraph (1) shall not apply with respect to the same portion of such interest.

(4) DUE DATE.—The additional tax imposed by this subsection shall become due and payable on the day which is 6 months after the date of the disposition or cessation referred to in paragraph (1).

(5) LIABILITY FOR TAX; FURNISHING OF BOND.—The qualified heir shall be personally liable for the additional tax imposed by this subsection with respect to his interest unless the heir has furnished bond which meets the requirements of subsection (e)(11).

(6) CESSATION OF QUALIFIED USE.—For purposes of paragraph (1)(B), real property shall cease to be used for the qualified use if—

(A) such property ceases to be used for the qualified use set forth in subparagraph (A) or (B) of subsection (b)(2) under which the property qualified under subsection (b), or

(B) during any period of 8 years ending after the date of the decedent's death and before the date of the death of the qualified heir, there had been periods aggregating more than 3 years during which—

(i) in the case of periods during which the property was held by the decedent, there was no material participation by the decedent or any member of his family in the operation of the farm or other business, and

(ii) in the case of periods during which the property was held by any qualified heir, there was no material participation by such qualified heir or any member of his family in the operation of the farm or other business.

(7) SPECIAL RULES.—

(A) NO TAX IF USE BEGINS WITHIN 2 YEARS.—If the date on which the qualified heir begins to use the qualified real property (hereinafter in this subparagraph referred to as the commencement date) is before the date 2 years after the decedent's death—

(i) no tax shall be imposed under paragraph (1) by reason of the failure by the qualified heir to so use such property before the commencement date, and

(ii) the 10-year period under paragraph (1) shall be extended by the period after the decedent's death and before the commencement date.

(B) ACTIVE MANAGEMENT BY ELIGIBLE QUALIFIED HEIR TREATED AS MATERIAL PARTICIPATION.—For purposes of paragraph (6)(B)(ii), the active management of a farm or other business by—

(i) an eligible qualified heir, or

(ii) a fiduciary of an eligible qualified heir described in clause (ii) or (iii) of subparagraph (C),

shall be treated as material participation by such eligible qualified heir in the operation of such farm or business. In the case of an eligible qualified heir described in clause (ii), (iii), or (iv) of subparagraph (C), the preceding sentence shall apply only during periods during which such heir meets the requirements of such clause.

(C) ELIGIBLE QUALIFIED HEIR.—For purposes of this paragraph, the term "eligible qualified heir" means a qualified heir who—

(i) is the surviving spouse of the decedent,

(ii) has not attained the age of 21,

(iii) is disabled (within the meaning of subsection (b)(4)(B)), or

(iv) is a student.

(D) STUDENT.—For purposes of subparagraph (C), an individual shall be treated as a student with respect to periods during any calendar year if (and only if) such individual is a student (within the meaning of section 152(f)(2)) for such calendar year.

(E) CERTAIN RENTS TREATED AS QUALIFIED USE.—For purposes of this subsection, a surviving spouse or lineal descendant of the decedent shall not be treated as failing to use qualified real property in a qualified use solely because such spouse or descendant rents such property to a member of the family of such spouse or descendant on a net cash basis. For purposes of the preceding sentence, a legally adopted child of an individual shall be treated as the child of such individual by blood.

(8) QUALIFIED CONSERVATION CONTRIBUTION IS NOT A DISPOSITION.—A qualified conservation contribution (as defined in section 170(h)) by gift or otherwise shall not be deemed a disposition under subsection (c)(1)(A).

(d) ELECTION; AGREEMENT.—

(1) ELECTION.—The election under this section shall be made on the return of the tax imposed by section 2001. Such election shall be made in such manner as the Secretary shall by regulations prescribe. Such an election, once made, shall be irrevocable.

(2) AGREEMENT.—The agreement referred to in this paragraph is a written agreement signed by each person in being who has an interest (whether or not in possession) in any property designated in such agreement consenting to the application of subsection (c) with respect to such property.

(3) MODIFICATION OF ELECTION AND AGREEMENT TO BE PERMITTED.—The Secretary shall prescribe procedures which provide that in any case in which the executor makes an election under paragraph (1) (and submits the agreement referred to in paragraph (2)) within the time prescribed therefor, but—

(A) the notice of election, as filed, does not contain all required information, or

(B) signatures of 1 or more persons required to enter into the agreement described in paragraph (2) are not in-

cluded on the agreement as filed, or the agreement does not contain all required information,

the executor will have a reasonable period of time (not exceeding 90 days) after notification of such failures to provide such information or signatures.

(e) DEFINITIONS; SPECIAL RULES.—For purposes of this section—

(1) QUALIFIED HEIR.—The term "qualified heir" means, with respect to any property, a member of the decedent's family who acquired such property (or to whom such property passed) from the decedent. If a qualified heir disposes of any interest in qualified real property to any member of his family, such member shall thereafter be treated as the qualified heir with respect to such interest.

(2) MEMBER OF FAMILY.—The term "member of the family" means, with respect to any individual, only—

(A) an ancestor of such individual,

(B) the spouse of such individual,

(C) a lineal descendant of such individual, of such individual's spouse, or of a parent of such individual, or

(D) the spouse of any lineal descendant described in subparagraph (C).

For purposes of the preceding sentence, a legally adopted child of an individual shall be treated as the child of such individual by blood.

(3) CERTAIN REAL PROPERTY INCLUDED.—In the case of real property which meets the requirements of subparagraph (C) of subsection (b)(1), residential buildings and related improvements on such real property occupied on a regular basis by the owner or lessee of such real property or by persons employed by such owner or lessee for the purpose of operating or maintaining such real property, and roads, buildings, and other structures and improvements functionally related to the qualified use shall be treated as real property devoted to the qualified use.

(4) FARM.—The term "farm" includes stock, dairy, poultry, fruit, furbearing animal, and truck farms, plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities, and orchards and woodlands.

(5) FARMING PURPOSES.—The term "farming purposes" means—

(A) cultivating the soil or raising or harvesting any agricultural or horticultural commodity (including the raising, shearing, feeding, caring for, training, and management of animals) on a farm;

(B) handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant, or operator of the farm regularly produces more than one-half of the commodity so treated; and

(C)(i) the planting, cultivating, caring for, or cutting of trees, or

(ii) the preparation (other than milling) of trees for market.

(6) MATERIAL PARTICIPATION.—Material participation shall be determined in a manner similar to the manner used for purposes of paragraph (1) of section 1402(a) (relating to net earnings from self-employment).

(7) METHOD OF VALUING FARMS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the value of a farm for farming purposes shall be determined by dividing—

(i) the excess of the average annual gross cash rental for comparable land used for farming purposes and located in the locality of such farm over the average annual State and local real estate taxes for such comparable land, by

(ii) the average annual effective interest rate for all new Federal Land Bank loans.

For purposes of the preceding sentence, each average annual computation shall be made on the basis of the 5 most recent calendar years ending before the date of the decedent's death.

(B) VALUE BASED ON NET SHARE RENTAL IN CERTAIN CASES.—

(i) IN GENERAL.—If there is no comparable land from which the average annual gross cash rental may be determined but there is comparable land from which the average net share rental may be determined, subparagraph (A)(i) shall be applied by substituting "average annual net share rental" for "average annual gross cash rental".

(ii) NET SHARE RENTAL.—For purposes of this paragraph, the term "net share rental" means the excess of—

(I) the value of the produce received by the lessor of the land on which such produce is grown, over

(II) the cash operating expenses of growing such produce which, under the lease, are paid by the lessor.

(C) EXCEPTION.—The formula provided by subparagraph (A) shall not be used—

(i) where it is established that there is no comparable land from which the average annual gross cash rental may be determined, or

(ii) where the executor elects to have the value of the farm for farming purposes determined and that there is no comparable land from which the average net share rental may be determined under paragraph (8).

(8) METHOD OF VALUING CLOSELY HELD BUSINESS INTERESTS, ETC..—In any case to which paragraph (7)(A) does not apply, the following factors shall apply in determining the value of any qualified real property:

(A) The capitalization of income which the property can be expected to yield for farming or closely held business purposes over a reasonable period of time under prudent management using traditional cropping patterns for the

area, taking into account soil capacity, terrain configuration, and similar factors,

(B) The capitalization of the fair rental value of the land for farm land or closely held business purposes,

(C) Assessed land values in a State which provides a differential or use value assessment law for farmland or closely held business,

(D) Comparable sales of other farm or closely held business land in the same geographical area far enough removed from a metropolitan or resort area so that nonagricultural use is not a significant factor in the sales price, and

(E) Any other factor which fairly values the farm or closely held business value of the property.

(9) PROPERTY ACQUIRED FROM DECEDENT.—Property shall be considered to have been acquired from or to have passed from the decedent if—

(A) such property is so considered under section 1014(b) (relating to basis of property acquired from a decedent),

(B) such property is acquired by any person from the estate, or

(C) such property is acquired by any person from a trust (to the extent such property is includible in the gross estate of the decedent).

(10) COMMUNITY PROPERTY.—If the decedent and [his surviving spouse] *the decedent's surviving spouse* at any time held qualified real property as community property, the interest of the surviving spouse in such property shall be taken into account under this section to the extent necessary to provide a result under this section with respect to such property which is consistent with the result which would have obtained under this section if such property had not been community property.

(11) BOND IN LIEU OF PERSONAL LIABILITY.—If the qualified heir makes written application to the Secretary for determination of the maximum amount of the additional tax which may be imposed by subsection (c) with respect to the qualified heir's interest, the Secretary (as soon as possible, and in any event within 1 year after the making of such application) shall notify the heir of such maximum amount. The qualified heir, on furnishing a bond in such amount and for such period as may be required, shall be discharged from personal liability for any additional tax imposed by subsection (c) and shall be entitled to a receipt or writing showing such discharge.

(12) ACTIVE MANAGEMENT.—The term "active management" means the making of the management decisions of a business (other than the daily operating decisions).

(13) SPECIAL RULES FOR WOODLANDS.—

(A) IN GENERAL.—In the case of any qualified woodland with respect to which the executor elects to have this subparagraph apply, trees growing on such woodland shall not be treated as a crop.

(B) QUALIFIED WOODLAND.—The term "qualified woodland" means any real property which—

(i) is used in timber operations, and

(ii) is an identifiable area of land such as an acre or other area for which records are normally maintained in conducting timber operations.

(C) TIMBER OPERATIONS.—The term "timber operations" means—

(i) the planting, cultivating, caring for, or cutting of trees, or

(ii) the preparation (other than milling) of trees for market.

(D) ELECTION.—An election under subparagraph (A) shall be made on the return of the tax imposed by section 2001. Such election shall be made in such manner as the Secretary shall by regulations prescribe. Such an election, once made, shall be irrevocable.

(14) TREATMENT OF REPLACEMENT PROPERTY ACQUIRED IN SECTION 1031 OR 1033 TRANSACTIONS.—

(A) IN GENERAL.—In the case of any qualified replacement property, any period during which there was ownership, qualified use, or material participation with respect to the replaced property by the decedent or any member of his family shall be treated as a period during which there was such ownership, use, or material participation (as the case may be) with respect to the qualified replacement property.

(B) LIMITATION.—Subparagraph (A) shall not apply to the extent that the fair market value of the qualified replacement property (as of the date of its acquisition) exceeds the fair market value of the replaced property (as of the date of its disposition).

(C) DEFINITIONS.—For purposes of this paragraph—

(i) QUALIFIED REPLACEMENT PROPERTY.—The term "qualified replacement property" means any real property which is—

(I) acquired in an exchange which qualifies under section 1031, or

(II) the acquisition of which results in the nonrecognition of gain under section 1033.

Such term shall only include property which is used for the same qualified use as the replaced property was being used before the exchange.

(ii) REPLACED PROPERTY.—The term "replaced property" means—

(I) the property transferred in the exchange which qualifies under section 1031, or

(II) the property compulsorily or involuntarily converted (within the meaning of section 1033).

(f) STATUTE OF LIMITATIONS.—If qualified real property is disposed of or ceases to be used for a qualified use, then—

(1) the statutory period for the assessment of any additional tax under subsection (c) attributable to such disposition or cessation shall not expire before the expiration of 3 years from the date the Secretary is notified (in such manner as the Secretary may by regulations prescribe) of such disposition or cessation (or if later in the case of an involuntary conversion or exchange to which subsection (h) or (i) applies, 3 years from the date the

Secretary is notified of the replacement of the converted property or of an intention not to replace or of the exchange of property), and

(2) such additional tax may be assessed before the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

(g) APPLICATION OF THIS SECTION AND SECTION 6324B TO INTERESTS IN PARTNERSHIPS, CORPORATIONS, AND TRUSTS.—The Secretary shall prescribe regulations setting forth the application of this section and section 6324B in the case of an interest in a partnership, corporation, or trust which, with respect to the decedent, is an interest in a closely held business (within the meaning of paragraph (1) of section 6166(b)). For purposes of the preceding sentence, an interest in a discretionary trust all the beneficiaries of which are qualified heirs shall be treated as a present interest.

(h) SPECIAL RULES FOR INVOLUNTARY CONVERSIONS OF QUALIFIED REAL PROPERTY.—

(1) TREATMENT OF CONVERTED PROPERTY.—

(A) IN GENERAL.—If there is an involuntary conversion of an interest in qualified real property—

(i) no tax shall be imposed by subsection (c) on such conversion if the cost of the qualified replacement property equals or exceeds the amount realized on such conversion, or

(ii) if clause (i) does not apply, the amount of the tax imposed by subsection (c) on such conversion shall be the amount determined under subparagraph (B).

(B) AMOUNT OF TAX WHERE THERE IS NOT COMPLETE REINVESTMENT.—The amount determined under this subparagraph with respect to any involuntary conversion is the amount of the tax which (but for this subsection) would have been imposed on such conversion reduced by an amount which—

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

(ii) the cost of the qualified replacement property bears to the amount realized on the conversion.

(2) TREATMENT OF REPLACEMENT PROPERTY.—For purposes of subsection (c)—

(A) any qualified replacement property shall be treated in the same manner as if it were a portion of the interest in qualified real property which was involuntarily converted; except that with respect to such qualified replacement property the 10-year period under paragraph (1) of subsection (c) shall be extended by any period, beyond the 2-year period referred to in section 1033(a)(2)(B)(i), during which the qualified heir was allowed to replace the qualified real property,

(B) any tax imposed by subsection (c) on the involuntary conversion shall be treated as a tax imposed on a partial disposition, and

(C) paragraph (6) of subsection (c) shall be applied—

(i) by not taking into account periods after the involuntary conversion and before the acquisition of the qualified replacement property, and

(ii) by treating material participation with respect to the converted property as material participation with respect to the qualified replacement property.

(3) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

(A) INVOLUNTARY CONVERSION.—The term "involuntary conversion" means a compulsory or involuntary conversion within the meaning of section 1033.

(B) QUALIFIED REPLACEMENT PROPERTY.—The term "qualified replacement property" means—

(i) in the case of an involuntary conversion described in section 1033(a)(1), any real property into which the qualified real property is converted, or

(ii) in the case of an involuntary conversion described in section 1033(a)(2), any real property purchased by the qualified heir during the period specified in section 1033(a)(2)(B) for purposes of replacing the qualified real property.

Such term only includes property which is to be used for the qualified use set forth in subparagraph (A) or (B) of subsection (b)(2) under which the qualified real property qualified under subsection (a).

(4) CERTAIN RULES MADE APPLICABLE.—The rules of the last sentence of section 1033(a)(2)(A) shall apply for purposes of paragraph (3)(B)(ii).

(i) EXCHANGES OF QUALIFIED REAL PROPERTY.—

(1) TREATMENT OF PROPERTY EXCHANGED.—

(A) EXCHANGES SOLELY FOR QUALIFIED EXCHANGE PROPERTY.—If an interest in qualified real property is exchanged solely for an interest in qualified exchange property in a transaction which qualifies under section 1031, no tax shall be imposed by subsection (c) by reason of such exchange.

(B) EXCHANGES WHERE OTHER PROPERTY RECEIVED.—If an interest in qualified real property is exchanged for an interest in qualified exchange property and other property in a transaction which qualifies under section 1031, the amount of the tax imposed by subsection (c) by reason of such exchange shall be the amount of tax which (but for this subparagraph) would have been imposed on such exchange under subsection (c)(1), reduced by an amount which—

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

(ii) the fair market value of the qualified exchange property bears to the fair market value of the qualified real property exchanged.

For purposes of clause (ii) of the preceding sentence, fair market value shall be determined as of the time of the exchange.

(2) TREATMENT OF QUALIFIED EXCHANGE PROPERTY.—For purposes of subsection (c)—

(A) any interest in qualified exchange property shall be treated in the same manner as if it were a portion of the interest in qualified real property which was exchanged,

(B) any tax imposed by subsection (c) by reason of the exchange shall be treated as a tax imposed on a partial disposition, and

(C) paragraph (6) of subsection (c) shall be applied by treating material participation with respect to the exchanged property as material participation with respect to the qualified exchange property.

(3) QUALIFIED EXCHANGE PROPERTY.—For purposes of this subsection, the term "qualified exchange property" means real property which is to be used for the qualified use set forth in subparagraph (A) or (B) of subsection (b)(2) under which the real property exchanged therefor originally qualified under subsection (a).

* * * * * * *

SEC. 2035. ADJUSTMENTS FOR CERTAIN GIFTS MADE WITHIN 3 YEARS OF DECEDENT'S DEATH.

(a) INCLUSION OF CERTAIN PROPERTY IN GROSS ESTATE.—If—

(1) the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and

(2) the value of such property (or an interest therein) would have been included in the decedent's gross estate under section 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of his death,

the value of the gross estate shall include the value of any property (or interest therein) which would have been so included.

(b) INCLUSION OF GIFT TAX ON GIFTS MADE DURING 3 YEARS BEFORE DECEDENT'S DEATH.—The amount of the gross estate (determined without regard to this subsection) shall be increased by the amount of any tax paid under chapter 12 by the decedent or [his estate] *the decedent's estate* on any gift made by the decedent or [his spouse] *the decedent's spouse* during the 3-year period ending on the date of the decedent's death.

(c) OTHER RULES RELATING TO TRANSFERS WITHIN 3 YEARS OF DEATH.—

(1) IN GENERAL.—For purposes of—

(A) section 303(b) (relating to distributions in redemption of stock to pay death taxes),

(B) section 2032A (relating to special valuation of certain farms, etc., real property), and

(C) subchapter C of chapter 64 (relating to lien for taxes),

the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, during the 3-year period ending on the date of the decedent's death.

(2) COORDINATION WITH SECTION 6166.—An estate shall be treated as meeting the 35 percent of adjusted gross estate requirement of section 6166(a)(1) only if the estate meets such requirement both with and without the application of subsection (a).

(3) MARITAL AND SMALL TRANSFERS.—Paragraph (1) shall not apply to any transfer (other than a transfer with respect to a life insurance policy) made during a calendar year to any donee if the decedent was not required by section 6019 (other than by reason of section 6019(2)) to file any gift tax return for such year with respect to transfers to such donee.

(d) EXCEPTION.—Subsection (a) and paragraph (1) of subsection (c) shall not apply to any bona fide sale for an adequate and full consideration in money or money's worth.

(e) TREATMENT OF CERTAIN TRANSFERS FROM REVOCABLE TRUSTS.—For purposes of this section and section 2038, any transfer from any portion of a trust during any period that such portion was treated under section 676 as owned by the decedent by reason of a power in the grantor (determined without regard to section 672(e)) shall be treated as a transfer made directly by the decedent.

* * * * * * *

SEC. 2040. JOINT INTERESTS.

(a) GENERAL RULE.—The value of the gross estate shall include the value of all property to the extent of the interest therein held as joint tenants with right of survivorship by the decedent and any other person, or as tenants by the entirety by the decedent and spouse, or deposited, with any person carrying on the banking business, in their joint names and payable to either or the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have been received or acquired by the latter from the decedent for less than an adequate and full consideration in money or money's worth: *Provided*, That where such property or any part thereof, or part of the consideration with which such property was acquired, is shown to have been at any time acquired by such other person from the decedent for less than an adequate and full consideration in money or money's worth, there shall be excepted only such part of the value of such property as is proportionate to the consideration furnished by such other person: *Provided further*, That where any property has been acquired by gift, bequest, devise, or inheritance, as a tenancy by the entirety by the decedent and spouse, then to the extent of one-half of the value thereof, or, where so acquired by the decedent and any other person as joint tenants with right of survivorship and their interests are not otherwise specified or fixed by law, then to the extent of the value of a fractional part to be determined by dividing the value of the property by the number of joint tenants with right of survivorship.

(b) [CERTAIN JOINT INTERESTS OF HUSBAND AND WIFE] *CERTAIN JOINT INTERESTS OF MARRIED COUPLE*.—

(1) INTERESTS OF SPOUSE EXCLUDED FROM GROSS ESTATE.—Notwithstanding subsection (a), in the case of any qualified joint interest, the value included in the gross estate with respect to such interest by reason of this section is one-half of the value of such qualified joint interest.

(2) QUALIFIED JOINT INTEREST DEFINED.—For purposes of paragraph (1), the term "qualified joint interest" means any interest in property held by the decedent and the decedent's spouse as—

(A) tenants by the entirety, or

(B) joint tenants with right of survivorship, but only if the decedent and the spouse of the decedent are the only joint tenants.

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PART IV—TAXABLE ESTATE

* * * * * * *

SEC. 2056. BEQUESTS, ETC., TO SURVIVING SPOUSE.

(a) ALLOWANCE OF MARITAL DEDUCTION.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsection (b), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to [his] surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

(b) LIMITATION IN THE CASE OF LIFE ESTATE OR OTHER TERMINABLE INTEREST.—

(1) GENERAL RULE.—Where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed under this section with respect to such interest—

(A) if an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse); and

(B) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse;

and no deduction shall be allowed with respect to such interest (even if such deduction is not disallowed under subparagraphs (A) and (B))—

(C) if such interest is to be acquired for the surviving spouse, pursuant to directions of the decedent, by his executor or by the trustee of a trust.

For purposes of this paragraph, an interest shall not be considered as an interest which will terminate or fail merely because it is the ownership of a bond, note, or similar contractual obligation, the discharge of which would not have the effect of an annuity for life or for a term.

(2) INTEREST IN UNIDENTIFIED ASSETS.—Where the assets (included in the decedent's gross estate) out of which, or the proceeds of which, an interest passing to the surviving spouse may be satisfied include a particular asset or assets with respect to which no deduction would be allowed if such asset or assets passed from the decedent to such spouse, then the value of such interest passing to such spouse shall, for purposes of subsection (a), be reduced by the aggregate value of such particular assets.

(3) INTEREST OF SPOUSE CONDITIONAL ON SURVIVAL FOR LIMITED PERIOD.—For purposes of this subsection, an interest passing to the surviving spouse shall not be considered as an

interest which will terminate or fail on the death of such spouse if—

(A) such death will cause a termination or failure of such interest only if it occurs within a period not exceeding 6 months after the decedent's death, or only if it occurs as a result of a common disaster resulting in the death of the decedent and the surviving spouse, or only if it occurs in the case of either such event; and

(B) such termination or failure does not in fact occur.

(4) VALUATION OF INTEREST PASSING TO SURVIVING SPOUSE.—In determining for purposes of subsection (a) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this section—

(A) there shall be taken into account the effect which the tax imposed by section 2001, or any estate, succession, legacy, or inheritance tax, has on the net value to the surviving spouse of such interest; and

(B) where such interest or property is encumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined.

(5) LIFE ESTATE WITH POWER OF APPOINTMENT IN SURVIVING SPOUSE.—In the case of an interest in property passing from the decedent, if [his] surviving spouse is entitled for life to all the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire interest, or such specific portion (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the interest, or such specific portion, to any person other than the surviving spouse—

(A) the interest or such portion thereof so passing shall, for purposes of subsection (a), be considered as passing to the surviving spouse, and

(B) no part of the interest so passing shall, for purposes of paragraph (1)(A), be considered as passing to any person other than the surviving spouse.

This paragraph shall apply only if such power in the surviving spouse to appoint the entire interest, or such specific portion thereof, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

(6) LIFE INSURANCE OR ANNUITY PAYMENTS WITH POWER OF APPOINTMENT IN SURVIVING SPOUSE.—In the case of an interest in property passing from the decedent consisting of proceeds under a life insurance, endowment, or annuity contract, if under the terms of the contract such proceeds are payable in installments or are held by the insurer subject to an agreement to pay interest thereon (whether the proceeds, on the termination of any interest payments, are payable in a lump sum or

in annual or more frequent installments), and such installment or interest payments are payable annually or at more frequent intervals, commencing not later than 13 months after the decedent's death, and all amounts, or a specific portion of all such amounts, payable during the life of the surviving spouse are payable only to such spouse, and such spouse has the power to appoint all amounts, or such specific portion, payable under such contract (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), with no power in any other person to appoint such amounts to any person other than the surviving spouse—

(A) such amounts shall, for purposes of subsection (a), be considered as passing to the surviving spouse, and

(B) no part of such amounts shall, for purposes of paragraph (1)(A), be considered as passing to any person other than the surviving spouse.

This paragraph shall apply only if, under the terms of the contract, such power in the surviving spouse to appoint such amounts, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

(7) ELECTION WITH RESPECT TO LIFE ESTATE FOR SURVIVING SPOUSE.—

(A) IN GENERAL.—In the case of qualified terminable interest property—

(i) for purposes of subsection (a), such property shall be treated as passing to the surviving spouse, and

(ii) for purposes of paragraph (1)(A), no part of such property shall be treated as passing to any person other than the surviving spouse.

(B) QUALIFIED TERMINABLE INTEREST PROPERTY DEFINED.—For purposes of this paragraph—

(i) IN GENERAL.—The term "qualified terminable interest property" means property—

(I) which passes from the decedent,

(II) in which the surviving spouse has a qualifying income interest for life, and

(III) to which an election under this paragraph applies.

(ii) QUALIFYING INCOME INTEREST FOR LIFE.—The surviving spouse has a qualifying income interest for life if—

(I) the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, or has a usufruct interest for life in the property, and

(II) no person has a power to appoint any part of the property to any person other than the surviving spouse.

Subclause (II) shall not apply to a power exercisable only at or after the death of the surviving spouse. To the extent provided in regulations, an annuity shall be treated in a manner similar to an income interest in property (regardless of whether the property from which the annuity is payable can be separately identified).

(iii) PROPERTY INCLUDES INTEREST THEREIN.—The term "property" includes an interest in property.

(iv) SPECIFIC PORTION TREATED AS SEPARATE PROPERTY.—A specific portion of property shall be treated as separate property.

(v) ELECTION.—An election under this paragraph with respect to any property shall be made by the executor on the return of tax imposed by section 2001. Such an election, once made, shall be irrevocable.

(C) TREATMENT OF SURVIVOR ANNUITIES.—In the case of an annuity included in the gross estate of the decedent under section 2039 (or, in the case of an interest in an annuity arising under the community property laws of a State, included in the gross estate of the decedent under section 2033) where only the surviving spouse has the right to receive payments before the death of such surviving spouse—

(i) the interest of such surviving spouse shall be treated as a qualifying income interest for life, and

(ii) the executor shall be treated as having made an election under this subsection with respect to such annuity unless the executor otherwise elects on the return of tax imposed by section 2001.

An election under clause (ii), once made, shall be irrevocable.

(8) SPECIAL RULE FOR CHARITABLE REMAINDER TRUSTS.—

(A) IN GENERAL.—If the surviving spouse of the decedent is the only beneficiary of a qualified charitable remainder trust who is not a charitable beneficiary nor an ESOP beneficiary, paragraph (1) shall not apply to any interest in such trust which passes or has passed from the decedent to such surviving spouse.

(B) DEFINITIONS.—For purposes of subparagraph (A)—

(i) CHARITABLE BENEFICIARY.—The term "charitable beneficiary" means any beneficiary which is an organization described in section 170(c).

(ii) ESOP BENEFICIARY.—The term "ESOP beneficiary" means any beneficiary which is an employee stock ownership plan (as defined in section 4975(e)(7)) that holds a remainder interest in qualified employer securities (as defined in section 664(g)(4)) to be transferred to such plan in a qualified gratuitous transfer (as defined in section 664(g)(1)).

(iii) QUALIFIED CHARITABLE REMAINDER TRUST.—The term "qualified charitable remainder trust" means a charitable remainder annuity trust or a charitable remainder unitrust (described in section 664).

(9) DENIAL OF DOUBLE DEDUCTION.—Nothing in this section or any other provision of this chapter shall allow the value of any interest in property to be deducted under this chapter more than once with respect to the same decedent.

(10) SPECIFIC PORTION.—For purposes of paragraphs (5), (6), and (7)(B)(iv), the term "specific portion" only includes a portion determined on a fractional or percentage basis.

(c) DEFINITION.—For purposes of this section, an interest in property shall be considered as passing from the decedent to any person if and only if—

(1) such interest is bequeathed or devised to such person by the decedent;

(2) such interest is inherited by such person from the decedent;

(3) such interest is the dower or curtesy interest (or statutory interest in lieu thereof) of such person as surviving spouse of the decedent;

(4) such interest has been transferred to such person by the decedent at any time;

(5) such interest was, at the time of the decedent's death, held by such person and the decedent (or by them and any other person) in joint ownership with right of survivorship;

(6) the decedent had a power (either alone or in conjunction with any person) to appoint such interest and if he appoints or has appointed such interest to such person, or if such person takes such interest in default on the release or nonexercise of such power; or

(7) such interest consists of proceeds of insurance on the life of the decedent receivable by such person.

Except as provided in paragraph (5) or (6) of subsection (b), where at the time of the decedent's death it is not possible to ascertain the particular person or persons to whom an interest in property may pass from the decedent, such interest shall, for purposes of subparagraphs (A) and (B) of subsection (b)(1), be considered as passing from the decedent to a person other than the surviving spouse.

(d) DISALLOWANCE OF MARITAL DEDUCTION WHERE SURVIVING SPOUSE NOT UNITED STATES CITIZEN.—

(1) IN GENERAL.—Except as provided in paragraph (2), if the surviving spouse of the decedent is not a citizen of the United States—

(A) no deduction shall be allowed under subsection (a), and

(B) section 2040(b) shall not apply.

(2) MARITAL DEDUCTION ALLOWED FOR CERTAIN TRANSFERS IN TRUST.—

(A) IN GENERAL.—Paragraph (1) shall not apply to any property passing to the surviving spouse in a qualified domestic trust.

(B) SPECIAL RULE.—If any property passes from the decedent to the surviving spouse of the decedent, for purposes of subparagraph (A), such property shall be treated as passing to such spouse in a qualified domestic trust if—

(i) such property is transferred to such a trust before the date on which the return of the tax imposed by this chapter is made, or

(ii) such property is irrevocably assigned to such a trust under an irrevocable assignment made on or before such date which is enforceable under local law.

(3) ALLOWANCE OF CREDIT TO CERTAIN SPOUSES.—If—

(A) property passes to the surviving spouse of the decedent (hereinafter in this paragraph referred to as the "first decedent"),

(B) without regard to this subsection, a deduction would be allowable under subsection (a) with respect to such property, and

(C) such surviving spouse dies and the estate of such surviving spouse is subject to the tax imposed by this chapter,

the Federal estate tax paid (or treated as paid under section 2056A(b)(7)) by the first decedent with respect to such property shall be allowed as a credit under section 2013 to the estate of such surviving spouse and the amount of such credit shall be determined under such section without regard to when the first decedent died and without regard to subsection (d)(3) of such section.

(4) SPECIAL RULE WHERE RESIDENT SPOUSE BECOMES CITIZEN.—Paragraph (1) shall not apply if—

(A) the surviving spouse of the decedent becomes a citizen of the United States before the day on which the return of the tax imposed by this chapter is made, and

(B) such spouse was a resident of the United States at all times after the date of the death of the decedent and before becoming a citizen of the United States.

(5) REFORMATIONS PERMITTED.—

(A) IN GENERAL.—In the case of any property with respect to which a deduction would be allowable under subsection (a) but for this subsection, the determination of whether a trust is a qualified domestic trust shall be made—

(i) as of the date on which the return of the tax imposed by this chapter is made, or

(ii) if a judicial proceeding is commenced on or before the due date (determined with regard to extensions) for filing such return to change such trust into a trust which is a qualified domestic trust, as of the time when the changes pursuant to such proceeding are made.

(B) STATUTE OF LIMITATIONS.—If a judicial proceeding described in subparagraph (A)(ii) is commenced with respect to any trust, the period for assessing any deficiency of tax attributable to any failure of such trust to be a qualified domestic trust shall not expire before the date 1 year after the date on which the Secretary is notified that the trust has been changed pursuant to such judicial proceeding or that such proceeding has been terminated.

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CHAPTER 12—GIFT TAX

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Subchapter B—TRANSFERS

Sec. 2511. Transfers in general.

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[Sec. 2513. Gift by husband or wife to third party.]
Sec. 2513. Gift by spouse to third party.

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SEC. 2513. [GIFT BY HUSBAND OR WIFE TO THIRD PARTY] *GIFT BY SPOUSE TO THIRD PARTY.*

(a) CONSIDERED AS MADE ONE-HALF BY EACH.—

[(1) IN GENERAL.—A gift made by one spouse to any person other than his spouse shall, for the purposes of this chapter, be considered as made one-half by him and one-half by his spouse, but only if at the time of the gift each spouse is a citizen or resident of the United States. This paragraph shall not apply with respect to a gift by a spouse of an interest in property if he creates in his spouse a general power of appointment, as defined in section 2514(c), over such interest. For purposes of this section, an individual shall be considered as the spouse of another individual only if he is married to such individual at the time of the gift and does not remarry during the remainder of the calendar year.]

(1) IN GENERAL.—A gift made by one individual to any person other than such individual's spouse shall, for the purposes of this chapter, be considered as made one-half by the individual and one-half by such individual's spouse, but only if at the time of the gift each spouse is a citizen or resident of the United States. This paragraph shall not apply with respect to a gift by an individual of an interest in property if such individual creates in the individual's spouse a general power of appointment, as defined in section 2514(c), over such interest. For purposes of this section, an individual shall be considered as the spouse of another only if the individual is married to the individual's spouse at the time of the gift and does not remarry during the remainder of the calendar year.

(2) CONSENT OF BOTH SPOUSES.—Paragraph (1) shall apply only if both spouses have signified (under the regulations provided for in subsection (b)) their consent to the application of paragraph (1) in the case of all such gifts made during the calendar year by either while married to the other.

(b) MANNER AND TIME OF SIGNIFYING CONSENT.—

(1) MANNER.— A consent under this section shall be signified in such manner as is provided under regulations prescribed by the Secretary.

(2) TIME.—Such consent may be so signified at any time after the close of the calendar year in which the gift was made, subject to the following limitations—

(A) The consent may not be signified after the 15th day of April following the close of such year, unless before such 15th day no return has been filed for such year by either spouse, in which case the consent may not be signified after a return for such year is filed by either spouse.

(B) The consent may not be signified after a notice of deficiency with respect to the tax for such year has been sent to either spouse in accordance with section 6212(a).

(c) REVOCATION OF CONSENT.—Revocation of a consent previously signified shall be made in such manner as in provided under regulations prescribed by the Secretary, but the right to revoke a consent previously signified with respect to a calendar year—

(1) shall not exist after the 15th day of April following the close of such year if the consent was signified on or before such 15th day; and

(2) shall not exist if the consent was not signified until after such 15th day.

(d) JOINT AND SEVERAL LIABILITY FOR TAX.—If the consent required by subsection (a)(2) is signified with respect to a gift made in any calendar year, the liability with respect to the entire tax imposed by this chapter of each spouse for such year shall be joint and several.

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SEC. 2516. CERTAIN PROPERTY SETTLEMENTS.

[Where a husband and wife enter**]** *(a) IN GENERAL.— Where a married couple enters* into a written agreement relative to their marital and property rights and divorce occurs within the 3-year period beginning on the date 1 year before such agreement is entered into (whether or not such agreement is approved by the divorce decree), any transfers of property or interests in property made pursuant to such agreement—

(1) to either spouse in settlement of his or her marital or property rights, or

(2) to provide a reasonable allowance for the support of issue of the marriage during minority,

shall be deemed to be transfers made for a full and adequate consideration in money or money's worth.

(b) SPOUSE.—For purposes of this section, if the spouses referred to are divorced, wherever appropriate to the meaning of this section, the term "spouse" shall read "former spouse".

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Subchapter C—DEDUCTIONS

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SEC. 2523. GIFT TO SPOUSE.

(a) ALLOWANCE OF DEDUCTION.—Where a donor transfers during the calendar year by gift an interest in property to a donee who at the time of the gift is the donor's spouse, there shall be allowed as a deduction in computing taxable gifts for the calendar year an amount with respect to such interest equal to its value.

(b) LIFE ESTATE OR OTHER TERMINABLE INTEREST.—Where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, such interest transferred to the spouse will terminate or fail, no deduction shall be allowed with respect to such interest—

(1) if the donor retains in **[**himself**]** *the donor's self* , or transfers or has transferred (for less than an adequate and full

consideration in money or money's worth) to any person other than such donee spouse (or the estate of such spouse), an interest in such property, and if by reason of such retention or transfer the donor [(or his heirs or assigns) or such person (or his heirs or assigns)] *(or the donor's heirs or assigns) or such person (or such person's heirs or assigns)* may possess or enjoy any part of such property after such termination or failure of the interest transferred to the donee spouse; or

(2) if the donor immediately after the transfer to the donee spouse has a power to appoint an interest in such property which [he] *the donor* can exercise (either alone or in conjunction with any person) in such manner that the appointee may possess or enjoy any part of such property after such termination or failure of the interest transferred to the donee spouse. For purposes of this paragraph, the donor shall be considered as having immediately after the transfer to the donee spouse such power to appoint even though such power cannot be exercised until after the lapse of time, upon the occurrence of an event or contingency, or on the failure of an event or contingency to occur.

An exercise or release at any time by the donor, either alone or in conjunction with any person, of a power to appoint an interest in property, even though not otherwise a transfer, shall, for purposes of paragraph (1), be considered as a transfer by [him] *the donor* . Except as provided in subsection (e), where at the time of the transfer it is impossible to ascertain the particular person or persons who may receive from the donor an interest in property so transferred by [him] *the donor* , such interest shall, for purposes of paragraph (1), be considered as transferred to a person other than the donee spouse.

(c) INTEREST IN UNIDENTIFIED ASSETS.—Where the assets out of which, or the proceeds of which, the interest transferred to the donee spouse may be satisfied include a particular asset or assets with respect to which no deduction would be allowed if such asset or assets were transferred from the donor to such spouse, then the value of the interest transferred to such spouse shall, for purposes of subsection (a), be reduced by the aggregate value of such particular assets.

(d) JOINT INTERESTS.—If the interest is transferred to the donee spouse as sole joint tenant with the donor or as tenant by the entirety, the interest of the donor in the property which exists solely by reason of the possibility that the donor may survive the donee spouse, or that there may occur a severance of the tenancy, shall not be considered for purposes of subsection (b) as an interest retained by the donor in [himself] *the donor's self* .

(e) LIFE ESTATE WITH POWER OF APPOINTMENT IN DONEE SPOUSE.—Where the donor transfers an interest in property, if by such transfer [his spouse] *the donor's spouse* is entitled for life to all of the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the donee spouse to appoint the entire interest, or such specific portion (exercisable in favor of such donee spouse, or of the estate of such donee spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part

of such interest, or such portion, to any person other than the donee spouse—

(1) the interest, or such portion, so transferred shall, for purposes of subsection (a) be considered as transferred to the donee spouse, and

(2) no part of the interest, or such portion, so transferred shall, for purposes of subsection (b)(1), be considered as retained in the donor or transferred to any person other than the donee spouse.

This subsection shall apply only if, by such transfer, such power in the donee spouse to appoint the interest, or such portion, whether exercisable by will or during life, is exercisable by such spouse alone and in all events. For purposes of this subsection, the term "specific portion" only includes a portion determined on a fractional or percentage basis.

(f) ELECTION WITH RESPECT TO LIFE ESTATE FOR DONEE SPOUSE.—

(1) IN GENERAL.—In the case of qualified terminable interest property—

(A) for purposes of subsection (a), such property shall be treated as transferred to the donee spouse, and

(B) for purposes of subsection (b)(1), no part of such property shall be considered as retained in the donor or transferred to any person other than the donee spouse.

(2) QUALIFIED TERMINABLE INTEREST PROPERTY.—For purposes of this subsection, the term "qualified terminable interest property" means any property—

(A) which is transferred by the donor spouse,

(B) in which the donee spouse has a qualifying income interest for life, and

(C) to which an election under this subsection applies.

(3) CERTAIN RULES MADE APPLICABLE.—For purposes of this subsection, rules similar to the rules of clauses (ii), (iii), and (iv) of section 2056(b)(7)(B) shall apply and the rules of section 2056(b)(10) shall apply.

(4) ELECTION.—

(A) TIME AND MANNER.—An election under this subsection with respect to any property shall be made on or before the date prescribed by section 6075(b) for filing a gift tax return with respect to the transfer (determined without regard to section 6019(2)) and shall be made in such manner as the Secretary shall by regulations prescribe.

(B) ELECTION IRREVOCABLE.—An election under this subsection, once made, shall be irrevocable.

(5) TREATMENT OF INTEREST RETAINED BY DONOR SPOUSE.—

(A) IN GENERAL.—In the case of any qualified terminable interest property—

(i) such property shall not be includible in the gross estate of the donor spouse, and

(ii) any subsequent transfer by the donor spouse of an interest in such property shall not be treated as a transfer for purposes of this chapter.

(B) SUBPARAGRAPH (A) NOT TO APPLY AFTER TRANSFER BY DONEE SPOUSE.—Subparagraph (A) shall not apply with respect to any property after the donee spouse is treated as having transferred such property under section 2519, or such property is includible in the donee spouse's gross estate under section 2044.

(6) TREATMENT OF JOINT AND SURVIVOR ANNUITIES.—In the case of a joint and survivor annuity where only the donor spouse and donee spouse have the right to receive payments before the death of the last spouse to die—

(A) the donee spouse's interest shall be treated as a qualifying income interest for life,

(B) the donor spouse shall be treated as having made an election under this subsection with respect to such annuity unless the donor spouse otherwise elects on or before the date specified in paragraph (4)(A),

(C) paragraph (5) and section 2519 shall not apply to the donor spouse's interest in the annuity, and

(D) if the donee spouse dies before the donor spouse, no amount shall be includible in the gross estate of the donee spouse under section 2044 with respect to such annuity.

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

(g) SPECIAL RULE FOR CHARITABLE REMAINDER TRUSTS.—

(1) IN GENERAL.—If, after the transfer, the donee spouse is the only beneficiary who is not a charitable beneficiary (other than the donor) of a qualified charitable remainder trust, subsection (b) shall not apply to the interest in such trust which is transferred to the donee spouse.

(2) DEFINITIONS.—For purposes of paragraph (1), the term "charitable beneficiary" and "qualified charitable remainder trust" have the meanings given to such terms by section 2056(b)(8)(B).

(h) DENIAL OF DOUBLE DEDUCTION.—Nothing in this section or any other provision of this chapter shall allow the value of any interest in property to be deducted under this chapter more than once with respect to the same donor.

(i) DISALLOWANCE OF MARITAL DEDUCTION WHERE SPOUSE NOT CITIZEN.—If the spouse of the donor is not a citizen of the United States—

(1) no deduction shall be allowed under this section,

(2) section 2503(b) shall be applied with respect to gifts which are made by the donor to such spouse and with respect to which a deduction would be allowable under this section but for paragraph (1) by substituting "$100,000" for "$10,000", and

(3) the principles of sections 2515 and 2515A (as such sections were in effect before their repeal by the Economic Recovery Tax Act of 1981) shall apply, except that the provisions of such section 2515 providing for an election shall not apply.

This subsection shall not apply to any transfer resulting from the acquisition of rights under a joint and survivor annuity described in subsection (f)(6).

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Subtitle C—Employment Taxes

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CHAPTER 21—FEDERAL INSURANCE CONTRIBUTIONS ACT

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Subchapter C—GENERAL PROVISIONS

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SEC. 3121. DEFINITIONS.

(a) WAGES.—For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include—

(1) in the case of the taxes imposed by sections 3101(a) and 3111(a) that part of the remuneration which, after remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) equal to the contribution and benefit base (as determined under section 230 of the Social Security Act) with respect to employment has been paid to an individual by an employer during the calendar year with respect to which such contribution and benefit base is effective, is paid to such individual by such employer during such calendar year. If an employer (hereinafter referred to as successor employer) during any calendar year acquires substantially all the property used in a trade or business of another employer (hereinafter referred to as a predecessor), or used in a separate unit of a trade or business of a predecessor, and immediately after the acquisition employs in his trade or business an individual who immediately prior to the acquisition was employed in the trade or business of such predecessor, then, for the purpose of determining whether the successor employer has paid remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) with respect to employment equal to the contribution and benefit base (as determined under section 230 of the Social Security Act) to such individual during such calendar year, any remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) with respect to employment paid (or considered under this paragraph as having been paid) to such individual by such predecessor during such calendar year and prior to such acquisition shall be considered as having been paid by such successor employer;

(2) the amount of any payment (including any amount paid by an employer for insurance or annuities, or into a fund, to provide for any such payment) made to, or on behalf of, an employee or any of his dependents under a plan or system established by an employer which makes provision for his employees generally (or for his employees generally and their dependents) or for a class or classes of his employees (or for a class or classes of his employees and their dependents), on account of—

(A) sickness or accident disability (but, in the case of payments made to an employee or any of his dependents, this subparagraph shall exclude from the term "wages" only payments which are received under a workman's compensation law), or

(B) medical or hospitalization expenses in connection with sickness or accident disability, or

(C) death, except that this paragraph does not apply to a payment for group-term life insurance to the extent that such payment is includible in the gross income of the employee;

(4) any payment on account of sickness or accident disability, or medical or hospitalization expenses in connection with sickness or accident disability, made by an employer to, or on behalf of, an employee after the expiration of 6 calendar months following the last calendar month in which the employee worked for such employer;

(5) any payment made to, or on behalf of, an employee or his beneficiary—

(A) from or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust,

(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a),

(C) under a simplified employee pension (as defined in section 408(k)(1)), other than any contributions described in section 408(k)(6),

(D) under or to an annuity contract described in section 403(b), other than a payment for the purchase of such contract which is made by reason of a salary reduction agreement (whether evidenced by a written instrument or otherwise),

(E) under or to an exempt governmental deferred compensation plan (as defined in subsection (v)(3)),

(F) to supplement pension benefits under a plan or trust described in any of the foregoing provisions of this paragraph to take into account some portion or all of the increase in the cost of living (as determined by the Secretary of Labor) since retirement but only if such supplemental payments are under a plan which is treated as a welfare plan under section 3(2)(B)(ii) of the Employee Retirement Income Security Act of 1974,

(G) under a cafeteria plan (within the meaning of section 125) if such payment would not be treated as wages without regard to such plan and it is reasonable to believe that (if section 125 applied for purposes of this section) section 125 would not treat any wages as constructively received,

(H) under an arrangement to which section 408(p) applies, other than any elective contributions under paragraph (2)(A)(i) thereof, or

(I) under a plan described in section 457(e)(11)(A)(ii) and maintained by an eligible employer (as defined in section 457(e)(1));

(6) the payment by an employer (without deduction from the remuneration of the employee)—

(A) of the tax imposed upon an employee under section 3101, or

(B) of any payment required from an employee under a State unemployment compensation law,

with respect to remuneration paid to an employee for domestic service in a private home of the employer or for agricultural labor;

(7)(A) remuneration paid in any medium other than cash to an employee for service not in the course of the employer's trade or business or for domestic service in a private home of the employer;

(B) cash remuneration paid by an employer in any calendar year to an employee for domestic service in a private home of the employer (including domestic service on a farm operated for profit), if the cash remuneration paid in such year by the employer to the employee for such service is less than the applicable dollar threshold (as defined in subsection (x)) for such year;

(C) cash remuneration paid by an employer in any calendar year to an employee for service not in the course of the employer's trade or business, if the cash remuneration paid in such year by the employer to the employee for such service is less than $100. As used in this subparagraph, the term "service not in the course of the employer's trade or business" does not include domestic service in a private home of the employer and does not include service described in subsection (g)(5);

(8)(A) remuneration paid in any medium other than cash for agricultural labor;

(B) cash remuneration paid by an employer in any calendar year to an employee for agricultural labor unless—

(i) the cash remuneration paid in such year by the employer to the employee for such labor is $150 or more, or

(ii) the employer's expenditures for agricultural labor in such year equal or exceed $2,500,

except that clause (ii) shall not apply in determining whether remuneration paid to an employee constitutes "wages" under this section if such employee (I) is employed as a hand harvest laborer and is paid on a piece rate basis in an operation which has been, and is customarily and generally recognized as having been, paid on a piece rate basis in the region of employment, (II) commutes daily from his permanent residence to the farm on which he is so employed, and (III) has been employed in agriculture less than 13 weeks during the preceding calendar year;

(10) remuneration paid by an employer in any calendar year to an employee for service described in subsection (d)(3)(C) (relating to home workers), if the cash remuneration paid in such year by the employer to the employee for such service is less than $100;

(11) remuneration paid to or on behalf of an employee if (and to the extent that) at the time of the payment of such remuneration it is reasonable to believe that a corresponding deduction is allowable under section 217 (determined without regard to section 274(n));

(12)(A) tips paid in any medium other than cash;

(B) cash tips received by an employee in any calendar month in the course of his employment by an employer unless the amount of such cash tips is $20 or more;

(13) any payment or series of payments by an employer to an employee or any of his dependents which is paid—

(A) upon or after the termination of an employee's employment relationship because of (i) death, or (ii) retirement for disability, and

(B) under a plan established by the employer which makes provision for his employees generally or a class or classes of his employees (or for such employees or class or classes of employees and their dependents),

other than any such payment or series of payments which would have been paid if the employee's employment relationship had not been so terminated;

(14) any payment made by an employer to a survivor or the estate of a former employee after the calendar year in which such employee died;

(15) any payment made by an employer to an employee, if at the time such payment is made such employee is entitled to disability insurance benefits under section 223(a) of the Social Security Act and such entitlement commenced prior to the calendar year in which such payment is made, and if such employee did not perform any services for such employer during the period for which such payment is made;

(16) remuneration paid by an organization exempt from income tax under section 501(a) (other than an organization described in section 401(a)) or under section 521 in any calendar year to an employee for service rendered in the employ of such organization, if the remuneration paid in such year by the organization to the employee for such service is less than $100;

(18) any payment made, or benefit furnished, to or for the benefit of an employee if at the time of such payment or such furnishing it is reasonable to believe that the employee will be able to exclude such payment or benefit from income under section 127, 129, 134(b)(4), or 134(b)(5);

(19) the value of any meals or lodging furnished by or on behalf of the employer if at the time of such furnishing it is reasonable to believe that the employee will be able to exclude such items from income under section 119;

(20) any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 74(c), 108(f)(4), 117, or 132;

(21) in the case of a member of an Indian tribe, any remuneration on which no tax is imposed by this chapter by reason of section 7873 (relating to income derived by Indians from exercise of fishing rights);

(22) remuneration on account of—

(A) a transfer of a share of stock to any individual pursuant to an exercise of an incentive stock option (as defined in section 422(b)) or under an employee stock purchase plan (as defined in section 423(b)), or

(B) any disposition by the individual of such stock; or

(23) any benefit or payment which is excludable from the gross income of the employee under section 139B(b).

Nothing in the regulations prescribed for purposes of chapter 24 (relating to income tax withholding) which provides an exclusion from "wages" as used in such chapter shall be construed to require a similar exclusion from "wages" in the regulations prescribed for purposes of this chapter. Except as otherwise provided in regulations prescribed by the Secretary, any third party which makes a payment included in wages solely by reason of the parenthetical matter contained in subparagraph (A) of paragraph (2) shall be treated for purposes of this chapter and chapter 22 as the employer with respect to such wages.

(b) EMPLOYMENT.—For purposes of this chapter, the term "employment" means any service, of whatever nature, performed (A) by an employee for the person employing him, irrespective of the citizenship or residence of either, (i) within the United States, or (ii) on or in connection with an American vessel or American aircraft under a contract of service which is entered into within the United States or during the performance of which and while the employee is employed on the vessel or aircraft it touches at a port in the United States, if the employee is employed on and in connection with such vessel or aircraft when outside the United States, or (B) outside the United States by a citizen or resident of the United States as an employee for an American employer (as defined in subsection (h)), or (C) if it is service, regardless of where or by whom performed, which is designated as employment or recognized as equivalent to employment under an agreement entered into under section 233 of the Social Security Act; except that such term shall not include—

(1) service performed by foreign agricultural workers lawfully admitted to the United States from the Bahamas, Jamaica, and the other British West Indies, or from any other foreign country or possession thereof, on a temporary basis to perform agricultural labor;

(2) domestic service performed in a local college club, or local chapter of a college fraternity or sorority, by a student who is enrolled and is regularly attending classes at a school, college, or university;

(3)(A) service performed by a child under the age of 18 in the employ of [his father] *the child's father* or mother;

(B) service not in the course of the employer's trade or business, or domestic service in a private home of the employer, performed by an individual under the age of 21 in the employ of [his father] *the individual's father* or mother, or performed by an individual in the employ of [his spouse] *the individual's spouse* or son or daughter; except that the provisions of this subparagraph shall not be applicable to such domestic service performed by an individual in the employ of [his son] *the individual's son* or daughter if—

(i) the employer is a surviving spouse or a divorced individual and has not remarried, or has a spouse living in the home who has a mental or physical condition which results in such spouse's being incapable of caring for a son, daughter, stepson, or stepdaughter (referred to in clause (ii)) for

at least 4 continuous weeks in the calendar quarter in which the service is rendered, and

(ii) a son, daughter, stepson, or stepdaughter of such employer is living in the home, and

(iii) the son, daughter, stepson, or stepdaughter (referred to in clause (ii)) has not attained age 18 or has a mental or physical condition which requires the personal care and supervision of an adult for at least 4 continuous weeks in the calendar quarter in which the service is rendered;

(4) service performed by an individual on or in connection with a vessel not an American vessel, or on or in connection with an aircraft not an American aircraft, if (A) the individual is employed on and in connection with such vessel or aircraft, when outside the United States and (B)(i) such individual is not a citizen of the United States or (ii) the employer is not an American employer;

(5) service performed in the employ of the United States or any instrumentality of the United States, if such service—

(A) would be excluded from the term "employment" for purposes of this title if the provisions of paragraphs (5) and (6) of this subsection as in effect in January 1983 had remained in effect, and

(B) is performed by an individual who—

(i) has been continuously performing service described in subparagraph (A) since December 31, 1983, and for purposes of this clause—

(I) if an individual performing service described in subparagraph (A) returns to the performance of such service after being separated therefrom for a period of less than 366 consecutive days, regardless of whether the period began before, on, or after December 31, 1983, then such service shall be considered continuous,

(II) if an individual performing service described in subparagraph (A) returns to the performance of such service after being detailed or transferred to an international organization as described under section 3343 of subchapter III of chapter 33 of title 5, United States Code, or under section 3581 of chapter 35 of such title, then the service performed for that organization shall be considered service described in subparagraph (A),

(III) if an individual performing service described in subparagraph (A) is reemployed or reinstated after being separated from such service for the purpose of accepting employment with the American Institute in Taiwan as provided under section 3310 of chapter 48 of title 22, United States Code, then the service performed for that Institute shall be considered service described in subparagraph (A),

(IV) if an individual performing service described in subparagraph (A) returns to the performance of such service after performing service as a member of a uniformed service (including, for

purposes of this clause, service in the National Guard and temporary service in the Coast Guard Reserve) and after exercising restoration or reemployment rights as provided under chapter 43 of title 38, United States Code, then the service so performed as a member of a uniformed service shall be considered service described in subparagraph (A), and

(V) if an individual performing service described in subparagraph (A) returns to the performance of such service after employment (by a tribal organization) to which section 104(e)(2) of the Indian Self-Determination Act applies, then the service performed for that tribal organization shall be considered service described in subparagraph (A); or

(ii) is receiving an annuity from the Civil Service Retirement and Disability Fund, or benefits (for service as an employee) under another retirement system established by a law of the United States for employees of the Federal Government (other than for members of the uniformed service);

except that this paragraph shall not apply with respect to any such service performed on or after any date on which such individual performs—

(C) service performed as the President or Vice President of the United States,

(D) service performed—

(i) in a position placed in the Executive Schedule under sections 5312 through 5317 of title 5, United States Code,

(ii) as a noncareer appointee in the Senior Executive Service or a noncareer member of the Senior Foreign Service, or

(iii) in a position to which the individual is appointed by the President (or his designee) or the Vice President under section 105(a)(1), 106(a)(1), or 107 (a)(1) or (b)(1) of title 3, United States Code, if the maximum rate of basic pay for such position is at or above the rate for level V of the Executive Schedule,

(E) service performed as the Chief Justice of the United States, an Associate Justice of the Supreme Court, a judge of a United States court of appeals, a judge of a United States district court (including the district court of a territory), a judge of the United States Court of Federal Claims, a judge of the United States Court of International Trade, a judge of the United States Tax Court, a United States magistrate judge, or a referee in bankruptcy or United States bankruptcy judge,

(F) service performed as a Member, Delegate, or Resident Commissioner of or to the Congress,

(G) any other service in the legislative branch of the Federal Government if such service—

(i) is performed by an individual who was not subject to subchapter III of chapter 83 of title 5, United

States Code, or to another retirement system established by a law of the United States for employees of the Federal Government (other than for members of the uniformed services), on December 31, 1983, or

(ii) is performed by an individual who has, at any time after December 31, 1983, received a lump-sum payment under section 8342(a) of title 5, United States Code, or under the corresponding provision of the law establishing the other retirement system described in clause (i), or

(iii) is performed by an individual after such individual has otherwise ceased to be subject to subchapter III of chapter 83 of title 5, United States Code (without having an application pending for coverage under such subchapter), while performing service in the legislative branch (determined without regard to the provisions of subparagraph (B) relating to continuity of employment), for any period of time after December 31, 1983,

and for purposes of this subparagraph (G) an individual is subject to such subchapter III or to any such other retirement system at any time only if (a) such individual's pay is subject to deductions, contributions, or similar payments (concurrent with the service being performed at that time) under section 8334(a) of such title 5 or the corresponding provision of the law establishing such other system, or (in a case to which section 8332(k)(1) of such title applies) such individual is making payments of amounts equivalent to such deductions, contributions, or similar payments while on leave without pay, or (b) such individual is receiving an annuity from the Civil Service Retirement and Disability Fund, or is receiving benefits (for service as an employee) under another retirement system established by a law of the United States for employees of the Federal Government (other than for members of the uniformed services), or

(H) service performed by an individual—

(i) on or after the effective date of an election by such individual, under section 301 of the Federal Employees' Retirement System Act of 1986, section 307 of the Central Intelligence Agency Retirement Act (50 U.S.C. 2157), or the Federal Employees' Retirement System Open Enrollment Act of 1997, to become subject to the Federal Employees' Retirement System provided in chapter 84 of title 5, United States Code, or

(ii) on or after the effective date of an election by such individual, under regulations issued under section 860 of the Foreign Service Act of 1980, to become subject to the Foreign Service Pension System provided in subchapter II of chapter 8 of title I of such Act;

(6) service performed in the employ of the United States or any instrumentality of the United States if such service is performed—

(A) in a penal institution of the United States by an inmate thereof;

(B) by any individual as an employee included under section 5351(2) of title 5, United States Code (relating to certain interns, student nurses, and other student employees of hospitals of the Federal Government), other than as a medical or dental intern or a medical or dental resident in training; or

(C) by any individual as an employee serving on a temporary basis in case of fire, storm, earthquake, flood, or other similar emergency;

(7) service performed in the employ of a State, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing which is wholly owned thereby, except that this paragraph shall not apply in the case of—

(A) service which, under subsection (j), constitutes covered transportation service,

(B) service in the employ of the Government of Guam or the Government of American Samoa or any political subdivision thereof, or of any instrumentality of any one or more of the foregoing which is wholly owned thereby, performed by an officer or employee thereof (including a member of the legislature of any such Government or political subdivision), and, for purposes of this title with respect to the taxes imposed by this chapter—

(i) any person whose service as such an officer or employee is not covered by a retirement system established by a law of the United States shall not, with respect to such service, be regarded as an employee of the United States or any agency or instrumentality thereof, and

(ii) the remuneration for service described in clause (i) (including fees paid to a public official) shall be deemed to have been paid by the Government of Guam or the Government of American Samoa or by a political subdivision thereof or an instrumentality of any one or more of the foregoing which is wholly owned thereby, whichever is appropriate,

(C) service performed in the employ of the District of Columbia or any instrumentality which is wholly owned thereby, if such service is not covered by a retirement system established by a law of the United States (other than the Federal Employees Retirement System provided in chapter 84 of title 5, United States Code); except that the provisions of this subparagraph shall not be applicable to service performed—

(i) in a hospital or penal institution by a patient or inmate thereof;

(ii) by any individual as an employee included under section 5351(2) of title 5, United States Code (relating to certain interns, student nurses, and other student employees of hospitals of the District of Columbia Government), other than as a medical or dental intern or as a medical or dental resident in training;

(iii) by any individual as an employee serving on a temporary basis in case of fire, storm, snow, earthquake, flood or other similar emergency; or

(iv) by a member of a board, committee, or council of the District of Columbia, paid on a per diem, meeting, or other fee basis,

(D) service performed in the employ of the Government of Guam (or any instrumentality which is wholly owned by such Government) by an employee properly classified as a temporary or intermittent employee, if such service is not covered by a retirement system established by a law of Guam; except that (i) the provisions of this subparagraph shall not be applicable to services performed by an elected official or a member of the legislature or in a hospital or penal institution by a patient or inmate thereof, and (ii) for purposes of this subparagraph, clauses (i) and (ii) of subparagraph (B) shall apply,

(E) service included under an agreement entered into pursuant to section 218 of the Social Security Act, or

(F) service in the employ of a State (other than the District of Columbia, Guam, or American Samoa), of any political subdivision thereof, or of any instrumentality of any one or more of the foregoing which is wholly owned thereby, by an individual who is not a member of a retirement system of such State, political subdivision, or instrumentality, except that the provisions of this subparagraph shall not be applicable to service performed—

(i) by an individual who is employed to relieve such individual from unemployment;

(ii) in a hospital, home, or other institution by a patient or inmate thereof;

(iii) by any individual as an employee serving on a temporary basis in case of fire, storm, snow, earthquake, flood, or other similar emergency;

(iv) by an election official or election worker if the remuneration paid in a calendar year for such service is less than $1,000 with respect to service performed during any calendar year commencing on or after January 1, 1995, ending on or before December 31, 1999, and the adjusted amount determined under section 218(c)(8)(B) of the Social Security Act for any calendar year commencing on or after January 1, 2000, with respect to service performed during such calendar year; or

(v) by an employee in a position compensated solely on a fee basis which is treated pursuant to section 1402(c)(2)(E) as a trade or business for purposes of inclusion of such fees in net earnings from self-employment;

for purposes of this subparagraph, except as provided in regulations prescribed by the Secretary, the term "retirement system" has the meaning given such term by section 218(b)(4) of the Social Security Act;

(8)(A) service performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry

or by a member of a religious order in the exercise of duties required by such order, except that this subparagraph shall not apply to service performed by a member of such an order in the exercise of such duties, if an election of coverage under subsection (r) is in effect with respect to such order, or with respect to the autonomous subdivision thereof to which such member belongs;

(B) service performed in the employ of a church or qualified church-controlled organization if such church or organization has in effect an election under subsection (w), other than service in an unrelated trade or business (within the meaning of section 513(a));

(9) service performed by an individual as an employee or employee representative as defined in section 3231;

(10) service performed in the employ of—

(A) a school, college, or university, or

(B) an organization described in section 509(a)(3) if the organization is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of a school, college, or university and is operated, supervised, or controlled by or in connection with such school, college, or university, unless it is a school, college, or university of a State or a political subdivision thereof and the services performed in its employ by a student referred to in section 218(c)(5) of the Social Security Act are covered under the agreement between the Commissioner of Social Security and such State entered into pursuant to section 218 of such Act;

if such service is performed by a student who is enrolled and regularly attending classes at such school, college, or university;

(11) service performed in the employ of a foreign government (including service as a consular or other officer or employee or a nondiplomatic representative);

(12) service performed in the employ of an instrumentality wholly owned by a foreign government—

(A) if the service is of a character similar to that performed in foreign countries by employees of the United States Government or of an instrumentality thereof; and

(B) if the Secretary of State shall certify to the Secretary of the Treasury that the foreign government, with respect to whose instrumentality and employees thereof exemption is claimed, grants an equivalent exemption with respect to similar service performed in the foreign country by employees of the United States Government and of instrumentalities thereof;

(13) service performed as a student nurse in the employ of a hospital or a nurses' training school by an individual who is enrolled and is regularly attending classes in a nurses' training school chartered or approved pursuant to State law;

(14)(A) service performed by an individual under the age of 18 in the delivery or distribution of newspapers or shopping news, not including delivery or distribution to any point for subsequent delivery or distribution;

(B) service performed by an individual in, and at the time of, the sale of newspapers or magazines to ultimate consumers, under an arrangement under which the newspapers or magazines are to be sold by him at a fixed price, his compensation being based on the retention of the excess of such price over the amount at which the newspapers or magazines are charged to him, whether or not he is guaranteed a minimum amount of compensation for such service, or is entitled to be credited with the unsold newspapers or magazines turned back;

(15) service performed in the employ of an international organization, except service which constitutes "employment" under subsection (y);

(16) service performed by an individual under an arrangement with the owner or tenant of land pursuant to which—

(A) such individual undertakes to produce agricultural or horticultural commodities (including livestock, bees, poultry, and fur-bearing animals and wildlife) on such land,

(B) the agricultural or horticultural commodities produced by such individual, or the proceeds therefrom, are to be divided between such individual and such owner or tenant, and

(C) the amount of such individual's share depends on the amount of the agricultural or horticultural commodities produced;

(18) service performed in Guam by a resident of the Republic of the Philippines while in Guam on a temporary basis as a nonimmigrant alien admitted to Guam pursuant to section 101(a)(15)(H)(ii) of the Immigration and Nationality Act (8 U.S.C. 1101(a)(15)(H)(ii));

(19) Service which is performed by a nonresident alien individual for the period he is temporarily present in the United States as a nonimmigrant under subparagraph (F), (J), (M), or (Q) of section 101(a)(15) of the Immigration and Nationality Act, as amended, and which is performed to carry out the purpose specified in subparagraph (F), (J), (M), or (Q), as the case may be;

(20) service (other than service described in paragraph (3)(A)) performed by an individual on a boat engaged in catching fish or other forms of aquatic animal life under an arrangement with the owner or operator of such boat pursuant to which—

(A) such individual does not receive any cash remuneration other than as provided in subparagraph (B) and other than cash remuneration—

(i) which does not exceed $100 per trip;

(ii) which is contingent on a minimum catch; and

(iii) which is paid solely for additional duties (such as mate, engineer, or cook) for which additional cash remuneration is traditional in the industry,

(B) such individual receives a share of the boat's (or the boats' in the case of a fishing operation involving more than one boat) catch of fish or other forms of aquatic animal life or a share of the proceeds from the sale of such catch, and

(C) the amount of such individual's share depends on the amount of the boat's (or the boats' in the case of a fishing operation involving more than one boat) catch of fish or other forms of aquatic animal life,

but only if the operating crew of such boat (or each boat from which the individual receives a share in the case of a fishing operation involving more than one boat) is normally made up of fewer than 10 individuals;

(21) domestic service in a private home of the employer which—

(A) is performed in any year by an individual under the age of 18 during any portion of such year; and

(B) is not the principal occupation of such employee; or

(22) service performed by members of Indian tribal councils as tribal council members in the employ of an Indian tribal government, except that this paragraph shall not apply in the case of service included under an agreement under section 218A of the Social Security Act.

For purposes of paragraph (20), the operating crew of a boat shall be treated as normally made up of fewer than 10 individuals if the average size of the operating crew on trips made during the preceding 4 calendar quarters consisted of fewer than 10 individuals.

(c) INCLUDED AND EXCLUDED SERVICE.—For purposes of this chapter, if the services performed during one-half or more of any pay period by an employee for the person employing him constitute employment, all the services of such employee for such period shall be deemed to be employment; but if the services performed during more than one-half of any such pay period by an employee for the person employing him do not constitute employment, then none of the services of such employee for such period shall be deemed to be employment. As used in this subsection, the term "pay period" means a period (of not more than 31 consecutive days) for which a payment of remuneration is ordinarily made to the employee by the person employing him. This subsection shall not be applicable with respect to services performed in a pay period by an employee for the person employing him, where any of such service is excepted by subsection (b)(9).

(d) EMPLOYEE.—For purposes of this chapter, the term "employee" means—

(1) any officer of a corporation; or

(2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee; or

(3) any individual (other than an individual who is an employee under paragraph (1) or (2)) who performs services for remuneration for any person—

(A) as an agent-driver or commission-driver engaged in distributing meat products, vegetable products, fruit products, bakery products, beverages (other than milk), or laundry or dry-cleaning services, for his principal;

(B) as a full-time life insurance salesman;

(C) as a home worker performing work, according to specifications furnished by the person for whom the services are performed, on materials or goods furnished by

such person which are required to be returned to such person or a person designated by him; or

(D) as a traveling or city salesman, other than as an agent-driver or commission-driver, engaged upon a full-time basis in the solicitation on behalf of, and the transmission to, his principal (except for side-line sales activities on behalf of some other person) of orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments for merchandise for resale or supplies for use in their business operations;

if the contract of service contemplates that substantially all of such services are to be performed personally by such individual; except that an individual shall not be included in the term "employee" under the provisions of this paragraph if such individual has a substantial investment in facilities used in connection with the performance of such services (other than in facilities for transportation), or if the services are in the nature of a single transaction not part of a continuing relationship with the person for whom the services are performed; or

(4) any individual who performs services that are included under an agreement entered into pursuant to section 218 or 218A of the Social Security Act.

(e) STATE, UNITED STATES, AND CITIZEN.—For purposes of this chapter—

(1) STATE.—The term "State" includes the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, and American Samoa.

(2) UNITED STATES.—The term "United States" when used in a geographical sense includes the Commonwealth of Puerto Rico, the Virgin Islands, Guam, and American Samoa.

An individual who is a citizen of the Commonwealth of Puerto Rico (but not otherwise a citizen of the United States) shall be considered, for purposes of this section, as a citizen of the United States.

(f) AMERICAN VESSEL AND AIRCRAFT.—For purposes of this chapter, the term "American vessel" means any vessel documented or numbered under the laws of the United States; and includes any vessel which is neither documented or numbered under the laws of the United States nor documented under the laws of any foreign country, if its crew is employed solely by one or more citizens or residents of the United States or corporations organized under the laws of the United States or of any State; and the term "American aircraft" means an aircraft registered under the laws of the United States.

(g) AGRICULTURAL LABOR.—For purposes of this chapter, the term "agricultural labor" includes all service performed—

(1) on a farm, in the employ of any person, in connection with cultivating the soil, or in connection with raising or harvesting any agricultural or horticultural commodity, including the raising, shearing, feeding, caring for, training, and management of livestock, bees, poultry, and fur-bearing animals and wildlife;

(2) in the employ of the owner or tenant or other operator of a farm, in connection with the operation, management, conservation, improvement, or maintenance of such farm and its tools and equipment, or in salvaging timber or clearing land of

brush and other debris left by a hurricane, if the major part of such service is performed on a farm;

(3) in connection with the production or harvesting of any commodity defined as an agricultural commodity in section 15(g) of the Agricultural Marketing Act, as amended (12 U.S.C. 1141j), or in connection with the ginning of cotton, or in connection with the operation or maintenance of ditches, canals, reservoirs, or waterways, not owned or operated for profit, used exclusively for supplying and storing water for farming purposes;

(4)(A) in the employ of the operator of a farm in handling, planting, drying, packing, packaging, processing, freezing, grading, storing, or delivering to storage or to market or to a carrier for transportation to market, in its unmanufactured state, any agricultural or horticultural commodity; but only if such operator produced more than one-half of the commodity with respect to which such service is performed;

(B) in the employ of a group of operators of farms (other than a cooperative organization) in the performance of service described in subparagraph (A), but only if such operators produced all of the commodity with respect to which such service is performed. For purposes of this subparagraph, any unincorporated group of operators shall be deemed a cooperative organization if the number of operators comprising such group is more than 20 at any time during the calendar year in which such service is performed;

(C) the provisions of subparagraphs (A) and (B) shall not be deemed to be applicable with respect to service performed in connection with commercial canning or commercial freezing or in connection with any agricultural or horticultural commodity after its delivery to a terminal market for distribution for consumption; or

(5) on a farm operated for profit if such service is not in the course of the employer's trade or business.

As used in this subsection, the term "farm" includes stock, dairy, poultry, fruit, fur-bearing animal, and truck farms, plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities, and orchards.

(h) AMERICAN EMPLOYER.—For purposes of this chapter, the term "American employer" means an employer which is—

(1) the United States or any instrumentality thereof,

(2) an individual who is a resident of the United States,

(3) a partnership, if two-thirds or more of the partners are residents of the United States,

(4) a trust, if all of the trustees are residents of the United States, or

(5) a corporation organized under the laws of the United States or of any State.

(i) COMPUTATION OF WAGES IN CERTAIN CASES.—

(1) DOMESTIC SERVICE.—For purposes of this chapter, in the case of domestic service described in subsection (a)(7)(B), any payment of cash remuneration for such service which is more or less than a whole-dollar amount shall, under such conditions and to such extent as may be prescribed by regulations made

under this chapter, be computed to the nearest dollar. For the purpose of the computation to the nearest dollar, the payment of a fractional part of a dollar shall be disregarded unless it amounts to one-half dollar or more, in which case it shall be increased to $1. The amount of any payment of cash remuneration so computed to the nearest dollar shall, in lieu of the amount actually paid, be deemed to constitute the amount of cash remuneration for purposes of subsection (a)(7)(B).

(2) SERVICE IN THE UNIFORMED SERVICES.—For purposes of this chapter, in the case of an individual performing service, as a member of a uniformed service, to which the provisions of subsection (m)(1) are applicable, the term "wages" shall, subject to the provisions of subsection (a)(1) of this section, include as such individual's remuneration for such service only (A) his basic pay as described in chapter 3 and section 1009 of title 37, United States Code, in the case of an individual performing service to which subparagraph (A) of such subsection (m)(1) applies, or (B) his compensation for such service as determined under section 206(a) of title 37, United States Code, in the case of an individual performing service to which subparagraph (B) of such subsection (m)(1) applies.

(3) PEACE CORPS VOLUNTEER SERVICE.—For purposes of this chapter, in the case of an individual performing service, as a volunteer or volunteer leader within the meaning of the Peace Corps Act, to which the provisions of section 3121(p) are applicable, the term "wages" shall, subject to the provisions of subsection (a)(1) of this section, include as such individual's remuneration for such service only amounts paid pursuant to section 5(c) or 6(1) of the Peace Corps Act.

(4) SERVICE PERFORMED BY CERTAIN MEMBERS OF RELIGIOUS ORDERS.—For purposes of this chapter, in any case where an individual is a member of a religious order (as defined in subsection (r)(2)) performing service in the exercise of duties required by such order, and an election of coverage under subsection (r) is in effect with respect to such order or with respect to the autonomous subdivision thereof to which such member belongs, the term "wages" shall, subject to the provisions of subsection (a)(1), include as such individual's remuneration for such service the fair market value of any board, lodging, clothing, and other perquisites furnished to such member by such order or subdivision thereof or by any other person or organization pursuant to an agreement with such order or subdivision, except that the amount included as such individual's remuneration under this paragraph shall not be less than $100 a month.

(5) SERVICE PERFORMED BY CERTAIN RETIRED JUSTICES AND JUDGES.—For purposes of this chapter, in the case of an individual performing service under the provisions of section 294 of title 28, United States Code (relating to assignment of retired justices and judges to active duty), the term "wages" shall not include any payment under section 371(b) of such title 28 which is received during the period of such service.

(j) COVERED TRANSPORTATION SERVICE.—For purposes of this chapter—

(1) EXISTING TRANSPORTATION SYSTEMS—GENERAL RULE.—Except as provided in paragraph (2), all service performed in the employ of a State or political subdivision in connection with its operation of a public transportation system shall constitute covered transportation service if any part of the transportation system was acquired from private ownership after 1936 and prior to 1951.

(2) EXISTING TRANSPORTATION SYSTEMS—CASES IN WHICH NO TRANSPORTATION EMPLOYEES, OR ONLY CERTAIN EMPLOYEES, ARE COVERED.—Service performed in the employ of a State or political subdivision in connection with the operation of its public transportation system shall not constitute covered transportation service if—

(A) any part of the transportation system was acquired from private ownership after 1936 and prior to 1951, and substantially all service in connection with the operation of the transportation system was, on December 31, 1950, covered under a general retirement system providing benefits which, by reason of a provision of the State constitution dealing specifically with retirement systems of the State or political subdivisions thereof, cannot be diminished or impaired; or

(B) no part of the transportation system operated by the State or political subdivision on December 31, 1950, was acquired from private ownership after 1936 and prior to 1951;

except that if such State or political subdivision makes an acquisition after 1950 from private ownership of any part of its transportation system, then, in the case of any employee who—

(C) became an employee of such State or political subdivision in connection with and at the time of its acquisition after 1950 of such part, and

(D) prior to such acquisition rendered service in employment (including as employment service covered by an agreement under section 218 of the Social Security Act) in connection with the operation of such part of the transportation system acquired by the State or political subdivision,

the service of such employee in connection with the operation of the transportation system shall constitute covered transportation service, commencing with the first day of the third calendar quarter following the calendar quarter in which the acquisition of such part took place, unless on such first day such service of such employee is covered by a general retirement system which does not, with respect to such employee, contain special provisions applicable only to employees described in subparagraph (C).

(3) TRANSPORTATION SYSTEMS ACQUIRED AFTER 1950.—All service performed in the employ of a State or political subdivision thereof in connection with its operation of a public transportation system shall constitute covered transportation service if the transportation system was not operated by the State or political subdivision prior to 1951 and, at the time of its first acquisition (after 1950) from private ownership of any part of its transportation system, the State or political subdivision did

not have a general retirement system covering substantially all service performed in connection with the operation of the transportation system.

(4) DEFINITIONS.—For purposes of this subsection—

(A) The term "general retirement system" means any pension, annuity, retirement, or similar fund or system established by a State or by a political subdivision thereof for employees of the State, political subdivision, or both; but such term shall not include such a fund or system which covers only service performed in positions connected with the operation of its public transportation system.

(B) A transportation system or a part thereof shall be considered to have been acquired by a State or political subdivision from private ownership if prior to the acquisition service performed by employees in connection with the operation of the system or part thereof acquired constituted employment under this chapter or subchapter A of chapter 9 of the Internal Revenue Code of 1939 or was covered by an agreement made pursuant to section 218 of the Social Security Act and some of such employees became employees of the State or political subdivision in connection with and at the time of such acquisition.

(C) The term "political subdivision" includes an instrumentality of—

(i) a State,

(ii) one or more political subdivisions of a State, or

(iii) a State and one or more of its political subdivisions.

(l) AGREEMENTS ENTERED INTO BY AMERICAN EMPLOYERS WITH RESPECT TO FOREIGN AFFILIATES.—

(1) AGREEMENT WITH RESPECT TO CERTAIN EMPLOYEES OF FOREIGN AFFILIATE.—The Secretary shall, at the American employer's request, enter into an agreement (in such manner and form as may be prescribed by the Secretary) with any American employer (as defined in subsection (h)) who desires to have the insurance system established by title II of the Social Security Act extended to service performed outside the United States in the employ of any 1 or more of such employer's foreign affiliates (as defined in paragraph (6)) by all employees who are citizens or residents of the United States, except that the agreement shall not apply to any service performed by, or remuneration paid to, an employee if such service or remuneration would be excluded from the term "employment" or "wages", as defined in this section, had the service been performed in the United States. Such agreement may be amended at any time so as to be made applicable, in the same manner and under the same conditions, with respect to any other foreign affiliate of such American employer. Such agreement shall be applicable with respect to citizens or residents of the United States who, on or after the effective date of the agreement, are employees of and perform services outside the United States for any foreign affiliate specified in the agreement. Such agreement shall provide—

(A) that the American employer shall pay to the Secretary, at such time or times as the Secretary may by reg-

ulations prescribe, amounts equivalent to the sum of the taxes which would be imposed by sections 3101 and 3111 (including amounts equivalent to the interest, additions to the taxes, additional amounts, and penalties which would be applicable) with respect to the remuneration which would be wages if the services covered by the agreement constituted employment as defined in this section; and

(B) that the American employer will comply with such regulations relating to payments and reports as the Secretary may prescribe to carry out the purposes of this subsection.

(2) EFFECTIVE PERIOD OF AGREEMENT.—An agreement entered into pursuant to paragraph (1) shall be in effect for the period beginning with the first day of the calendar quarter in which such agreement is entered into or the first day of the succeeding calendar quarter, as may be specified in the agreement; except that in case such agreement is amended to include the services performed for any other affiliate and such amendment is executed after the first month following the first calendar quarter for which the agreement is in effect, the agreement shall be in effect with respect to service performed for such other affiliate only after the calendar quarter in which such amendment is executed. Notwithstanding any other provision of this subsection, the period for which any such agreement is effective with respect to any foreign entity shall terminate at the end of any calendar quarter in which the foreign entity, at any time in such quarter, ceases to be a foreign affiliate as defined in paragraph (6).

(3) NO TERMINATION OF AGREEMENT.—No agreement under this subsection may be terminated, either in its entirety or with respect to any foreign affiliate, on or after June 15, 1989.

(4) DEPOSITS IN TRUST FUNDS.—For purposes of section 201 of the Social Security Act, relating to appropriations to the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund, such remuneration—

(A) paid for services covered by an agreement entered into pursuant to paragraph (1) as would be wages if the services constituted employment, and

(B) as is reported to the Secretary pursuant to the provisions of such agreement or of the regulations issued under this subsection,

shall be considered wages subject to the taxes imposed by this chapter.

(5) OVERPAYMENTS AND UNDERPAYMENTS.—(A) If more or less than the correct amount due under an agreement entered into pursuant to this subsection is paid with respect to any payment of remuneration, proper adjustments with respect to the amounts due under such agreement shall be made, without interest, in such manner and at such times as may be required by regulations prescribed by the Secretary.

(B) If an overpayment cannot be adjusted under subparagraph (A), the amount thereof shall be paid by the Secretary, through the Fiscal Service of the Treasury Department, but only if a claim for such overpayment is filed with the Secretary within two years from the time such overpayment was made.

(6) FOREIGN AFFILIATE DEFINED.—For purposes of this subsection and section 210(a) of the Social Security Act—

(A) IN GENERAL.—A foreign affiliate of an American employer is any foreign entity in which such American employer has not less than a 10-percent interest.

(B) DETERMINATION OF 10-PERCENT INTEREST.—For purposes of subparagraph (A), an American employer has a 10-percent interest in any entity if such employer has such an interest directly (or through one or more entities)—

(i) in the case of a corporation, in the voting stock thereof, and

(ii) in the case of any other entity, in the profits thereof.

(7) AMERICAN EMPLOYER AS SEPARATE ENTITY.—Each American employer which enters into an agreement pursuant to paragraph (1) of this subsection shall, for purposes of this subsection and section 6413(c)(2)(C), relating to special refunds in the case of employees of certain foreign entities, be considered an employer in its capacity as a party to such agreement separate and distinct from its identity as a person employing individuals on its own account.

(8) REGULATIONS.—Regulations of the Secretary to carry out the purposes of this subsection shall be designed to make the requirements imposed on American employers with respect to services covered by an agreement entered into pursuant to this subsection the same, so far as practicable, as those imposed upon employers pursuant to this title with respect to the taxes imposed by this chapter.

(m) SERVICE IN THE UNIFORMED SERVICES.—For purposes of this chapter—

(1) INCLUSION OF SERVICE.—The term "employment" shall, notwithstanding the provisions of subsection (b) of this section, include—

(A) service performed by an individual as a member of a uniformed service on active duty, but such term shall not include any such service which is performed while on leave without pay, and

(B) service performed by an individual as a member of a uniformed service on inactive duty training.

(2) ACTIVE DUTY.—The term "active duty" means "active duty" as described in paragraph (21) of section 101 of title 38, United States Code, except that it shall also include "active duty for training" as described in paragraph (22) of such section.

(3) INACTIVE DUTY TRAINING.—The term "inactive duty training" means "inactive duty training" as described in paragraph (23) of such section 101.

(n) MEMBER OF A UNIFORMED SERVICE.—For purposes of this chapter, the term "member of a uniformed service" means any person appointed, enlisted, or inducted in a component of the Army, Navy, Air Force, Marine Corps, or Coast Guard (including a reserve component as defined in section 101(27) of title 38, United States Code), or in one of those services without specification of component, or as a commissioned officer of the Coast and Geodetic Survey, the National Oceanic and Atmospheric Administration

Corps, or the Regular or Reserve Corps of the Public Health Service, and any person serving in the Army or Air Force under call or conscription. The term includes—

(1) a retired member of any of those services;

(2) a member of the Fleet Reserve or Fleet Marine Corps Reserve;

(3) a cadet at the United States Military Academy, a midshipman at the United States Naval Academy, and a cadet at the United States Coast Guard Academy or United States Air Force Academy;

(4) a member of the Reserve Officers' Training Corps, the Naval Reserve Officers' Training Corps, or the Air Force Reserve Officers' Training Corps, when ordered to annual training duty for fourteen days or more, and while performing authorized travel to and from that duty; and

(5) any person while en route to or from, or at, a place for final acceptance or for entry upon active duty in the military, naval, or air service—

(A) who has been provisionally accepted for such duty; or

(B) who, under the Military Selective Service Act, has been selected for active military, naval, or air service;

and has been ordered or directed to proceed to such place.

The term does not include a temporary member of the Coast Guard Reserve.

(o) CREW LEADER.—For purposes of this chapter, the term "crew leader" means an individual who furnishes individuals to perform agricultural labor for another person, if such individual pays (either on his own behalf or on behalf of such person) the individuals so furnished by him for the agricultural labor performed by them and if such individual has not entered into a written agreement with such person whereby such individual has been designated as an employee of such person; and such individuals furnished by the crew leader to perform agricultural labor for another person shall be deemed to be the employees of such crew leader. For purposes of this chapter and chapter 2, a crew leader shall, with respect to service performed in furnishing individuals to perform agricultural labor for another person and service performed as a member of the crew, be deemed not to be an employee of such other person.

(p) PEACE CORPS VOLUNTEER SERVICE.—For purposes of this chapter, the term "employment" shall, notwithstanding the provisions of subsection (b) of this section, include service performed by an individual as a volunteer or volunteer leader within the meaning of the Peace Corps Act.

(q) TIPS INCLUDED FOR BOTH EMPLOYEE AND EMPLOYER TAXES.—For purposes of this chapter, tips received by an employee in the course of his employment shall be considered remuneration for such employment (and deemed to have been paid by the employer for purposes of subsections (a) and (b) of section 3111). Such remuneration shall be deemed to be paid at the time a written statement including such tips is furnished to the employer pursuant to section 6053(a) or (if no statement including such tips is so furnished) at the time received; except that, in determining the employer's liability in connection with the taxes imposed by section 3111 with respect to such tips in any case where no statement including such tips was so furnished (or to the extent that the state-

ment so furnished was inaccurate or incomplete), such remuneration shall be deemed for purposes of subtitle F to be paid on the date on which notice and demand for such taxes is made to the employer by the Secretary.

(r) ELECTION OF COVERAGE BY RELIGIOUS ORDERS.—

(1) CERTIFICATE OF ELECTION BY ORDER.—A religious order whose members are required to take a vow of poverty, or any autonomous subdivision of such order, may file a certificate (in such form and manner, and with such official, as may be prescribed by regulations under this chapter) electing to have the insurance system established by title II of the Social Security Act extended to services performed by its members in the exercise of duties required by such order or such subdivision thereof. Such certificate of election shall provide that—

(A) such election of coverage by such order or subdivision shall be irrevocable;

(B) such election shall apply to all current and future members of such order, or in the case of a subdivision thereof to all current and future members of such order who belong to such subdivision;

(C) all services performed by a member of such an order or subdivision in the exercise of duties required by such order or subdivision shall be deemed to have been performed by such member as an employee of such order or subdivision; and

(D) the wages of each member, upon which such order or subdivision shall pay the taxes imposed by sections 3101 and 3111, will be determined as provided in subsection (i)(4).

(2) DEFINITION OF MEMBER.—For purposes of this subsection, a member of a religious order means any individual who is subject to a vow of poverty as a member of such order and who performs tasks usually required (and to the extent usually required) of an active member of such order and who is not considered retired because of old age or total disability.

(3) EFFECTIVE DATE FOR ELECTION.—(A) A certificate of election of coverage shall be in effect, for purposes of subsection (b)(8) and for purposes of section 210(a)(8) of the Social Security Act, for the period beginning with whichever of the following may be designated by the order or subdivision thereof:

(i) the first day of the calendar quarter in which the certificate is filed,

(ii) the first day of the calendar quarter succeeding such quarter, or

(iii) the first day of any calendar quarter preceding the calendar quarter in which the certificate is filed, except that such date may not be earlier than the first day of the twentieth calendar quarter preceding the quarter in which such certificate is filed.

Whenever a date is designated under clause (iii), the election shall apply to services performed before the quarter in which the certificate is filed only if the member performing such services was a member at the time such services were performed and is living on the first day of the quarter in which such certificate is filed.

(B) If a certificate of election filed pursuant to this subsection is effective for one or more calendar quarters prior to the quarter in which such certificate is filed, then—

(i) for purposes of computing interest and for purposes of section 6651 (relating to addition to tax for failure to file tax return), the due date for the return and payment of the tax for such prior calendar quarters resulting from the filing of such certificate shall be the last day of the calendar month following the calendar quarter in which the certificate is filed; and

(ii) the statutory period for the assessment of such tax shall not expire before the expiration of 3 years from such due date.

(s) CONCURRENT EMPLOYMENT BY TWO OR MORE EMPLOYERS.—For purposes of sections 3102, 3111, and 3121(a)(1), if two or more related corporations concurrently employ the same individual and compensate such individual through a common paymaster which is one of such corporations, each such corporation shall be considered to have paid as remuneration to such individual only the amounts actually disbursed by it to such individual and shall not be considered to have paid as remuneration to such individual amounts actually disbursed to such individual by another of such corporations.

(u) APPLICATION OF HOSPITAL INSURANCE TAX TO FEDERAL, STATE, AND LOCAL EMPLOYMENT.—

(1) FEDERAL EMPLOYMENT.—For purposes of the taxes imposed by sections 3101(b) and 3111(b), subsection (b) shall be applied without regard to paragraph (5) thereof.

(2) STATE AND LOCAL EMPLOYMENT.—For purposes of the taxes imposed by sections 3101(b) and 3111(b)—

(A) IN GENERAL.—Except as provided in subparagraphs (B) and (C), subsection (b) shall be applied without regard to paragraph (7) thereof.

(B) EXCEPTION FOR CERTAIN SERVICES.—Service shall not be treated as employment by reason of subparagraph (A) if—

(i) the service is included under an agreement under section 218 of the Social Security Act, or

(ii) the service is performed—

(I) by an individual who is employed by a State or political subdivision thereof to relieve him from unemployment,

(II) in a hospital, home, or other institution by a patient or inmate thereof as an employee of a State or political subdivision thereof or of the District of Columbia,

(III) by an individual, as an employee of a State or political subdivision thereof or of the District of Columbia, serving on a temporary basis in case of fire, storm, snow, earthquake, flood or other similar emergency,

(IV) by any individual as an employee included under section 5351(2) of title 5, United States Code (relating to certain interns, student nurses, and other student employees of hospitals of the District of Columbia Government), other than as a

medical or dental intern or a medical or dental resident in training,

(V) by an election official or election worker if the remuneration paid in a calendar year for such service is less than $1,000 with respect to service performed during any calendar year commencing on or after January 1, 1995, ending on or before December 31, 1999, and the adjusted amount determined under section 218(c)(8)(B) of the Social Security Act for any calendar year commencing on or after January 1, 2000, with respect to service performed during such calendar year, or

(VI) by an individual in a position described in section 1402(c)(2)(E).

As used in this subparagraph, the terms "State" and "political subdivision" have the meanings given those terms in section 218(b) of the Social Security Act.

(C) EXCEPTION FOR CURRENT EMPLOYMENT WHICH CONTINUES.—Service performed for an employer shall not be treated as employment by reason of subparagraph (A) if—

(i) such service would be excluded from the term "employment" for purposes of this chapter if subparagraph (A) did not apply;

(ii) such service is performed by an individual—

(I) who was performing substantial and regular service for remuneration for that employer before April 1, 1986,

(II) who is a bona fide employee of that employer on March 31, 1986, and

(III) whose employment relationship with that employer was not entered into for purposes of meeting the requirements of this subparagraph; and

(iii) the employment relationship with that employer has not been terminated after March 31, 1986.

(D) TREATMENT OF AGENCIES AND INSTRUMENTALITIES.—For purposes of subparagraph (C), under regulations—

(i) All agencies and instrumentalities of a State (as defined in section 218(b) of the Social Security Act) or of the District of Columbia shall be treated as a single employer.

(ii) All agencies and instrumentalities of a political subdivision of a State (as so defined) shall be treated as a single employer and shall not be treated as described in clause (i).

(3) MEDICARE QUALIFIED GOVERNMENT EMPLOYMENT.—For purposes of this chapter, the term "medicare qualified government employment" means service which—

(A) is employment (as defined in subsection (b)) with the application of paragraphs (1) and (2), but

(B) would not be employment (as so defined) without the application of such paragraphs.

(v) TREATMENT OF CERTAIN DEFERRED COMPENSATION AND SALARY REDUCTION ARRANGEMENTS.—

(1) CERTAIN EMPLOYER CONTRIBUTIONS TREATED AS WAGES.—Nothing in any paragraph of subsection (a) (other than paragraph (1)) shall exclude from the term "wages"—

(A) any employer contribution under a qualified cash or deferred arrangement (as defined in section 401(k)) to the extent not included in gross income by reason of section 402(e)(3) or consisting of designated Roth contributions (as defined in section 402A(c)), or

(B) any amount treated as an employer contribution under section 414(h)(2) where the pickup referred to in such section is pursuant to a salary reduction agreement (whether evidenced by a written instrument or otherwise).

(2) TREATMENT OF CERTAIN NONQUALIFIED DEFERRED COMPENSATION PLANS.—

(A) IN GENERAL.—Any amount deferred under a nonqualified deferred compensation plan shall be taken into account for purposes of this chapter as of the later of—

(i) when the services are performed, or

(ii) when there is no substantial risk of forfeiture of the rights to such amount.

The preceding sentence shall not apply to any excess parachute payment (as defined in section 280G(b)) or to any specified stock compensation (as defined in section 4985) on which tax is imposed by section 4985.

(B) TAXED ONLY ONCE.—Any amount taken into account as wages by reason of subparagraph (A) (and the income attributable thereto) shall not thereafter be treated as wages for purposes of this chapter.

(C) NONQUALIFIED DEFERRED COMPENSATION PLAN.—For purposes of this paragraph, the term "nonqualified deferred compensation plan" means any plan or other arrangement for deferral of compensation other than a plan described in subsection (a)(5).

(3) EXEMPT GOVERNMENTAL DEFERRED COMPENSATION PLAN.—For purposes of subsection (a)(5), the term "exempt governmental deferred compensation plan" means any plan providing for deferral of compensation established and maintained for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing. Such term shall not include—

(A) any plan to which section 83, 402(b), 403(c), 457(a), or 457(f)(1) applies,

(B) any annuity contract described in section 403(b), and

(C) the Thrift Savings Fund (within the meaning of subchapter III of chapter 84 of title 5, United States Code).

(w) EXEMPTION OF CHURCHES AND QUALIFIED CHURCH-CONTROLLED ORGANIZATIONS.—

(1) GENERAL RULE.—Any church or qualified church-controlled organization (as defined in paragraph (3)) may make an election within the time period described in paragraph (2), in accordance with such procedures as the Secretary determines to be appropriate, that services performed in the employ of such church or organization shall be excluded from employment for purposes of title II of the Social Security Act and this chapter. An election may be made under this subsection only

if the church or qualified church-controlled organization states that such church or organization is opposed for religious reasons to the payment of the tax imposed under section 3111.

(2) TIMING AND DURATION OF ELECTION.—An election under this subsection must be made prior to the first date, more than 90 days after July 18, 1984, on which a quarterly employment tax return for the tax imposed under section 3111 is due, or would be due but for the election, from such church or organization. An election under this subsection shall apply to current and future employees, and shall apply to service performed after December 31, 1983. The election may be revoked by the church or organization under regulations prescribed by the Secretary. The election shall be revoked by the Secretary if such church or organization fails to furnish the information required under section 6051 to the Secretary for a period of 2 years or more with respect to remuneration paid for such services by such church or organization, and, upon request by the Secretary, fails to furnish all such previously unfurnished information for the period covered by the election. Any revocation under the preceding sentence shall apply retroactively to the beginning of the 2-year period for which the information was not furnished.

(3) DEFINITIONS.—(A) For purposes of this subsection, the term "church" means a church, a convention or association of churches, or an elementary or secondary school which is controlled, operated, or principally supported by a church or by a convention or association of churches.

(B) For purposes of this subsection, the term "qualified church-controlled organization" means any church-controlled tax-exempt organization described in section 501(c)(3), other than an organization which—

(i) offers goods, services, or facilities for sale, other than on an incidental basis, to the general public, other than goods, services, or facilities which are sold at a nominal charge which is substantially less than the cost of providing such goods, services, or facilities; and

(ii) normally receives more than 25 percent of its support from either (I) governmental sources, or (II) receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in activities which are not unrelated trades or businesses, or both.

(x) APPLICABLE DOLLAR THRESHOLD.—For purposes of subsection (a)(7)(B), the term "applicable dollar threshold" means $1,000. In the case of calendar years after 1995, the Commissioner of Social Security shall adjust such $1,000 amount at the same time and in the same manner as under section 215(a)(1)(B)(ii) of the Social Security Act with respect to the amounts referred to in section 215(a)(1)(B)(i) of such Act, except that, for purposes of this paragraph, 1993 shall be substituted for the calendar year referred to in section 215(a)(1)(B)(ii)(II) of such Act. If any amount as adjusted under the preceding sentence is not a multiple of $100, such amount shall be rounded to the next lowest multiple of $100.

(y) SERVICE IN THE EMPLOY OF INTERNATIONAL ORGANIZATIONS BY CERTAIN TRANSFERRED FEDERAL EMPLOYEES.—

(1) IN GENERAL.—For purposes of this chapter, service performed in the employ of an international organization by an individual pursuant to a transfer of such individual to such international organization pursuant to section 3582 of title 5, United States Code, shall constitute "employment" if—

(A) immediately before such transfer, such individual performed service with a Federal agency which constituted "employment" under subsection (b) for purposes of the taxes imposed by sections 3101(a) and 3111(a), and

(B) such individual would be entitled, upon separation from such international organization and proper application, to reemployment with such Federal agency under such section 3582.

(2) DEFINITIONS.—For purposes of this subsection—

(A) FEDERAL AGENCY.—The term "Federal agency" means an agency, as defined in section 3581(1) of title 5, United States Code.

(B) INTERNATIONAL ORGANIZATION.—The term "international organization" has the meaning provided such term by section 3581(3) of title 5, United States Code.

(z) TREATMENT OF CERTAIN FOREIGN PERSONS AS AMERICAN EMPLOYERS.—

(1) IN GENERAL.—If any employee of a foreign person is performing services in connection with a contract between the United States Government (or any instrumentality thereof) and any member of any domestically controlled group of entities which includes such foreign person, such foreign person shall be treated for purposes of this chapter as an American employer with respect to such services performed by such employee.

(2) DOMESTICALLY CONTROLLED GROUP OF ENTITIES.—For purposes of this subsection—

(A) IN GENERAL.—The term "domestically controlled group of entities" means a controlled group of entities the common parent of which is a domestic corporation.

(B) CONTROLLED GROUP OF ENTITIES.—The term "controlled group of entities" means a controlled group of corporations as defined in section 1563(a)(1), except that—

(i) "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears therein, and

(ii) the determination shall be made without regard to subsections (a)(4) and (b)(2) of section 1563.

A partnership or any other entity (other than a corporation) shall be treated as a member of a controlled group of entities if such entity is controlled (within the meaning of section 954(d)(3)) by members of such group (including any entity treated as a member of such group by reason of this sentence).

(3) LIABILITY OF COMMON PARENT.—In the case of a foreign person who is a member of any domestically controlled group of entities, the common parent of such group shall be jointly and severally liable for any tax under this chapter for which such foreign person is liable by reason of this subsection, and for any penalty imposed on such person by this title with respect to any failure to pay such tax or to file any return or

statement with respect to such tax or wages subject to such tax. No deduction shall be allowed under this title for any liability imposed by the preceding sentence.

(4) PROVISIONS PREVENTING DOUBLE TAXATION.—

(A) AGREEMENTS.—Paragraph (1) shall not apply to any services which are covered by an agreement under subsection (*l*).

(B) EQUIVALENT FOREIGN TAXATION.—Paragraph (1) shall not apply to any services if the employer establishes to the satisfaction of the Secretary that the remuneration paid by such employer for such services is subject to a tax imposed by a foreign country which is substantially equivalent to the taxes imposed by this chapter.

(5) CROSS REFERENCE.—For relief from taxes in cases covered by certain international agreements, see sections 3101(c) and 3111(c).

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CHAPTER 23—FEDERAL UNEMPLOYMENT TAX ACT

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SEC. 3306. DEFINITIONS.

(a) EMPLOYER.—For purposes of this chapter—

(1) IN GENERAL.—The term "employer" means, with respect to any calendar year, any person who—

(A) during any calendar quarter in the calendar year or the preceding calendar year paid wages of $1,500 or more, or

(B) on each of some 20 days during the calendar year or during the preceding calendar year, each day being in a different calendar week, employed at least one individual in employment for some portion of the day.

For purposes of this paragraph, there shall not be taken into account any wages paid to, or employment of, an employee performing domestic services referred to in paragraph (3).

(2) AGRICULTURAL LABOR.—In the case of agricultural labor, the term "employer" means, with respect to any calendar year, any person who—

(A) during any calendar quarter in the calendar year or the preceding calendar year paid wages of $20,000 or more for agricultural labor, or

(B) on each of some 20 days during the calendar year or during the preceding calendar year, each day being in a different calendar week, employed at least 10 individuals in employment in agricultural labor for some portion of the day.

(3) DOMESTIC SERVICE.—In the case of domestic service in a private home, local college club, or local chapter of a college fraternity or sorority, the term "employer" means, with respect to any calendar year, any person who during any calendar quarter in the calendar year or the preceding calendar year paid wages in cash of $1,000 or more for such service.

(4) SPECIAL RULE.—A person treated as an employer under paragraph (3) shall not be treated as an employer with respect to wages paid for any service other than domestic service referred to in paragraph (3) unless such person is treated as an employer under paragraph (1) or (2) with respect to such other service.

(b) WAGES.—For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include—

(1) that part of the remuneration which, after remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) equal to $7,000 with respect to employment has been paid to an individual by an employer during any calendar year, is paid to such individual by such employer during such calendar year. If an employer (hereinafter referred to as successor employer) during any calendar year acquires substantially all the property used in a trade or business of another employer (hereinafter referred to as a predecessor), or used in a separate unit of a trade or business of a predecessor, and immediately after the acquisition employs in his trade or business an individual who immediately prior to the acquisition was employed in the trade or business of such predecessor, then, for the purpose of determining whether the successor employer has paid remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) with respect to employment equal to $7,000 to such individual during such calendar year, any remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) with respect to employment paid (or considered under this paragraph as having been paid) to such individual by such predecessor during such calendar year and prior to such acquisition shall be considered as having been paid by such successor employer;

(2) the amount of any payment (including any amount paid by an employer for insurance or annuities, or into a fund, to provide for any such payment) made to, or on behalf of, an employee or any of his dependents under a plan or system established by an employer which makes provision for his employees generally (or for his employees generally and their dependents) or for a class or classes of his employees (or for a class or classes of his employees and their dependents), on account of—

(A) sickness or accident disability (but, in the case of payments made to an employee or any of his dependents, this subparagraph shall exclude from the term "wages" only payments which are received under a workmen's compensation law), or

(B) medical or hospitalization expenses in connection with sickness or accident disability, or

(C) death;

(4) any payment on account of sickness or accident disability, or medical or hospitalization expenses in connection with sickness or accident disability, made by an employer to, or on behalf of, an employee after the expiration of 6 calendar months

following the last calendar month in which the employee worked for such employer;

(5) any payment made to, or on behalf of, an employee or his beneficiary—

(A) from or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust, or

(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a),

(C) under a simplified employee pension (as defined in section 408(k)(1)), other than any contributions described in section 408(k)(6),

(D) under or to an annuity contract described in section 403(b), other than a payment for the purchase of such contract which is made by reason of a salary reduction agreement (whether evidenced by a written instrument or otherwise),

(E) under or to an exempt governmental deferred compensation plan (as defined in section 3121(v)(3)),

(F) to supplement pension benefits under a plan or trust described in any of the foregoing provisions of this paragraph to take into account some portion or all of the increase in the cost of living (as determined by the Secretary of Labor) since retirement but only if such supplemental payments are under a plan which is treated as a welfare plan under section 3(2)(B)(ii) of the Employee Retirement Income Security Act of 1974,

(G) under a cafeteria plan (within the meaning of section 125) if such payment would not be treated as wages without regard to such plan and it is reasonable to believe that (if section 125 applied for purposes of this section) section 125 would not treat any wages as constructively received, or

(H) under an arrangement to which section 408(p) applies, other than any elective contributions under paragraph (2)(A)(i) thereof,

(6) the payment by an employer (without deduction from the remuneration of the employee)—

(A) of the tax imposed upon an employee under section 3101, or

(B) of any payment required from an employee under a State unemployment compensation law,

with respect to remuneration paid to an employee for domestic service in a private home of the employer or for agricultural labor;

(7) remuneration paid in any medium other than cash to an employee for service not in the course of the employer's trade or business;

(9) remuneration paid to or on behalf of an employee if (and to the extent that) at the time of the payment of such remuneration it is reasonable to believe that a corresponding deduction is allowable under section 217 (determined without regard to section 274(n));

(10) any payment or series of payments by an employer to an employee or any of his dependents which is paid—

(A) upon or after the termination of an employee's employment relationship because of (i) death, or (ii) retirement for disability, and

(B) under a plan established by the employer which makes provision for his employees generally or a class or classes of his employees (or for such employees or class or classes of employees and their dependents),

other than any such payment or series of payments which would have been paid if the employee's employment relationship had not been so terminated;

(11) remuneration for agricultural labor paid in any medium other than cash;

(13) any payment made, or benefit furnished, to or for the benefit of an employee if at the time of such payment or such furnishing it is reasonable to believe that the employee will be able to exclude such payment or benefit from income under section 127, 129, 134(b)(4), or 134(b)(5);

(14) the value of any meals or lodging furnished by or on behalf of the employer if at the time of such furnishing it is reasonable to believe that the employee will be able to exclude such items from income under section 119;

(15) any payment made by an employer to a survivor or the estate of a former employee after the calendar year in which such employee died;

(16) any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 74(c), 108(f)(4), 117, or 132;

(17) any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(b);

(18) any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(d);

(19) remuneration on account of—

(A) a transfer of a share of stock to any individual pursuant to an exercise of an incentive stock option (as defined in section 422(b)) or under an employee stock purchase plan (as defined in section 423(b)), or

(B) any disposition by the individual of such stock; or

(20) any benefit or payment which is excludable from the gross income of the employee under section 139B(b).

Except as otherwise provided in regulations prescribed by the Secretary, any third party which makes a payment included in wages solely by reason of the parenthetical matter contained in subparagraph (A) of paragraph (2) shall be treated for purposes of this chapter and chapter 22 as the employer with respect to such wages. Nothing in the regulations prescribed for purposes of chapter 24 (relating to income tax withholding) which provides an exclusion from "wages" as used in such chapter shall be construed to

require a similar exclusion from "wages" in the regulations prescribed for purposes of this chapter.

(c) EMPLOYMENT.—For purposes of this chapter, the term "employment" means any service performed prior to 1955, which was employment for purposes of subchapter C of chapter 9 of the Internal Revenue Code of 1939 under the law applicable to the period in which such service was performed, and (A) any service, of whatever nature, performed after 1954 by an employee for the person employing him, irrespective of the citizenship or residence of either, (i) within the United States, or (ii) on or in connection with an American vessel or American aircraft under a contract of service which is entered into within the United States or during the performance of which and while the employee is employed on the vessel or aircraft it touches at a port in the United States, if the employee is employed on and in connection with such vessel or aircraft when outside the United States, and (B) any service, of whatever nature, performed after 1971 outside the United States (except in a contiguous country with which the United States has an agreement relating to unemployment compensation) by a citizen of the United States as an employee of an American employer (as defined in subsection (j)(3)), except—

(1) agricultural labor (as defined in subsection (k)) unless—

(A) such labor is performed for a person who—

(i) during any calendar quarter in the calendar year or the preceding calendar year paid remuneration in cash of $20,000 or more to individuals employed in agricultural labor (including labor performed by an alien referred to in subparagraph (B)), or

(ii) on each of some 20 days during the calendar year or the preceding calendar year, each day being in a different calendar week, employed in agricultural labor (including labor performed by an alien referred to in subparagraph (B)) for some portion of the day (whether or not at the same moment of time) 10 or more individuals; and

(B) such labor is not agricultural labor performed by an individual who is an alien admitted to the United States to perform agricultural labor pursuant to sections 214(c) and 101(a)(15)(H) of the Immigration and Nationality Act;

(2) domestic service in a private home, local college club, or local chapter of a college fraternity or sorority unless performed for a person who paid cash remuneration of $1,000 or more to individuals employed in such domestic service in any calendar quarter in the calendar year or the preceding calendar year;

(3) service not in the course of the employer's trade or business performed in any calendar quarter by an employee, unless the cash remuneration paid for such service is $50 or more and such service is performed by an individual who is regularly employed by such employer to perform such service. For purposes of this paragraph, an individual shall be deemed to be regularly employed by an employer during a calendar quarter only if—

(A) on each of some 24 days during such quarter such individual performs for such employer for some portion of

the day service not in the course of the employer's trade or business, or

(B) such individual was regularly employed (as determined under subparagraph (A)) by such employer in the performance of such service during the preceding calendar quarter;

(4) service performed on or in connection with a vessel or aircraft not an American vessel or American aircraft, if the employee is employed on and in connection with such vessel or aircraft when outside the United States;

(5) service performed by an individual in the employ of [his son] *the individual's son* , daughter, or spouse, and service performed by a child under the age of 21 in the employ of [his father] *the child's father* or mother;

(6) service performed in the employ of the United States Government or of an instrumentality of the United States which is—

(A) wholly or partially owned by the United States, or

(B) exempt from the tax imposed by section 3301 by virtue of any provision of law which specifically refers to such section (or the corresponding section of prior law) in granting such exemption;

(7) service performed in the employ of a State, or any political subdivision thereof, or in the employ of an Indian tribe, or any instrumentality of any one or more of the foregoing which is wholly owned by one or more States or political subdivisions or Indian tribes; and any service performed in the employ of any instrumentality of one or more States or political subdivisions to the extent that the instrumentality is, with respect to such service, immune under the Constitution of the United States from the tax imposed by section 3301;

(8) service performed in the employ of a religious, charitable, educational, or other organization described in section 501(c)(3) which is exempt from income tax under section 501(a);

(9) service performed by an individual as an employee or employee representative as defined in section 1 of the Railroad Unemployment Insurance Act (45 U.S.C. 351);

(10)(A) service performed in any calendar quarter in the employ of any organization exempt from income tax under section 501(a) (other than an organization described in section 401(a)) or under section 521, if the remuneration for such service is less than $50, or

(B) service performed in the employ of a school, college, or university, if such service is performed (i) by a student who is enrolled and is regularly attending classes at such school, college, or university, or (ii) by the spouse of such a student, if such spouse is advised, at the time such spouse commences to perform such service, that (I) the employment of such spouse to perform such service is provided under a program to provide financial assistance to such student by such school, college, or university, and (II) such employment will not be covered by any program of unemployment insurance, or

(C) service performed by an individual who is enrolled at a nonprofit or public educational institution which normally maintains a regular faculty and curriculum and normally has

a regularly organized body of students in attendance at the place where its educational activities are carried on as a student in a full-time program, taken for credit at such institution, which combines academic instruction with work experience, if such service is an integral part of such program, and such institution has so certified to the employer, except that this subparagraph shall not apply to service performed in a program established for or on behalf of an employer or group of employers, or

(D) service performed in the employ of a hospital, if such service is performed by a patient of such hospital;

(11) service performed in the employ of a foreign government (including service as a consular or other officer or employee or a nondiplomatic representative);

(12) service performed in the employ of an instrumentality wholly owned by a foreign government—

(A) if the service is of a character similar to that performed in foreign countries by employees of the United States Government or of an instrumentality thereof; and

(B) if the Secretary of State shall certify to the Secretary of the Treasury that the foreign government, with respect to whose instrumentality exemption is claimed, grants an equivalent exemption with respect to similar service performed in the foreign country by employees of the United States Government and of instrumentalities thereof;

(13) service performed as a student nurse in the employ of a hospital or a nurses' training school by an individual who is enrolled and is regularly attending classes in a nurses' training school chartered or approved pursuant to State law; and service performed as an intern in the employ of a hospital by an individual who has completed a 4 years' course in a medical school chartered or approved pursuant to State law;

(14) service performed by an individual for a person as an insurance agent or as an insurance solicitor, if all such service performed by such individual for such person is performed for remuneration solely by way of commission;

(15)(A) service performed by an individual under the age of 18 in the delivery or distribution of newspapers or shopping news, not including delivery or distribution to any point for subsequent delivery or distribution;

(B) service performed by an individual in, and at the time of, the sale of newspapers or magazines to ultimate consumers, under an arrangement under which the newspapers or magazines are to be sold by him at a fixed price, his compensation being based on the retention of the excess of such price over the amount at which the newspapers or magazines are charged to him, whether or not he is guaranteed a minimum amount of compensation for such service, or is entitled to be credited with the unsold newspapers or magazines turned back;

(16) service performed in the employ of an international organization;

(17) service performed by an individual in (or as an officer or member of the crew of a vessel while it is engaged in) the catching, taking, harvesting, cultivating, or farming of any kind of fish, shellfish, crustacea, sponges, seaweeds, or other

aquatic forms of animal and vegetable life (including service performed by any such individual as an ordinary incident to any such activity), except—

(A) service performed in connection with the catching or taking of salmon or halibut, for commercial purposes, and

(B) service performed on or in connection with a vessel of more than 10 net tons (determined in the manner provided for determining the register tonnage of merchant vessels under the laws of the United States);

(18) service described in section 3121(b)(20);

(19) service which is performed by a nonresident alien individual for the period he is temporarily present in the United States as a nonimmigrant under subparagraph (F), (J), (M), or (Q) of section 101(a)(15) of the Immigration and Nationality Act, as amended (8 U.S.C. 1101(a)(15)(F), (J), (M), or (Q)), and which is performed to carry out the purpose specified in subparagraph (F), (J), (M), or (Q), as the case may be;

(20) service performed by a full time student (as defined in subsection (q)) in the employ of an organized camp—

(A) if such camp—

(i) did not operate for more than 7 months in the calendar year and did not operate for more than 7 months in the preceding calendar year, or

(ii) had average gross receipts for any 6 months in the preceding calendar year which were not more than 331/3 percent of its average gross receipts for the other 6 months in the preceding calendar year; and

(B) if such full time student performed services in the employ of such camp for less than 13 calendar weeks in such calendar year; or

(21) service performed by a person committed to a penal institution.

(d) INCLUDED AND EXCLUDED SERVICE.—For purposes of this chapter, if the services performed during one-half or more of any pay period by an employee for the person employing him constitute employment, all the services of such employee for such period shall be deemed to be employment; but if the services performed during more than one-half of any such pay period by an employee for the person employing him do not constitute employment, then none of the services of such employee for such period shall be deemed to be employment. As used in this subsection, the term "pay period" means a period (of not more than 31 consecutive days) for which a payment of remuneration is ordinarily made to the employee by the person employing him. This subsection shall not be applicable with respect to services performed in a pay period by an employee for the person employing him, where any of such service is excepted by subsection (c)(9).

(e) STATE AGENCY.—For purposes of this chapter, the term "State agency" means any State officer, board, or other authority, designated under a State law to administer the unemployment fund in such State.

(f) UNEMPLOYMENT FUND.—For purposes of this chapter, the term "unemployment fund" means a special fund, established under a State law and administered by a State agency, for the payment of compensation. Any sums standing to the account of the

State agency in the Unemployment Trust Fund established by section 904 of the Social Security Act, as amended (42 U.S.C. 1104), shall be deemed to be a part of the unemployment fund of the State, and no sums paid out of the Unemployment Trust Fund to such State agency shall cease to be a part of the unemployment fund of the State until expended by such State agency. An unemployment fund shall be deemed to be maintained during a taxable year only if throughout such year, or such portion of the year as the unemployment fund was in existence, no part of the moneys of such fund was expended for any purpose other than the payment of compensation (exclusive of expenses of administration) and for refunds of sums erroneously paid into such fund and refunds paid in accordance with the provisions of section 3305(b); except that—

(1) an amount equal to the amount of employee payments into the unemployment fund of a State may be used in the payment of cash benefits to individuals with respect to their disability, exclusive of expenses of administration;

(2) the amounts specified by section 903(c)(2) or 903(d)(4) of the Social Security Act may, subject to the conditions prescribed in such section, be used for expenses incurred by the State for administration of its unemployment compensation law and public employment offices,

(3) nothing in this subsection shall be construed to prohibit deducting any amount from unemployment compensation otherwise payable to an individual and using the amount so deducted to pay for health insurance, or the withholding of Federal, State, or local individual income tax, if the individual elected to have such deduction made and such deduction was made under a program approved by the Secretary of Labor;

(4) amounts may be deducted from unemployment benefits and used to repay overpayments as provided in section 303(g) of the Social Security Act;

(5) amounts may be withdrawn for the payment of short-time compensation under a short-time compensation program (as defined in subsection (v)); and

(6) amounts may be withdrawn for the payment of allowances under a self-employment assistance program (as defined in subsection (t)).

(g) CONTRIBUTIONS.—For purposes of this chapter, the term "contributions" means payments required by a State law to be made into an unemployment fund by any person on account of having individuals in his employ, to the extent that such payments are made by him without being deducted or deductible from the remuneration of individuals in his employ.

(h) COMPENSATION.—For purposes of this chapter, the term "compensation" means cash benefits payable to individuals with respect to their unemployment.

(i) EMPLOYEE.—For purposes of this chapter, the term "employee" has the meaning assigned to such term by section 3121(d), except that paragraph (4) and subparagraphs (B) and (C) of paragraph (3) shall not apply.

(j) STATE, UNITED STATES, AND AMERICAN EMPLOYER.—For purposes of this chapter—

(1) STATE.—The term "State" includes the District of Columbia, the Commonwealth of Puerto Rico, and the Virgin Islands.

(2) UNITED STATES.—The term "United States" when used in a geographical sense includes the States, the District of Columbia, the Commonwealth of Puerto Rico, and the Virgin Islands.

(3) AMERICAN EMPLOYER.—The term "American employer" means a person who is—

(A) an individual who is a resident of the United States,

(B) a partnership, if two-thirds or more of the partners are residents of the United States,

(C) a trust, if all of the trustees are residents of the United States, or

(D) a corporation organized under the laws of the United States or of any State.

An individual who is a citizen of the Commonwealth of Puerto Rico or the Virgin Islands (but not otherwise a citizen of the United States) shall be considered, for purposes of this section, as a citizen of the United States.

(k) AGRICULTURAL LABOR.—For purposes of this chapter, the term "agricultural labor" has the meaning assigned to such term by subsection (g) of section 3121, except that for purposes of this chapter subparagraph (B) of paragraph (4) of such subsection (g) shall be treated as reading:

"(B) in the employ of a group of operators of farms (or a cooperative organization of which such operators are members) in the performance of service described in subparagraph (A), but only if such operators produced more than one-half of the commodity with respect to which such service is performed;".

(m) AMERICAN VESSEL AND AIRCRAFT.—For purposes of this chapter, the term "American vessel" means any vessel documented or numbered under the laws of the United States; and includes any vessel which is neither documented or numbered under the laws of the United States nor documented under the laws of any foreign country, if its crew is employed solely by one or more citizens or residents of the United States or corporations organized under the laws of the United States or of any State; and the term "American aircraft" means an aircraft registered under the laws of the United States.

(n) VESSELS OPERATED BY GENERAL AGENTS OF UNITED STATES.—Notwithstanding the provisions of subsection (c)(6), service performed by officers and members of the crew of a vessel which would otherwise be included as employment under subsection (c) shall not be excluded by reason of the fact that it is performed on or in connection with an American vessel—

(1) owned by or bareboat chartered to the United States and

(2) whose business is conducted by a general agent of the Secretary of Transportation.

For purposes of this chapter, each such general agent shall be considered a legal entity in his capacity as such general agent, separate and distinct from his identity as a person employing individuals on his own account, and the officers and members of the crew of such an American vessel whose business is conducted by a general agent of the Secretary of Transportation shall be deemed to be performing services for such general agent rather than the United States. Each such general agent who in his capacity as such is an

employer within the meaning of subsection (a) shall be subject to all the requirements imposed upon an employer under this chapter with respect to service which constitutes employment by reason of this subsection.

(o) SPECIAL RULE IN CASE OF CERTAIN AGRICULTURAL WORKERS.—

(1) CREW LEADERS WHO ARE REGISTERED OR PROVIDE SPECIALIZED AGRICULTURAL LABOR.—For purposes of this chapter, any individual who is a member of a crew furnished by a crew leader to perform agricultural labor for any other person shall be treated as an employee of such crew leader—

(A) if—

(i) such crew leader holds a valid certificate of registration under the Migrant and Seasonal Agricultural Worker Protection Act; or

(ii) substantially all the members of such crew operate or maintain tractors, mechanized harvesting or crop-dusting equipment, or any other mechanized equipment, which is provided by such crew leader; and

(B) if such individual is not an employee of such other person within the meaning of subsection (i).

(2) OTHER CREW LEADERS.—For purposes of this chapter, in the case of any individual who is furnished by a crew leader to perform agricultural labor for any other person and who is not treated as an employee of such crew leader under paragraph (1)—

(A) such other person and not the crew leader shall be treated as the employer of such individual; and

(B) such other person shall be treated as having paid cash remuneration to such individual in an amount equal to the amount of cash remuneration paid to such individual by the crew leader (either on his behalf or on behalf of such other person) for the agricultural labor performed for such other person.

(3) CREW LEADER.—For purposes of this subsection, the term "crew leader" means an individual who—

(A) furnishes individuals to perform agricultural labor for any other person,

(B) pays (either on his behalf or on behalf of such other person) the individuals so furnished by him for the agricultural labor performed by them, and

(C) has not entered into a written agreement with such other person under which such individual is designated as an employee of such other person.

(p) CONCURRENT EMPLOYMENT BY TWO OR MORE EMPLOYERS.—For purposes of sections 3301, 3302, and 3306(b)(1), if two or more related corporations concurrently employ the same individual and compensate such individual through a common paymaster which is one of such corporations, each such corporation shall be considered to have paid as remuneration to such individual only the amounts actually disbursed by it to such individual and shall not be considered to have paid as remuneration to such individual amounts actually disbursed to such individual by another of such corporations.

(q) FULL TIME STUDENT.—For purposes of subsection (c)(20), an individual shall be treated as a full time student for any period—

(1) during which the individual is enrolled as a full time student at an educational institution, or

(2) which is between academic years or terms if—

(A) the individual was enrolled as a full time student at an educational institution for the immediately preceding academic year or term, and

(B) there is a reasonable assurance that the individual will be so enrolled for the immediately succeeding academic year or term after the period described in subparagraph (A).

(r) TREATMENT OF CERTAIN DEFERRED COMPENSATION AND SALARY REDUCTION ARRANGEMENTS.—

(1) CERTAIN EMPLOYER CONTRIBUTIONS TREATED AS WAGES.—Nothing in any paragraph of subsection (b) (other than paragraph (1)) shall exclude from the term "wages"—

(A) any employer contribution under a qualified cash or deferred arrangement (as defined in section 401(k)) to the extent not included in gross income by reason of section 402(e)(3), or

(B) any amount treated as an employer contribution under section 414(h)(2) where the pickup referred to in such section is pursuant to a salary reduction agreement (whether evidenced by a written instrument or otherwise).

(2) TREATMENT OF CERTAIN NONQUALIFIED DEFERRED COMPENSATION PLANS.—

(A) IN GENERAL.—Any amount deferred under a nonqualified deferred compensation plan shall be taken into account for purposes of this chapter as of the later of—

(i) when the services are performed, or

(ii) when there is no substantial risk of forfeiture of the rights to such amount.

(B) TAXED ONLY ONCE.—Any amount taken into account as wages by reason of subparagraph (A) (and the income attributable thereto) shall not thereafter be treated as wages for purposes of this chapter.

(C) NONQUALIFIED DEFERRED COMPENSATION PLAN.—For purposes of this paragraph, the term "nonqualified deferred compensation plan" means any plan or other arrangement for deferral of compensation other than a plan described in subsection (b)(5).

(s) TIPS TREATED AS WAGES.—For purposes of this chapter, the term "wages" includes tips which are—

(1) received while performing services which constitute employment, and

(2) included in a written statement furnished to the employer pursuant to section 6053(a).

(t) SELF-EMPLOYMENT ASSISTANCE PROGRAM.—For the purposes of this chapter, the term "self-employment assistance program" means a program under which—

(1) individuals who meet the requirements described in paragraph (3) are eligible to receive an allowance in lieu of regular unemployment compensation under the State law for the purpose of assisting such individuals in establishing a business and becoming self-employed;

(2) the allowance payable to individuals pursuant to paragraph (1) is payable in the same amount, at the same interval, on the same terms, and subject to the same conditions, as regular unemployment compensation under the State law, except that—

(A) State requirements relating to availability for work, active search for work, and refusal to accept work are not applicable to such individuals;

(B) State requirements relating to disqualifying income are not applicable to income earned from self-employment by such individuals; and

(C) such individuals are considered to be unemployed for the purposes of Federal and State laws applicable to unemployment compensation,

as long as such individuals meet the requirements applicable under this subsection;

(3) individuals may receive the allowance described in paragraph (1) if such individuals—

(A) are eligible to receive regular unemployment compensation under the State law, or would be eligible to receive such compensation except for the requirements described in subparagraph (A) or (B) of paragraph (2);

(B) are identified pursuant to a State worker profiling system as individuals likely to exhaust regular unemployment compensation; and

(C) are participating in self-employment assistance activities which—

(i) include entrepreneurial training, business counseling, and technical assistance; and

(ii) are approved by the State agency; and

(D) are actively engaged on a full-time basis in activities (which may include training) relating to the establishment of a business and becoming self-employed;

(4) the aggregate number of individuals receiving the allowance under the program does not at any time exceed 5 percent of the number of individuals receiving regular unemployment compensation under the State law at such time;

(5) the program does not result in any cost to the Unemployment Trust Fund (established by section 904(a) of the Social Security Act) in excess of the cost that would be incurred by such State and charged to such Fund if the State had not participated in such program; and

(6) the program meets such other requirements as the Secretary of Labor determines to be appropriate.

(u) INDIAN TRIBE.—For purposes of this chapter, the term "Indian tribe" has the meaning given to such term by section 4(e) of the Indian Self-Determination and Education Assistance Act (25 U.S.C. 5304(e)), and includes any subdivision, subsidiary, or business enterprise wholly owned by such an Indian tribe.

(v) SHORT-TIME COMPENSATION PROGRAM.—For purposes of this section, the term "short-time compensation program" means a program under which—

(1) the participation of an employer is voluntary;

(2) an employer reduces the number of hours worked by employees in lieu of layoffs;

(3) such employees whose workweeks have been reduced by at least 10 percent, and by not more than the percentage, if any, that is determined by the State to be appropriate (but in no case more than 60 percent), are not disqualified from unemployment compensation;

(4) the amount of unemployment compensation payable to any such employee is a pro rata portion of the unemployment compensation which would otherwise be payable to the employee if such employee were unemployed;

(5) such employees meet the availability for work and work search test requirements while collecting short-time compensation benefits, by being available for their workweek as required by the State agency;

(6) eligible employees may participate, as appropriate, in training (including employer-sponsored training or worker training funded under the Workforce Investment Act of 1998) to enhance job skills if such program has been approved by the State agency;

(7) the State agency shall require employers to certify that if the employer provides health benefits and retirement benefits under a defined benefit plan (as defined in section 414(j)) or contributions under a defined contribution plan (as defined in section 414(i)) to any employee whose workweek is reduced under the program that such benefits will continue to be provided to employees participating in the short-time compensation program under the same terms and conditions as though the workweek of such employee had not been reduced or to the same extent as other employees not participating in the short-time compensation program;

(8) the State agency shall require an employer to submit a written plan describing the manner in which the requirements of this subsection will be implemented (including a plan for giving advance notice, where feasible, to an employee whose workweek is to be reduced) together with an estimate of the number of layoffs that would have occurred absent the ability to participate in short-time compensation and such other information as the Secretary of Labor determines is appropriate;

(9) the terms of the employer's written plan and implementation shall be consistent with employer obligations under applicable Federal and State laws; and

(10) upon request by the State and approval by the Secretary of Labor, only such other provisions are included in the State law that are determined to be appropriate for purposes of a short-time compensation program.

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CHAPTER 24—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

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SEC. 3402. INCOME TAX COLLECTED AT SOURCE.

(a) REQUIREMENT OF WITHHOLDING.—

(1) IN GENERAL.—Except as otherwise provided in this section, every employer making payment of wages shall deduct

and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary. Any tables or procedures prescribed under this paragraph shall—

(A) apply with respect to the amount of wages paid during such periods as the Secretary may prescribe, and

(B) be in such form, and provide for such amounts to be deducted and withheld, as the Secretary determines to be most appropriate to carry out the purposes of this chapter and to reflect the provisions of chapter 1 applicable to such periods.

(2) AMOUNT OF WAGES.—For purposes of applying tables or procedures prescribed under paragraph (1), the term "the amount of wages" means the amount by which the wages exceed the taxpayer's withholding allowance, prorated to the payroll period.

(b) PERCENTAGE METHOD OF WITHHOLDING.—(1) If wages are paid with respect to a period which is not a payroll period, the withholding allowance allowable with respect to each payment of such wages shall be the allowance allowed for a miscellaneous payroll period containing a number of days (including Sundays and holidays) equal to the number of days in the period with respect to which such wages are paid.

(2) In any case in which wages are paid by an employer without regard to any payroll period or other period, the withholding allowance allowable with respect to each payment of such wages shall be the allowance allowed for a miscellaneous payroll period containing a number of days equal to the number of days (including Sundays and holidays) which have elapsed since the date of the last payment of such wages by such employer during the calendar year, or the date of commencement of employment with such employer during such year, or January 1 of such year, whichever is the later.

(3) In any case in which the period, or the time described in paragraph (2), in respect of any wages is less than one week, the Secretary, under regulations prescribed by him, may authorize an employer to compute the tax to be deducted and withheld as if the aggregate of the wages paid to the employee during the calendar week were paid for a weekly payroll period.

(4) In determining the amount to be deducted and withheld under this subsection, the wages may, at the election of the employer, be computed to the nearest dollar.

(c) WAGE BRACKET WITHHOLDING.—(1) At the election of the employer with respect to any employee, the employer shall deduct and withhold upon the wages paid to such employee a tax (in lieu of the tax required to be deducted and withheld under subsection (a)) determined in accordance with tables prescribed by the Secretary in accordance with paragraph (6).

(2) If wages are paid with respect to a period which is not a payroll period, the amount to be deducted and withheld shall be that applicable in the case of a miscellaneous payroll period containing a number of days (including Sundays and holidays) equal to the number of days in the period with respect to which such wages are paid.

(3) In any case in which wages are paid by an employer without regard to any payroll period or other period, the amount to be deducted and withheld shall be that applicable in the case of a miscellaneous payroll period containing a number of days equal to the number of days (including Sundays and holidays) which have elapsed since the date of the last payment of such wages by such employer during the calendar year, or the date of commencement of employment with such employer during such year, or January 1 of such year, whichever is the later.

(4) In any case in which the period, or the time described in paragraph (3), in respect of any wages is less than one week, the Secretary, under regulations prescribed by him, may authorize an employer to determine the amount to be deducted and withheld under the tables applicable in the case of a weekly payroll period, in which case the aggregate of the wages paid to the employee during the calendar week shall be considered the weekly wages.

(5) If the wages exceed the highest wage bracket, in determining the amount to be deducted and withheld under this subsection, the wages may, at the election of the employer, be computed to the nearest dollar.

(6) In the case of wages paid after December 31, 1969, the amount deducted and withheld under paragraph (1) shall be determined in accordance with tables prescribed by the Secretary. In the tables so prescribed, the amounts set forth as amounts of wages and amounts of income tax to be deducted and withheld shall be computed on the basis of the table for an annual payroll period prescribed pursuant to subsection (a).

(d) TAX PAID BY RECIPIENT.—If the employer, in violation of the provisions of this chapter, fails to deduct and withhold the tax under this chapter, and thereafter the tax against which such tax may be credited is paid, the tax so required to be deducted and withheld shall not be collected from the employer; but this subsection shall in no case relieve the employer from liability for any penalties or additions to the tax otherwise applicable in respect of such failure to deduct and withhold.

(e) INCLUDED AND EXCLUDED WAGES.—If the remuneration paid by an employer to an employee for services performed during one-half or more of any payroll period of not more than 31 consecutive days constitutes wages, all the remuneration paid by such employer to such employee for such period shall be deemed to be wages; but if the remuneration paid by an employer to an employee for services performed during more than one-half of any such payroll period does not constitute wages, then none of the remuneration paid by such employer to such employee for such period shall be deemed to be wages.

(f) WITHHOLDING ALLOWANCE.—

(1) IN GENERAL.—Under rules determined by the Secretary, an employee receiving wages shall on any day be entitled to a withholding allowance determined based on—

(A) whether the employee is an individual for whom a deduction is allowable with respect to another taxpayer under section 151;

(B) if the employee is married, whether the employee's spouse is entitled to an allowance, or would be so entitled if such spouse were an employee receiving wages, under

subparagraph (A) or (D), but only if such spouse does not have in effect a withholding allowance certificate claiming such allowance;

(C) the number of individuals with respect to whom, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable a credit under section 24(a) for the taxable year under subtitle A in respect of which amounts deducted and withheld under this chapter in the calendar year in which such day falls are allowed as a credit;

(D) any additional amounts to which the employee elects to take into account under subsection (m), but only if the employee's spouse does not have in effect a withholding allowance certificate making such an election;

(E) the standard deduction allowable to such employee (one-half of such standard deduction in the case of an employee who is married (as determined under section 7703) and whose spouse is an employee receiving wages subject to withholding); and

(F) whether the employee has withholding allowance certificates in effect with respect to more than 1 employer.

(2) ALLOWANCE CERTIFICATES.—

(A) ON COMMENCEMENT OF EMPLOYMENT.—On or before the date of the commencement of employment with an employer, the employee shall furnish the employer with a signed withholding allowance certificate relating to the withholding allowance claimed by the employee, which shall in no event exceed the amount to which the employee is entitled.

(B) CHANGE OF STATUS.—If, on any day during the calendar year, an employee's withholding allowance is in excess of the withholding allowance to which the employee would be entitled had the employee submitted a true and accurate withholding allowance certificate to the employer on that day, the employee shall within 10 days thereafter furnish the employer with a new withholding allowance certificate. If, on any day during the calendar year, an employee's withholding allowance is greater than the withholding allowance claimed, the employee may furnish the employer with a new withholding allowance certificate relating to the withholding allowance to which the employee is so entitled, which shall in no event exceed the amount to which the employee is entitled on such day.

(C) CHANGE OF STATUS WHICH AFFECTS NEXT CALENDAR YEAR.—If on any day during the calendar year the withholding allowance to which the employee will be, or may reasonably be expected to be, entitled at the beginning of the employee's next taxable year under subtitle A is different from the allowance to which the employee is entitled on such day, the employee shall, in such cases and at such times as the Secretary shall by regulations prescribe, furnish the employer with a withholding allowance certificate relating to the withholding allowance which the employee claims with respect to such next taxable year, which shall in no event exceed the withholding allowance

to which the employee will be, or may reasonably be expected to be, so entitled.

(3) WHEN CERTIFICATE TAKES EFFECT.—

(A) FIRST CERTIFICATE FURNISHED.—A withholding allowance certificate furnished the employer in cases in which no previous such certificate is in effect shall take effect as of the beginning of the first payroll period ending, or the first payment of wages made without regard to a payroll period, on or after the date on which such certificate is so furnished.

(B) FURNISHED TO TAKE PLACE OF EXISTING CERTIFICATE.—

(i) IN GENERAL.—Except as provided in clauses (ii) and (iii), a withholding allowance certificate furnished to the employer in cases in which a previous such certificate is in effect shall take effect as of the beginning of the 1st payroll period ending (or the 1st payment of wages made without regard to a payroll period) on or after the 30th day after the day on which such certificate is so furnished.

(ii) EMPLOYER MAY ELECT EARLIER EFFECTIVE DATE.—At the election of the employer, a certificate described in clause (i) may be made effective beginning with any payment of wages made on or after the day on which the certificate is so furnished and before the 30th day referred to in clause (i).

(iii) CHANGE OF STATUS WHICH AFFECTS NEXT YEAR.—Any certificate furnished pursuant to paragraph (2)(C) shall not take effect, and may not be made effective, with respect to any payment of wages made in the calendar year in which the certificate is furnished.

(4) PERIOD DURING WHICH CERTIFICATE REMAINS IN EFFECT.—A withholding allowance certificate which takes effect under this subsection, or which on December 31, 1954, was in effect under the corresponding subsection of prior law, shall continue in effect with respect to the employer until another such certificate takes effect under this subsection.

(5) FORM AND CONTENTS OF CERTIFICATE.—Withholding allowance certificates shall be in such form and contain such information as the Secretary may by regulations prescribe.

(6) EXEMPTION OF CERTAIN NONRESIDENT ALIENS.—Notwithstanding the provisions of paragraph (1), a nonresident alien individual (other than an individual described in section 3401(a)(6)(A) or (B)) shall be entitled to only one withholding exemption.

(7) ALLOWANCE WHERE CERTIFICATE WITH ANOTHER EMPLOYER IS IN EFFECT.—If a withholding allowance certificate is in effect with respect to one employer, an employee shall not be entitled under a certificate in effect with any other employer to any withholding allowance which he has claimed under such first certificate.

(g) OVERLAPPING PAY PERIODS, AND PAYMENT BY AGENT OR FIDUCIARY.—If a payment of wages is made to an employee by an employer—

(1) with respect to a payroll period or other period, any part of which is included in a payroll period or other period with respect to which wages are also paid to such employee by such employer, or

(2) without regard to any payroll period or other period, but on or prior to the expiration of a payroll period or other period with respect to which wages are also paid to such employee by such employer, or

(3) with respect to a period beginning in one and ending in another calendar year, or

(4) through an agent, fiduciary, or other person who also has the control, receipt, custody, or disposal of, or pays, the wages payable by another employer to such employee,

the manner of withholding and the amount to be deducted and withheld under this chapter shall be determined in accordance with regulations prescribed by the Secretary under which the withholding allowance allowed to the employee in any calendar year shall approximate the withholding allowance allowable with respect to an annual payroll period.

(h) ALTERNATIVE METHODS OF COMPUTING AMOUNT TO BE WITHHELD.—The Secretary may, under regulations prescribed by him, authorize—

(1) WITHHOLDING ON BASIS OF AVERAGE WAGES.—An employer—

(A) to estimate the wages which will be paid to any employee in any quarter of the calendar year,

(B) to determine the amount to be deducted and withheld upon each payment of wages to such employee during such quarter as if the appropriate average of the wages so estimated constituted the actual wages paid, and

(C) to deduct and withhold upon any payment of wages to such employee during such quarter (and, in the case of tips referred to in subsection (k), within 30 days thereafter) such amount as may be necessary to adjust the amount actually deducted and withheld upon the wages of such employee during such quarter to the amount required to be deducted and withheld during such quarter without regard to this subsection.

(2) WITHHOLDING ON BASIS OF ANNUALIZED WAGES.—An employer to determine the amount of tax to be deducted and withheld upon a payment of wages to an employee for a payroll period by—

(A) multiplying the amount of an employee's wages for a payroll period by the number of such payroll periods in the calendar year,

(B) determining the amount of tax which would be required to be deducted and withheld upon the amount determined under subparagraph (A) if such amount constituted the actual wages for the calendar year and the payroll period of the employee were an annual payroll period, and

(C) dividing the amount of tax determined under subparagraph (B) by the number of payroll periods (described in subparagraph (A)) in the calendar year.

(3) WITHHOLDING ON BASIS OF CUMULATIVE WAGES.—An employer, in the case of any employee who requests to have the amount of tax to be withheld from his wages computed on the basis of his cumulative wages, to—

(A) add the amount of the wages to be paid to the employee for the payroll period to the total amount of wages paid by the employer to the employee during the calendar year,

(B) divide the aggregate amount of wages computed under subparagraph (A) by the number of payroll periods to which such aggregate amount of wages relates,

(C) compute the total amount of tax that would have been required to be deducted and withheld under subsection (a) if the average amount of wages (as computed under subparagraph (B)) had been paid to the employee for the number of payroll periods to which the aggregate amount of wages (computed under subparagraph (A)) relates,

(D) determine the excess, if any, of the amount of tax computed under subparagraph (C) over the total amount of tax deducted and withheld by the employer from wages paid to the employee during the calendar year, and

(E) deduct and withhold upon the payment of wages (referred to in subparagraph (A)) to the employee an amount equal to the excess (if any) computed under subparagraph (D).

(4) OTHER METHODS.—An employer to determine the amount of tax to be deducted and withheld upon the wages paid to an employee by any other method which will require the employer to deduct and withhold upon such wages substantially the same amount as would be required to be deducted and withheld by applying subsection (a) or (c), either with respect to a payroll period or with respect to the entire taxable year.

(i) CHANGES IN WITHHOLDING.—

(1) IN GENERAL.—The Secretary may by regulations provide for increases in the amount of withholding otherwise required under this section in cases where the employee requests such changes.

(2) TREATMENT AS TAX.—Any increased withholding under paragraph (1) shall for all purposes be considered tax required to be deducted and withheld under this chapter.

(j) NONCASH REMUNERATION TO RETAIL COMMISSION SALESMAN.—In the case of remuneration paid in any medium other than cash for services performed by an individual as a retail salesman for a person, where the service performed by such individual for such person is ordinarily performed for remuneration solely by way of cash commission an employer shall not be required to deduct or withhold any tax under this subchapter with respect to such remuneration, provided that such employer files with the Secretary such information with respect to such remuneration as the Secretary may by regulation prescribe.

(k) TIPS.—In the case of tips which constitute wages, subsection (a) shall be applicable only to such tips as are included in a written statement furnished to the employer pursuant to section 6053(a), and only to the extent that the tax can be deducted and withheld

by the employer, at or after the time such statement is so furnished and before the close of the calendar year in which such statement is furnished, from such wages of the employee (excluding tips, but including funds turned over by the employee to the employer for the purpose of such deduction and withholding) as are under the control of the employer; and an employer who is furnished by an employee a written statement of tips (received in a calendar month) pursuant to section 6053(a) to which paragraph (16)(B) of section 3401(a) is applicable may deduct and withhold the tax with respect to such tips from any wages of the employee (excluding tips) under his control, even though at the time such statement is furnished the total amount of the tips included in statements furnished to the employer as having been received by the employee in such calendar month in the course of his employment by such employer is less than $20. Such tax shall not at any time be deducted and withheld in an amount which exceeds the aggregate of such wages and funds (including funds turned over under section 3102(c)(2) or section 3202(c)(2)) minus any tax required by section 3102(a) or section 3202(a) to be collected from such wages and funds.

(l) DETERMINATION AND DISCLOSURE OF MARITAL STATUS.—

(1) DETERMINATION OF STATUS BY EMPLOYER.—For purposes of applying the tables in subsections (a) and (c) to a payment of wages, the employer shall treat the employee as a single person unless there is in effect with respect to such payment of wages a withholding allowance certificate furnished to the employer by the employee after the date of the enactment of this subsection indicating that the employee is married.

(2) DISCLOSURE OF STATUS BY EMPLOYEE.—An employee shall be entitled to furnish the employer with a withholding allowance certificate indicating [he] *the employee* is married only if, on the day of such furnishing, [he] *the employee* is married (determined with the application of the rules in paragraph (3)). An employee whose marital status changes from married to single shall, at such time as the Secretary may by regulations prescribe, furnish the employer with a new withholding allowance certificate.

(3) DETERMINATION OF MARITAL STATUS.—For purposes of paragraph (2), an employee shall on any day be considered—

(A) as not married, if (i) [he] *the employee* is legally separated from [his spouse] *the employee's spouse* under a decree of divorce or separate maintenance, or (ii) either [he] *the employee* or [his spouse] *the employee's spouse* is, or on any preceding day within the calendar year was, a nonresident alien; or

(B) as married, if (i) [his spouse] *the employee's spouse* (other than a spouse referred to in subparagraph (A)) died within the portion of [his taxable year] *the employee's taxable year* which precedes such day, or (ii) [his spouse] *the employee's spouse* died during one of the two taxable years immediately preceding the current taxable year and, on the basis of facts existing at the beginning of such day, the employee reasonably expects, at the close of [his taxable year] *the employee's taxable year* , to be a surviving spouse (as defined in section 2(a)).

(m) WITHHOLDING ALLOWANCES.—Under regulations prescribed by the Secretary, an employee shall be entitled to an additional withholding allowance or additional reductions in withholding under this subsection. In determining the additional withholding allowance or the amount of additional reductions in withholding under this subsection, the employee may take into account (to the extent and in the manner provided by such regulations)—

(1) estimated itemized deductions allowable under chapter 1 and the estimated deduction allowed under section 199A (other than the deductions referred to in section 151 and other than the deductions required to be taken into account in determining adjusted gross income under section 62(a)),

(2) estimated tax credits allowable under chapter 1, and

(3) such additional deductions (including the additional standard deduction under section 63(c)(3) for the aged and blind) and other items as may be specified by the Secretary in regulations.

(n) EMPLOYEES INCURRING NO INCOME TAX LIABILITY.—Notwithstanding any other provision of this section, an employer shall not be required to deduct and withhold any tax under this chapter upon a payment of wages to an employee if there is in effect with respect to such payment a withholding allowance certificate (in such form and containing such other information as the Secretary may prescribe) furnished to the employer by the employee certifying that the employee—

(1) incurred no liability for income tax imposed under subtitle A for his preceding taxable year, and

(2) anticipates that he will incur no liability for income tax imposed under subtitle A for his current taxable year.

The Secretary shall by regulations provide for the coordination of the provisions of this subsection with the provisions of subsection (f).

(o) EXTENSION OF WITHHOLDING TO CERTAIN PAYMENTS OTHER THAN WAGES.—

(1) GENERAL RULE.—For purposes of this chapter (and so much of subtitle F as relates to this chapter)—

(A) any supplemental unemployment compensation benefit paid to an individual,

(B) any payment of an annuity to an individual, if at the time the payment is made a request that such annuity be subject to withholding under this chapter is in effect, and

(C) any payment to an individual of sick pay which does not constitute wages (determined without regard to this subsection), if at the time the payment is made a request that such sick pay be subject to withholding under this chapter is in effect,

shall be treated as if it were a payment of wages by an employer to an employee for a payroll period.

(2) DEFINITIONS.—

(A) SUPPLEMENTAL UNEMPLOYMENT COMPENSATION BENEFITS.—For purposes of paragraph (1), the term "supplemental unemployment compensation benefits" means amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether

or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employee's gross income.

(B) ANNUITY.—For purposes of this subsection, the term "annuity" means any amount paid to an individual as a pension or annuity.

(C) SICK PAY.—For purposes of this subsection, the term "sick pay" means any amount which—

(i) is paid to an employee pursuant to a plan to which the employer is a party, and

(ii) constitutes remuneration or a payment in lieu of remuneration for any period during which the employee is temporarily absent from work on account of sickness or personal injuries.

(3) AMOUNT WITHHELD FROM ANNUITY PAYMENTS OR SICK PAY.—If a payee makes a request that an annuity or any sick pay be subject to withholding under this chapter, the amount to be deducted and withheld under this chapter from any payment to which such request applies shall be an amount (not less than a minimum amount determined under regulations prescribed by the Secretary) specified by the payee in such request. The amount deducted and withheld with respect to a payment which is greater or less than a full payment shall bear the same relation to the specified amount as such payment bears to a full payment.

(4) REQUEST FOR WITHHOLDING.—A request that an annuity or any sick pay be subject to withholding under this chapter—

(A) shall be made by the payee in writing to the person making the payments and shall contain the social security number of the payee,

(B) shall specify the amount to be deducted and withheld from each full payment, and

(C) shall take effect—

(i) in the case of sick pay, with respect to payments made more than 7 days after the date on which such request is furnished to the payor, or

(ii) in the case of an annuity, at such time (after the date on which such request is furnished to the payor) as the Secretary shall by regulations prescribe.

Such a request may be changed or terminated by furnishing to the person making the payments a written statement of change or termination which shall take effect in the same manner as provided in subparagraph (C). At the election of the payor, any such request (or statement of change or revocation) may take effect earlier than as provided in subparagraph (C).

(5) SPECIAL RULE FOR SICK PAY PAID PURSUANT TO CERTAIN COLLECTIVE-BARGAINING AGREEMENTS.—In the case of any sick pay paid pursuant to a collective-bargaining agreement between employee representatives and one or more employers which contains a provision specifying that this paragraph is to apply to sick pay paid pursuant to such agreement and contains a provision for determining the amount to be deducted and withheld from each payment of such sick pay—

(A) the requirement of paragraph (1)(C) that a request for withholding be in effect shall not apply, and

(B) except as provided in subsection (n), the amounts to be deducted and withheld under this chapter shall be determined in accordance with such agreement.

The preceding sentence shall not apply with respect to sick pay paid pursuant to any agreement to any individual unless the social security number of such individual is furnished to the payor and the payor is furnished with such information as is necessary to determine whether the payment is pursuant to the agreement and to determine the amount to be deducted and withheld.

(6) COORDINATION WITH WITHHOLDING ON DESIGNATED DISTRIBUTIONS UNDER SECTION 3405.—This subsection shall not apply to any amount which is a designated distribution (within the meaning of section 3405(e)(1)).

(p) VOLUNTARY WITHHOLDING AGREEMENTS.—

(1) CERTAIN FEDERAL PAYMENTS.—

(A) IN GENERAL.—If, at the time a specified Federal payment is made to any person, a request by such person is in effect that such payment be subject to withholding under this chapter, then for purposes of this chapter and so much of subtitle F as relates to this chapter, such payment shall be treated as if it were a payment of wages by an employer to an employee.

(B) AMOUNT WITHHELD.—The amount to be deducted and withheld under this chapter from any payment to which any request under subparagraph (A) applies shall be an amount equal to the percentage of such payment specified in such request. Such a request shall apply to any payment only if the percentage specified is 7 percent, any percentage applicable to any of the 3 lowest income brackets in the table under section 1(c), or such other percentage as is permitted under regulations prescribed by the Secretary.

(C) SPECIFIED FEDERAL PAYMENTS.—For purposes of this paragraph, the term "specified Federal payment" means—

(i) any payment of a social security benefit (as defined in section 86(d)),

(ii) any payment referred to in the second sentence of section 451(d) which is treated as insurance proceeds,

(iii) any amount which is includible in gross income under section 77(a), and

(iv) any other payment made pursuant to Federal law which is specified by the Secretary for purposes of this paragraph.

(D) REQUESTS FOR WITHHOLDING.—Rules similar to the rules that apply to annuities under subsection (*o*)(4) shall apply to requests under this paragraph and paragraph (2).

(2) VOLUNTARY WITHHOLDING ON UNEMPLOYMENT BENEFITS.—If, at the time a payment of unemployment compensation (as defined in section 85(b)) is made to any person, a request by such person is in effect that such payment be subject to withholding under this chapter, then for purposes of this

chapter and so much of subtitle F as relates to this chapter, such payment shall be treated as if it were a payment of wages by an employer to an employee. The amount to be deducted and withheld under this chapter from any payment to which any request under this paragraph applies shall be an amount equal to 10 percent of such payment.

(3) AUTHORITY FOR OTHER VOLUNTARY WITHHOLDING.—The Secretary is authorized by regulations to provide for withholding—

(A) from remuneration for services performed by an employee for the employee's employer which (without regard to this paragraph) does not constitute wages, and

(B) from any other type of payment with respect to which the Secretary finds that withholding would be appropriate under the provisions of this chapter,

if the employer and employee, or the person making and the person receiving such other type of payment, agree to such withholding. Such agreement shall be in such form and manner as the Secretary may by regulations prescribe. For purposes of this chapter (and so much of subtitle F as relates to this chapter), remuneration or other payments with respect to which such agreement is made shall be treated as if they were wages paid by an employer to an employee to the extent that such remuneration is paid or other payments are made during the period for which the agreement is in effect.

(q) EXTENSION OF WITHHOLDING TO CERTAIN GAMBLING WINNINGS.—

(1) GENERAL RULE.—Every person, including the Government of the United States, a State, or a political subdivision thereof, or any instrumentalities of the foregoing, making any payment of winnings which are subject to withholding shall deduct and withhold from such payment a tax in an amount equal to the product of the third lowest rate of tax applicable under section 1(c) and such payment.

(2) EXEMPTION WHERE TAX OTHERWISE WITHHELD.—In the case of any payment of winnings which are subject to withholding made to a nonresident alien individual or a foreign corporation, the tax imposed under paragraph (1) shall not apply to any such payment subject to tax under section 1441(a) (relating to withholding on nonresident aliens) or tax under section 1442(a) (relating to withholding on foreign corporations).

(3) WINNINGS WHICH ARE SUBJECT TO WITHHOLDING.—For purposes of this subsection, the term "winnings which are subject to withholding" means proceeds from a wager determined in accordance with the following:

(A) IN GENERAL.—Except as provided in subparagraphs (B) and (C), proceeds of more than $5,000 from a wagering transaction, if the amount of such proceeds is at least 300 times as large as the amount wagered.

(B) STATE-CONDUCTED LOTTERIES.—Proceeds of more than $5,000 from a wager placed in a lottery conducted by an agency of a State acting under authority of State law, but only if such wager is placed with the State agency conducting such lottery, or with its authorized employees or agents.

(C) SWEEPSTAKES, WAGERING POOLS, CERTAIN PARIMUTUEL POOLS, JAI ALAI, AND LOTTERIES.—Proceeds of more than $5,000 from—

(i) a wager placed in a sweepstakes, wagering pool, or lottery (other than a wager described in subparagraph (B)), or

(ii) a wagering transaction in a parimutuel pool with respect to horse races, dog races, or jai alai if the amount of such proceeds is at least 300 times as large as the amount wagered.

(4) RULES FOR DETERMINING PROCEEDS FROM A WAGER.—For purposes of this subsection—

(A) proceeds from a wager shall be determined by reducing the amount received by the amount of the wager, and

(B) proceeds which are not money shall be taken into account at their fair market value.

(5) EXEMPTION FOR BINGO, KENO, AND SLOT MACHINES.—The tax imposed under paragraph (1) shall not apply to winnings from a slot machine, keno, and bingo.

(6) STATEMENT BY RECIPIENT.—Every person who is to receive a payment of winnings which are subject to withholding shall furnish the person making such payment a statement, made under the penalties of perjury, containing the name, address, and taxpayer identification number of the person receiving the payment and of each person entitled to any portion of such payment.

(7) COORDINATION WITH OTHER SECTIONS.—For purposes of sections 3403 and 3404 and for purposes of so much of subtitle F (except section 7205) as relates to this chapter, payments to any person of winnings which are subject to withholding shall be treated as if they were wages paid by an employer to an employee.

(r) EXTENSION OF WITHHOLDING TO CERTAIN TAXABLE PAYMENTS OF INDIAN CASINO PROFITS.—

(1) IN GENERAL.—Every person, including an Indian tribe, making a payment to a member of an Indian tribe from the net revenues of any class II or class III gaming activity conducted or licensed by such tribe shall deduct and withhold from such payment a tax in an amount equal to such payment's proportionate share of the annualized tax.

(2) EXCEPTION.—The tax imposed by paragraph (1) shall not apply to any payment to the extent that the payment, when annualized, does not exceed an amount equal to the sum of—

(A) the basic standard deduction (as defined in section 63(c)) for an individual to whom section 63(c)(2)(C) applies, and

(B) the exemption amount (as defined in section 151(d)).

(3) ANNUALIZED TAX.—For purposes of paragraph (1), the term "annualized tax" means, with respect to any payment, the amount of tax which would be imposed by section 1(c) (determined without regard to any rate of tax in excess of the fourth lowest rate of tax applicable under section 1(c)) on an amount of taxable income equal to the excess of—

(A) the annualized amount of such payment, over

(B) the amount determined under paragraph (2).

(4) CLASSES OF GAMING ACTIVITIES, ETC..—For purposes of this subsection, terms used in paragraph (1) which are defined in section 4 of the Indian Gaming Regulatory Act (25 U.S.C. 2701 et seq.), as in effect on the date of the enactment of this subsection, shall have the respective meanings given such terms by such section.

(5) ANNUALIZATION.—Payments shall be placed on an annualized basis under regulations prescribed by the Secretary.

(6) ALTERNATE WITHHOLDING PROCEDURES.—At the election of an Indian tribe, the tax imposed by this subsection on any payment made by such tribe shall be determined in accordance with such tables or computational procedures as may be specified in regulations prescribed by the Secretary (in lieu of in accordance with paragraphs (2) and (3)).

(7) COORDINATION WITH OTHER SECTIONS.—For purposes of this chapter and so much of subtitle F as relates to this chapter, payments to any person which are subject to withholding under this subsection shall be treated as if they were wages paid by an employer to an employee.

(s) EXEMPTION FROM WITHHOLDING FOR ANY VEHICLE FRINGE BENEFIT.—

(1) EMPLOYER ELECTION NOT TO WITHHOLD.—The employer may elect not to deduct and withhold any tax under this chapter with respect to any vehicle fringe benefit provided to any employee if such employee is notified by the employer of such election (at such time and in such manner as the Secretary shall by regulations prescribe). The preceding sentence shall not apply to any vehicle fringe benefit unless the amount of such benefit is included by the employer on a statement timely furnished under section 6051.

(2) EMPLOYER MUST FURNISH W–2.—Any vehicle fringe benefit shall be treated as wages from which amounts are required to be deducted and withheld under this chapter for purposes of section 6051.

(3) VEHICLE FRINGE BENEFIT.—For purposes of this subsection, the term "vehicle fringe benefit" means any fringe benefit—

(A) which constitutes wages (as defined in section 3401), and

(B) which consists of providing a highway motor vehicle for the use of the employee.

(t) RATE OF WITHHOLDING FOR CERTAIN STOCK.—In the case of any qualified stock (as defined in section 83(i)(2)) with respect to which an election is made under section 83(i)—

(1) the rate of tax under subsection (a) shall not be less than the maximum rate of tax in effect under section 1, and

(2) such stock shall be treated for purposes of section 3501(b) in the same manner as a non-cash fringe benefit.

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Subtitle D—Miscellaneous Excise Taxes

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CHAPTER 40—GENERAL PROVISIONS RELATING TO OCCUPATIONAL TAXES

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SEC. 4905. LIABILITY IN CASE OF DEATH OR CHANGE OF LOCATION.

(a) REQUIREMENTS.—When any person who has paid the special tax for any trade or business dies, [his spouse] *such person's spouse* or child, or executors or administrators or other legal representatives, may occupy the house or premises, and in like manner carry on, for the residue of the term for which the tax is paid, the same trade or business as the deceased before carried on, in the same house and upon the same premises, without the payment of any additional tax. When any person removes from the house or premises for which any trade or business was taxed to any other place, he may carry on the trade or business specified in the register kept in the office of the official in charge of the internal revenue district at the place to which he removes, without the payment of any additional tax: *Provided*, That all cases of death, change, or removal, as aforesaid, with the name of the successor to any person deceased, or of the person making such change or removal, shall be registered with the Secretary, under regulations to be prescribed by the Secretary.

(b) REGISTRATION.—For registration in case of wagering, see section 4412.

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CHAPTER 42—PRIVATE FOUNDATIONS; AND CERTAIN OTHER TAX-EXEMPT ORGANIZATIONS

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Subchapter A—PRIVATE FOUNDATIONS

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SEC. 4946. DEFINITIONS AND SPECIAL RULES.

(a) DISQUALIFIED PERSON.—

(1) IN GENERAL.—For purposes of this subchapter, the term "disqualified person" means, with respect to a private foundation, a person who is—

(A) a substantial contributor to the foundation,

(B) a foundation manager (within the meaning of subsection (b)(1)),

(C) an owner of more than 20 percent of—

(i) the total combined voting power of a corporation,

(ii) the profits interest of a partnership, or

(iii) the beneficial interest of a trust or unincorporated enterprise,

which is a substantial contributor to the foundation,

(D) a member of the family (as defined in subsection (d)) of any individual described in subparagraph (A), (B), or (C),

(E) a corporation of which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the total combined voting power,

(F) a partnership in which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the profits interest,

(G) a trust or estate in which persons described in subparagraph (A), (B), (C), or (D) hold more than 35 percent of the beneficial interest,

(H) only for purposes of section 4943, a private foundation—

(i) which is effectively controlled (directly or indirectly) by the same person or persons who control the private foundation in question, or

(ii) substantially all of the contributions to which were made (directly or indirectly) by the same person or persons described in subparagraph (A), (B), or (C), or members of their families (within the meaning of subsection (d)), who made (directly or indirectly) substantially all of the contributions to the private foundation in question, and

(I) only for purposes of section 4941, a government official (as defined in subsection (c)).

(2) SUBSTANTIAL CONTRIBUTORS.—For purposes of paragraph (1), the term "substantial contributor" means a person who is described in section 507(d)(2).

(3) STOCKHOLDINGS.—For purposes of paragraphs (1)(C)(i) and (1)(E), there shall be taken into account indirect stockholdings which would be taken into account under section 267(c), except that, for purposes of this paragraph, section 267(c)(4) shall be treated as providing that the members of the family of an individual are the members within the meaning of subsection (d).

(4) PARTNERSHIPS; TRUSTS.—For purposes of paragraphs (1)(C)(ii) and (iii), (1)(F), and (1)(G), the ownership of profits or beneficial interests shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) (other than paragraph (3) thereof), except that section 267(c)(4) shall be treated as providing that the members of the family of an individual are the members within the meaning of subsection (d).

(b) FOUNDATION MANAGER.—For purposes of this subchapter, the term "foundation manager" means, with respect to any private foundation—

(1) an officer, director, or trustee of a foundation (or an individual having powers or responsibilities similar to those of officers, directors, or trustees of the foundation), and

(2) with respect to any act (or failure to act), the employees of the foundation having authority or responsibility with respect to such act (or failure to act).

(c) GOVERNMENT OFFICIAL.—For purposes of subsection (a)(1)(I) and section 4941, the term "government official" means, with respect to an act of self-dealing described in section 4941, an individual who, at the time of such act, holds any of the following of-

fices or positions (other than as a "special Government employee", as defined in section 202(a) of title 18, United States Code):

(1) an elective public office in the executive or legislative branch of the Government of the United States,

(2) an office in the executive or judicial branch of the Government of the United States, appointment to which was made by the President,

(3) a position in the executive, legislative, or judicial branch of the Government of the United States—

(A) which is listed in schedule C of rule VI of the Civil Service Rules, or

(B) the compensation for which is equal to or greater than the lowest rate of basic pay for the Senior Executive Service under section 5382 of title 5, United States Code,

(4) a position under the House of Representatives or the Senate of the United States held by an individual receiving gross compensation at an annual rate of $15,000 or more,

(5) an elective or appointive public office in the executive, legislative, or judicial branch of the government of a State, possession of the United States, or political subdivision or other area of any of the foregoing, or of the District of Columbia, held by an individual receiving gross compensation at an annual rate of $20,000 or more,

(6) a position as personal or executive assistant or secretary to any of the foregoing, or

(7) a member of the Internal Revenue Service Oversight Board.

(d) MEMBERS OF FAMILY.—For purposes of subsection (a)(1), the family of any individual shall include only [his spouse] *the individual's spouse* , ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren, and great grandchildren.

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CHAPTER 43—QUALIFIED PENSION, ETC., PLANS

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SEC. 4975. TAX ON PROHIBITED TRANSACTIONS.

(a) INITIAL TAXES ON DISQUALIFIED PERSON.—There is hereby imposed a tax on each prohibited transaction. The rate of tax shall be equal to 15 percent of the amount involved with respect to the prohibited transaction for each year (or part thereof) in the taxable period. The tax imposed by this subsection shall be paid by any disqualified person who participates in the prohibited transaction (other than a fiduciary acting only as such).

(b) ADDITIONAL TAXES ON DISQUALIFIED PERSON.—In any case in which an initial tax is imposed by subsection (a) on a prohibited transaction and the transaction is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of the amount involved. The tax imposed by this subsection shall be paid by any disqualified person who participated in the prohibited transaction (other than a fiduciary acting only as such).

(c) PROHIBITED TRANSACTION.—

(1) GENERAL RULE.—For purposes of this section, the term "prohibited transaction" means any direct or indirect—

(A) sale or exchange, or leasing, of any property between a plan and a disqualified person;

(B) lending of money or other extension of credit between a plan and a disqualified person;

(C) furnishing of goods, services, or facilities between a plan and a disqualified person;

(D) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;

(E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or

(F) receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

(2) SPECIAL EXEMPTION.—The Secretary shall establish an exemption procedure for purposes of this subsection. Pursuant to such procedure, he may grant a conditional or unconditional exemption of any disqualified person or transaction, orders of disqualified persons or transactions, from all or part of the restrictions imposed by paragraph (1) of this subsection. Action under this subparagraph may be taken only after consultation and coordination with the Secretary of Labor. The Secretary may not grant an exemption under this paragraph unless he finds that such exemption is—

(A) administratively feasible,

(B) in the interests of the plan and of its participants and beneficiaries, and

(C) protective of the rights of participants and beneficiaries of the plan.

Before granting an exemption under this paragraph, the Secretary shall require adequate notice to be given to interested persons and shall publish notice in the Federal Register of the pendency of such exemption and shall afford interested persons an opportunity to present views. No exemption may be granted under this paragraph with respect to a transaction described in subparagraph (E) or (F) of paragraph (1) unless the Secretary affords an opportunity for a hearing and makes a determination on the record with respect to the findings required under subparagraphs (A), (B), and (C) of this paragraph, except that in lieu of such hearing the Secretary may accept any record made by the Secretary of Labor with respect to an application for exemption under section 408(a) of title I of the Employee Retirement Income Security Act of 1974.

(3) SPECIAL RULE FOR INDIVIDUAL RETIREMENT ACCOUNTS.—An individual for whose benefit an individual retirement account is established and his beneficiaries shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be an individual retirement account by reason of the application of section 408(e)(2)(A) or if section 408(e)(4) applies to such account.

(4) SPECIAL RULE FOR ARCHER MSAS.—An individual for whose benefit an Archer MSA (within the meaning of section 220(d)) is established shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if section 220(e)(2) applies to such transaction.

(5) SPECIAL RULE FOR COVERDELL EDUCATION SAVINGS ACCOUNTS.—An individual for whose benefit a Coverdell education savings account is established and any contributor to such account shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if section 530(d) applies with respect to such transaction.

(6) SPECIAL RULE FOR HEALTH SAVINGS ACCOUNTS.—An individual for whose benefit a health savings account (within the meaning of section 223(d)) is established shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be a health savings account by reason of the application of section 223(e)(2) to such account.

(d) EXEMPTIONS.—Except as provided in subsection (f)(6), the prohibitions provided in subsection (c) shall not apply to—

(1) any loan made by the plan to a disqualified person who is a participant or beneficiary of the plan if such loan—

(A) is available to all such participants or beneficiaries on a reasonably equivalent basis,

(B) is not made available to highly compensated employees (within the meaning of section 414(q)) in an amount greater than the amount made available to other employees,

(C) is made in accordance with specific provisions regarding such loans set forth in the plan,

(D) bears a reasonable rate of interest, and

(E) is adequately secured;

(2) any contract, or reasonable arrangement, made with a disqualified person for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor;

(3) any loan to a leveraged employee stock ownership plan (as defined in subsection (e)(7)), if—

(A) such loan is primarily for the benefit of participants and beneficiaries of the plan, and

(B) such loan is at a reasonable rate of interest, and any collateral which is given to a disqualified person by the plan consists only of qualifying employer securities (as defined in subsection (e)(8));

(4) the investment of all or part of a plan's assets in deposits which bear a reasonable interest rate in a bank or similar financial institution supervised by the United States or a State, if such bank or other institution is a fiduciary of such plan and if—

(A) the plan covers only employees of such bank or other institution and employees of affiliates of such bank or other institution, or

(B) such investment is expressly authorized by a provision of the plan or by a fiduciary (other than such bank or institution or affiliates thereof) who is expressly empowered by the plan to so instruct the trustee with respect to such investment;

(5) any contract for life insurance, health insurance, or annuities with one or more insurers which are qualified to do business in a State if the plan pays no more than adequate consideration, and if each such insurer or insurers is—

(A) the employer maintaining the plan, or

(B) a disqualified person which is wholly owned (directly or indirectly) by the employer establishing the plan, or by any person which is a disqualified person with respect to the plan, but only if the total premiums and annuity considerations written by such insurers for life insurance, health insurance, or annuities for all plans (and their employers) with respect to which such insurers are disqualified persons (not including premiums or annuity considerations written by the employer maintaining the plan) do not exceed 5 percent of the total premiums and annuity considerations written for all lines of insurance in that year by such insurers (not including premiums or annuity considerations written by the employer maintaining the plan);

(6) the provision of any ancillary service by a bank or similar financial institution supervised by the United States or a State, if such service is provided at not more than reasonable compensation, if such bank or other institution is a fiduciary of such plan, and if—

(A) such bank or similar financial institution has adopted adequate internal safeguards which assure that the provision of such ancillary service is consistent with sound banking and financial practice, as determined by Federal or State supervisory authority, and

(B) the extent to which such ancillary service is provided is subject to specific guidelines issued by such bank or similar financial institution (as determined by the Secretary after consultation with Federal and State supervisory authority), and under such guidelines the bank or similar financial institution does not provide such ancillary service—

(i) in an excessive or unreasonable manner, and

(ii) in a manner that would be inconsistent with the best interests of participants and beneficiaries of employee benefit plans;

(7) the exercise of a privilege to convert securities, to the extent provided in regulations of the Secretary, but only if the plan receives no less than adequate consideration pursuant to such conversion;

(8) any transaction between a plan and a common or collective trust fund or pooled investment fund maintained by a disqualified person which is a bank or trust company supervised

by a State or Federal agency or between a plan and a pooled investment fund of an insurance company qualified to do business in a State if—

(A) the transaction is a sale or purchase of an interest in the fund,

(B) the bank, trust company, or insurance company receives not more than a reasonable compensation, and

(C) such transaction is expressly permitted by the instrument under which the plan is maintained, or by a fiduciary (other than the bank, trust company, or insurance company, or an affiliate thereof) who has authority to manage and control the assets of the plan;

(9) receipt by a disqualified person of any benefit to which he may be entitled as a participant or beneficiary in the plan, so long as the benefit is computed and paid on a basis which is consistent with the terms of the plan as applied to all other participants and beneficiaries;

(10) receipt by a disqualified person of any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan, but no person so serving who already receives full-time pay from an employer or an association of employers, whose employees are participants in the plan or from an employee organization whose members are participants in such plan shall receive compensation from such fund, except for reimbursement of expenses properly and actually incurred;

(11) service by a disqualified person as a fiduciary in addition to being an officer, employee, agent, or other representative of a disqualified person;

(12) the making by a fiduciary of a distribution of the assets of the trust in accordance with the terms of the plan if such assets are distributed in the same manner as provided under section 4044 of title IV of the Employee Retirement Income Security Act of 1974 (relating to allocation of assets);

(13) any transaction which is exempt from section 406 of such Act by reason of section 408(e) of such Act (or which would be so exempt if such section 406 applied to such transaction) or which is exempt from section 406 of such Act by reason of section 408(b)(12) of such Act;

(14) any transaction required or permitted under part 1 of subtitle E of title IV or section 4223 of the Employee Retirement Income Security Act of 1974, but this paragraph shall not apply with respect to the application of subsection (c)(1) (E) or (F);

(15) a merger of multiemployer plans, or the transfer of assets or liabilities between multiemployer plans, determined by the Pension Benefit Guaranty Corporation to meet the requirements of section 4231 of such Act, but this paragraph shall not apply with respect to the application of subsection (c)(1)(E) or (F);

(16) a sale of stock held by a trust which constitutes an individual retirement account under section 408(a) to the individual for whose benefit such account is established if—

(A) such stock is in a bank (as defined in section 581) or a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(1))),

(B) such stock is held by such trust as of the date of the enactment of this paragraph,

(C) such sale is pursuant to an election under section 1362(a) by such bank or company,

(D) such sale is for fair market value at the time of sale (as established by an independent appraiser) and the terms of the sale are otherwise at least as favorable to such trust as the terms that would apply on a sale to an unrelated party,

(E) such trust does not pay any commissions, costs, or other expenses in connection with the sale, and

(F) the stock is sold in a single transaction for cash not later than 120 days after the S corporation election is made;

(17) any transaction in connection with the provision of investment advice described in subsection (e)(3)(B) to a participant or beneficiary in a plan that permits such participant or beneficiary to direct the investment of plan assets in an individual account, if—

(A) the transaction is—

(i) the provision of the investment advice to the participant or beneficiary of the plan with respect to a security or other property available as an investment under the plan,

(ii) the acquisition, holding, or sale of a security or other property available as an investment under the plan pursuant to the investment advice, or

(iii) the direct or indirect receipt of fees or other compensation by the fiduciary adviser or an affiliate thereof (or any employee, agent, or registered representative of the fiduciary adviser or affiliate) in connection with the provision of the advice or in connection with an acquisition, holding, or sale of a security or other property available as an investment under the plan pursuant to the investment advice; and

(B) the requirements of subsection (f)(8) are met,

(18) any transaction involving the purchase or sale of securities, or other property (as determined by the Secretary of Labor), between a plan and a disqualified person (other than a fiduciary described in subsection (e)(3)) with respect to a plan if—

(A) the transaction involves a block trade,

(B) at the time of the transaction, the interest of the plan (together with the interests of any other plans maintained by the same plan sponsor), does not exceed 10 percent of the aggregate size of the block trade,

(C) the terms of the transaction, including the price, are at least as favorable to the plan as an arm's length transaction, and

(D) the compensation associated with the purchase and sale is not greater than the compensation associated with an arm's length transaction with an unrelated party,

(19) any transaction involving the purchase or sale of securities, or other property (as determined by the Secretary of Labor), between a plan and a disqualified person if—

(A) the transaction is executed through an electronic communication network, alternative trading system, or similar execution system or trading venue subject to regulation and oversight by—

(i) the applicable Federal regulating entity, or

(ii) such foreign regulatory entity as the Secretary of Labor may determine by regulation,

(B) either—

(i) the transaction is effected pursuant to rules designed to match purchases and sales at the best price available through the execution system in accordance with applicable rules of the Securities and Exchange Commission or other relevant governmental authority, or

(ii) neither the execution system nor the parties to the transaction take into account the identity of the parties in the execution of trades,

(C) the price and compensation associated with the purchase and sale are not greater than the price and compensation associated with an arm's length transaction with an unrelated party,

(D) if the disqualified person has an ownership interest in the system or venue described in subparagraph (A), the system or venue has been authorized by the plan sponsor or other independent fiduciary for transactions described in this paragraph, and

(E) not less than 30 days prior to the initial transaction described in this paragraph executed through any system or venue described in subparagraph (A), a plan fiduciary is provided written or electronic notice of the execution of such transaction through such system or venue,

(20) transactions described in subparagraphs (A), (B), and (D) of subsection (c)(1) between a plan and a person that is a disqualified person other than a fiduciary (or an affiliate) who has or exercises any discretionary authority or control with respect to the investment of the plan assets involved in the transaction or renders investment advice (within the meaning of subsection (e)(3)(B)) with respect to those assets, solely by reason of providing services to the plan or solely by reason of a relationship to such a service provider described in subparagraph (F), (G), (H), or (I) of subsection (e)(2), or both, but only if in connection with such transaction the plan receives no less, nor pays no more, than adequate consideration,

(21) any foreign exchange transactions, between a bank or broker-dealer (or any affiliate of either) and a plan (as defined in this section) with respect to which such bank or broker-dealer (or affiliate) is a trustee, custodian, fiduciary, or other disqualified person, if—

(A) the transaction is in connection with the purchase, holding, or sale of securities or other investment assets (other than a foreign exchange transaction unrelated to any other investment in securities or other investment assets),

(B) at the time the foreign exchange transaction is entered into, the terms of the transaction are not less favorable to the plan than the terms generally available in comparable arm's length foreign exchange transactions between unrelated parties, or the terms afforded by the bank or broker-dealer (or any affiliate of either) in comparable arm's-length foreign exchange transactions involving unrelated parties,

(C) the exchange rate used by such bank or broker-dealer (or affiliate) for a particular foreign exchange transaction does not deviate by more than 3 percent from the interbank bid and asked rates for transactions of comparable size and maturity at the time of the transaction as displayed on an independent service that reports rates of exchange in the foreign currency market for such currency, and

(D) the bank or broker-dealer (or any affiliate of either) does not have investment discretion, or provide investment advice, with respect to the transaction,

(22) any transaction described in subsection (c)(1)(A) involving the purchase and sale of a security between a plan and any other account managed by the same investment manager, if—

(A) the transaction is a purchase or sale, for no consideration other than cash payment against prompt delivery of a security for which market quotations are readily available,

(B) the transaction is effected at the independent current market price of the security (within the meaning of section 270.17a–7(b) of title 17, Code of Federal Regulations),

(C) no brokerage commission, fee (except for customary transfer fees, the fact of which is disclosed pursuant to subparagraph (D)), or other remuneration is paid in connection with the transaction,

(D) a fiduciary (other than the investment manager engaging in the cross-trades or any affiliate) for each plan participating in the transaction authorizes in advance of any cross-trades (in a document that is separate from any other written agreement of the parties) the investment manager to engage in cross trades at the investment manager's discretion, after such fiduciary has received disclosure regarding the conditions under which cross trades may take place (but only if such disclosure is separate from any other agreement or disclosure involving the asset management relationship), including the written policies and procedures of the investment manager described in subparagraph (H),

(E) each plan participating in the transaction has assets of at least $100,000,000, except that if the assets of a plan are invested in a master trust containing the assets of plans maintained by employers in the same controlled

group (as defined in section 407(d)(7) of the Employee Retirement Income Security Act of 1974), the master trust has assets of at least $100,000,000,

(F) the investment manager provides to the plan fiduciary who authorized cross trading under subparagraph (D) a quarterly report detailing all cross trades executed by the investment manager in which the plan participated during such quarter, including the following information, as applicable: (i) the identity of each security bought or sold; (ii) the number of shares or units traded; (iii) the parties involved in the cross-trade; and (iv) trade price and the method used to establish the trade price,

(G) the investment manager does not base its fee schedule on the plan's consent to cross trading, and no other service (other than the investment opportunities and cost savings available through a cross trade) is conditioned on the plan's consent to cross trading,

(H) the investment manager has adopted, and cross-trades are effected in accordance with, written cross-trading policies and procedures that are fair and equitable to all accounts participating in the cross-trading program, and that include a description of the manager's pricing policies and procedures, and the manager's policies and procedures for allocating cross trades in an objective manner among accounts participating in the cross-trading program, and

(I) the investment manager has designated an individual responsible for periodically reviewing such purchases and sales to ensure compliance with the written policies and procedures described in subparagraph (H), and following such review, the individual shall issue an annual written report no later than 90 days following the period to which it relates signed under penalty of perjury to the plan fiduciary who authorized cross trading under subparagraph (D) describing the steps performed during the course of the review, the level of compliance, and any specific instances of non-compliance.

The written report shall also notify the plan fiduciary of the plan's right to terminate participation in the investment manager's cross-trading program at any time, or

(23) except as provided in subsection (f)(11), a transaction described in subparagraph (A), (B), (C), or (D) of subsection (c)(1) in connection with the acquisition, holding, or disposition of any security or commodity, if the transaction is corrected before the end of the correction period.

(e) DEFINITIONS.—

(1) PLAN.—For purposes of this section, the term "plan" means—

(A) a trust described in section 401(a) which forms a part of a plan, or a plan described in section 403(a), which trust or plan is exempt from tax under section 501(a),

(B) an individual retirement account described in section 408(a),

(C) an individual retirement annuity described in section 408(b),

(D) an Archer MSA described in section 220(d),

(E) a health savings account described in section 223(d),

(F) a Coverdell education savings account described in section 530, or

(G) a trust, plan, account, or annuity which, at any time, has been determined by the Secretary to be described in any preceding subparagraph of this paragraph.

(2) DISQUALIFIED PERSON.—For purposes of this section, the term "disqualified person" means a person who is—

(A) a fiduciary;

(B) a person providing services to the plan;

(C) an employer any of whose employees are covered by the plan;

(D) an employee organization any of whose members are covered by the plan;

(E) an owner, direct or indirect, of 50 percent or more of—

(i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of a corporation,

(ii) the capital interest or the profits interest of a partnership, or

(iii) the beneficial interest of a trust or unincorporated enterprise,

which is an employer or an employee organization described in subparagraph (C) or (D);

(F) a member of the family (as defined in paragraph (6)) of any individual described in subparagraph (A), (B), (C), or (E);

(G) a corporation, partnership, or trust or estate of which (or in which) 50 percent or more of—

(i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of such corporation,

(ii) the capital interest or profits interest of such partnership, or

(iii) the beneficial interest of such trust or estate,

is owned directly or indirectly, or held by persons described in subparagraph (A), (B), (C), (D), or (E);

(H) an officer, director (or an individual having powers or responsibilities similar to those of officers or directors), a 10 percent or more shareholder, or a highly compensated employee (earning 10 percent or more of the yearly wages of an employer) of a person described in subparagraph (C), (D), (E), or (G); or

(I) a 10 percent or more (in capital or profits) partner or joint venturer of a person described in subparagraph (C), (D), (E), or (G).

The Secretary, after consultation and coordination with the Secretary of Labor or his delegate, may by regulation prescribe a percentage lower than 50 percent for subparagraphs (E) and (G) and lower than 10 percent for subparagraphs (H) and (I).

(3) FIDUCIARY.—For purposes of this section, the term "fiduciary" means any person who—

(A) exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets,

(B) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or

(C) has any discretionary authority or discretionary responsibility in the administration of such plan.

Such term includes any person designated under section 405(c)(1)(B) of the Employee Retirement Income Security Act of 1974.

(4) STOCKHOLDINGS.—For purposes of paragraphs (2)(E)(i) and (G)(i) there shall be taken into account indirect stockholdings which would be taken into account under section 267(c), except that, for purposes of this paragraph, section 267(c)(4) shall be treated as providing that the members of the family of an individual are the members within the meaning of paragraph (6).

(5) PARTNERSHIPS; TRUSTS.—For purposes of paragraphs (2)(E)(ii) and (iii), (G)(ii) and (iii), and (I) the ownership of profits or beneficial interests shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) (other than paragraph (3) thereof), except that section 267(c)(4) shall be treated as providing that the members of the family of an individual are the members within the meaning of paragraph (6).

(6) MEMBER OF FAMILY.—For purposes of paragraph (2)(F), the family of any individual shall include [his spouse] *the individual's spouse* , ancestor, lineal descendant, and any spouse of a lineal descendant.

(7) EMPLOYEE STOCK OWNERSHIP PLAN.—The term "employee stock ownership plan" means a defined contribution plan—

(A) which is a stock bonus plan which is qualified, or a stock bonus and a money purchase plan both of which are qualified under section 401(a), and which are designed to invest primarily in qualifying employer securities; and

(B) which is otherwise defined in regulations prescribed by the Secretary.

A plan shall not be treated as an employee stock ownership plan unless it meets the requirements of section 409(h), section 409(*o*), and, if applicable, section 409(n), section 409(p), and section 664(g) and, if the employer has a registration-type class of securities (as defined in section 409(e)(4)), it meets the requirements of section 409(e).

(8) QUALIFYING EMPLOYER SECURITY.—The term "qualifying employer security" means any employer security within the meaning of section 409(*l*). If any moneys or other property of a plan are invested in shares of an investment company registered under the Investment Company Act of 1940, the investment shall not cause that investment company or that investment company's investment adviser or principal underwriter to be treated as a fiduciary or a disqualified person for purposes of this section, except when an investment company or its in-

vestment adviser or principal underwriter acts in connection with a plan covering employees of the investment company, its investment adviser, or its principal underwriter.

(9) SECTION MADE APPLICABLE TO WITHDRAWAL LIABILITY PAYMENT FUNDS.—For purposes of this section—

(A) IN GENERAL.—The term "plan" includes a trust described in section 501(c)(22).

(B) DISQUALIFIED PERSON.—In the case of any trust to which this section applies by reason of subparagraph (A), the term "disqualified person" includes any person who is a disqualified person with respect to any plan to which such trust is permitted to make payments under section 4223 of the Employee Retirement Income Security Act of 1974.

(f) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) JOINT AND SEVERAL LIABILITY.—If more than one person is liable under subsection (a) or (b) with respect to any one prohibited transaction, all such persons shall be jointly and severally liable under such subsection with respect to such transaction.

(2) TAXABLE PERIOD.—The term "taxable period" means, with respect to any prohibited transaction, the period beginning with the date on which the prohibited transaction occurs and ending on the earliest of—

(A) the date of mailing a notice of deficiency with respect to the tax imposed by subsection (a) under section 6212,

(B) the date on which the tax imposed by subsection (a) is assessed, or

(C) the date on which correction of the prohibited transaction is completed.

(3) SALE OR EXCHANGE; ENCUMBERED PROPERTY.—A transfer or real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer.

(4) AMOUNT INVOLVED.—The term "amount involved" means, with respect to a prohibited transaction, the greater of the amount of money and the fair market value of the other property given or the amount of money and the fair market value of the other property received; except that, in the case of services described in paragraphs (2) and (10) of subsection (d) the amount involved shall be only the excess compensation. For purposes of the preceding sentence, the fair market value—

(A) in the case of the tax imposed by subsection (a), shall be determined as of the date on which the prohibited transaction occurs; and

(B) in the case of the tax imposed by subsection (b), shall be the highest fair market value during the taxable period.

(5) CORRECTION.—The terms "correction" and "correct" mean, with respect to a prohibited transaction, undoing the transaction to the extent possible, but in any case placing the plan in a financial position not worse than that in which it would

be if the disqualified person were acting under the highest fiduciary standards.

(6) EXEMPTIONS NOT TO APPLY TO CERTAIN TRANSACTIONS.—

(A) IN GENERAL.—In the case of a trust described in section 401(a) which is part of a plan providing contributions or benefits for employees some or all of whom are owner-employees (as defined in section 401(c)(3)), the exemptions provided by subsection (d) (other than paragraphs (9) and (12)) shall not apply to a transaction in which the plan directly or indirectly—

(i) lends any part of the corpus or income of the plan to,

(ii) pays any compensation for personal services rendered to the plan to, or

(iii) acquires for the plan any property from, or sells any property to,

any such owner-employee, a member of the family (as defined in section 267(c)(4)) of any such owner-employee, or any corporation in which any such owner-employee owns, directly or indirectly, 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

(B) SPECIAL RULES FOR SHAREHOLDER-EMPLOYEES, ETC..—

(i) IN GENERAL.—For purposes of subparagraph (A), the following shall be treated as owner-employees:

(I) A shareholder-employee.

(II) A participant or beneficiary of an individual retirement plan (as defined in section 7701(a)(37)).

(III) An employer or association of employees which establishes such an individual retirement plan under section 408(c).

(ii) EXCEPTION FOR CERTAIN TRANSACTIONS INVOLVING SHAREHOLDER-EMPLOYEES.—Subparagraph (A)(iii) shall not apply to a transaction which consists of a sale of employer securities to an employee stock ownership plan (as defined in subsection (e)(7)) by a shareholder-employee, a member of the family (as defined in section 267(c)(4)) of such shareholder-employee, or a corporation in which such a shareholder-employee owns stock representing a 50 percent or greater interest described in subparagraph (A).

(iii) LOAN EXCEPTION.—For purposes of subparagraph (A)(i), the term "owner-employee" shall only include a person described in subclause (II) or (III) of clause (i).

(C) SHAREHOLDER-EMPLOYEE.—For purposes of subparagraph (B), the term "shareholder-employee" means an employee or officer of an S corporation who owns (or is considered as owning within the meaning of section 318(a)(1)) more than 5 percent of the outstanding stock of the corporation on any day during the taxable year of such corporation.

(7) S CORPORATION REPAYMENT OF LOANS FOR QUALIFYING EMPLOYER SECURITIES.—A plan shall not be treated as violating the requirements of section 401 or 409 or subsection (e)(7), or as engaging in a prohibited transaction for purposes of subsection (d)(3), merely by reason of any distribution (as described in section 1368(a)) with respect to S corporation stock that constitutes qualifying employer securities, which in accordance with the plan provisions is used to make payments on a loan described in subsection (d)(3) the proceeds of which were used to acquire such qualifying employer securities (whether or not allocated to participants). The preceding sentence shall not apply in the case of a distribution which is paid with respect to any employer security which is allocated to a participant unless the plan provides that employer securities with a fair market value of not less than the amount of such distribution are allocated to such participant for the year which (but for the preceding sentence) such distribution would have been allocated to such participant.

(8) PROVISION OF INVESTMENT ADVICE TO PARTICIPANT AND BENEFICIARIES.—

(A) IN GENERAL.—The prohibitions provided in subsection (c) shall not apply to transactions described in subsection (d)(17) if the investment advice provided by a fiduciary adviser is provided under an eligible investment advice arrangement.

(B) ELIGIBLE INVESTMENT ADVICE ARRANGEMENT.—For purposes of this paragraph, the term "eligible investment advice arrangement" means an arrangement—

(i) which either—

(I) provides that any fees (including any commission or other compensation) received by the fiduciary adviser for investment advice or with respect to the sale, holding, or acquisition of any security or other property for purposes of investment of plan assets do not vary depending on the basis of any investment option selected, or

(II) uses a computer model under an investment advice program meeting the requirements of subparagraph (C) in connection with the provision of investment advice by a fiduciary adviser to a participant or beneficiary, and

(ii) with respect to which the requirements of subparagraphs (D), (E), (F), (G), (H), and (I) are met.

(C) INVESTMENT ADVICE PROGRAM USING COMPUTER MODEL.—

(i) IN GENERAL.—An investment advice program meets the requirements of this subparagraph if the requirements of clauses (ii), (iii), and (iv) are met.

(ii) COMPUTER MODEL.—The requirements of this clause are met if the investment advice provided under the investment advice program is provided pursuant to a computer model that—

(I) applies generally accepted investment theories that take into account the historic returns of

different asset classes over defined periods of time,

(II) utilizes relevant information about the participant, which may include age, life expectancy, retirement age, risk tolerance, other assets or sources of income, and preferences as to certain types of investments,

(III) utilizes prescribed objective criteria to provide asset allocation portfolios comprised of investment options available under the plan,

(IV) operates in a manner that is not biased in favor of investments offered by the fiduciary adviser or a person with a material affiliation or contractual relationship with the fiduciary adviser, and

(V) takes into account all investment options under the plan in specifying how a participant's account balance should be invested and is not inappropriately weighted with respect to any investment option.

(iii) CERTIFICATION.—

(I) IN GENERAL.—The requirements of this clause are met with respect to any investment advice program if an eligible investment expert certifies, prior to the utilization of the computer model and in accordance with rules prescribed by the Secretary of Labor, that the computer model meets the requirements of clause (ii).

(II) RENEWAL OF CERTIFICATIONS.—If, as determined under regulations prescribed by the Secretary of Labor, there are material modifications to a computer model, the requirements of this clause are met only if a certification described in subclause (I) is obtained with respect to the computer model as so modified.

(III) ELIGIBLE INVESTMENT EXPERT.—The term "eligible investment expert" means any person which meets such requirements as the Secretary of Labor may provide and which does not bear any material affiliation or contractual relationship with any investment adviser or a related person thereof (or any employee, agent, or registered representative of the investment adviser or related person).

(iv) EXCLUSIVITY OF RECOMMENDATION.—The requirements of this clause are met with respect to any investment advice program if—

(I) the only investment advice provided under the program is the advice generated by the computer model described in clause (ii), and

(II) any transaction described in subsection (d)(17)(A)(ii) occurs solely at the direction of the participant or beneficiary.

Nothing in the preceding sentence shall preclude the participant or beneficiary from requesting investment advice

other than that described in clause (i), but only if such request has not been solicited by any person connected with carrying out the arrangement.

(D) EXPRESS AUTHORIZATION BY SEPARATE FIDUCIARY.—The requirements of this subparagraph are met with respect to an arrangement if the arrangement is expressly authorized by a plan fiduciary other than the person offering the investment advice program, any person providing investment options under the plan, or any affiliate of either.

(E) AUDITS.—

(i) IN GENERAL.—The requirements of this subparagraph are met if an independent auditor, who has appropriate technical training or experience and proficiency and so represents in writing—

(I) conducts an annual audit of the arrangement for compliance with the requirements of this paragraph, and

(II) following completion of the annual audit, issues a written report to the fiduciary who authorized use of the arrangement which presents its specific findings regarding compliance of the arrangement with the requirements of this paragraph.

(ii) SPECIAL RULE FOR INDIVIDUAL RETIREMENT AND SIMILAR PLANS.—In the case of a plan described in subparagraphs (B) through (F) (and so much of subparagraph (G) as relates to such subparagraphs) of subsection (e)(1), in lieu of the requirements of clause (i), audits of the arrangement shall be conducted at such times and in such manner as the Secretary of Labor may prescribe.

(iii) INDEPENDENT AUDITOR.—For purposes of this subparagraph, an auditor is considered independent if it is not related to the person offering the arrangement to the plan and is not related to any person providing investment options under the plan.

(F) DISCLOSURE.—The requirements of this subparagraph are met if—

(i) the fiduciary adviser provides to a participant or a beneficiary before the initial provision of the investment advice with regard to any security or other property offered as an investment option, a written notification (which may consist of notification by means of electronic communication)—

(I) of the role of any party that has a material affiliation or contractual relationship with the fiduciary adviser in the development of the investment advice program and in the selection of investment options available under the plan,

(II) of the past performance and historical rates of return of the investment options available under the plan,

(III) of all fees or other compensation relating to the advice that the fiduciary adviser or any affil-

iate thereof is to receive (including compensation provided by any third party) in connection with the provision of the advice or in connection with the sale, acquisition, or holding of the security or other property,

(IV) of any material affiliation or contractual relationship of the fiduciary adviser or affiliates thereof in the security or other property,

(V) of the manner, and under what circumstances, any participant or beneficiary information provided under the arrangement will be used or disclosed,

(VI) of the types of services provided by the fiduciary adviser in connection with the provision of investment advice by the fiduciary adviser,

(VII) that the adviser is acting as a fiduciary of the plan in connection with the provision of the advice, and

(VIII) that a recipient of the advice may separately arrange for the provision of advice by another adviser, that could have no material affiliation with and receive no fees or other compensation in connection with the security or other property, and

(ii) at all times during the provision of advisory services to the participant or beneficiary, the fiduciary adviser—

(I) maintains the information described in clause (i) in accurate form and in the manner described in subparagraph (H),

(II) provides, without charge, accurate information to the recipient of the advice no less frequently than annually,

(III) provides, without charge, accurate information to the recipient of the advice upon request of the recipient, and

(IV) provides, without charge, accurate information to the recipient of the advice concerning any material change to the information required to be provided to the recipient of the advice at a time reasonably contemporaneous to the change in information.

(G) OTHER CONDITIONS.—The requirements of this subparagraph are met if—

(i) the fiduciary adviser provides appropriate disclosure, in connection with the sale, acquisition, or holding of the security or other property, in accordance with all applicable securities laws,

(ii) the sale, acquisition, or holding occurs solely at the direction of the recipient of the advice,

(iii) the compensation received by the fiduciary adviser and affiliates thereof in connection with the sale, acquisition, or holding of the security or other property is reasonable, and

(iv) the terms of the sale, acquisition, or holding of the security or other property are at least as favorable to the plan as an arm's length transaction would be.

(H) STANDARDS FOR PRESENTATION OF INFORMATION.—

(i) IN GENERAL.—The requirements of this subparagraph are met if the notification required to be provided to participants and beneficiaries under subparagraph (F)(i) is written in a clear and conspicuous manner and in a manner calculated to be understood by the average plan participant and is sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of the information required to be provided in the notification.

(ii) MODEL FORM FOR DISCLOSURE OF FEES AND OTHER COMPENSATION.—The Secretary of Labor shall issue a model form for the disclosure of fees and other compensation required in subparagraph (F)(i)(III) which meets the requirements of clause (i).

(I) MAINTENANCE FOR 6 YEARS OF EVIDENCE OF COMPLIANCE.—The requirements of this subparagraph are met if a fiduciary adviser who has provided advice referred to in subparagraph (A) maintains, for a period of not less than 6 years after the provision of the advice, any records necessary for determining whether the requirements of the preceding provisions of this paragraph and of subsection (d)(17) have been met. A transaction prohibited under subsection (c) shall not be considered to have occurred solely because the records are lost or destroyed prior to the end of the 6-year period due to circumstances beyond the control of the fiduciary adviser.

(J) DEFINITIONS.—For purposes of this paragraph and subsection (d)(17)—

(i) FIDUCIARY ADVISER.—The term "fiduciary adviser" means, with respect to a plan, a person who is a fiduciary of the plan by reason of the provision of investment advice referred to in subsection (e)(3)(B) by the person to a participant or beneficiary of the plan and who is—

(I) registered as an investment adviser under the Investment Advisers Act of 1940 (15 U.S.C. 80b–1 et seq.) or under the laws of the State in which the fiduciary maintains its principal office and place of business,

(II) a bank or similar financial institution referred to in subsection (d)(4) or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1)), but only if the advice is provided through a trust department of the bank or similar financial institution or savings association which is subject to periodic examination and review by Federal or State banking authorities,

(III) an insurance company qualified to do business under the laws of a State,

(IV) a person registered as a broker or dealer under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.),

(V) an affiliate of a person described in any of subclauses (I) through (IV), or

(VI) an employee, agent, or registered representative of a person described in subclauses (I) through (V) who satisfies the requirements of applicable insurance, banking, and securities laws relating to the provision of the advice.

For purposes of this title, a person who develops the computer model described in subparagraph (C)(ii) or markets the investment advice program or computer model shall be treated as a person who is a fiduciary of the plan by reason of the provision of investment advice referred to in subsection (e)(3)(B) to a participant or beneficiary and shall be treated as a fiduciary adviser for purposes of this paragraph and subsection (d)(17), except that the Secretary of Labor may prescribe rules under which only 1 fiduciary adviser may elect to be treated as a fiduciary with respect to the plan.

(ii) AFFILIATE.—The term "affiliate" of another entity means an affiliated person of the entity (as defined in section 2(a)(3) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(3))).

(iii) REGISTERED REPRESENTATIVE.—The term "registered representative" of another entity means a person described in section 3(a)(18) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(18)) (substituting the entity for the broker or dealer referred to in such section) or a person described in section 202(a)(17) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a)(17)) (substituting the entity for the investment adviser referred to in such section).

(9) BLOCK TRADE.—The term "block trade" means any trade of at least 10,000 shares or with a market value of at least $200,000 which will be allocated across two or more unrelated client accounts of a fiduciary.

(10) ADEQUATE CONSIDERATION.—The term "adequate consideration" means—

(A) in the case of a security for which there is a generally recognized market—

(i) the price of the security prevailing on a national securities exchange which is registered under section 6 of the Securities Exchange Act of 1934, taking into account factors such as the size of the transaction and marketability of the security, or

(ii) if the security is not traded on such a national securities exchange, a price not less favorable to the plan than the offering price for the security as established by the current bid and asked prices quoted by persons independent of the issuer and of the party in interest, taking into account factors such as the size of the transaction and marketability of the security, and

(B) in the case of an asset other than a security for which there is a generally recognized market, the fair market value of the asset as determined in good faith by a fiduciary or fiduciaries in accordance with regulations prescribed by the Secretary of Labor.

(11) CORRECTION PERIOD.—

(A) IN GENERAL.—For purposes of subsection (d)(23), the term "correction period" means the 14-day period beginning on the date on which the disqualified person discovers, or reasonably should have discovered, that the transaction would (without regard to this paragraph and subsection (d)(23)) constitute a prohibited transaction.

(B) EXCEPTIONS.—

(i) EMPLOYER SECURITIES.—Subsection (d)(23) does not apply to any transaction between a plan and a plan sponsor or its affiliates that involves the acquisition or sale of an employer security (as defined in section 407(d)(1) of the Employee Retirement Income Security Act of 1974) or the acquisition, sale, or lease of employer real property (as defined in section 407(d)(2) of such Act).

(ii) KNOWING PROHIBITED TRANSACTION.—In the case of any disqualified person, subsection (d)(23) does not apply to a transaction if, at the time the transaction is entered into, the disqualified person knew (or reasonably should have known) that the transaction would (without regard to this paragraph) constitute a prohibited transaction.

(C) ABATEMENT OF TAX WHERE THERE IS A CORRECTION.—If a transaction is not treated as a prohibited transaction by reason of subsection (d)(23), then no tax under subsections (a) and (b) shall be assessed with respect to such transaction, and if assessed the assessment shall be abated, and if collected shall be credited or refunded as an overpayment.

(D) DEFINITIONS.—For purposes of this paragraph and subsection (d)(23)—

(i) SECURITY.—The term "security" has the meaning given such term by section 475(c)(2) (without regard to subparagraph (F)(iii) and the last sentence thereof).

(ii) COMMODITY.—The term "commodity" has the meaning given such term by section 475(e)(2) (without regard to subparagraph (D)(iii) thereof).

(iii) CORRECT.—The term "correct" means, with respect to a transaction—

(I) to undo the transaction to the extent possible and in any case to make good to the plan or affected account any losses resulting from the transaction, and

(II) to restore to the plan or affected account any profits made through the use of assets of the plan.

(g) APPLICATION OF SECTION.—This section shall not apply—

(1) in the case of a plan to which a guaranteed benefit policy (as defined in section 401(b)(2)(B) of the Employee Retirement

Income Security Act of 1974) is issued, to any assets of the insurance company, insurance service, or insurance organization merely because of its issuance of such policy;

(2) to a governmental plan (within the meaning of section 414(d)); or

(3) to a church plan (within the meaning of section 414(e)) with respect to which the election provided by section 410(d) has not been made.

In the case of a plan which invests in any security issued by an investment company registered under the Investment Company Act of 1940, the assets of such plan shall be deemed to include such security but shall not, by reason of such investment, be deemed to include any assets of such company.

(h) NOTIFICATION OF SECRETARY OF LABOR.—Before sending a notice of deficiency with respect to the tax imposed by subsection (a) or (b), the Secretary shall notify the Secretary of Labor and provide him a reasonable opportunity to obtain a correction of the prohibited transaction or to comment on the imposition of such tax.

(i) CROSS REFERENCE.—For provisions concerning coordination procedures between Secretary of Labor and Secretary of the Treasury with respect to application of tax imposed by this section and for authority to waive imposition of the tax imposed by subsection (b), see section 3003 of the Employee Retirement Income Security Act of 1974.

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Subtitle E—Alcohol, Tobacco, and Certain Other Excise Taxes

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CHAPTER 52—TOBACCO PRODUCTS AND CIGARETTE PAPERS AND TUBES

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Subchapter D—OCCUPATIONAL TAX

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SEC. 5733. PROVISIONS RELATING TO LIABILITY FOR OCCUPATIONAL TAXES.

(a) PARTNERS.—Any number of persons doing business in partnership at any one place shall be required to pay but one special tax.

(b) DIFFERENT BUSINESSES OF SAME OWNERSHIP AND LOCATION.—Whenever more than one of the pursuits or occupations described in this subchapter are carried on in the same place by the same person at the same time, except as otherwise provided in this subchapter, the tax shall be paid for each according to the rates severally prescribed.

(c) BUSINESSES IN MORE THAN ONE LOCATION.—

(1) LIABILITY FOR TAX.—The payment of a special tax imposed by this subchapter shall not exempt from an additional

special tax the person carrying on a trade or business in any other place than that stated in the register kept in the office of the official in charge of the internal revenue district.

(2) STORAGE.—Nothing contained in paragraph (1) shall require a special tax for the storage of tobacco products and cigarette papers and tubes at a location other than the place where tobacco products and cigarette papers and tubes are sold or offered for sale.

(3) DEFINITION OF PLACE.—The term "place" as used in this section means the entire office, plant or area of the business in any one location under the same proprietorship; and passageways, streets, highways, rail crossings, waterways, or partitions dividing the premises, shall not be deemed sufficient separation to require additional special tax, if the various divisions are otherwise contiguous.

(d) DEATH OR CHANGE OF LOCATION.—Certain persons, other than the person who has paid the special tax under this subchapter for the carrying on of any business at any place, may secure the right to carry on, without incurring additional special tax, the same business at the same place for the remainder of the taxable period for which the special tax was paid. The persons who may secure such right are:

(1) the surviving spouse or child, or executor or administrator or other legal representative, of a deceased taxpayer;

(2) a [husband or wife] *married individual* succeeding to the business of his or her living spouse;

(3) a receiver or trustee in bankruptcy, or an assignee for benefit of creditors; and

(4) the partner or partners remaining after death or withdrawal of a member of a partnership.

When any person moves to any place other than the place for which special tax was paid for the carrying on of any business, he may secure the right to carry on, without incurring additional special tax, the same business at his new location for the remainder of the taxable period for which the special tax was paid. To secure the right to carry on the business without incurring additional special tax, the successor, or the person relocating his business, must register the succession or relocation with the Secretary in accordance with regulations prescribed by the Secretary.

(e) FEDERAL AGENCIES OR INSTRUMENTALITIES.—Any tax imposed by this subchapter shall apply to any agency or instrumentality of the United States unless such agency or instrumentality is granted by statute a specific exemption from such tax.

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Subtitle F—Procedure and Administration

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CHAPTER 61—INFORMATION AND RETURNS

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Subchapter A—RETURNS AND RECORDS

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PART II—TAX RETURNS OR STATEMENTS

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Subpart B—INCOME TAX RETURNS

Sec 6012. Persons required to make returns of income.
[Sec. 6013. Joint returns of income tax by husband and wife.]
Sec. 6013. Joint returns of income tax by a married couple.

* * * * * * *

SEC. 6012. PERSONS REQUIRED TO MAKE RETURNS OF INCOME.

(a) GENERAL RULE.—Returns with respect to income taxes under subtitle A shall be made by the following:

(1)(A) Every individual having for the taxable year gross income which equals or exceeds the exemption amount, except that a return shall not be required of an individual—

(i) who is not married (determined by applying section 7703), is not a surviving spouse (as defined in section 2(a)), is not a head of a household (as defined in section 2(b)), and for the taxable year has gross income of less than the sum of the exemption amount plus the basic standard deduction applicable to such an individual,

(ii) who is a head of a household (as so defined) and for the taxable year has gross income of less than the sum of the exemption amount plus the basic standard deduction applicable to such an individual,

(iii) who is a surviving spouse (as so defined) and for the taxable year has gross income of less than the sum of the exemption amount plus the basic standard deduction applicable to such an individual, or

(iv) who is entitled to make a joint return and whose gross income, when combined with the gross income of [his spouse] *the individual's spouse* , is, for the taxable year, less than the sum of twice the exemption amount plus the basic standard deduction applicable to a joint return, but only if such individual and [his spouse] *the individual's spouse* , at the close of the taxable year, had the same household as their home.

Clause (iv) shall not apply if for the taxable year such spouse makes a separate return or any other taxpayer is entitled to an exemption for such spouse under section 151(c).

(B) The amount specified in clause (i), (ii), or (iii) of subparagraph (A) shall be increased by the amount of 1 additional standard deduction (within the meaning of section 63(c)(3)) in the case of an individual entitled to such deduction by reason of section 63(f)(1)(A) (relating to individuals age 65 or more), and the amount specified in clause (iv) of subparagraph (A) shall be increased by the amount of the additional standard deduction for each additional standard deduction to which the individual or [his spouse] *the individual's spouse* is entitled by reason of section 63(f)(1).

(C) The exception under subparagraph (A) shall not apply to any individual—

(i) who is described in section 63(c)(5) and who has—

(I) income (other than earned income) in excess of the sum of the amount in effect under section 63(c)(5)(A) plus the additional standard deduction (if any) to which the individual is entitled, or

(II) total gross income in excess of the standard deduction, or

(ii) for whom the standard deduction is zero under section 63(c)(6).

(D) For purposes of this subsection—

(i) The terms "standard deduction", "basic standard deduction" and "additional standard deduction" have the respective meanings given such terms by section 63(c).

(ii) The term "exemption amount" has the meaning given such term by section 151(d). In the case of an individual described in section 151(d)(2), the exemption amount shall be zero.

(2) Every corporation subject to taxation under subtitle A;

(3) Every estate the gross income of which for the taxable year is $600 or more;

(4) Every trust having for the taxable year any taxable income, or having gross income of $600 or over, regardless of the amount of taxable income;

(5) Every estate or trust of which any beneficiary is a nonresident alien;

(6) Every political organization (within the meaning of section 527(e)(1)), and every fund treated under section 527(g) as if it constituted a political organization, which has political organization taxable income (within the meaning of section 527(c)(1)) for the taxable year;

(7) Every homeowners association (within the meaning of section 528(c)(1)) which has homeowners association taxable income (within the meaning of section 528(d)) for the taxable year; and

(8) Every estate of an individual under chapter 7 or 11 of title 11 of the United States Code (relating to bankruptcy) the gross income of which for the taxable year is not less than the sum of the exemption amount plus the basic standard deduction under section 63(c)(2)(C);

except that subject to such conditions, limitations, and exceptions and under such regulations as may be prescribed by the Secretary, nonresident alien individuals subject to the tax imposed by section 871 and foreign corporations subject to the tax imposed by section 881 may be exempted from the requirement of making returns under this section.

(b) RETURNS MADE BY FIDUCIARIES AND RECEIVERS.—

(1) RETURNS OF DECEDENTS.—If an individual is deceased, the return of such individual required under subsection (a) shall be made by his executor, administrator, or other person charged with the property of such decedent.

(2) PERSONS UNDER A DISABILITY.—If an individual is unable to make a return required under subsection (a), the return of such individual shall be made by a duly authorized agent, his

committee, guardian, fiduciary or other person charged with the care of the person or property of such individual. The preceding sentence shall not apply in the case of a receiver appointed by authority of law in possession of only a part of the property of an individual.

(3) RECEIVERS, TRUSTEES AND ASSIGNEES FOR CORPORATIONS.—In a case where a receiver, trustee in a case under title 11 of the United States Code, or assignee, by order of a court of competent jurisdiction, by operation of law or otherwise, has possession of or holds title to all or substantially all the property or business of a corporation, whether or not such property or business is being operated, such receiver, trustee, or assignee shall make the return of income for such corporation in the same manner and form as corporations are required to make such returns.

(4) RETURNS OF ESTATES AND TRUSTS.—Returns of an estate, a trust, or an estate of an individual under chapter 7 or 11 of title 11 of the United States Code shall be made by the fiduciary thereof.

(5) JOINT FIDUCIARIES.—Under such regulations as the Secretary may prescribe, a return made by one of two or more joint fiduciaries shall be sufficient compliance with the requirements of this section. A return made pursuant to this paragraph shall contain a statement that the fiduciary has sufficient knowledge of the affairs of the person for whom the return is made to enable him to make the return, and that the return is, to the best of his knowledge and belief, true and correct.

(6) IRA SHARE OF PARTNERSHIP INCOME.—In the case of a trust which is exempt from taxation under section 408(e), for purposes of this section, the trust's distributive share of items of gross income and gain of any partnership to which subchapter C or D of chapter 63 applies shall be treated as equal to the trust's distributive share of the taxable income of such partnership.

(c) CERTAIN INCOME EARNED ABROAD OR FROM SALE OF RESIDENCE.—For purposes of this section, gross income shall be computed without regard to the exclusion provided for in section 121 (relating to gain from sale of principal residence) and without regard to the exclusion provided for in section 911 (relating to citizens or residents of the United States living abroad).

(d) TAX-EXEMPT INTEREST REQUIRED TO BE SHOWN ON RETURN.—Every person required to file a return under this section for the taxable year shall include on such return the amount of interest received or accrued during the taxable year which is exempt from the tax imposed by chapter 1.

(e) CONSOLIDATED RETURNS.—For provisions relating to consolidated returns by affiliated corporations, see chapter 6.

(f) SPECIAL RULE FOR TAXABLE YEARS 2018 THROUGH 2025.—In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026, subsection (a)(1) shall not apply, and every individual who has gross income for the taxable year shall be required to make returns with respect to income taxes under subtitle A, except that a return shall not be required of—

(1) an individual who is not married (determined by applying section 7703) and who has gross income for the taxable year which does not exceed the standard deduction applicable to such individual for such taxable year under section 63, or

(2) an individual entitled to make a joint return if—

(A) the gross income of such individual, when combined with the gross income of such individual's spouse, for the taxable year does not exceed the standard deduction which would be applicable to the taxpayer for such taxable year under section 63 if such individual and such individual's spouse made a joint return,

(B) such individual and such individual's spouse have the same household as their home at the close of the taxable year,

(C) such individual's spouse does not make a separate return, and

(D) neither such individual nor such individual's spouse is an individual described in section 63(c)(5) who has income (other than earned income) in excess of the amount in effect under section 63(c)(5)(A).

SEC. 6013. [JOINT RETURNS OF INCOME TAX BY HUSBAND AND WIFE] ***JOINT RETURNS OF INCOME TAX BY A MARRIED COUPLE***

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(a) JOINT RETURNS.—A [husband and wife] *married couple* may make a single return jointly of income taxes under subtitle A, even though one of the spouses has neither gross income nor deductions, except as provided below:

(1) no joint return shall be made if [either the husband or wife] *either spouse* at any time during the taxable year is a nonresident alien;

(2) no joint return shall be made if the [husband and wife] *spouses* have different taxable years; except that if such taxable years begin on the same day and end on different days because of the death of either or both, then the joint return may be made with respect to the taxable year of each. The above exception shall not apply if the surviving spouse remarries before the close of [his taxable year] *such spouse's taxable year* , nor if the taxable year of either spouse is a fractional part of a year under section 443(a)(1);

(3) in the case of death of one spouse or both spouses the joint return with respect to the decedent may be made only by [his executor or administrator] *the decedent's executor or administrator* ; except that in the case of the death of one spouse the joint return may be made by the surviving spouse [with respect to both himself and the decedent] *with respect to both the surviving spouse and the decedent* if no return for the taxable year has been made by the decedent, no executor or administrator has been appointed, and no executor or administrator is appointed before the last day prescribed by law for filing the return of the surviving spouse. If an executor or administrator of the decedent is appointed after the making of the joint return by the surviving spouse, the executor or administrator may disaffirm such joint return by making, within 1 year after the last day prescribed by law for filing the return of the surviving spouse, a separate return for the taxable year

of the decedent with respect to which the joint return was made, in which case the return made by the survivor shall [constitute his separate return] *constitute the survivor's separate return* .

(b) JOINT RETURN AFTER FILING SEPARATE RETURN.—

[(1) IN GENERAL.—Except as provided in paragraph (2), if an individual has filed a separate return for a taxable year for which a joint return could have been made by him and his spouse under subsection (a) and the time prescribed by law for filing the return for such taxable year has expired, such individual and his spouse may nevertheless make a joint return for such taxable year. A joint return filed by the husband and wife under this subsection shall constitute the return of the husband and wife for such taxable year, and all payments, credits, refunds, or other repayments made or allowed with respect to the separate return of either spouse for such taxable year shall be taken into account in determining the extent to which the tax based upon the joint return has been paid. If a joint return is made under this subsection, any election (other than the election to file a separate return) made by either spouse in his separate return for such taxable year with respect to the treatment of any income, deduction, or credit of such spouse shall not be changed in the making of the joint return where such election would have been irrevocable if the joint return had not been made. If a joint return is made under this subsection after the death of either spouse, such return with respect to the decedent can be made only by his executor or administrator.]

(1) IN GENERAL.—Except as provided in paragraph (2), if an individual has filed a separate return for a taxable year for which a joint return could have been made by the individual and the individual's spouse under subsection (a) and the time prescribed by law for filing the return for such taxable year has expired, such individual and such spouse may nevertheless make a joint return for such taxable year. A joint return filed under this subsection shall constitute the return of the individual and the individual's spouse for such taxable year, and all payments, credits, refunds, or other repayments made or allowed with respect to the separate return of either spouse for such taxable year shall be taken into account in determining the extent to which the tax based upon the joint return has been paid. If a joint return is made under this subsection, any election (other than the election to file a separate return) made by either spouse in a separate return for such taxable year with respect to the treatment of any income, deduction, or credit of such spouse shall not be changed in the making of the joint return where such election would have been irrevocable if the joint return had not been made. If a joint return is made under this subsection after the death of either spouse, such return with respect to the decedent can be made only by the decedent's executor or administrator.

(2) LIMITATIONS FOR MAKING OF ELECTION.—The election provided for in paragraph (1) may not be made—

(A) after the expiration of 3 years from the last date prescribed by law for filing the return for such taxable year

(determined without regard to any extension of time granted to either spouse); or

(B) after there has been mailed to either spouse, with respect to such taxable year, a notice of deficiency under section 6212, if the spouse, as to such notice, files a petition with the Tax Court within the time prescribed in section 6213; or

(C) after either spouse has commenced a suit in any court for the recovery of any part of the tax for such taxable year; or

(D) after either spouse has entered into a closing agreement under section 7121 with respect to such taxable year, or after any civil or criminal case arising against either spouse with respect to such taxable year has been compromised under section 7122.

(3) WHEN RETURN DEEMED FILED.—

(A) ASSESSMENT AND COLLECTION.—For purposes of section 6501 (relating to periods of limitations on assessment and collection), and for purposes of section 6651 (relating to delinquent returns), a joint return made under this subsection shall be deemed to have been filed—

(i) Where both spouses filed separate returns prior to making the joint return—on the date the last separate return was filed (but not earlier than the last date prescribed by law for filing the return of either spouse);

(ii) Where only one spouse filed a separate return prior to the making of the joint return, and the other spouse had less than the exemption amount of gross income for such taxable year—on the date of the filing of such separate return (but not earlier than the last date prescribed by law for the filing of such separate return); or

(iii) Where only one spouse filed a separate return prior to the making of the joint return, and the other spouse had gross income of the exemption amount or more for such taxable year—on the date of the filing of such joint return.

For purposes of this subparagraph, the term "exemption amount" has the meaning given to such term by section 151(d). For purposes of clauses (ii) and (iii), if the spouse whose gross income is being compared to the exemption amount is 65 or over, such clauses shall be applied by substituting "the sum of the exemption amount and the additional standard deduction under section 63(c)(2) by reason of section 63(f)(1)(A)" for "the exemption amount".

(B) CREDIT OR REFUND.—For purposes of section 6511, a joint return made under this subsection shall be deemed to have been filed on the last date prescribed by law for filing the return for such taxable year (determined without regard to any extension of time granted to either spouse).

(4) ADDITIONAL TIME FOR ASSESSMENT.—If a joint return is made under this subsection, the periods of limitations provided in sections 6501 and 6502 on the making of assessments and the beginning of levy or a proceeding in court for collection

shall with respect to such return include one year immediately after the date of the filing of such joint return (computed without regard to the provisions of paragraph (3)).

(5) ADDITIONS TO THE TAX AND PENALTIES.—

(A) COORDINATION WITH PART II OF SUBCHAPTER A OF CHAPTER 68.—For purposes of part II of subchapter A of chapter 68, where the sum of the amounts shown as tax on the separate returns of each spouse is less than the amount shown as tax on the joint return made under this subsection—

(i) such sum shall be treated as the amount shown on the joint return,

(ii) any negligence (or disregard of rules or regulations) on either separate return shall be treated as negligence (or such disregard) on the joint return, and

(iii) any fraud on either separate return shall be treated as fraud on the joint return.

(B) CRIMINAL PENALTY.—For purposes of section 7206(1) and (2) and section 7207 (relating to criminal penalties in the case of fraudulent returns) the term "return" includes a separate return filed by a spouse with respect to a taxable year for which a joint return is made under this subsection after the filing of such separate return.

(c) TREATMENT OF JOINT RETURN AFTER DEATH OF EITHER SPOUSE.—For purposes of sections 15, 443, and 7851(a)(1)(A), where the [husband and wife] *spouses* have different taxable years because of the death of either spouse, the joint return shall be treated as if the taxable years of both spouses ended on the date of the closing of the surviving spouse's taxable year.

(d) SPECIAL RULES.—For purposes of this section—

(1) the [status as husband and wife] *the marital status with respect to each other* of two individuals having taxable years beginning on the same day shall be determined—

(A) if both have the same taxable year—as of the close of such year; or

(B) if one dies before the close of the taxable year of the other—as of the time of such death;

(2) an individual who is legally separated from [his spouse] *the spouse of the individual* under a decree of divorce or of separate maintenance shall not be considered as married; and

(3) if a joint return is made, the tax shall be computed on the aggregate income and the liability with respect to the tax shall be joint and several.

(f) JOINT RETURN WHERE INDIVIDUAL IS IN MISSING STATUS.—For purposes of this section and subtitle A—

(1) ELECTION BY SPOUSE.—If—

(A) an individual is in a missing status (within the meaning of paragraph (3)) as a result of service in a combat zone (as determined for purposes of section 112), and

(B) the spouse of such individual is otherwise entitled to file a joint return for any taxable year which begins on or before the day which is 2 years after the date designated under section 112 as the date of termination of combatant activities in such zone,

then such spouse may elect under subsection (a) to file a joint return for such taxable year. With respect to service in the combat zone designated for purposes of the Vietnam conflict, such election may be made for any taxable year while an individual is in missing status.

(2) EFFECT OF ELECTION.—If the spouse of an individual described in paragraph (1)(A) elects to file a joint return under subsection (a) for a taxable year, then, until such election is revoked—

(A) such election shall be valid even if such individual died before the beginning of such year, and

(B) except for purposes of section 692 (relating to income taxes of members of the Armed Forces, astronauts, and victims of certain terrorist attacks on death), the income tax liability of ⟦such individual, his spouse, and his estate shall be determined as if he were alive⟧ *such individual, the individual's spouse, and the individual's estate shall be determined as if the individual were alive* throughout the taxable year.

(3) MISSING STATUS.—For purposes of this subsection—

(A) UNIFORMED SERVICES.—A member of a uniformed service (within the meaning of section 101(3) of title 37 of the United States Code) is in a missing status for any period ⟦for which he is entitled⟧ *for which such member is entitled* to pay and allowances under section 552 of such title 37.

(B) CIVILIAN EMPLOYEES.—An employee (within the meaning of section 5561(2) of title 5 of the United States Code) is in a missing status for any period ⟦for which he is entitled⟧ *for which such employee is entitled* to pay and allowances under section 5562 of such title 5.

(4) MAKING OF ELECTION; REVOCATION.—An election described in this subsection with respect to any taxable year may be made by filing a joint return in accordance with subsection (a) and under such regulations as may be prescribed by the Secretary. Such an election may be revoked by either spouse on or before the due date (including extensions) for such taxable year, and, in the case of an executor or administrator, may be revoked by disaffirming as provided in the last sentence of subsection (a)(3).

(g) ELECTION TO TREAT NONRESIDENT ALIEN INDIVIDUAL AS RESIDENT OF THE UNITED STATES.—

(1) IN GENERAL.—A nonresident alien individual with respect to whom this subsection is in effect for the taxable year shall be treated as a resident of the United States—

(A) for purposes of chapter 1 for all of such taxable year, and

(B) for purposes of chapter 24 (relating to wage withholding) for payments of wages made during such taxable year.

(2) INDIVIDUALS WITH RESPECT TO WHOM THIS SUBSECTION IS IN EFFECT.—This subsection shall be in effect with respect to any individual who, at the close of the taxable year for which an election under this subsection was made, was a nonresident alien individual married to a citizen or resident of the United

States, if both of them made such election to have the benefits of this subsection apply to them.

(3) DURATION OF ELECTION.—An election under this subsection shall apply to the taxable year for which made and to all subsequent taxable years until terminated under paragraph (4) or (5); except that any such election shall not apply for any taxable year if neither spouse is a citizen or resident of the United States at any time during such year.

(4) TERMINATION OF ELECTION.—An election under this subsection shall terminate at the earliest of the following times:

(A) REVOCATION BY TAXPAYERS.—If either taxpayer revokes the election, as of the first taxable year for which the last day prescribed by law for filing the return of tax under chapter 1 has not yet occurred.

(B) DEATH.—In the case of the death of either spouse, as of the beginning of the first taxable year of the spouse who survives following the taxable year in which such death occurred; except that if the spouse who survives is a citizen or resident of the United States who is a surviving spouse entitled to the benefits of section 2, the time provided by this subparagraph shall be as of the close of the last taxable year for which such individual is entitled to the benefits of section 2.

(C) LEGAL SEPARATION.—In the case of the legal separation of the couple under a decree of divorce or of separate maintenance, as of the beginning of the taxable year in which such legal separation occurs.

(D) TERMINATION BY SECRETARY.—At the time provided in paragraph (5).

(5) TERMINATION BY SECRETARY.—The Secretary may terminate any election under this subsection for any taxable year if he determines that either spouse has failed—

(A) to keep such books and records,

(B) to grant such access to such books and records, or

(C) to supply such other information,

as may be reasonably necessary to ascertain the amount of liability for taxes under chapter 1 of either spouse for such taxable year.

(6) ONLY ONE ELECTION.—If any election under this subsection for any two individuals is terminated under paragraph (4) or (5) for any taxable year, such two individuals shall be ineligible to make an election under this subsection for any subsequent taxable year.

(h) JOINT RETURN, ETC., FOR YEAR IN WHICH NONRESIDENT ALIEN BECOMES RESIDENT OF UNITED STATES.—

(1) IN GENERAL.—If—

(A) any individual is a nonresident alien individual at the beginning of any taxable year but is a resident of the United States at the close of such taxable year,

(B) at the close of such taxable year, such individual is married to a citizen or resident of the United States, and

(C) both individuals elect the benefits of this subsection at the time and in the manner prescribed by the Secretary by regulation,

then the individual referred to in subparagraph (A) shall be treated as a resident of the United States for purposes of chapter 1 for all of such taxable year, and for purposes of chapter 24 (relating to wage withholding) for payments of wages made during such taxable year.

(2) ONLY ONE ELECTION.—If any election under this subsection applies for any 2 individuals for any taxable year, such 2 individuals shall be ineligible to make an election under this subsection for any subsequent taxable year.

SEC. 6014. INCOME TAX RETURN—TAX NOT COMPUTED BY TAXPAYER.

(a) ELECTION BY TAXPAYER.—An individual who does not itemize his deductions and who is not described in section 6012(a)(1)(C)(i), whose gross income is less than $10,000 and includes no income other than remuneration for services performed by him as an employee, dividends or interest, and whose gross income other than wages, as defined in section 3401(a), does not exceed $100, shall at his election not be required to show on the return the tax imposed by section 1. Such election shall be made by using the form prescribed for purposes of this section. In such case the tax shall be computed by the Secretary who shall mail to the taxpayer a notice stating the amount determined as payable.

(b) REGULATIONS.—The Secretary shall prescribe regulations for carrying out this section, and such regulations may provide for the application of the rules of this section—

(1) to cases where the gross income includes items other than those enumerated by subsection (a),

(2) to cases where the gross income from sources other than wages on which the tax has been withheld at the source is more than $100,

(3) to cases where the gross income is $10,000 or more, or

(4) to cases where the taxpayer itemizes his deductions or where the taxpayer claims a reduced standard deduction by reason of section 63(c)(5).

Such regulations shall provide for the application of this section in the case of [husband and wife] *a married couple* , including provisions determining when a joint return under this section may be permitted or required, whether the liability shall be joint and several, and whether one spouse may make return under this section and the other without regard to this section.

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SEC. 6017. SELF-EMPLOYMENT TAX RETURNS.

Every individual (other than a nonresident alien individual) having net earnings from self-employment of $400 or more for the taxable year shall make a return with respect to the self-employment tax imposed by chapter 2. In the case of a [husband and wife] *married couple* filing a joint return under section 6013, the tax imposed by chapter 2 shall not be computed on the aggregate income but shall be the sum of the taxes computed under such chapter on the separate self-employment income of each spouse.

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PART III—INFORMATION RETURNS

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Subpart B—INFORMATION CONCERNING TRANSACTIONS WITH OTHER PERSONS

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SEC. 6046. RETURNS AS TO ORGANIZATION OR REORGANIZATION OF FOREIGN CORPORATIONS AND AS TO ACQUISITIONS OF THEIR STOCK.

(a) REQUIREMENT OF RETURN.—

(1) IN GENERAL.—A return complying with the requirements of subsection (b) shall be made by—

(A) each United States citizen or resident who becomes an officer or director of a foreign corporation if a United States person (as defined in section 7701(a)(30)) meets the stock ownership requirements of paragraph (2) with respect to such corporation,

(B) each United States person—

(i) who acquires stock which, when added to any stock owned on the date of such acquisition, meets the stock ownership requirements of paragraph (2) with respect to a foreign corporation, or

(ii) who acquires stock which, without regard to stock owned on the date of such acquisition, meets the stock ownership requirements of paragraph (2) with respect to a foreign corporation,

(C) each person (not described in subparagraph (B)) who is treated as a United States shareholder under section 953(c) with respect to a foreign corporation, and

(D) each person who becomes a United States person while meeting the stock ownership requirements of paragraph (2) with respect to stock of a foreign corporation.

In the case of a foreign corporation with respect to which any person is treated as a United States shareholder under section 953(c), subparagraph (A) shall be treated as including a reference to each United States person who is an officer or director of such corporation.

(2) STOCK OWNERSHIP REQUIREMENTS.—A person meets the stock ownership requirements of this paragraph with respect to any corporation if such person owns 10 percent or more of—

(A) the total combined voting power of all classes of stock of such corporation entitled to vote, or

(B) the total value of the stock of such corporation.

(b) FORM AND CONTENTS OF RETURNS.—The returns required by subsection (a) shall be in such form and shall set forth, in respect of the foreign corporation, such information as the Secretary prescribes by forms or regulations as necessary for carrying out the provisions of the income tax laws, except that in the case of persons described only in subsection (a)(1)(A) the information required shall be limited to the names and addresses of persons described in subparagraph (B) or (C) of subsection (a)(1).

(c) OWNERSHIP OF STOCK.—For purposes of subsection (a), stock owned directly or indirectly by a person (including, in the case of an individual, stock owned by members of [his] *the individual's* family) shall be taken into account. For purposes of the preceding sentence, the family of an individual shall be considered as including only [his] *the individual's* brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

(d) TIME FOR FILING.—Any return required by subsection (a) shall be filed on or before the 90th day after the day on which, under any provision of subsection (a), the United States citizen, resident, or person becomes liable to file such return (or on or before such later day as the Secretary may by forms or regulations prescribe).

(e) LIMITATION.—No information shall be required to be furnished under this section with respect to any foreign corporation unless such information was required to be furnished under regulations which have been in effect for at least 90 days before the date on which the United States citizen, resident, or person becomes liable to file a return required under subsection (a).

(f) CROSS REFERENCE.—For provisions relating to penalties for violations of this section, sections 6679 and 7203.

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PART VIII—DESIGNATION OF INCOME TAX PAYMENTS TO PRESIDENTIAL ELECTION CAMPAIGN FUND

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SEC. 6096. DESIGNATION BY INDIVIDUALS.

(a) IN GENERAL.—Every individual (other than a nonresident alien) whose income tax liability for the taxable year is $3 or more may designate that $3 shall be paid over to the Presidential Election Campaign Fund in accordance with the provisions of section 9006(a). In the case of a joint return [of husband and wife having] *reporting* an income tax liability of $6 or more, each spouse may designate that $3 shall be paid to the fund.

(b) INCOME TAX LIABILITY.—For purposes of subsection (a), the income tax liability of an individual for any taxable year is the amount of the tax imposed by chapter 1 on such individual for such taxable year (as shown on his return), reduced by the sum of the credits (as shown in his return) allowable under part IV of subchapter A of chapter 1 (other than subpart C thereof).

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

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

(2) at any other time (after the time of filing the return of the tax imposed by chapter 1 for such taxable year) specified in regulations prescribed by the Secretary.

Such designation shall be made in such manner as the Secretary prescribes by regulations except that, if such designation is made at the time of filing the return of the tax imposed by chapter 1 for such taxable year, such designation shall be made either on the first page of the return or on the page bearing the taxpayer's signature.

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Subchapter B—MISCELLANEOUS PROVISIONS

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SEC. 6103. CONFIDENTIALITY AND DISCLOSURE OF RETURNS AND RETURN INFORMATION.

(a) GENERAL RULE.—Returns and return information shall be confidential, and except as authorized by this title—

(1) no officer or employee of the United States,

(2) no officer or employee of any State, any local law enforcement agency receiving information under subsection (i)(1)(C) or (7)(A), any local child support enforcement agency, or any local agency administering a program listed in subsection (*l*)(7)(D) who has or had access to returns or return information under this section or section 6104(c), and

(3) no other person (or officer or employee thereof) who has or had access to returns or return information under subsection (e)(1)(D)(iii), subsection (k)(10), paragraph (6), (10), (12), (16), (19), (20), or (21) of subsection (*l*), paragraph (2) or (4)(B) of subsection (m), or subsection (n),

shall disclose any return or return information obtained by him in any manner in connection with his service as such an officer or an employee or otherwise or under the provisions of this section. For purposes of this subsection, the term "officer or employee" includes a former officer or employee.

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

(1) RETURN.—The term "return" means any tax or information return, declaration of estimated tax, or claim for refund required by, or provided for or permitted under, the provisions of this title which is filed with the Secretary by, on behalf of, or with respect to any person, and any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed.

(2) RETURN INFORMATION.—The term "return information" means—

(A) a taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense,

(B) any part of any written determination or any background file document relating to such written determination (as such terms are defined in section 6110(b)) which is not open to public inspection under section 6110,

(C) any advance pricing agreement entered into by a taxpayer and the Secretary and any background information related to such agreement or any application for an advance pricing agreement, and

(D) any agreement under section 7121, and any similar agreement, and any background information related to such an agreement or request for such an agreement,

but such term does not include data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer. Nothing in the preceding sentence, or in any other provision of law, shall be construed to require the disclosure of standards used or to be used for the selection of returns for examination, or data used or to be used for determining such standards, if the Secretary determines that such disclosure will seriously impair assessment, collection, or enforcement under the internal revenue laws.

(3) TAXPAYER RETURN INFORMATION.—The term "taxpayer return information" means return information as defined in paragraph (2) which is filed with, or furnished to, the Secretary by or on behalf of the taxpayer to whom such return information relates.

(4) TAX ADMINISTRATION.—The term "tax administration"—

(A) means—

(i) the administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws or related statutes (or equivalent laws and statutes of a State) and tax conventions to which the United States is a party, and

(ii) the development and formulation of Federal tax policy relating to existing or proposed internal revenue laws, related statutes, and tax conventions, and

(B) includes assessment, collection, enforcement, litigation, publication, and statistical gathering functions under such laws, statutes, or conventions.

(5) STATE.—

(A) IN GENERAL.—The term "State" means—

(i) any of the 50 States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands,

(ii) for purposes of subsections (a)(2), (b)(4), (d)(1), (h)(4), and (p), any municipality—

(I) with a population in excess of 250,000 (as determined under the most recent decennial United States census data available),

(II) which imposes a tax on income or wages, and

(III) with which the Secretary (in his sole discretion) has entered into an agreement regarding disclosure, and

(iii) for purposes of subsections (a)(2), (b)(4), (d)(1), (h)(4), and (p), any governmental entity—

(I) which is formed and operated by a qualified group of municipalities, and

(II) with which the Secretary (in his sole discretion) has entered into an agreement regarding disclosure.

(B) REGIONAL INCOME TAX AGENCIES.—For purposes of subparagraph (A)(iii)—

(i) QUALIFIED GROUP OF MUNICIPALITIES.—The term "qualified group of municipalities" means, with respect to any governmental entity, 2 or more municipalities—

(I) each of which imposes a tax on income or wages,

(II) each of which, under the authority of a State statute, administers the laws relating to the imposition of such taxes through such entity, and

(III) which collectively have a population in excess of 250,000 (as determined under the most recent decennial United States census data available).

(ii) REFERENCES TO STATE LAW, ETC..—For purposes of applying subparagraph (A)(iii) to the subsections referred to in such subparagraph, any reference in such subsections to State law, proceedings, or tax returns shall be treated as references to the law, proceedings, or tax returns, as the case may be, of the municipalities which form and operate the governmental entity referred to in such subparagraph.

(iii) DISCLOSURE TO CONTRACTORS AND OTHER AGENTS.—Notwithstanding any other provision of this section, no return or return information shall be disclosed to any contractor or other agent of a governmental entity referred to in subparagraph (A)(iii) unless such entity, to the satisfaction of the Secretary—

(I) has requirements in effect which require each such contractor or other agent which would have access to returns or return information to provide safeguards (within the meaning of subsection (p)(4)) to protect the confidentiality of such returns or return information,

(II) agrees to conduct an on-site review every 3 years (or a mid-point review in the case of contracts or agreements of less than 3 years in duration) of each contractor or other agent to determine compliance with such requirements,

(III) submits the findings of the most recent review conducted under subclause (II) to the Secretary as part of the report required by subsection (p)(4)(E), and

(IV) certifies to the Secretary for the most recent annual period that such contractor or other agent is in compliance with all such requirements.

The certification required by subclause (IV) shall include the name and address of each contractor and other agent, a description of the contract or agreement with such contractor or other agent, and the duration of such contract or agreement. The requirements of this clause shall not apply to disclosures pursuant to subsection (n) for purposes of Federal tax administration and a rule similar to the rule of subsection (p)(8)(B) shall apply for purposes of this clause.

(6) TAXPAYER IDENTITY.—The term "taxpayer identity" means the name of a person with respect to whom a return is filed, his mailing address, his taxpayer identifying number (as described in section 6109), or a combination thereof.

(7) INSPECTION.—The terms "inspected" and "inspection" mean any examination of a return or return information.

(8) DISCLOSURE.—The term "disclosure" means the making known to any person in any manner whatever a return or return information.

(9) FEDERAL AGENCY.—The term "Federal agency" means an agency within the meaning of section 551(1) of title 5, United States Code.

(10) CHIEF EXECUTIVE OFFICER.—The term "chief executive officer" means, with respect to any municipality, any elected official and the chief official (even if not elected) of such municipality.

(11) TERRORIST INCIDENT, THREAT, OR ACTIVITY.—The term "terrorist incident, threat, or activity" means an incident, threat, or activity involving an act of domestic terrorism (as defined in section 2331(5) of title 18, United States Code) or international terrorism (as defined in section 2331(1) of such title).

(c) DISCLOSURE OF RETURNS AND RETURN INFORMATION TO DESIGNEE OF TAXPAYER.—The Secretary may, subject to such requirements and conditions as he may prescribe by regulations, disclose the return of any taxpayer, or return information with respect to such taxpayer, to such person or persons as the taxpayer may designate in a request for or consent to such disclosure, or to any other person at the taxpayer's request to the extent necessary to comply with a request for information or assistance made by the taxpayer to such other person. However, return information shall not be disclosed to such person or persons if the Secretary determines that such disclosure would seriously impair Federal tax administration.

(d) DISCLOSURE TO STATE TAX OFFICIALS AND STATE AND LOCAL LAW ENFORCEMENT AGENCIES.—

(1) IN GENERAL.—Returns and return information with respect to taxes imposed by chapters 1, 2, 6, 11, 12, 21, 23, 24, 31, 32, 44, 51, and 52 and subchapter D of chapter 36 shall be open to inspection by, or disclosure to, any State agency, body, or commission, or its legal representative, which is charged under the laws of such State with responsibility for the administration of State tax laws for the purpose of, and only to the extent necessary in, the administration of such laws, including any procedures with respect to locating any person who may be entitled to a refund. Such inspection shall be permitted, or such disclosure made, only upon written request by the head of such agency, body, or commission, and only to the representatives of such agency, body, or commission designated in such written request as the individuals who are to inspect or to receive the returns or return information on behalf of such agency, body, or commission. Such representatives shall not include any individual who is the chief executive officer of such State or who is neither an employee or legal representative of such agency, body, or commission nor a person described in subsection (n). However, such return information shall not be disclosed to the extent that the Secretary determines that such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation.

(2) DISCLOSURE TO STATE AUDIT AGENCIES.—

(A) IN GENERAL.—Any returns or return information obtained under paragraph (1) by any State agency, body, or commission may be open to inspection by, or disclosure to, officers and employees of the State audit agency for the purpose of, and only to the extent necessary in, making an audit of the State agency, body, or commission referred to in paragraph (1).

(B) STATE AUDIT AGENCY.—For purposes of subparagraph (A), the term "State audit agency" means any State agency, body, or commission which is charged under the laws of the State with the responsibility of auditing State revenues and programs.

(3) EXCEPTION FOR REIMBURSEMENT UNDER SECTION 7624.—Nothing in this section shall be construed to prevent the Secretary from disclosing to any State or local law enforcement agency which may receive a payment under section 7624 the amount of the recovered taxes with respect to which such a payment may be made.

(4) AVAILABILITY AND USE OF DEATH INFORMATION.—

(A) IN GENERAL.—No returns or return information may be disclosed under paragraph (1) to any agency, body, or commission of any State (or any legal representative thereof) during any period during which a contract meeting the requirements of subparagraph (B) is not in effect between such State and the Secretary of Health and Human Services.

(B) CONTRACTUAL REQUIREMENTS.—A contract meets the requirements of this subparagraph if—

(i) such contract requires the State to furnish the Secretary of Health and Human Services information concerning individuals with respect to whom death certificates (or equivalent documents maintained by the State or any subdivision thereof) have been officially filed with it, and

(ii) such contract does not include any restriction on the use of information obtained by such Secretary pursuant to such contract, except that such contract may provide that such information is only to be used by the Secretary (or any other Federal agency) for purposes of ensuring that Federal benefits or other payments are not erroneously paid to deceased individuals.

Any information obtained by the Secretary of Health and Human Services under such a contract shall be exempt from disclosure under section 552 of title 5, United States Code, and from the requirements of section 552a of such title 5.

(C) SPECIAL EXCEPTION.—The provisions of subparagraph (A) shall not apply to any State which on July 1, 1993, was not, pursuant to a contract, furnishing the Secretary of Health and Human Services information concerning individuals with respect to whom death certificates (or equivalent documents maintained by the State or any subdivision thereof) have been officially filed with it.

(5) DISCLOSURE FOR COMBINED EMPLOYMENT TAX REPORTING.—

(A) IN GENERAL.—The Secretary may disclose taxpayer identity information and signatures to any agency, body, or commission of any State for the purpose of carrying out with such agency, body, or commission a combined Federal and State employment tax reporting program approved by the Secretary. Subsections (a)(2) and (p)(4) and sections 7213 and 7213A shall not apply with respect to disclosures or inspections made pursuant to this paragraph.

(B) TERMINATION.—The Secretary may not make any disclosure under this paragraph after December 31, 2007.

(6) LIMITATION ON DISCLOSURE REGARDING REGIONAL INCOME TAX AGENCIES TREATED AS STATES.—For purposes of paragraph (1), inspection by or disclosure to an entity described in subsection (b)(5)(A)(iii) shall be for the purpose of, and only to the extent necessary in, the administration of the laws of the member municipalities in such entity relating to the imposition of a tax on income or wages. Such entity may not redisclose any return or return information received pursuant to paragraph (1) to any such member municipality.

(e) DISCLOSURE TO PERSONS HAVING MATERIAL INTEREST.—

(1) IN GENERAL.—The return of a person shall, upon written request, be open to inspection by or disclosure to—

(A) in the case of the return of an individual—

(i) that individual,

(ii) the spouse of that individual if the individual and such spouse have signified their consent to consider a gift reported on such return as made one-half by [him] *the individual* and one-half by the spouse pursuant to the provisions of section 2513; or

(iii) the child of that individual (or such child's legal representative) to the extent necessary to comply with the provisions of section 1(g);

(B) in the case of an income tax return filed jointly, either of the individuals with respect to whom the return is filed;

(C) in the case of the return of a partnership, any person who was a member of such partnership during any part of the period covered by the return;

(D) in the case of the return of a corporation or a subsidiary thereof—

(i) any person designated by resolution of its board of directors or other similar governing body,

(ii) any officer or employee of such corporation upon written request signed by any principal officer and attested to by the secretary or other officer,

(iii) any bona fide shareholder of record owning 1 percent or more of the outstanding stock of such corporation,

(iv) if the corporation was an S corporation, any person who was a shareholder during any part of the period covered by such return during which an election under section 1362(a) was in effect, or

(v) if the corporation has been dissolved, any person authorized by applicable State law to act for the corporation or any person who the Secretary finds to

have a material interest which will be affected by information contained therein;

(E) in the case of the return of an estate—

(i) the administrator, executor, or trustee of such estate, and

(ii) any heir at law, next of kin, or beneficiary under the will, of the decedent, but only if the Secretary finds that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained therein; and

(F) in the case of the return of a trust—

(i) the trustee or trustees, jointly or separately, and

(ii) any beneficiary of such trust, but only if the Secretary finds that such beneficiary has a material interest which will be affected by information contained therein.

(2) INCOMPETENCY.—If an individual described in paragraph (1) is legally incompetent, the applicable return shall, upon written request, be open to inspection by or disclosure to the committee, trustee, or guardian of his estate.

(3) DECEASED INDIVIDUALS.—The return of a decedent shall, upon written request, be open to inspection by or disclosure to—

(A) the administrator, executor, or trustee of his estate, and

(B) any heir at law, next of kin, or beneficiary under the will, of such decedent, or a donee of property, but only if the Secretary finds that such heir at law, next of kin, beneficiary, or donee has a material interest which will be affected by information contained therein.

(4) TITLE 11 CASES AND RECEIVERSHIP PROCEEDINGS.—If—

(A) there is a trustee in a title 11 case in which the debtor is the person with respect to whom the return is filed, or

(B) substantially all of the property of the person with respect to whom the return is filed is in the hands of a receiver,

such return or returns for prior years of such person shall, upon written request, be open to inspection by or disclosure to such trustee or receiver, but only if the Secretary finds that such trustee or receiver, in his fiduciary capacity, has a material interest which will be affected by information contained therein.

(5) INDIVIDUAL'S TITLE 11 CASE.—

(A) IN GENERAL.—In any case to which section 1398 applies (determined without regard to section 1398(b)(1)), any return of the debtor for the taxable year in which the case commenced or any preceding taxable year shall, upon written request, be open to inspection by or disclosure to the trustee in such case.

(B) RETURN OF ESTATE AVAILABLE TO DEBTOR.—Any return of an estate in a case to which section 1398 applies shall, upon written request, be open to inspection by or disclosure to the debtor in such case.

(C) SPECIAL RULE FOR INVOLUNTARY CASES.—In an involuntary case, no disclosure shall be made under subparagraph (A) until the order for relief has been entered by the court having jurisdiction of such case unless such court finds that such disclosure is appropriate for purposes of determining whether an order for relief should be entered.

(6) ATTORNEY IN FACT.—Any return to which this subsection applies shall, upon written request, also be open to inspection by or disclosure to the attorney in fact duly authorized in writing by any of the persons described in paragraph (1), (2), (3), (4), (5), (8), or (9) to inspect the return or receive the information on his behalf, subject to the conditions provided in such paragraphs.

(7) RETURN INFORMATION.—Return information with respect to any taxpayer may be open to inspection by or disclosure to any person authorized by this subsection to inspect any return of such taxpayer if the Secretary determines that such disclosure would not seriously impair Federal tax administration.

(8) DISCLOSURE OF COLLECTION ACTIVITIES WITH RESPECT TO JOINT RETURN.—If any deficiency of tax with respect to a joint return is assessed and the individuals filing such return are no longer married or no longer reside in the same household, upon request in writing by either of such individuals, the Secretary shall disclose in writing to the individual making the request whether the Secretary has attempted to collect such deficiency from such other individual, the general nature of such collection activities, and the amount collected. The preceding sentence shall not apply to any deficiency which may not be collected by reason of section 6502.

(9) DISCLOSURE OF CERTAIN INFORMATION WHERE MORE THAN 1 PERSON SUBJECT TO PENALTY UNDER SECTION 6672.—If the Secretary determines that a person is liable for a penalty under section 6672(a) with respect to any failure, upon request in writing of such person, the Secretary shall disclose in writing to such person—

(A) the name of any other person whom the Secretary has determined to be liable for such penalty with respect to such failure, and

(B) whether the Secretary has attempted to collect such penalty from such other person, the general nature of such collection activities, and the amount collected.

(10) LIMITATION ON CERTAIN DISCLOSURES UNDER THIS SUBSECTION.—In the case of an inspection or disclosure under this subsection relating to the return of a partnership, S corporation, trust, or an estate, the information inspected or disclosed shall not include any supporting schedule, attachment, or list which includes the taxpayer identity information of a person other than the entity making the return or the person conducting the inspection or to whom the disclosure is made.

(11) DISCLOSURE OF INFORMATION REGARDING STATUS OF INVESTIGATION OF VIOLATION OF THIS SECTION.—In the case of a person who provides to the Secretary information indicating a violation of section 7213, 7213A, or 7214 with respect to any return or return information of such person, the Secretary may disclose to such person (or such person's designee)—

(A) whether an investigation based on the person's provision of such information has been initiated and whether it is open or closed,

(B) whether any such investigation substantiated such a violation by any individual, and

(C) whether any action has been taken with respect to such individual (including whether a referral has been made for prosecution of such individual).

(f) DISCLOSURE TO COMMITTEES OF CONGRESS.—

(1) COMMITTEE ON WAYS AND MEANS, COMMITTEE ON FINANCE, AND JOINT COMMITTEE ON TAXATION.—Upon written request from the chairman of the Committee on Ways and Means of the House of Representatives, the chairman of the Committee on Finance of the Senate, or the chairman of the Joint Committee on Taxation, the Secretary shall furnish such committee with any return or return information specified in such request, except that any return or return information which can be associated with, or otherwise identify, directly or indirectly, a particular taxpayer shall be furnished to such committee only when sitting in closed executive session unless such taxpayer otherwise consents in writing to such disclosure.

(2) CHIEF OF STAFF OF JOINT COMMITTEE ON TAXATION.—Upon written request by the Chief of Staff of the Joint Committee on Taxation, the Secretary shall furnish him with any return or return information specified in such request. Such Chief of Staff may submit such return or return information to any committee described in paragraph (1), except that any return or return information which can be associated with, or otherwise identify, directly or indirectly, a particular taxpayer shall be furnished to such committee only when sitting in closed executive session unless such taxpayer otherwise consents in writing to such disclosure.

(3) OTHER COMMITTEES.—Pursuant to an action by, and upon written request by the chairman of, a committee of the Senate or the House of Representatives (other than a committee specified in paragraph (1)) specially authorized to inspect any return or return information by a resolution of the Senate or the House of Representatives or, in the case of a joint committee (other than the joint committee specified in paragraph (1)) by concurrent resolution, the Secretary shall furnish such committee, or a duly authorized and designated subcommittee thereof, sitting in closed executive session, with any return or return information which such resolution authorizes the committee or subcommittee to inspect. Any resolution described in this paragraph shall specify the purpose for which the return or return information is to be furnished and that such information cannot reasonably be obtained from any other source.

(4) AGENTS OF COMMITTEES AND SUBMISSION OF INFORMATION TO SENATE OR HOUSE OF REPRESENTATIVES.—

(A) COMMITTEES DESCRIBED IN PARAGRAPH (1).—Any committee described in paragraph (1) or the Chief of Staff of the Joint Committee on Taxation shall have the authority, acting directly, or by or through such examiners or agents as the chairman of such committee or such chief of staff may designate or appoint, to inspect returns and return in-

formation at such time and in such manner as may be determined by such chairman or chief of staff. Any return or return information obtained by or on behalf of such committee pursuant to the provisions of this subsection may be submitted by the committee to the Senate or the House of Representatives, or to both. The Joint Committee on Taxation may also submit such return or return information to any other committee described in paragraph (1), except that any return or return information which can be associated with, or otherwise identify, directly or indirectly, a particular taxpayer shall be furnished to such committee only when sitting in closed executive session unless such taxpayer otherwise consents in writing to such disclosure.

(B) OTHER COMMITTEES.—Any committee or subcommittee described in paragraph (3) shall have the right, acting directly, or by or through no more than four examiners or agents, designated or appointed in writing in equal numbers by the chairman and ranking minority member of such committee or subcommittee, to inspect returns and return information at such time and in such manner as may be determined by such chairman and ranking minority member. Any return or return information obtained by or on behalf of such committee or subcommittee pursuant to the provisions of this subsection may be submitted by the committee to the Senate or the House of Representatives, or to both, except that any return or return information which can be associated with, or otherwise identify, directly or indirectly, a particular taxpayer, shall be furnished to the Senate or the House of Representatives only when sitting in closed executive session unless such taxpayer otherwise consents in writing to such disclosure.

(5) DISCLOSURE BY WHISTLEBLOWER.—Any person who otherwise has or had access to any return or return information under this section may disclose such return or return information to a committee referred to in paragraph (1) or any individual authorized to receive or inspect information under paragraph (4)(A) if such person believes such return or return information may relate to possible misconduct, maladministration, or taxpayer abuse.

(g) DISCLOSURE TO PRESIDENT AND CERTAIN OTHER PERSONS.—

(1) IN GENERAL.—Upon written request by the President, signed by him personally, the Secretary shall furnish to the President, or to such employee or employees of the White House Office as the President may designate by name in such request, a return or return information with respect to any taxpayer named in such request. Any such request shall state—

(A) the name and address of the taxpayer whose return or return information is to be disclosed,

(B) the kind of return or return information which is to be disclosed,

(C) the taxable period or periods covered by such return or return information, and

(D) the specific reason why the inspection or disclosure is requested.

(2) DISCLOSURE OF RETURN INFORMATION AS TO PRESIDENTIAL APPOINTEES AND CERTAIN OTHER FEDERAL GOVERNMENT APPOINTEES.—The Secretary may disclose to a duly authorized representative of the Executive Office of the President or to the head of any Federal agency, upon written request by the President or head of such agency, or to the Federal Bureau of Investigation on behalf of and upon written request by the President or such head, return information with respect to an individual who is designated as being under consideration for appointment to a position in the executive or judicial branch of the Federal Government. Such return information shall be limited to whether such individual—

(A) has filed returns with respect to the taxes imposed under chapter 1 for not more than the immediately preceding 3 years;

(B) has failed to pay any tax within 10 days after notice and demand, or has been assessed any penalty under this title for negligence, in the current year or immediately preceding 3 years;

(C) has been or is under investigation for possible criminal offenses under the internal revenue laws and the results of any such investigation; or

(D) has been assessed any civil penalty under this title for fraud.

Within 3 days of the receipt of any request for any return information with respect to any individual under this paragraph, the Secretary shall notify such individual in writing that such information has been requested under the provisions of this paragraph.

(3) RESTRICTION ON DISCLOSURE.—The employees to whom returns and return information are disclosed under this subsection shall not disclose such returns and return information to any other person except the President or the head of such agency without the personal written direction of the President or the head of such agency.

(4) RESTRICTION ON DISCLOSURE TO CERTAIN EMPLOYEES.—Disclosure of returns and return information under this subsection shall not be made to any employee whose annual rate of basic pay is less than the annual rate of basic pay specified for positions subject to section 5316 of title 5, United States Code.

(5) REPORTING REQUIREMENTS.—Within 30 days after the close of each calendar quarter, the President and the head of any agency requesting returns and return information under this subsection shall each file a report with the Joint Committee on Taxation setting forth the taxpayers with respect to whom such requests were made during such quarter under this subsection, the returns or return information involved, and the reasons for such requests. The President shall not be required to report on any request for returns and return information pertaining to an individual who was an officer or employee of the executive branch of the Federal Government at the time such request was made. Reports filed pursuant to this para-

graph shall not be disclosed unless the Joint Committee on Taxation determines that disclosure thereof (including identifying details) would be in the national interest. Such reports shall be maintained by the Joint Committee on Taxation for a period not exceeding 2 years unless, within such period, the Joint Committee on Taxation determines that a disclosure to the Congress is necessary.

(h) DISCLOSURE TO CERTAIN FEDERAL OFFICERS AND EMPLOYEES FOR PURPOSES OF TAX ADMINISTRATION, ETC..—

(1) DEPARTMENT OF THE TREASURY.—Returns and return information shall, without written request, be open to inspection by or disclosure to officers and employees of the Department of the Treasury whose official duties require such inspection or disclosure for tax administration purposes.

(2) DEPARTMENT OF JUSTICE.—In a matter involving tax administration, a return or return information shall be open to inspection by or disclosure to officers and employees of the Department of Justice (including United States attorneys) personally and directly engaged in, and solely for their use in, any proceeding before a Federal grand jury or preparation for any proceeding (or investigation which may result in such a proceeding) before a Federal grand jury or any Federal or State court, but only if—

(A) the taxpayer is or may be a party to the proceeding, or the proceeding arose out of, or in connection with, determining the taxpayer's civil or criminal liability, or the collection of such civil liability in respect of any tax imposed under this title;

(B) the treatment of an item reflected on such return is or may be related to the resolution of an issue in the proceeding or investigation; or

(C) such return or return information relates or may relate to a transactional relationship between a person who is or may be a party to the proceeding and the taxpayer which affects, or may affect, the resolution of an issue in such proceeding or investigation.

(3) FORM OF REQUEST.—In any case in which the Secretary is authorized to disclose a return or return information to the Department of Justice pursuant to the provisions of this subsection—

(A) if the Secretary has referred the case to the Department of Justice, or if the proceeding is authorized by subchapter B of chapter 76, the Secretary may make such disclosure on his own motion, or

(B) if the Secretary receives a written request from the Attorney General, the Deputy Attorney General, or an Assistant Attorney General for a return of, or return information relating to, a person named in such request and setting forth the need for the disclosure, the Secretary shall disclose return or return the information so requested.

(4) DISCLOSURE IN JUDICIAL AND ADMINISTRATIVE TAX PROCEEDINGS.—A return or return information may be disclosed in a Federal or State judicial or administrative proceeding pertaining to tax administration, but only—

(A) if the taxpayer is a party to the proceeding, or the proceeding arose out of, or in connection with, determining the taxpayer's civil or criminal liability, or the collection of such civil liability, in respect of any tax imposed under this title;

(B) if the treatment of an item reflected on such return is directly related to the resolution of an issue in the proceeding;

(C) if such return or return information directly relates to a transactional relationship between a person who is a party to the proceeding and the taxpayer which directly affects the resolution of an issue in the proceeding; or

(D) to the extent required by order of a court pursuant to section 3500 of title 18, United States Code, or rule 16 of the Federal Rules of Criminal Procedure, such court being authorized in the issuance of such order to give due consideration to congressional policy favoring the confidentiality of returns and return information as set forth in this title.

However, such return or return information shall not be disclosed as provided in subparagraph (A), (B), or (C) if the Secretary determines that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation.

(5) WITHHOLDING OF TAX FROM SOCIAL SECURITY BENEFITS.—Upon written request of the payor agency, the Secretary may disclose available return information from the master files of the Internal Revenue Service with respect to the address and status of an individual as a nonresident alien or as a citizen or resident of the United States to the Social Security Administration or the Railroad Retirement Board (whichever is appropriate) for purposes of carrying out its responsibilities for withholding tax under section 1441 from social security benefits (as defined in section 86(d)).

(6) INTERNAL REVENUE SERVICE OVERSIGHT BOARD.—

(A) IN GENERAL.—Notwithstanding paragraph (1), and except as provided in subparagraph (B), no return or return information may be disclosed to any member of the Oversight Board described in subparagraph (A) or (D) of section 7802(b)(1) or to any employee or detailee of such Board by reason of their service with the Board. Any request for information not permitted to be disclosed under the preceding sentence, and any contact relating to a specific taxpayer, made by any such individual to an officer or employee of the Internal Revenue Service shall be reported by such officer or employee to the Secretary, the Treasury Inspector General for Tax Administration, and the Joint Committee on Taxation.

(B) EXCEPTION FOR REPORTS TO THE BOARD.—If—

(i) the Commissioner or the Treasury Inspector General for Tax Administration prepares any report or other matter for the Oversight Board in order to assist the Board in carrying out its duties; and

(ii) the Commissioner or such Inspector General determines it is necessary to include any return or re-

turn information in such report or other matter to enable the Board to carry out such duties,

such return or return information (other than information regarding taxpayer identity) may be disclosed to members, employees, or detailees of the Board solely for the purpose of carrying out such duties.

(i) DISCLOSURE TO FEDERAL OFFICERS OR EMPLOYEES FOR ADMINISTRATION OF FEDERAL LAWS NOT RELATING TO TAX ADMINISTRATION.—

(1) DISCLOSURE OF RETURNS AND RETURN INFORMATION FOR USE IN CRIMINAL INVESTIGATIONS.—

(A) IN GENERAL.—Except as provided in paragraph (6), any return or return information with respect to any specified taxable period or periods shall, pursuant to and upon the grant of an ex parte order by a Federal district court judge or magistrate judge under subparagraph (B), be open (but only to the extent necessary as provided in such order) to inspection by, or disclosure to, officers and employees of any Federal agency who are personally and directly engaged in—

(i) preparation for any judicial or administrative proceeding pertaining to the enforcement of a specifically designated Federal criminal statute (not involving tax administration) to which the United States or such agency is or may be a party, or pertaining to the case of a missing or exploited child,

(ii) any investigation which may result in such a proceeding, or

(iii) any Federal grand jury proceeding pertaining to enforcement of such a criminal statute to which the United States or such agency is or may be a party, or to such a case of a missing or exploited child,

solely for the use of such officers and employees in such preparation, investigation, or grand jury proceeding.

(B) APPLICATION FOR ORDER.—The Attorney General, the Deputy Attorney General, the Associate Attorney General, any Assistant Attorney General, any United States attorney, any special prosecutor appointed under section 593 of title 28, United States Code, or any attorney in charge of a criminal division organized crime strike force established pursuant to section 510 of title 28, United States Code, may authorize an application to a Federal district court judge or magistrate judge for the order referred to in subparagraph (A). Upon such application, such judge or magistrate judge may grant such order if he determines on the basis of the facts submitted by the applicant that—

(i) there is reasonable cause to believe, based upon information believed to be reliable, that a specific criminal act has been committed,

(ii) there is reasonable cause to believe that the return or return information is or may be relevant to a matter relating to the commission of such act, and

(iii) the return or return information is sought exclusively for use in a Federal criminal investigation or proceeding concerning such act (or any criminal inves-

tigation or proceeding, in the case of a matter relating to a missing or exploited child), and the information sought to be disclosed cannot reasonably be obtained, under the circumstances, from another source.

(C) DISCLOSURE TO STATE AND LOCAL LAW ENFORCEMENT AGENCIES IN THE CASE OF MATTERS PERTAINING TO A MISSING OR EXPLOITED CHILD.—

(i) IN GENERAL.—In the case of an investigation pertaining to a missing or exploited child, the head of any Federal agency, or his designee, may disclose any return or return information obtained under subparagraph (A) to officers and employees of any State or local law enforcement agency, but only if—

(I) such State or local law enforcement agency is part of a team with the Federal agency in such investigation, and

(II) such information is disclosed only to such officers and employees who are personally and directly engaged in such investigation.

(ii) LIMITATION ON USE OF INFORMATION.—Information disclosed under this subparagraph shall be solely for the use of such officers and employees in locating the missing child, in a grand jury proceeding, or in any preparation for, or investigation which may result in, a judicial or administrative proceeding.

(iii) MISSING CHILD.—For purposes of this subparagraph, the term "missing child" shall have the meaning given such term by section 403 of the Missing Children's Assistance Act (42 U.S.C. 5772).

(iv) EXPLOITED CHILD.—For purposes of this subparagraph, the term "exploited child" means a minor with respect to whom there is reason to believe that a specified offense against a minor (as defined by section 111(7) of the Sex Offender Registration and Notification Act (42 U.S.C. 16911(7))) has or is occurring.

(2) DISCLOSURE OF RETURN INFORMATION OTHER THAN TAXPAYER RETURN INFORMATION FOR USE IN CRIMINAL INVESTIGATIONS.—

(A) IN GENERAL.—Except as provided in paragraph (6), upon receipt by the Secretary of a request which meets the requirements of subparagraph (B) from the head of any Federal agency or the Inspector General thereof, or, in the case of the Department of Justice, the Attorney General, the Deputy Attorney General, the Associate Attorney General, any Assistant Attorney General, the Director of the Federal Bureau of Investigation, the Administrator of the Drug Enforcement Administration, any United States attorney, any special prosecutor appointed under section 593 of title 28, United States Code, or any attorney in charge of a criminal division organized crime strike force established pursuant to section 510 of title 28, United States Code, the Secretary shall disclose return information (other than taxpayer return information) to officers and employees of such agency who are personally and directly engaged in—

(i) preparation for any judicial or administrative proceeding described in paragraph (1)(A)(i),

(ii) any investigation which may result in such a proceeding, or

(iii) any grand jury proceeding described in paragraph (1)(A)(iii),

solely for the use of such officers and employees in such preparation, investigation, or grand jury proceeding.

(B) REQUIREMENTS.—A request meets the requirements of this subparagraph if the request is in writing and sets forth—

(i) the name and address of the taxpayer with respect to whom the requested return information relates;

(ii) the taxable period or periods to which such return information relates;

(iii) the statutory authority under which the proceeding or investigation described in subparagraph (A) is being conducted; and

(iv) the specific reason or reasons why such disclosure is, or may be, relevant to such proceeding or investigation.

(C) TAXPAYER IDENTITY.—For purposes of this paragraph, a taxpayer's identity shall not be treated as taxpayer return information.

(3) DISCLOSURE OF RETURN INFORMATION TO APPRISE APPROPRIATE OFFICIALS OF CRIMINAL OR TERRORIST ACTIVITIES OR EMERGENCY CIRCUMSTANCES.—

(A) POSSIBLE VIOLATIONS OF FEDERAL CRIMINAL LAW.—

(i) IN GENERAL.—Except as provided in paragraph (6), the Secretary may disclose in writing return information (other than taxpayer return information) which may constitute evidence of a violation of any Federal criminal law (not involving tax administration) to the extent necessary to apprise the head of the appropriate Federal agency charged with the responsibility of enforcing such law. The head of such agency may disclose such return information to officers and employees of such agency to the extent necessary to enforce such law.

(ii) TAXPAYER IDENTITY.—If there is return information (other than taxpayer return information) which may constitute evidence of a violation by any taxpayer of any Federal criminal law (not involving tax administration), such taxpayer's identity may also be disclosed under clause (i).

(B) EMERGENCY CIRCUMSTANCES.—

(i) DANGER OF DEATH OR PHYSICAL INJURY.—Under circumstances involving an imminent danger of death or physical injury to any individual, the Secretary may disclose return information to the extent necessary to apprise appropriate officers or employees of any Federal or State law enforcement agency of such circumstances.

(ii) FLIGHT FROM FEDERAL PROSECUTION.—Under circumstances involving the imminent flight of any individual from Federal prosecution, the Secretary may disclose return information to the extent necessary to apprise appropriate officers or employees of any Federal law enforcement agency of such circumstances.

(C) TERRORIST ACTIVITIES, ETC..—

(i) IN GENERAL.—Except as provided in paragraph (6), the Secretary may disclose in writing return information (other than taxpayer return information) that may be related to a terrorist incident, threat, or activity to the extent necessary to apprise the head of the appropriate Federal law enforcement agency responsible for investigating or responding to such terrorist incident, threat, or activity. The head of the agency may disclose such return information to officers and employees of such agency to the extent necessary to investigate or respond to such terrorist incident, threat, or activity.

(ii) DISCLOSURE TO THE DEPARTMENT OF JUSTICE.—Returns and taxpayer return information may also be disclosed to the Attorney General under clause (i) to the extent necessary for, and solely for use in preparing, an application under paragraph (7)(D).

(iii) TAXPAYER IDENTITY.—For purposes of this subparagraph, a taxpayer's identity shall not be treated as taxpayer return information.

(4) USE OF CERTAIN DISCLOSED RETURNS AND RETURN INFORMATION IN JUDICIAL OR ADMINISTRATIVE PROCEEDINGS.—

(A) RETURNS AND TAXPAYER RETURN INFORMATION.—Except as provided in subparagraph (C), any return or taxpayer return information obtained under paragraph (1) or (7)(C) may be disclosed in any judicial or administrative proceeding pertaining to enforcement of a specifically designated Federal criminal statute or related civil forfeiture (not involving tax administration) to which the United States or a Federal agency is a party—

(i) if the court finds that such return or taxpayer return information is probative of a matter in issue relevant in establishing the commission of a crime or the guilt or liability of a party, or

(ii) to the extent required by order of the court pursuant to section 3500 of title 18, United States Code, or rule 16 of the Federal Rules of Criminal Procedure.

(B) RETURN INFORMATION (OTHER THAN TAXPAYER RETURN INFORMATION).—Except as provided in subparagraph (C), any return information (other than taxpayer return information) obtained under paragraph (1), (2), (3)(A) or (C), or (7) may be disclosed in any judicial or administrative proceeding pertaining to enforcement of a specifically designated Federal criminal statute or related civil forfeiture (not involving tax administration) to which the United States or a Federal agency is a party.

(C) CONFIDENTIAL INFORMANT; IMPAIRMENT OF INVESTIGATIONS.—No return or return information shall be ad-

mitted into evidence under subparagraph (A)(i) or (B) if the Secretary determines and notifies the Attorney General or his delegate or the head of the Federal agency that such admission would identify a confidential informant or seriously impair a civil or criminal tax investigation.

(D) CONSIDERATION OF CONFIDENTIALITY POLICY.—In ruling upon the admissibility of returns or return information, and in the issuance of an order under subparagraph (A)(ii), the court shall give due consideration to congressional policy favoring the confidentiality of returns and return information as set forth in this title.

(E) REVERSIBLE ERROR.—The admission into evidence of any return or return information contrary to the provisions of this paragraph shall not, as such, constitute reversible error upon appeal of a judgment in the proceeding.

(5) DISCLOSURE TO LOCATE FUGITIVES FROM JUSTICE.—

(A) IN GENERAL.—Except as provided in paragraph (6), the return of an individual or return information with respect to such individual shall, pursuant to and upon the grant of an ex parte order by a Federal district court judge or magistrate judge under subparagraph (B), be open (but only to the extent necessary as provided in such order) to inspection by, or disclosure to, officers and employees of any Federal agency exclusively for use in locating such individual.

(B) APPLICATION FOR ORDER.—Any person described in paragraph (1)(B) may authorize an application to a Federal district court judge or magistrate judge for an order referred to in subparagraph (A). Upon such application, such judge or magistrate judge may grant such order if he determines on the basis of the facts submitted by the applicant that—

(i) a Federal arrest warrant relating to the commission of a Federal felony offense has been issued for an individual who is a fugitive from justice,

(ii) the return of such individual or return information with respect to such individual is sought exclusively for use in locating such individual, and

(iii) there is reasonable cause to believe that such return or return information may be relevant in determining the location of such individual.

(6) CONFIDENTIAL INFORMANTS; IMPAIRMENT OF INVESTIGATIONS.—The Secretary shall not disclose any return or return information under paragraph (1), (2), (3)(A) or (C), (5), (7), or (8) if the Secretary determines (and, in the case of a request for disclosure pursuant to a court order described in paragraph (1)(B) or (5)(B), certifies to the court) that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation.

(7) DISCLOSURE UPON REQUEST OF INFORMATION RELATING TO TERRORIST ACTIVITIES, ETC..—

(A) DISCLOSURE TO LAW ENFORCEMENT AGENCIES.—

(i) IN GENERAL.—Except as provided in paragraph (6), upon receipt by the Secretary of a written request which meets the requirements of clause (iii), the Sec-

retary may disclose return information (other than taxpayer return information) to officers and employees of any Federal law enforcement agency who are personally and directly engaged in the response to or investigation of any terrorist incident, threat, or activity.

(ii) DISCLOSURE TO STATE AND LOCAL LAW ENFORCEMENT AGENCIES.—The head of any Federal law enforcement agency may disclose return information obtained under clause (i) to officers and employees of any State or local law enforcement agency but only if such agency is part of a team with the Federal law enforcement agency in such response or investigation and such information is disclosed only to officers and employees who are personally and directly engaged in such response or investigation.

(iii) REQUIREMENTS.—A request meets the requirements of this clause if—

(I) the request is made by the head of any Federal law enforcement agency (or his delegate) involved in the response to or investigation of any terrorist incident, threat, or activity, and

(II) the request sets forth the specific reason or reasons why such disclosure may be relevant to a terrorist incident, threat, or activity.

(iv) LIMITATION ON USE OF INFORMATION.—Information disclosed under this subparagraph shall be solely for the use of the officers and employees to whom such information is disclosed in such response or investigation.

(v) TAXPAYER IDENTITY.—For purposes of this subparagraph, a taxpayer's identity shall not be treated as taxpayer return information.

(B) DISCLOSURE TO INTELLIGENCE AGENCIES.—

(i) IN GENERAL.—Except as provided in paragraph (6), upon receipt by the Secretary of a written request which meets the requirements of clause (ii), the Secretary may disclose return information (other than taxpayer return information) to those officers and employees of the Department of Justice, the Department of the Treasury, and other Federal intelligence agencies who are personally and directly engaged in the collection or analysis of intelligence and counterintelligence information or investigation concerning any terrorist incident, threat, or activity. For purposes of the preceding sentence, the information disclosed under the preceding sentence shall be solely for the use of such officers and employees in such investigation, collection, or analysis.

(ii) REQUIREMENTS.—A request meets the requirements of this subparagraph if the request—

(I) is made by an individual described in clause (iii), and

(II) sets forth the specific reason or reasons why such disclosure may be relevant to a terrorist incident, threat, or activity.

(iii) REQUESTING INDIVIDUALS.—An individual described in this subparagraph is an individual—

(I) who is an officer or employee of the Department of Justice or the Department of the Treasury who is appointed by the President with the advice and consent of the Senate or who is the Director of the United States Secret Service, and

(II) who is responsible for the collection and analysis of intelligence and counterintelligence information concerning any terrorist incident, threat, or activity.

(iv) TAXPAYER IDENTITY.—For purposes of this subparagraph, a taxpayer's identity shall not be treated as taxpayer return information.

(C) DISCLOSURE UNDER EX PARTE ORDERS.—

(i) IN GENERAL.—Except as provided in paragraph (6), any return or return information with respect to any specified taxable period or periods shall, pursuant to and upon the grant of an ex parte order by a Federal district court judge or magistrate under clause (ii), be open (but only to the extent necessary as provided in such order) to inspection by, or disclosure to, officers and employees of any Federal law enforcement agency or Federal intelligence agency who are personally and directly engaged in any investigation, response to, or analysis of intelligence and counterintelligence information concerning any terrorist incident, threat, or activity. Return or return information opened to inspection or disclosure pursuant to the preceding sentence shall be solely for the use of such officers and employees in the investigation, response, or analysis, and in any judicial, administrative, or grand jury proceedings, pertaining to such terrorist incident, threat, or activity.

(ii) APPLICATION FOR ORDER.—The Attorney General, the Deputy Attorney General, the Associate Attorney General, any Assistant Attorney General, or any United States attorney may authorize an application to a Federal district court judge or magistrate for the order referred to in clause (i). Upon such application, such judge or magistrate may grant such order if he determines on the basis of the facts submitted by the applicant that—

(I) there is reasonable cause to believe, based upon information believed to be reliable, that the return or return information may be relevant to a matter relating to such terrorist incident, threat, or activity, and

(II) the return or return information is sought exclusively for use in a Federal investigation, analysis, or proceeding concerning any terrorist incident, threat, or activity.

(D) SPECIAL RULE FOR EX PARTE DISCLOSURE BY THE IRS.—

(i) IN GENERAL.—Except as provided in paragraph (6), the Secretary may authorize an application to a Federal district court judge or magistrate for the order referred to in subparagraph (C)(i). Upon such application, such judge or magistrate may grant such order if he determines on the basis of the facts submitted by the applicant that the requirements of subparagraph (C)(ii)(I) are met.

(ii) LIMITATION ON USE OF INFORMATION.—Information disclosed under clause (i)—

(I) may be disclosed only to the extent necessary to apprise the head of the appropriate Federal law enforcement agency responsible for investigating or responding to a terrorist incident, threat, or activity, and

(II) shall be solely for use in a Federal investigation, analysis, or proceeding concerning any terrorist incident, threat, or activity.

The head of such Federal agency may disclose such information to officers and employees of such agency to the extent necessary to investigate or respond to such terrorist incident, threat, or activity.

(8) COMPTROLLER GENERAL.—

(A) RETURNS AVAILABLE FOR INSPECTION.—Except as provided in subparagraph (C), upon written request by the Comptroller General of the United States, returns and return information shall be open to inspection by, or disclosure to, officers and employees of the Government Accountability Office for the purpose of, and to the extent necessary in, making—

(i) an audit of the Internal Revenue Service, the Bureau of Alcohol, Tobacco, Firearms, and Explosives, Department of Justice, or the Tax and Trade Bureau, Department of the Treasury, which may be required by section 713 of title 31, United States Code, or

(ii) any audit authorized by subsection (p)(6),

except that no such officer or employee shall, except to the extent authorized by subsection (f) or (p)(6), disclose to any person, other than another officer or employee of such office whose official duties require such disclosure, any return or return information described in section 4424(a) in a form which can be associated with, or otherwise identify, directly or indirectly, a particular taxpayer, nor shall such officer or employee disclose any other return or return information, except as otherwise expressly provided by law, to any person other than such other officer or employee of such office in a form which can be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.

(B) AUDITS OF OTHER AGENCIES.—

(i) IN GENERAL.—Nothing in this section shall prohibit any return or return information obtained under this title by any Federal agency (other than an agency referred to in subparagraph (A)) or by a Trustee as defined in the District of Columbia Retirement Protec-

tion Act of 1997, for use in any program or activity from being open to inspection by, or disclosure to, officers and employees of the Government Accountability Office if such inspection or disclosure is—

(I) for purposes of, and to the extent necessary in, making an audit authorized by law of such program or activity, and

(II) pursuant to a written request by the Comptroller General of the United States to the head of such Federal agency.

(ii) INFORMATION FROM SECRETARY.—If the Comptroller General of the United States determines that the returns or return information available under clause (i) are not sufficient for purposes of making an audit of any program or activity of a Federal agency (other than an agency referred to in subparagraph (A)), upon written request by the Comptroller General to the Secretary, returns and return information (of the type authorized by subsection (*l*) or (m) to be made available to the Federal agency for use in such program or activity) shall be open to inspection by, or disclosure to, officers and employees of the Government Accountability Office for the purpose of, and to the extent necessary in, making such audit.

(iii) REQUIREMENT OF NOTIFICATION UPON COMPLETION OF AUDIT.—Within 90 days after the completion of an audit with respect to which returns or return information were opened to inspection or disclosed under clause (i) or (ii), the Comptroller General of the United States shall notify in writing the Joint Committee on Taxation of such completion. Such notice shall include—

(I) a description of the use of the returns and return information by the Federal agency involved,

(II) such recommendations with respect to the use of returns and return information by such Federal agency as the Comptroller General deems appropriate, and

(III) a statement on the impact of any such recommendations on confidentiality of returns and return information and the administration of this title.

(iv) CERTAIN RESTRICTIONS MADE APPLICABLE.—The restrictions contained in subparagraph (A) on the disclosure of any returns or return information open to inspection or disclosed under such subparagraph shall also apply to returns and return information open to inspection or disclosed under this subparagraph.

(C) DISAPPROVAL BY JOINT COMMITTEE ON TAXATION.—Returns and return information shall not be open to inspection or disclosed under subparagraph (A) or (B) with respect to an audit—

(i) unless the Comptroller General of the United States notifies in writing the Joint Committee on Taxation of such audit, and

(ii) if the Joint Committee on Taxation disapproves such audit by a vote of at least two-thirds of its members within the 30-day period beginning on the day the Joint Committee on Taxation receives such notice.

(j) STATISTICAL USE.—

(1) DEPARTMENT OF COMMERCE.—Upon request in writing by the Secretary of Commerce, the Secretary shall furnish—

(A) such returns, or return information reflected thereon, to officers and employees of the Bureau of the Census, and

(B) such return information reflected on returns of corporations to officers and employees of the Bureau of Economic Analysis,

as the Secretary may prescribe by regulation for the purpose of, but only to the extent necessary in, the structuring of censuses and national economic accounts and conducting related statistical activities authorized by law.

(2) FEDERAL TRADE COMMISSION.—Upon request in writing by the Chairman of the Federal Trade Commission, the Secretary shall furnish such return information reflected on any return of a corporation with respect to the tax imposed by chapter 1 to officers and employees of the Division of Financial Statistics of the Bureau of Economics of such commission as the Secretary may prescribe by regulation for the purpose of, but only to the extent necessary in, administration by such division of legally authorized economic surveys of corporations.

(3) DEPARTMENT OF TREASURY.—Returns and return information shall be open to inspection by or disclosure to officers and employees of the Department of the Treasury whose official duties require such inspection or disclosure for the purpose of, but only to the extent necessary in, preparing economic or financial forecasts, projections, analyses, and statistical studies and conducting related activities. Such inspection or disclosure shall be permitted only upon written request which sets forth the specific reason or reasons why such inspection or disclosure is necessary and which is signed by the head of the bureau or office of the Department of the Treasury requesting the inspection or disclosure.

(4) ANONYMOUS FORM.—No person who receives a return or return information under this subsection shall disclose such return or return information to any person other than the taxpayer to whom it relates except in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.

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

(6) CONGRESSIONAL BUDGET OFFICE.—Upon written request by the Director of the Congressional Budget Office, the Secretary shall furnish to officers and employees of the Congres-

sional Budget Office return information for the purpose of, but only to the extent necessary for, long-term models of the social security and medicare programs.

(k) DISCLOSURE OF CERTAIN RETURNS AND RETURN INFORMATION FOR TAX ADMINISTRATION PURPOSES.—

(1) DISCLOSURE OF ACCEPTED OFFERS-IN-COMPROMISE.—Return information shall be disclosed to members of the general public to the extent necessary to permit inspection of any accepted offer-in-compromise under section 7122 relating to the liability for a tax imposed by this title.

(2) DISCLOSURE OF AMOUNT OF OUTSTANDING LIEN.—If a notice of lien has been filed pursuant to section 6323(f), the amount of the outstanding obligation secured by such lien may be disclosed to any person who furnishes satisfactory written evidence that he has a right in the property subject to such lien or intends to obtain a right in such property.

(3) DISCLOSURE OF RETURN INFORMATION TO CORRECT MISSTATEMENTS OF FACT.—The Secretary may, but only following approval by the Joint Committee on Taxation, disclose such return information or any other information with respect to any specific taxpayer to the extent necessary for tax administration purposes to correct a misstatement of fact published or disclosed with respect to such taxpayer's return or any transaction of the taxpayer with the Internal Revenue Service.

(4) DISCLOSURE TO COMPETENT AUTHORITY UNDER TAX CONVENTION.—A return or return information may be disclosed to a competent authority of a foreign government which has an income tax or gift and estate tax convention, or other convention or bilateral agreement relating to the exchange of tax information, with the United States but only to the extent provided in, and subject to the terms and conditions of, such convention or bilateral agreement.

(5) STATE AGENCIES REGULATING TAX RETURN PREPARERS.—Taxpayer identity information with respect to any tax return preparer, and information as to whether or not any penalty has been assessed against such tax return preparer under section 6694, 6695, or 7216, may be furnished to any agency, body, or commission lawfully charged under any State or local law with the licensing, registration, or regulation of tax return preparers. Such information may be furnished only upon written request by the head of such agency, body, or commission designating the officers or employees to whom such information is to be furnished. Information may be furnished and used under this paragraph only for purposes of the licensing, registration, or regulation of tax return preparers.

(6) DISCLOSURE BY CERTAIN OFFICERS AND EMPLOYEES FOR INVESTIGATIVE PURPOSES.—An internal revenue officer or employee and an officer or employee of the Office of Treasury Inspector General for Tax Administration may, in connection with his official duties relating to any audit, collection activity, or civil or criminal tax investigation or any other offense under the internal revenue laws, disclose return information to the extent that such disclosure is necessary in obtaining information, which is not otherwise reasonably available, with respect to the correct determination of tax, liability for tax, or the

amount to be collected or with respect to the enforcement of any other provision of this title. Such disclosures shall be made only in such situations and under such conditions as the Secretary may prescribe by regulation.

(7) DISCLOSURE OF EXCISE TAX REGISTRATION INFORMATION.—To the extent the Secretary determines that disclosure is necessary to permit the effective administration of subtitle D, the Secretary may disclose—

(A) the name, address, and registration number of each person who is registered under any provision of subtitle D (and, in the case of a registered terminal operator, the address of each terminal operated by such operator), and

(B) the registration status of any person.

(8) LEVIES ON CERTAIN GOVERNMENT PAYMENTS.—

(A) DISCLOSURE OF RETURN INFORMATION IN LEVIES ON FINANCIAL MANAGEMENT SERVICE.—In serving a notice of levy, or release of such levy, with respect to any applicable government payment, the Secretary may disclose to officers and employees of the Financial Management Service—

(i) return information, including taxpayer identity information,

(ii) the amount of any unpaid liability under this title (including penalties and interest), and

(iii) the type of tax and tax period to which such unpaid liability relates.

(B) RESTRICTION ON USE OF DISCLOSED INFORMATION.—Return information disclosed under subparagraph (A) may be used by officers and employees of the Financial Management Service only for the purpose of, and to the extent necessary in, transferring levied funds in satisfaction of the levy, maintaining appropriate agency records in regard to such levy or the release thereof, notifying the taxpayer and the agency certifying such payment that the levy has been honored, or in the defense of any litigation ensuing from the honor of such levy.

(C) APPLICABLE GOVERNMENT PAYMENT.—For purposes of this paragraph, the term "applicable government payment" means—

(i) any Federal payment (other than a payment for which eligibility is based on the income or assets (or both) of a payee) certified to the Financial Management Service for disbursement, and

(ii) any other payment which is certified to the Financial Management Service for disbursement and which the Secretary designates by published notice.

(9) DISCLOSURE OF INFORMATION TO ADMINISTER SECTION 6311.—The Secretary may disclose returns or return information to financial institutions and others to the extent the Secretary deems necessary for the administration of section 6311. Disclosures of information for purposes other than to accept payments by checks or money orders shall be made only to the extent authorized by written procedures promulgated by the Secretary.

(10) DISCLOSURE OF CERTAIN RETURNS AND RETURN INFORMATION TO CERTAIN PRISON OFFICIALS.—

(A) IN GENERAL.—Under such procedures as the Secretary may prescribe, the Secretary may disclose to officers and employees of the Federal Bureau of Prisons and of any State agency charged with the responsibility for administration of prisons any returns or return information with respect to individuals incarcerated in Federal or State prison systems whom the Secretary has determined may have filed or facilitated the filing of a false or fraudulent return to the extent that the Secretary determines that such disclosure is necessary to permit effective Federal tax administration.

(B) DISCLOSURE TO CONTRACTOR-RUN PRISONS.—Under such procedures as the Secretary may prescribe, the disclosures authorized by subparagraph (A) may be made to contractors responsible for the operation of a Federal or State prison on behalf of such Bureau or agency.

(C) RESTRICTIONS ON USE OF DISCLOSED INFORMATION.—Any return or return information received under this paragraph shall be used only for the purposes of and to the extent necessary in taking administrative action to prevent the filing of false and fraudulent returns, including administrative actions to address possible violations of administrative rules and regulations of the prison facility and in administrative and judicial proceedings arising from such administrative actions.

(D) RESTRICTIONS ON REDISCLOSURE AND DISCLOSURE TO LEGAL REPRESENTATIVES.—Notwithstanding subsection (h)—

(i) RESTRICTIONS ON REDISCLOSURE.—Except as provided in clause (ii), any officer, employee, or contractor of the Federal Bureau of Prisons or of any State agency charged with the responsibility for administration of prisons shall not disclose any information obtained under this paragraph to any person other than an officer or employee or contractor of such Bureau or agency personally and directly engaged in the administration of prison facilities on behalf of such Bureau or agency.

(ii) DISCLOSURE TO LEGAL REPRESENTATIVES.—The returns and return information disclosed under this paragraph may be disclosed to the duly authorized legal representative of the Federal Bureau of Prisons, State agency, or contractor charged with the responsibility for administration of prisons, or of the incarcerated individual accused of filing the false or fraudulent return who is a party to an action or proceeding described in subparagraph (C), solely in preparation for, or for use in, such action or proceeding.

(11) DISCLOSURE OF RETURN INFORMATION TO DEPARTMENT OF STATE FOR PURPOSES OF PASSPORT REVOCATION UNDER SECTION 7345.—

(A) IN GENERAL.—The Secretary shall, upon receiving a certification described in section 7345, disclose to the Sec-

retary of State return information with respect to a taxpayer who has a seriously delinquent tax debt described in such section. Such return information shall be limited to—

(i) the taxpayer identity information with respect to such taxpayer, and

(ii) the amount of such seriously delinquent tax debt.

(B) RESTRICTION ON DISCLOSURE.—Return information disclosed under subparagraph (A) may be used by officers and employees of the Department of State for the purposes of, and to the extent necessary in, carrying out the requirements of section 32101 of the FAST Act.

(12) QUALIFIED TAX COLLECTION CONTRACTORS.—Persons providing services pursuant to a qualified tax collection contract under section 6306 may, if speaking to a person who has identified himself or herself as having the name of the taxpayer to which a tax receivable (within the meaning of such section) relates, identify themselves as contractors of the Internal Revenue Service and disclose the business name of the contractor, and the nature, subject, and reason for the contact. Disclosures under this paragraph shall be made only in such situations and under such conditions as have been approved by the Secretary.

(l) DISCLOSURE OF RETURNS AND RETURN INFORMATION FOR PURPOSES OTHER THAN TAX ADMINISTRATION.—

(1) DISCLOSURE OF CERTAIN RETURNS AND RETURN INFORMATION TO SOCIAL SECURITY ADMINISTRATION AND RAILROAD RETIREMENT BOARD.—The Secretary may, upon written request, disclose returns and return information with respect to—

(A) taxes imposed by chapters 2, 21, and 24, to the Social Security Administration for purposes of its administration of the Social Security Act;

(B) a plan to which part I of subchapter D of chapter 1 applies, to the Social Security Administration for purposes of carrying out its responsibility under section 1131 of the Social Security Act, limited, however to return information described in section 6057(d); and

(C) taxes imposed by chapter 22, to the Railroad Retirement Board for purposes of its administration of the Railroad Retirement Act.

(2) DISCLOSURE OF RETURNS AND RETURN INFORMATION TO THE DEPARTMENT OF LABOR AND PENSION BENEFIT GUARANTY CORPORATION.—The Secretary may, upon written request, furnish returns and return information to the proper officers and employees of the Department of Labor and the Pension Benefit Guaranty Corporation for purposes of, but only to the extent necessary in, the administration of titles I and IV of the Employee Retirement Income Security Act of 1974.

(3) DISCLOSURE THAT APPLICANT FOR FEDERAL LOAN HAS TAX DELINQUENT ACCOUNT.—

(A) IN GENERAL.—Upon written request, the Secretary may disclose to the head of the Federal agency administering any included Federal loan program whether or not an applicant for a loan under such program has a tax delinquent account.

(B) RESTRICTION ON DISCLOSURE.—Any disclosure under subparagraph (A) shall be made only for the purpose of, and to the extent necessary in, determining the creditworthiness of the applicant for the loan in question.

(C) INCLUDED FEDERAL LOAN PROGRAM DEFINED.—For purposes of this paragraph, the term "included Federal loan program" means any program under which the United States or a Federal agency makes, guarantees, or insures loans.

(4) DISCLOSURE OF RETURNS AND RETURN INFORMATION FOR USE IN PERSONNEL OR CLAIMANT REPRESENTATIVE MATTERS.—The Secretary may disclose returns and return information—

(A) upon written request—

(i) to an employee or former employee of the Department of the Treasury, or to the duly authorized legal representative of such employee or former employee, who is or may be a party to any administrative action or proceeding affecting the personnel rights of such employee or former employee; or

(ii) to any person, or to the duly authorized legal representative of such person, whose rights are or may be affected by an administrative action or proceeding under section 330 of title 31, United States Code,

solely for use in the action or proceeding, or in preparation for the action or proceeding, but only to the extent that the Secretary determines that such returns or return information is or may be relevant and material to the action or proceeding; or

(B) to officers and employees of the Department of the Treasury for use in any action or proceeding described in subparagraph (A), or in preparation for such action or proceeding, to the extent necessary to advance or protect the interests of the United States.

(5) SOCIAL SECURITY ADMINISTRATION.—Upon written request by the Commissioner of Social Security, the Secretary may disclose information returns filed pursuant to part III of subchapter A of chapter 61 of this subtitle for the purpose of—

(A) carrying out, in accordance with an agreement entered into pursuant to section 232 of the Social Security Act, an effective return processing program; or

(B) providing information regarding the mortality status of individuals for epidemiological and similar research in accordance with section 1106(d) of the Social Security Act.

(6) DISCLOSURE OF RETURN INFORMATION TO FEDERAL, STATE, AND LOCAL CHILD SUPPORT ENFORCEMENT AGENCIES.—

(A) RETURN INFORMATION FROM INTERNAL REVENUE SERVICE.—The Secretary may, upon written request, disclose to the appropriate Federal, State, or local child support enforcement agency—

(i) available return information from the master files of the Internal Revenue Service relating to the social security account number (or numbers, if the individual involved has more than one such number), address, filing status, amounts and nature of income, and the number of dependents reported on any return filed by,

or with respect to, any individual with respect to whom child support obligations are sought to be established or enforced pursuant to the provisions of part D of title IV of the Social Security Act and with respect to any individual to whom such support obligations are owing, and

(ii) available return information reflected on any return filed by, or with respect to, any individual described in clause (i) relating to the amount of such individual's gross income (as defined in section 61) or consisting of the names and addresses of payors of such income and the names of any dependents reported on such return, but only if such return information is not reasonably available from any other source.

(B) DISCLOSURE TO CERTAIN AGENTS.—The following information disclosed to any child support enforcement agency under subparagraph (A) with respect to any individual with respect to whom child support obligations are sought to be established or enforced may be disclosed by such agency to any agent of such agency which is under contract with such agency to carry out the purposes described in subparagraph (C):

(i) The address and social security account number (or numbers) of such individual.

(ii) The amount of any reduction under section 6402(c) (relating to offset of past-due support against overpayments) in any overpayment otherwise payable to such individual.

(C) RESTRICTION ON DISCLOSURE.—Information may be disclosed under this paragraph only for purposes of, and to the extent necessary in, establishing and collecting child support obligations from, and locating, individuals owing such obligations.

(7) DISCLOSURE OF RETURN INFORMATION TO FEDERAL, STATE, AND LOCAL AGENCIES ADMINISTERING CERTAIN PROGRAMS UNDER THE SOCIAL SECURITY ACT, THE FOOD AND NUTRITION ACT OF 2008, OR TITLE 38, UNITED STATES CODE, OR CERTAIN HOUSING ASSISTANCE PROGRAMS.—

(A) RETURN INFORMATION FROM SOCIAL SECURITY ADMINISTRATION.—The Commissioner of Social Security shall, upon written request, disclose return information from returns with respect to net earnings from self-employment (as defined in section 1402), wages (as defined in section 3121(a) or 3401(a)), and payments of retirement income, which have been disclosed to the Social Security Administration as provided by paragraph (1) or (5) of this subsection, to any Federal, State, or local agency administering a program listed in subparagraph (D).

(B) RETURN INFORMATION FROM INTERNAL REVENUE SERVICE.—The Secretary shall, upon written request, disclose current return information from returns with respect to unearned income from the Internal Revenue Service files to any Federal, State, or local agency administering a program listed in subparagraph (D).

(C) RESTRICTION ON DISCLOSURE.—The Commissioner of Social Security and the Secretary shall disclose return information under subparagraphs (A) and (B) only for purposes of, and to the extent necessary in, determining eligibility for, or the correct amount of, benefits under a program listed in subparagraph (D).

(D) PROGRAMS TO WHICH RULE APPLIES.—The programs to which this paragraph applies are:

(i) a State program funded under part A of title IV of the Social Security Act;

(ii) medical assistance provided under a State plan approved under title XIX of the Social Security Act or subsidies provided under section 1860D–14 of such Act;

(iii) supplemental security income benefits provided under title XVI of the Social Security Act, and federally administered supplementary payments of the type described in section 1616(a) of such Act (including payments pursuant to an agreement entered into under section 212(a) of Public Law 93–66);

(iv) any benefits provided under a State plan approved under title I, X, XIV, or XVI of the Social Security Act (as those titles apply to Puerto Rico, Guam, and the Virgin Islands);

(v) unemployment compensation provided under a State law described in section 3304 of this title;

(vi) assistance provided under the Food and Nutrition Act of 2008;

(vii) State-administered supplementary payments of the type described in section 1616(a) of the Social Security Act (including payments pursuant to an agreement entered into under section 212(a) of Public Law 93–66);

(viii)(I) any needs-based pension provided under chapter 15 of title 38, United States Code, or under any other law administered by the Secretary of Veterans Affairs;

(II) parents' dependency and indemnity compensation provided under section 1315 of title 38, United States Code;

(III) health-care services furnished under sections 1710(a)(2)(G), 1710(a)(3), and 1710(b) of such title; and

(IV) compensation paid under chapter 11 of title 38, United States Code, at the 100 percent rate based solely on unemployability and without regard to the fact that the disability or disabilities are not rated as 100 percent disabling under the rating schedule; and

(ix) any housing assistance program administered by the Department of Housing and Urban Development that involves initial and periodic review of an applicant's or participant's income, except that return information may be disclosed under this clause only on written request by the Secretary of Housing and Urban Development and only for use by officers and employees of the Department of Housing and Urban

Development with respect to applicants for and participants in such programs.

Only return information from returns with respect to net earnings from self-employment and wages may be disclosed under this paragraph for use with respect to any program described in clause (viii)(IV).

(8) DISCLOSURE OF CERTAIN RETURN INFORMATION BY SOCIAL SECURITY ADMINISTRATION TO FEDERAL, STATE, AND LOCAL CHILD SUPPORT ENFORCEMENT AGENCIES.—

(A) IN GENERAL.—Upon written request, the Commissioner of Social Security shall disclose directly to officers and employees of a Federal or State or local child support enforcement agency return information from returns with respect to social security account numbers, net earnings from self-employment (as defined in section 1402), wages (as defined in section 3121(a) or 3401(a)), and payments of retirement income which have been disclosed to the Social Security Administration as provided by paragraph (1) or (5) of this subsection.

(B) RESTRICTION ON DISCLOSURE.—The Commissioner of Social Security shall disclose return information under subparagraph (A) only for purposes of, and to the extent necessary in, establishing and collecting child support obligations from, and locating, individuals owing such obligations. For purposes of the preceding sentence, the term "child support obligations" only includes obligations which are being enforced pursuant to a plan described in section 454 of the Social Security Act which has been approved by the Secretary of Health and Human Services under part D of title IV of such Act.

(C) STATE OR LOCAL CHILD SUPPORT ENFORCEMENT AGENCY.—For purposes of this paragraph, the term "State or local child support enforcement agency" means any agency of a State or political subdivision thereof operating pursuant to a plan described in subparagraph (B).

(9) DISCLOSURE OF ALCOHOL FUEL PRODUCERS TO ADMINISTRATORS OF STATE ALCOHOL LAWS.—Notwithstanding any other provision of this section, the Secretary may disclose—

(A) the name and address of any person who is qualified to produce alcohol for fuel use under section 5181, and

(B) the location of any premises to be used by such person in producing alcohol for fuel,

to any State agency, body, or commission, or its legal representative, which is charged under the laws of such State with responsibility for administration of State alcohol laws solely for use in the administration of such laws.

(10) DISCLOSURE OF CERTAIN INFORMATION TO AGENCIES REQUESTING A REDUCTION UNDER SUBSECTION (C), (D), (E), OR (F) OF SECTION 6402.—

(A) RETURN INFORMATION FROM INTERNAL REVENUE SERVICE.—The Secretary may, upon receiving a written request, disclose to officers and employees of any agency seeking a reduction under subsection (c), (d), (e), or (f) of section 6402, to officers and employees of the Department of Labor for purposes of facilitating the exchange of data

in connection with a notice submitted under subsection (f)(5)(C) of section 6402, and to officers and employees of the Department of the Treasury in connection with such reduction—

(i) taxpayer identity information with respect to the taxpayer against whom such a reduction was made or not made and with respect to any other person filing a joint return with such taxpayer,

(ii) the fact that a reduction has been made or has not been made under such subsection with respect to such taxpayer,

(iii) the amount of such reduction,

(iv) whether such taxpayer filed a joint return, and

(v) the fact that a payment was made (and the amount of the payment) to the spouse of the taxpayer on the basis of a joint return.

(B) RESTRICTION ON USE OF DISCLOSED INFORMATION.—(i) Any officers and employees of an agency receiving return information under subparagraph (A) shall use such information only for the purposes of, and to the extent necessary in, establishing appropriate agency records, locating any person with respect to whom a reduction under subsection (c), (d), (e), or (f) of section 6402 is sought for purposes of collecting the debt with respect to which the reduction is sought, or in the defense of any litigation or administrative procedure ensuing from a reduction made under subsection (c), (d), (e), or (f) of section 6402.

(ii) Notwithstanding clause (i), return information disclosed to officers and employees of the Department of Labor may be accessed by agents who maintain and provide technological support to the Department of Labor's Interstate Connection Network (ICON) solely for the purpose of providing such maintenance and support.

(11) DISCLOSURE OF RETURN INFORMATION TO CARRY OUT FEDERAL EMPLOYEES' RETIREMENT SYSTEM.—

(A) IN GENERAL.—The Commissioner of Social Security shall, on written request, disclose to the Office of Personnel Management return information from returns with respect to net earnings from self-employment (as defined in section 1402), wages (as defined in section 3121(a) or 3401(a)), and payments of retirement income, which have been disclosed to the Social Security Administration as provided by paragraph (1) or (5).

(B) RESTRICTION ON DISCLOSURE.—The Commissioner of Social Security shall disclose return information under subparagraph (A) only for purposes of, and to the extent necessary in, the administration of chapters 83 and 84 of title 5, United States Code.

(12) DISCLOSURE OF CERTAIN TAXPAYER IDENTITY INFORMATION FOR VERIFICATION OF EMPLOYMENT STATUS OF MEDICARE BENEFICIARY AND SPOUSE OF MEDICARE BENEFICIARY.—

(A) RETURN INFORMATION FROM INTERNAL REVENUE SERVICE.—The Secretary shall, upon written request from the Commissioner of Social Security, disclose to the Commissioner available filing status and taxpayer identity in-

formation from the individual master files of the Internal Revenue Service relating to whether any medicare beneficiary identified by the Commissioner was a married individual (as defined in section 7703) for any specified year after 1986, and, if so, the name of the spouse of such individual and such spouse's TIN.

(B) RETURN INFORMATION FROM SOCIAL SECURITY ADMINISTRATION.—The Commissioner of Social Security shall, upon written request from the Administrator of the Centers for Medicare & Medicaid Services, disclose to the Administrator the following information:

(i) The name and TIN of each medicare beneficiary who is identified as having received wages (as defined in section 3401(a)), above an amount (if any) specified by the Secretary of Health and Human Services, from a qualified employer in a previous year.

(ii) For each medicare beneficiary who was identified as married under subparagraph (A) and whose spouse is identified as having received wages, above an amount (if any) specified by the Secretary of Health and Human Services, from a qualified employer in a previous year—

(I) the name and TIN of the medicare beneficiary, and

(II) the name and TIN of the spouse.

(iii) With respect to each such qualified employer, the name, address, and TIN of the employer and the number of individuals with respect to whom written statements were furnished under section 6051 by the employer with respect to such previous year.

(C) DISCLOSURE BY CENTERS FOR MEDICARE & MEDICAID SERVICES.—With respect to the information disclosed under subparagraph (B), the Administrator of the Centers for Medicare & Medicaid Services may disclose—

(i) to the qualified employer referred to in such subparagraph the name and TIN of each individual identified under such subparagraph as having received wages from the employer (hereinafter in this subparagraph referred to as the "employee") for purposes of determining during what period such employee or the employee's spouse may be (or have been) covered under a group health plan of the employer and what benefits are or were covered under the plan (including the name, address, and identifying number of the plan),

(ii) to any group health plan which provides or provided coverage to such an employee or spouse, the name of such employee and the employee's spouse (if the spouse is a medicare beneficiary) and the name and address of the employer, and, for the purpose of presenting a claim to the plan—

(I) the TIN of such employee if benefits were paid under title XVIII of the Social Security Act with respect to the employee during a period in which the plan was a primary plan (as defined in

section 1862(b)(2)(A) of the Social Security Act), and

(II) the TIN of such spouse if benefits were paid under such title with respect to the spouse during such period, and

(iii) to any agent of such Administrator the information referred to in subparagraph (B) for purposes of carrying out clauses (i) and (ii) on behalf of such Administrator.

(D) SPECIAL RULES.—

(i) RESTRICTIONS ON DISCLOSURE.—Information may be disclosed under this paragraph only for purposes of, and to the extent necessary in, determining the extent to which any medicare beneficiary is covered under any group health plan.

(ii) TIMELY RESPONSE TO REQUESTS.—Any request made under subparagraph (A) or (B) shall be complied with as soon as possible but in no event later than 120 days after the date the request was made.

(E) DEFINITIONS.—For purposes of this paragraph—

(i) MEDICARE BENEFICIARY.—The term "medicare beneficiary" means an individual entitled to benefits under part A, or enrolled under part B, of title XVIII of the Social Security Act, but does not include such an individual enrolled in part A under section 1818.

(ii) GROUP HEALTH PLAN.—The term "group health plan" means any group health plan (as defined in section 5000(b)(1)).

(iii) QUALIFIED EMPLOYER.—The term "qualified employer" means, for a calendar year, an employer which has furnished written statements under section 6051 with respect to at least 20 individuals for wages paid in the year.

(13) DISCLOSURE OF RETURN INFORMATION TO CARRY OUT INCOME CONTINGENT REPAYMENT OF STUDENT LOANS.—

(A) IN GENERAL.—The Secretary may, upon written request from the Secretary of Education, disclose to officers and employees of the Department of Education return information with respect to a taxpayer who has received an applicable student loan and whose loan repayment amounts are based in whole or in part on the taxpayer's income. Such return information shall be limited to—

(i) taxpayer identity information with respect to such taxpayer,

(ii) the filing status of such taxpayer, and

(iii) the adjusted gross income of such taxpayer.

(B) RESTRICTION ON USE OF DISCLOSED INFORMATION.—Return information disclosed under subparagraph (A) may be used by officers and employees of the Department of Education only for the purposes of, and to the extent necessary in, establishing the appropriate income contingent repayment amount for an applicable student loan.

(C) APPLICABLE STUDENT LOAN.—For purposes of this paragraph, the term "applicable student loan" means—

(i) any loan made under the program authorized under part D of title IV of the Higher Education Act of 1965, and

(ii) any loan made under part B or E of title IV of the Higher Education Act of 1965 which is in default and has been assigned to the Department of Education.

(D) TERMINATION.—This paragraph shall not apply to any request made after December 31, 2007.

(14) DISCLOSURE OF RETURN INFORMATION TO UNITED STATES CUSTOMS SERVICE.—The Secretary may, upon written request from the Commissioner of the United States Customs Service, disclose to officers and employees of the Department of the Treasury such return information with respect to taxes imposed by chapters 1 and 6 as the Secretary may prescribe by regulations, solely for the purpose of, and only to the extent necessary in—

(A) ascertaining the correctness of any entry in audits as provided for in section 509 of the Tariff Act of 1930 (19 U.S.C. 1509), or

(B) other actions to recover any loss of revenue, or to collect duties, taxes, and fees, determined to be due and owing pursuant to such audits.

(15) DISCLOSURE OF RETURNS FILED UNDER SECTION 6050I.—The Secretary may, upon written request, disclose to officers and employees of—

(A) any Federal agency,

(B) any agency of a State or local government, or

(C) any agency of the government of a foreign country, information contained on returns filed under section 6050I. Any such disclosure shall be made on the same basis, and subject to the same conditions, as apply to disclosures of information on reports filed under section 5313 of title 31, United States Code; except that no disclosure under this paragraph shall be made for purposes of the administration of any tax law.

(16) DISCLOSURE OF RETURN INFORMATION FOR PURPOSES OF ADMINISTERING THE DISTRICT OF COLUMBIA RETIREMENT PROTECTION ACT OF 1997.—

(A) IN GENERAL.—Upon written request available return information (including such information disclosed to the Social Security Administration under paragraph (1) or (5) of this subsection), relating to the amount of wage income (as defined in section 3121(a) or 3401(a)), the name, address, and identifying number assigned under section 6109, of payors of wage income, taxpayer identity (as defined in section 6103(b)(6)), and the occupational status reflected on any return filed by, or with respect to, any individual with respect to whom eligibility for, or the correct amount of, benefits under the District of Columbia Retirement Protection Act of 1997, is sought to be determined, shall be disclosed by the Commissioner of Social Security, or to the extent not available from the Social Security Administration, by the Secretary, to any duly authorized officer or employee of the Department of the Treasury, or a

Trustee or any designated officer or employee of a Trustee (as defined in the District of Columbia Retirement Protection Act of 1997), or any actuary engaged by a Trustee under the terms of the District of Columbia Retirement Protection Act of 1997, whose official duties require such disclosure, solely for the purpose of, and to the extent necessary in, determining an individual's eligibility for, or the correct amount of, benefits under the District of Columbia Retirement Protection Act of 1997.

(B) DISCLOSURE FOR USE IN JUDICIAL OR ADMINISTRATIVE PROCEEDINGS.—Return information disclosed to any person under this paragraph may be disclosed in a judicial or administrative proceeding relating to the determination of an individual's eligibility for, or the correct amount of, benefits under the District of Columbia Retirement Protection Act of 1997.

(17) DISCLOSURE TO NATIONAL ARCHIVES AND RECORDS ADMINISTRATION.—The Secretary shall, upon written request from the Archivist of the United States, disclose or authorize the disclosure of returns and return information to officers and employees of the National Archives and Records Administration for purposes of, and only to the extent necessary in, the appraisal of records for destruction or retention. No such officer or employee shall, except to the extent authorized by subsection (f), (i)(8), or (p), disclose any return or return information disclosed under the preceding sentence to any person other than to the Secretary, or to another officer or employee of the National Archives and Records Administration whose official duties require such disclosure for purposes of such appraisal.

(18) DISCLOSURE OF RETURN INFORMATION FOR PURPOSES OF CARRYING OUT A PROGRAM FOR ADVANCE PAYMENT OF CREDIT FOR HEALTH INSURANCE COSTS OF ELIGIBLE INDIVIDUALS.—The Secretary may disclose to providers of health insurance for any certified individual (as defined in section 7527(c)) return information with respect to such certified individual only to the extent necessary to carry out the program established by section 7527 (relating to advance payment of credit for health insurance costs of eligible individuals).

(19) DISCLOSURE OF RETURN INFORMATION FOR PURPOSES OF PROVIDING TRANSITIONAL ASSISTANCE UNDER MEDICARE DISCOUNT CARD PROGRAM.—

(A) IN GENERAL.—The Secretary, upon written request from the Secretary of Health and Human Services pursuant to carrying out section 1860D–31 of the Social Security Act, shall disclose to officers, employees, and contractors of the Department of Health and Human Services with respect to a taxpayer for the applicable year—

(i)(I) whether the adjusted gross income, as modified in accordance with specifications of the Secretary of Health and Human Services for purposes of carrying out such section, of such taxpayer and, if applicable, such taxpayer's spouse, for the applicable year, exceeds the amounts specified by the Secretary of Health and Human Services in order to apply the 100 and 135

percent of the poverty lines under such section, (II) whether the return was a joint return, and (III) the applicable year, or

(ii) if applicable, the fact that there is no return filed for such taxpayer for the applicable year.

(B) DEFINITION OF APPLICABLE YEAR.—For the purposes of this subsection, the term "applicable year" means the most recent taxable year for which information is available in the Internal Revenue Service's taxpayer data information systems, or, if there is no return filed for such taxpayer for such year, the prior taxable year.

(C) RESTRICTION ON USE OF DISCLOSED INFORMATION.—Return information disclosed under this paragraph may be used only for the purposes of determining eligibility for and administering transitional assistance under section 1860D–31 of the Social Security Act.

(20) DISCLOSURE OF RETURN INFORMATION TO CARRY OUT MEDICARE PART B PREMIUM SUBSIDY ADJUSTMENT AND PART D BASE BENEFICIARY PREMIUM INCREASE.—

(A) IN GENERAL.—The Secretary shall, upon written request from the Commissioner of Social Security, disclose to officers, employees, and contractors of the Social Security Administration return information of a taxpayer whose premium (according to the records of the Secretary) may be subject to adjustment under section 1839(i) or increase under section 1860D–13(a)(7) of the Social Security Act. Such return information shall be limited to—

(i) taxpayer identity information with respect to such taxpayer,

(ii) the filing status of such taxpayer,

(iii) the adjusted gross income of such taxpayer,

(iv) the amounts excluded from such taxpayer's gross income under sections 135 and 911 to the extent such information is available,

(v) the interest received or accrued during the taxable year which is exempt from the tax imposed by chapter 1 to the extent such information is available,

(vi) the amounts excluded from such taxpayer's gross income by sections 931 and 933 to the extent such information is available,

(vii) such other information relating to the liability of the taxpayer as is prescribed by the Secretary by regulation as might indicate in the case of a taxpayer who is an individual described in subsection (i)(4)(B)(iii) of section 1839 of the Social Security Act that the amount of the premium of the taxpayer under such section may be subject to adjustment under subsection (i) of such section or increase under section 1860D–13(a)(7) of such Act and the amount of such adjustment, and

(viii) the taxable year with respect to which the preceding information relates.

(B) RESTRICTION ON USE OF DISCLOSED INFORMATION.—

(i) IN GENERAL.—Return information disclosed under subparagraph (A) may be used by officers, employees, and contractors of the Social Security Administration only for the purposes of, and to the extent necessary in, establishing the appropriate amount of any premium adjustment under such section 1839(i) or increase under such section 1860D–13(a)(7) or for the purpose of resolving taxpayer appeals with respect to any such premium adjustment or increase.

(ii) DISCLOSURE TO OTHER AGENCIES.—Officers, employees, and contractors of the Social Security Administration may disclose—

(I) the taxpayer identity information and the amount of the premium subsidy adjustment or premium increase with respect to a taxpayer described in subparagraph (A) to officers, employees, and contractors of the Centers for Medicare and Medicaid Services, to the extent that such disclosure is necessary for the collection of the premium subsidy amount or the increased premium amount,

(II) the taxpayer identity information and the amount of the premium subsidy adjustment or the increased premium amount with respect to a taxpayer described in subparagraph (A) to officers and employees of the Office of Personnel Management and the Railroad Retirement Board, to the extent that such disclosure is necessary for the collection of the premium subsidy amount or the increased premium amount,

(III) return information with respect to a taxpayer described in subparagraph (A) to officers and employees of the Department of Health and Human Services to the extent necessary to resolve administrative appeals of such premium subsidy adjustment or increased premium, and

(IV) return information with respect to a taxpayer described in subparagraph (A) to officers and employees of the Department of Justice for use in judicial proceedings to the extent necessary to carry out the purposes described in clause (i).

(21) DISCLOSURE OF RETURN INFORMATION TO CARRY OUT ELIGIBILITY REQUIREMENTS FOR CERTAIN PROGRAMS.—

(A) IN GENERAL.—The Secretary, upon written request from the Secretary of Health and Human Services, shall disclose to officers, employees, and contractors of the Department of Health and Human Services return information of any taxpayer whose income is relevant in determining any premium tax credit under section 36B or any cost-sharing reduction under section 1402 of the Patient Protection and Affordable Care Act or eligibility for participation in a State medicaid program under title XIX of the Social Security Act, a State's children's health insurance program under title XXI of the Social Security Act, or a basic health program under section 1331 of Patient Protec-

tion and Affordable Care Act. Such return information shall be limited to—

(i) taxpayer identity information with respect to such taxpayer,

(ii) the filing status of such taxpayer,

(iii) the number of individuals for whom a deduction is allowed under section 151 with respect to the taxpayer (including the taxpayer and the taxpayer's spouse),

(iv) the modified adjusted gross income (as defined in section 36B) of such taxpayer and each of the other individuals included under clause (iii) who are required to file a return of tax imposed by chapter 1 for the taxable year,

(v) such other information as is prescribed by the Secretary by regulation as might indicate whether the taxpayer is eligible for such credit or reduction (and the amount thereof), and

(vi) the taxable year with respect to which the preceding information relates or, if applicable, the fact that such information is not available.

(B) INFORMATION TO EXCHANGE AND STATE AGENCIES.—The Secretary of Health and Human Services may disclose to an Exchange established under the Patient Protection and Affordable Care Act or its contractors, or to a State agency administering a State program described in subparagraph (A) or its contractors, any inconsistency between the information provided by the Exchange or State agency to the Secretary and the information provided to the Secretary under subparagraph (A).

(C) RESTRICTION ON USE OF DISCLOSED INFORMATION.—Return information disclosed under subparagraph (A) or (B) may be used by officers, employees, and contractors of the Department of Health and Human Services, an Exchange, or a State agency only for the purposes of, and to the extent necessary in—

(i) establishing eligibility for participation in the Exchange, and verifying the appropriate amount of, any credit or reduction described in subparagraph (A),

(ii) determining eligibility for participation in the State programs described in subparagraph (A).

(22) DISCLOSURE OF RETURN INFORMATION TO DEPARTMENT OF HEALTH AND HUMAN SERVICES FOR PURPOSES OF ENHANCING MEDICARE PROGRAM INTEGRITY.—

(A) IN GENERAL.—The Secretary shall, upon written request from the Secretary of Health and Human Services, disclose to officers and employees of the Department of Health and Human Services return information with respect to a taxpayer who has applied to enroll, or reenroll, as a provider of services or supplier under the Medicare program under title XVIII of the Social Security Act. Such return information shall be limited to—

(i) the taxpayer identity information with respect to such taxpayer;

(ii) the amount of the delinquent tax debt owed by that taxpayer; and

(iii) the taxable year to which the delinquent tax debt pertains.

(B) RESTRICTION ON DISCLOSURE.—Return information disclosed under subparagraph (A) may be used by officers and employees of the Department of Health and Human Services for the purposes of, and to the extent necessary in, establishing the taxpayer's eligibility for enrollment or reenrollment in the Medicare program, or in any administrative or judicial proceeding relating to, or arising from, a denial of such enrollment or reenrollment, or in determining the level of enhanced oversight to be applied with respect to such taxpayer pursuant to section 1866(j)(3) of the Social Security Act.

(C) DELINQUENT TAX DEBT.—For purposes of this paragraph, the term "delinquent tax debt" means an outstanding debt under this title for which a notice of lien has been filed pursuant to section 6323, but the term does not include a debt that is being paid in a timely manner pursuant to an agreement under section 6159 or 7122, or a debt with respect to which a collection due process hearing under section 6330 is requested, pending, or completed and no payment is required.

(m) DISCLOSURE OF TAXPAYER IDENTITY INFORMATION.—

(1) TAX REFUNDS.—The Secretary may disclose taxpayer identity information to the press and other media for purposes of notifying persons entitled to tax refunds when the Secretary, after reasonable effort and lapse of time, has been unable to locate such persons.

(2) FEDERAL CLAIMS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the Secretary may, upon written request, disclose the mailing address of a taxpayer for use by officers, employees, or agents of a Federal agency for purposes of locating such taxpayer to collect or compromise a Federal claim against the taxpayer in accordance with sections 3711, 3717, and 3718 of title 31.

(B) SPECIAL RULE FOR CONSUMER REPORTING AGENCY.—In the case of an agent of a Federal agency which is a consumer reporting agency (within the meaning of section 603(f) of the Fair Credit Reporting Act (15 U.S.C. 1681a(f))), the mailing address of a taxpayer may be disclosed to such agent under subparagraph (A) only for the purpose of allowing such agent to prepare a commercial credit report on the taxpayer for use by such Federal agency in accordance with sections 3711, 3717, and 3718 of title 31.

(3) NATIONAL INSTITUTE FOR OCCUPATIONAL SAFETY AND HEALTH.—Upon written request, the Secretary may disclose the mailing address of taxpayers to officers and employees of the National Institute for Occupational Safety and Health solely for the purpose of locating individuals who are, or may have been, exposed to occupational hazards in order to determine

the status of their health or to inform them of the possible need for medical care and treatment.

(4) INDIVIDUALS WHO OWE AN OVERPAYMENT OF FEDERAL PELL GRANTS OR WHO HAVE DEFAULTED ON STUDENT LOANS ADMINISTERED BY THE DEPARTMENT OF EDUCATION.—

(A) IN GENERAL.—Upon written request by the Secretary of Education, the Secretary may disclose the mailing address of any taxpayer—

(i) who owes an overpayment of a grant awarded to such taxpayer under subpart 1 of part A of title IV of the Higher Education Act of 1965, or

(ii) who has defaulted on a loan—

(I) made under part B, D, or E of title IV of the Higher Education Act of 1965, or

(II) made pursuant to section 3(a)(1) of the Migration and Refugee Assistance Act of 1962 to a student at an institution of higher education,

for use only by officers, employees, or agents of the Department of Education for purposes of locating such taxpayer for purposes of collecting such overpayment or loan.

(B) DISCLOSURE TO EDUCATIONAL INSTITUTIONS, ETC..—Any mailing address disclosed under subparagraph (A)(i) may be disclosed by the Secretary of Education to—

(i) any lender, or any State or nonprofit guarantee agency, which is participating under part B or D of title IV of the Higher Education Act of 1965, or

(ii) any educational institution with which the Secretary of Education has an agreement under subpart 1 of part A, or part D or E, of title IV of such Act,

for use only by officers, employees, or agents of such lender, guarantee agency, or institution whose duties relate to the collection of student loans for purposes of locating individuals who have defaulted on student loans made under such loan programs for purposes of collecting such loans.

(5) INDIVIDUALS WHO HAVE DEFAULTED ON STUDENT LOANS ADMINISTERED BY THE DEPARTMENT OF HEALTH AND HUMAN SERVICES.—

(A) IN GENERAL.—Upon written request by the Secretary of Health and Human Services, the Secretary may disclose the mailing address of any taxpayer who has defaulted on a loan made under part C of title VII of the Public Health Service Act or under subpart II of part B of title VIII of such Act, for use only by officers, employees, or agents of the Department of Health and Human Services for purposes of locating such taxpayer for purposes of collecting such loan.

(B) DISCLOSURE TO SCHOOLS AND ELIGIBLE LENDERS.—Any mailing address disclosed under subparagraph (A) may be disclosed by the Secretary of Health and Human Services to—

(i) any school with which the Secretary of Health and Human Services has an agreement under subpart II of part C of title VII of the Public Health Service Act or subpart II of part B of title VIII of such Act, or

(ii) any eligible lender (within the meaning of section 737(4) of such Act) participating under subpart I of part C of title VII of such Act,

for use only by officers, employees, or agents of such school or eligible lender whose duties relate to the collection of student loans for purposes of locating individuals who have defaulted on student loans made under such subparts for the purposes of collecting such loans.

(6) BLOOD DONOR LOCATOR SERVICE.—

(A) IN GENERAL.—Upon written request pursuant to section 1141 of the Social Security Act, the Secretary shall disclose the mailing address of taxpayers to officers and employees of the Blood Donor Locator Service in the Department of Health and Human Services.

(B) RESTRICTION ON DISCLOSURE.—The Secretary shall disclose return information under subparagraph (A) only for purposes of, and to the extent necessary in, assisting under the Blood Donor Locator Service authorized persons (as defined in section 1141(h)(1) of the Social Security Act) in locating blood donors who, as indicated by donated blood or products derived therefrom or by the history of the subsequent use of such blood or blood products, have or may have the virus for acquired immune deficiency syndrome, in order to inform such donors of the possible need for medical care and treatment.

(C) SAFEGUARDS.—The Secretary shall destroy all related blood donor records (as defined in section 1141(h)(2) of the Social Security Act) in the possession of the Department of the Treasury upon completion of their use in making the disclosure required under subparagraph (A), so as to make such records undisclosable.

(7) SOCIAL SECURITY ACCOUNT STATEMENT FURNISHED BY SOCIAL SECURITY ADMINISTRATION.—Upon written request by the Commissioner of Social Security, the Secretary may disclose the mailing address of any taxpayer who is entitled to receive a social security account statement pursuant to section 1143(c) of the Social Security Act, for use only by officers, employees or agents of the Social Security Administration for purposes of mailing such statement to such taxpayer.

(n) CERTAIN OTHER PERSONS.—Pursuant to regulations prescribed by the Secretary, returns and return information may be disclosed to any person, including any person described in section 7513(a), to the extent necessary in connection with the processing, storage, transmission, and reproduction of such returns and return information, the programming, maintenance, repair, testing, and procurement of equipment, and the providing of other services, for purposes of tax administration.

(o) DISCLOSURE OF RETURNS AND RETURN INFORMATION WITH RESPECT TO CERTAIN TAXES.—

(1) TAXES IMPOSED BY SUBTITLE E.—

(A) IN GENERAL.—Returns and return information with respect to taxes imposed by subtitle E (relating to taxes on alcohol, tobacco, and firearms) shall be open to inspection by or disclosure to officers and employees of a Federal

agency whose official duties require such inspection or disclosure.

(B) USE IN CERTAIN PROCEEDINGS.—Returns and return information disclosed to a Federal agency under subparagraph (A) may be used in an action or proceeding (or in preparation for such action or proceeding) brought under section 625 of the American Jobs Creation Act of 2004 for the collection of any unpaid assessment or penalty arising under such Act.

(2) TAXES IMPOSED BY CHAPTER 35.—Returns and return information with respect to taxes imposed by chapter 35 (relating to taxes on wagering) shall, notwithstanding any other provision of this section, be open to inspection by or disclosure only to such person or persons and for such purpose or purposes as are prescribed by section 4424.

(p) PROCEDURE AND RECORDKEEPING.—

(1) MANNER, TIME, AND PLACE OF INSPECTIONS.—Requests for the inspection or disclosure of a return or return information and such inspection or disclosure shall be made in such manner and at such time and place as shall be prescribed by the Secretary.

(2) PROCEDURE.—

(A) REPRODUCTION OF RETURNS.—A reproduction or certified reproduction of a return shall, upon written request, be furnished to any person to whom disclosure or inspection of such return is authorized under this section. A reasonable fee may be prescribed for furnishing such reproduction or certified reproduction.

(B) DISCLOSURE OF RETURN INFORMATION.—Return information disclosed to any person under the provisions of this title may be provided in the form of written documents, reproductions of such documents, films or photoimpressions, or electronically produced tapes, disks, or records, or by any other mode or means which the Secretary determines necessary or appropriate. A reasonable fee may be prescribed for furnishing such return information.

(C) USE OF REPRODUCTIONS.—Any reproduction of any return, document, or other matter made in accordance with this paragraph shall have the same legal status as the original, and any such reproduction shall, if properly authenticated, be admissible in evidence in any judicial or administrative proceeding as if it were the original, whether or not the original is in existence.

(3) RECORDS OF INSPECTION AND DISCLOSURE.—

(A) SYSTEM OF RECORDKEEPING.—Except as otherwise provided by this paragraph, the Secretary shall maintain a permanent system of standardized records or accountings of all requests for inspection or disclosure of returns and return information (including the reasons for and dates of such requests) and of returns and return information inspected or disclosed under this section and section 6104(c). Notwithstanding the provisions of section 552a(c) of title 5, United States Code, the Secretary shall not be required to maintain a record or accounting of requests for inspection or disclosure of returns and return information,

or of returns and return information inspected or disclosed, under the authority of subsection (c), (e), (f)(5), (h)(1), (3)(A), or (4), (i)(4), or (8)(A)(ii), (k)(1), (2), (6), (8), or (9), (*l*)(1), (4)(B), (5), (7), (8), (9), (10), (11), (12), (13), (14), (15), (16), (17), or (18), (m), or (n). The records or accountings required to be maintained under this paragraph shall be available for examination by the Joint Committee on Taxation or the Chief of Staff of such joint committee. Such record or accounting shall also be available for examination by such person or persons as may be, but only to the extent, authorized to make such examination under section 552a(c)(3) of title 5, United States Code.

(B) REPORT BY THE SECRETARY.—The Secretary shall, within 90 days after the close of each calendar year, furnish to the Joint Committee on Taxation a report with respect to, or summary of, the records or accountings described in subparagraph (A) in such form and containing such information as such joint committee or the Chief of Staff of such joint committee may designate. Such report or summary shall not, however, include a record or accounting of any request by the President under subsection (g) for, or the disclosure in response to such request of, any return or return information with respect to any individual who, at the time of such request, was an officer or employee of the executive branch of the Federal Government. Such report or summary, or any part thereof, may be disclosed by such joint committee to such persons and for such purposes as the joint committee may, by record vote of a majority of the members of the joint committee, determine.

(C) PUBLIC REPORT ON DISCLOSURES.—The Secretary shall, within 90 days after the close of each calendar year, furnish to the Joint Committee on Taxation for disclosure to the public a report with respect to the records or accountings described in subparagraph (A) which—

(i) provides with respect to each Federal agency, each agency, body, or commission described in subsection (d), (i)(3)(B)(i) or (7)(A)(ii), or (*l*)(6), and the Government Accountability Office the number of—

(I) requests for disclosure of returns and return information,

(II) instances in which returns and return information were disclosed pursuant to such requests or otherwise,

(III) taxpayers whose returns, or return information with respect to whom, were disclosed pursuant to such requests, and

(ii) describes the general purposes for which such requests were made.

(4) SAFEGUARDS.—Any Federal agency described in subsection (h)(2), (h)(5), (i)(1), (2), (3), (5), or (7), (j)(1), (2), or (5), (k)(8), (10), or (11), (*l*)(1), (2), (3), (5), (10), (11), (13), (14), (17), or (22) or (*o*)(1)(A), the Government Accountability Office, the Congressional Budget Office, or any agency, body, or commission described in subsection (d), (i)(1)(C), (3)(B)(i), or (7)(A)(ii),

or (k)(10), (*l*)(6), (7), (8), (9), (12), (15), or (16), any appropriate State officer (as defined in section 6104(c)), or any other person described in subsection (k)(10), subsection (*l*)(10), (16), (18), (19), or (20), or any entity described in subsection (*l*)(21), shall, as a condition for receiving returns or return information—

(A) establish and maintain, to the satisfaction of the Secretary, a permanent system of standardized records with respect to any request, the reason for such request, and the date of such request made by or of it and any disclosure of return or return information made by or to it;

(B) establish and maintain, to the satisfaction of the Secretary, a secure area or place in which such returns or return information shall be stored;

(C) restrict, to the satisfaction of the Secretary, access to the returns or return information only to persons whose duties or responsibilities require access and to whom disclosure may be made under the provisions of this title;

(D) provide such other safeguards which the Secretary determines (and which he prescribes in regulations) to be necessary or appropriate to protect the confidentiality of the returns or return information;

(E) furnish a report to the Secretary, at such time and containing such information as the Secretary may prescribe, which describes the procedures established and utilized by such agency, body, or commission, the Government Accountability Office, or the Congressional Budget Office for ensuring the confidentiality of returns and return information required by this paragraph; and

(F) upon completion of use of such returns or return information—

(i) in the case of an agency, body, or commission described in subsection (d), (i)(3)(B)(i), (k)(10), or (*l*)(6), (7), (8), (9), or (16), any appropriate State officer (as defined in section 6104(c)), or any other person described in subsection (k)(10) or subsection (*l*)(10), (16), (18), (19), or (20) return to the Secretary such returns or return information (along with any copies made therefrom) or make such returns or return information undisclosable in any manner and furnish a written report to the Secretary describing such manner,

(ii) in the case of an agency described in subsection (h)(2), (h)(5), (i)(1), (2), (3), (5) or (7), (j)(1), (2), or (5), (k)(8), (10), or (11), (*l*)(1), (2), (3), (5), (10), (11), (12), (13), (14), (15), (17), or (22), or (*o*)(1)(A) or any entity described in subsection (*l*)(21), the Government Accountability Office, or the Congressional Budget Office, either—

(I) return to the Secretary such returns or return information (along with any copies made therefrom),

(II) otherwise make such returns or return information undisclosable, or

(III) to the extent not so returned or made undisclosable, ensure that the conditions of subparagraphs (A), (B), (C), (D), and (E) of this para-

graph continue to be met with respect to such returns or return information, and

(iii) in the case of the Department of Health and Human Services for purposes of subsection (m)(6), destroy all such return information upon completion of its use in providing the notification for which the information was obtained, so as to make such information undisclosable;

except that the conditions of subparagraphs (A), (B), (C), (D), and (E) shall cease to apply with respect to any return or return information if, and to the extent that, such return or return information is disclosed in the course of any judicial or administrative proceeding and made a part of the public record thereof. If the Secretary determines that any such agency, body, or commission, including an agency, an appropriate State officer (as defined in section 6104(c)), or any other person described in subsection (k)(10) or subsection (*l*)(10), (16), (18), (19), or (20) or any entity described in subsection (*l*)(21), or the Government Accountability Office or the Congressional Budget Office, has failed to, or does not, meet the requirements of this paragraph, he may, after any proceedings for review established under paragraph (7), take such actions as are necessary to ensure such requirements are met, including refusing to disclose returns or return information to such agency, body, or commission, including an agency, an appropriate State officer (as defined in section 6104(c)), or any other person described in subsection (k)(10) or subsection (*l*)(10), (16), (18), (19), or (20) or any entity described in subsection (*l*)(21), or the Government Accountability Office or the Congressional Budget Office, until he determines that such requirements have been or will be met. In the case of any agency which receives any mailing address under paragraph (2), (4), (6), or (7) of subsection (m) and which discloses any such mailing address to any agent or which receives any information under paragraph (6)(A), (10), (12)(B), or (16) of subsection (*l*) and which discloses any such information to any agent, or any person including an agent described in subsection (*l*)(10) or (16), this paragraph shall apply to such agency and each such agent or other person (except that, in the case of an agent, or any person including an agent described in subsection (*l*)(10) or (16), any report to the Secretary or other action with respect to the Secretary shall be made or taken through such agency). For purposes of applying this paragraph in any case to which subsection (m)(6) applies, the term "return information" includes related blood donor records (as defined in section 1141(h)(2) of the Social Security Act).

(5) REPORT ON PROCEDURES AND SAFEGUARDS.—After the close of each calendar year, the Secretary shall furnish to each committee described in subsection (f)(1) a report which describes the procedures and safeguards established and utilized by such agencies, bodies, or commissions, the Government Accountability Office, and the Congressional Budget Office for ensuring the confidentiality of returns and return information as required by this subsection. Such report shall also describe in-

stances of deficiencies in, and failure to establish or utilize, such procedures.

(6) AUDIT OF PROCEDURES AND SAFEGUARDS.—

(A) AUDIT BY COMPTROLLER GENERAL.—The Comptroller General may audit the procedures and safeguards established by such agencies, bodies, or commissions and the Congressional Budget Office pursuant to this subsection to determine whether such safeguards and procedures meet the requirements of this subsection and ensure the confidentiality of returns and return information. The Comptroller General shall notify the Secretary before any such audit is conducted.

(B) RECORDS OF INSPECTION AND REPORTS BY THE COMPTROLLER GENERAL.—The Comptroller General shall—

(i) maintain a permanent system of standardized records and accountings of returns and return information inspected by officers and employees of the Government Accountability Office under subsection (i)(8)(A)(ii) and shall, within 90 days after the close of each calendar year, furnish to the Secretary a report with respect to, or summary of, such records or accountings in such form and containing such information as the Secretary may prescribe, and

(ii) furnish an annual report to each committee described in subsection (f) and to the Secretary setting forth his findings with respect to any audit conducted pursuant to subparagraph (A).

The Secretary may disclose to the Joint Committee any report furnished to him under clause (i).

(7) ADMINISTRATIVE REVIEW.—The Secretary shall by regulations prescribe procedures which provide for administrative review of any determination under paragraph (4) that any agency, body, or commission described in subsection (d) has failed to meet the requirements of such paragraph.

(8) STATE LAW REQUIREMENTS.—

(A) SAFEGUARDS.—Notwithstanding any other provision of this section, no return or return information shall be disclosed after December 31, 1978, to any officer or employee of any State which requires a taxpayer to attach to, or include in, any State tax return a copy of any portion of his Federal return, or information reflected on such Federal return, unless such State adopts provisions of law which protect the confidentiality of the copy of the Federal return (or portion thereof) attached to, or the Federal return information reflected on, such State tax return.

(B) DISCLOSURE OF RETURNS OR RETURN INFORMATION IN STATE RETURNS.—Nothing in subparagraph (A) shall be construed to prohibit the disclosure by an officer or employee of any State of any copy of any portion of a Federal return or any information on a Federal return which is required to be attached or included in a State return to another officer or employee of such State (or political subdivision of such State) if such disclosure is specifically authorized by State law.

(q) REGULATIONS.—The Secretary is authorized to prescribe such other regulations as are necessary to carry out the provisions of this section.

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CHAPTER 62—TIME AND PLACE FOR PAYING TAX

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Subchapter B—EXTENSIONS OF TIME FOR PAYMENT

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SEC. 6166. EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX WHERE ESTATE CONSISTS LARGELY OF INTEREST IN CLOSELY HELD BUSINESS.

(a) 5-YEAR DEFERRAL; 10-YEAR INSTALLMENT PAYMENT.—

(1) IN GENERAL.—If the value of an interest in a closely held business which is included in determining the gross estate of a decedent who was (at the date of his death) a citizen or resident of the United States exceeds 35 percent of the adjusted gross estate, the executor may elect to pay part or all of the tax imposed by section 2001 in 2 or more (but not exceeding 10) equal installments.

(2) LIMITATION.—The maximum amount of tax which may be paid in installments under this subsection shall be an amount which bears the same ratio to the tax imposed by section 2001 (reduced by the credits against such tax) as—

(A) the closely held business amount, bears to

(B) the amount of the adjusted gross estate.

(3) DATE FOR PAYMENT OF INSTALLMENTS.—If an election is made under paragraph (1), the first installment shall be paid on or before the date selected by the executor which is not more than 5 years after the date prescribed by section 6151(a) for payment of the tax, and each succeeding installment shall be paid on or before the date which is 1 year after the date prescribed by this paragraph for payment of the preceding installment.

(b) DEFINITIONS AND SPECIAL RULES.—

(1) INTEREST IN CLOSELY HELD BUSINESS.—For purposes of this section, the term "interest in a closely held business" means—

(A) an interest as a proprietor in a trade or business carried on as a proprietorship;

(B) an interest as a partner in a partnership carrying on a trade or business, if—

(i) 20 percent or more of the total capital interest in such partnership is included in determining the gross estate of the decedent, or

(ii) such partnership had 45 or fewer partners; or

(C) stock in a corporation carrying on a trade or business if—

(i) 20 percent or more in value of the voting stock of such corporation is included in determining the gross estate of the decedent, or

(ii) such corporation had 45 or fewer shareholders.

(2) RULES FOR APPLYING PARAGRAPH (1).—For purposes of paragraph (1)—

(A) TIME FOR TESTING.—Determinations shall be made as of the time immediately before the decedent's death.

[(B) CERTAIN INTERESTS HELD BY HUSBAND AND WIFE.—Stock or a partnership interest which—

[(i) is community property of a husband and wife (or the income from which is community income) under the applicable community property law of a State, or

[(ii) is held by a husband and wife as joint tenants, tenants by the entirety, or tenants in common,

shall be treated as owned by one shareholder or one partner, as the case may be.]

(B) CERTAIN INTERESTS HELD BY MARRIED COUPLE.—Stock or a partnership interest which—

(i) is community property of a married couple (or the income from which is community income) under the applicable community property law of a State, or

(ii) is held by a married couple as joint tenants, tenants by the entirety, or tenants in common,

shall be treated as owned by 1 shareholder or 1 partner, as the case may be.

(C) INDIRECT OWNERSHIP.—Property owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries. For purposes of the preceding sentence, a person shall be treated as a beneficiary of any trust only if such person has a present interest in the trust.

(D) CERTAIN INTERESTS HELD BY MEMBERS OF DECEDENT'S FAMILY.—All stock and all partnership interests held by the decedent or by any member of his family (within the meaning of section 267(c)(4)) shall be treated as owned by the decedent.

(3) FARMHOUSES AND CERTAIN OTHER STRUCTURES TAKEN INTO ACCOUNT.—For purposes of the 35-percent requirement of subsection (a)(1), an interest in a closely held business which is the business of farming includes an interest in residential buildings and related improvements on the farm which are occupied on a regular basis by the owner or lessee of the farm or by persons employed by such owner or lessee for purposes of operating or maintaining the farm.

(4) VALUE.—For purposes of this section, value shall be value determined for purposes of chapter 11 (relating to estate tax).

(5) CLOSELY HELD BUSINESS AMOUNT.—For purposes of this section, the term "closely held business amount" means the value of the interest in a closely held business which qualifies under subsection (a)(1).

(6) ADJUSTED GROSS ESTATE.—For purposes of this section, the term, "adjusted gross estate" means the value of the gross estate reduced by the sum of the amounts allowable as a de-

duction under section 2053 or 2054. Such sum shall be determined on the basis of the facts and circumstances in existence on the date (including extensions) for filing the return of tax imposed by section 2001 (or, if earlier, the date on which such return is filed).

(7) PARTNERSHIP INTERESTS AND STOCK WHICH IS NOT READILY TRADABLE.—

(A) IN GENERAL.—If the executor elects the benefits of this paragraph (at such time and in such manner as the Secretary shall by regulations prescribe), then—

(i) for purposes of paragraph (1)(B)(i) or (1)(C)(i) (whichever is appropriate) and for purposes of subsection (c), any capital interest in a partnership and any non-readily-tradable stock which (after the application of paragraph (2)) is treated as owned by the decedent shall be treated as included in determining the value of the decedent's gross estate,

(ii) the executor shall be treated as having selected under subsection (a)(3) the date prescribed by section 6151(a), and

(iii) for purposes of applying section 6601(j), the 2-percent portion (as defined in such section) shall be treated as being zero.

(B) NON-READILY-TRADABLE STOCK DEFINED.—For purposes of this paragraph, the term "non-readily-tradable stock" means stock for which, at the time of the decedent's death, there was no market on a stock exchange or in an over-the-counter market.

(8) STOCK IN HOLDING COMPANY TREATED AS BUSINESS COMPANY STOCK IN CERTAIN CASES.—

(A) IN GENERAL.—If the executor elects the benefits of this paragraph, then—

(i) HOLDING COMPANY STOCK TREATED AS BUSINESS COMPANY STOCK.—For purposes of this section, the portion of the stock of any holding company which represents direct ownership (or indirect ownership through 1 or more other holding companies) by such company in a business company shall be deemed to be stock in such business company.

(ii) 5-YEAR DEFERRAL FOR PRINCIPAL NOT TO APPLY.—The executor shall be treated as having selected under subsection (a)(3) the date prescribed by section 6151(a).

(iii) 2-PERCENT INTEREST RATE NOT TO APPLY.—For purposes of applying section 6601(j), the 2-percent portion (as defined in such section) shall be treated as being zero.

(B) ALL STOCK MUST BE NON-READILY-TRADABLE STOCK.—

(i) IN GENERAL.—No stock shall be taken into account for purposes of applying this paragraph unless it is non-readily-tradable stock (within the meaning of paragraph (7)(B)).

(ii) SPECIAL APPLICATION WHERE ONLY HOLDING COMPANY STOCK IS NON-READILY-TRADABLE STOCK.—If the

requirements of clause (i) are not met, but all of the stock of each holding company taken into account is non-readily-tradable, then this paragraph shall apply, but subsection (a)(1) shall be applied by substituting "5" for "10".

(C) APPLICATION OF VOTING STOCK REQUIREMENT OF PARAGRAPH (1)(C)(I).—For purposes of clause (i) of paragraph (1)(C), the deemed stock resulting from the application of subparagraph (A) shall be treated as voting stock to the extent that voting stock in the holding company owns directly (or through the voting stock of 1 or more other holding companies) voting stock in the business company.

(D) DEFINITIONS.—For purposes of this paragraph—

(i) HOLDING COMPANY.—The term "holding company" means any corporation holding stock in another corporation.

(ii) BUSINESS COMPANY.—The term "business company" means any corporation carrying on a trade or business.

(9) DEFERRAL NOT AVAILABLE FOR PASSIVE ASSETS.—

(A) IN GENERAL.—For purposes of subsection (a)(1) and determining the closely held business amount (but not for purposes of subsection (g)), the value of any interest in a closely held business shall not include the value of that portion of such interest which is attributable to passive assets held by the business.

(B) PASSIVE ASSET DEFINED.—For purposes of this paragraph—

(i) IN GENERAL.—The term "passive asset" means any asset other than an asset used in carrying on a trade or business.

(ii) STOCK TREATED AS PASSIVE ASSET.—The term "passive asset" includes any stock in another corporation unless—

(I) such stock is treated as held by the decedent by reason of an election under paragraph (8), and

(II) such stock qualified under subsection (a)(1).

(iii) EXCEPTION FOR ACTIVE CORPORATIONS.—If—

(I) a corporation owns 20 percent or more in value of the voting stock of another corporation, or such other corporation has 45 or fewer shareholders, and

(II) 80 percent or more of the value of the assets of each such corporation is attributable to assets used in carrying on a trade or business,

then such corporations shall be treated as 1 corporation for purposes of clause (ii). For purposes of applying subclause (II) to the corporation holding the stock of the other corporation, such stock shall not be taken into account.

(10) STOCK IN QUALIFYING LENDING AND FINANCE BUSINESS TREATED AS STOCK IN AN ACTIVE TRADE OR BUSINESS COMPANY.—

(A) IN GENERAL.—If the executor elects the benefits of this paragraph, then—

(i) STOCK IN QUALIFYING LENDING AND FINANCE BUSINESS TREATED AS STOCK IN AN ACTIVE TRADE OR BUSINESS COMPANY.—For purposes of this section, any asset used in a qualifying lending and finance business shall be treated as an asset which is used in carrying on a trade or business.

(ii) 5-YEAR DEFERRAL FOR PRINCIPAL NOT TO APPLY.—The executor shall be treated as having selected under subsection (a)(3) the date prescribed by section 6151(a).

(iii) 5 EQUAL INSTALLMENTS ALLOWED.—For purposes of applying subsection (a)(1), "5" shall be substituted for "10".

(B) DEFINITIONS.—For purposes of this paragraph—

(i) QUALIFYING LENDING AND FINANCE BUSINESS.—The term "qualifying lending and finance business" means a lending and finance business, if—

(I) based on all the facts and circumstances immediately before the date of the decedent's death, there was substantial activity with respect to the lending and finance business, or

(II) during at least 3 of the 5 taxable years ending before the date of the decedent's death, such business had at least 1 full-time employee substantially all of whose services were the active management of such business, 10 full-time, nonowner employees substantially all of whose services were directly related to such business, and $5,000,000 in gross receipts from activities described in clause (ii).

(ii) LENDING AND FINANCE BUSINESS.—The term "lending and finance business" means a trade or business of—

(I) making loans,

(II) purchasing or discounting accounts receivable, notes, or installment obligations,

(III) engaging in rental and leasing of real and tangible personal property, including entering into leases and purchasing, servicing, and disposing of leases and leased assets,

(IV) rendering services or making facilities available in the ordinary course of a lending or finance business, and

(V) rendering services or making facilities available in connection with activities described in subclauses (I) through (IV) carried on by the corporation rendering services or making facilities available, or another corporation which is a member of the same affiliated group (as defined in section 1504 without regard to section 1504(b)(3)).

(iii) LIMITATION.—The term "qualifying lending and finance business" shall not include any interest in an entity, if the stock or debt of such entity or a controlled group (as defined in section 267(f)(1)) of which such entity was a member was readily tradable on an

established securities market or secondary market (as defined by the Secretary) at any time within 3 years before the date of the decedent's death.

(c) SPECIAL RULE FOR INTEREST IN 2 OR MORE CLOSELY HELD BUSINESSES.—For purposes of this section, interest in 2 or more closely held businesses, with respect to each of which there is included in determining the value of the decedent's gross estate 20 percent or more of the total value of each such business, shall be treated as an interest in a single closely held business. For purposes of the 20-percent requirement of the preceding sentence, an interest in a closely held business which represents the surviving spouse's interest in property held by the decedent and the surviving spouse as community property or as joint tenants, tenants by the entirety, or tenants in common shall be treated as having been included in determining the value of the decedent's gross estate.

(d) ELECTION.—Any election under subsection (a) shall be made not later than the time prescribed by section 6075(a) for filing the return of tax imposed by section 2001 (including extensions thereof), and shall be made in such manner as the Secretary shall by regulations prescribe. If an election under subsection (a) is made, the provisions of this subtitle shall apply as though the Secretary were extending the time for payment of the tax.

(e) PRORATION OF DEFICIENCY TO INSTALLMENTS.—If an election is made under subsection (a) to pay any part of the tax imposed by section 2001 in installments and a deficiency has been assessed, the deficiency shall (subject to the limitation provided by subsection (a)(2)) be prorated to the installments payable under subsection (a). The part of the deficiency so prorated to any installment the date for payment of which has not arrived shall be collected at the same time as, and as a part of, such installment. The part of the deficiency so prorated to any installment the date for payment of which has arrived shall be paid upon notice and demand from the Secretary. This subsection shall not apply if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

(f) TIME FOR PAYMENT OF INTEREST.—If the time for payment of any amount of tax has been extended under this section—

(1) INTEREST FOR FIRST 5 YEARS.—Interest payable under section 6601 of any unpaid portion of such amount attributable to the first 5 years after the date prescribed by section 6151(a) for payment of the tax shall be paid annually.

(2) INTEREST FOR PERIODS AFTER FIRST 5 YEARS.—Interest payable under section 6601 on any unpaid portion of such amount attributable to any period after the 5-year period referred to in paragraph (1) shall be paid annually at the same time as, and as a part of, each installment payment of the tax.

(3) INTEREST IN THE CASE OF CERTAIN DEFICIENCIES.—In the case of a deficiency to which subsection (e) applies which is assessed after the close of the 5-year period referred to in paragraph (1), interest attributable to such 5-year period, and interest assigned under paragraph (2) to any installment the date for payment of which has arrived on or before the date of the assessment of the deficiency, shall be paid upon notice and demand from the Secretary.

(4) SELECTION OF SHORTER PERIOD.—If the executor has selected a period shorter than 5 years under subsection (a)(3), such shorter period shall be substituted for 5 years in paragraphs (1), (2), and (3) of this subsection.

(g) ACCELERATION OF PAYMENT.—

(1) DISPOSITION OF INTEREST; WITHDRAWAL OF FUNDS FROM BUSINESS.—

(A) If—

(i)(I) any portion of an interest in a closely held business which qualifies under subsection (a)(1) is distributed, sold, exchanged, or otherwise disposed of, or

(II) money and other property attributable to such an interest is withdrawn from such trade or business, and

(ii) the aggregate of such distributions, sales, exchanges, or other dispositions and withdrawals equals or exceeds 50 percent of the value of such interest,

then the extension of time for payment of tax provided in subsection (a) shall cease to apply, and the unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Secretary.

(B) In the case of a distribution in redemption of stock to which section 303 (or so much of section 304 as relates to section 303) applies—

(i) the redemption of such stock, and the withdrawal of money and other property distributed in such redemption, shall not be treated as a distribution or withdrawal for purposes of subparagraph (A), and

(ii) for purposes of subparagraph (A), the value of the interest in the closely held business shall be considered to be such value reduced by the value of the stock redeemed.

This subparagraph shall apply only if, on or before the date prescribed by subsection (a)(3) for the payment of the first installment which becomes due after the date of the distribution (or, if earlier, on or before the day which is 1 year after the date of the distribution), there is paid an amount of the tax imposed by section 2001 not less than the amount of money and other property distributed.

(C) Subparagraph (A)(i) does not apply to an exchange of stock pursuant to a plan of reorganization described in subparagraph (D), (E), or (F) of section 368(a)(1) nor to an exchange to which section 355 (or so much of section 356 as relates to section 355) applies; but any stock received in such an exchange shall be treated for purposes of subparagraph (A)(i) as an interest qualifying under subsection (a)(1).

(D) Subparagraph (A)(i) does not apply to a transfer of property of the decedent to a person entitled by reason of the decedent's death to receive such property under the decedent's will, the applicable law of descent and distribution, or a trust created by the decedent. A similar rule shall apply in the case of a series of subsequent transfers of the property by reason of death so long as each transfer

is to a member of the family (within the meaning of section 267(c)(4)) of the transferor in such transfer.

(E) CHANGES IN INTEREST IN HOLDING COMPANY.—If any stock in a holding company is treated as stock in a business company by reason of subsection (b)(8)(A)—

(i) any disposition of any interest in such stock in such holding company which was included in determining the gross estate of the decedent, or

(ii) any withdrawal of any money or other property from such holding company attributable to any interest included in determining the gross estate of the decedent,

shall be treated for purposes of subparagraph (A) as a disposition of (or a withdrawal with respect to) the stock qualifying under subsection (a)(1).

(F) CHANGES IN INTEREST IN BUSINESS COMPANY.—If any stock in a holding company is treated as stock in a business company by reason of subsection (b)(8)(A)—

(i) any disposition of any interest in such stock in the business company by such holding company, or

(ii) any withdrawal of any money or other property from such business company attributable to such stock by such holding company owning such stock,

shall be treated for purposes of subparagraph (A) as a disposition of (or a withdrawal with respect to) the stock qualifying under subsection (a)(1).

(2) UNDISTRIBUTED INCOME OF ESTATE.—

(A) If an election is made under this section and the estate has undistributed net income for any taxable year ending on or after the due date for the first installment, the executor shall, on or before the date prescribed by law for filing the income tax return for such taxable year (including extensions thereof), pay an amount equal to such undistributed net income in liquidation of the unpaid portion of the tax payable in installments.

(B) For purposes of subparagraph (A), the undistributed net income of the estate for any taxable year is the amount by which the distributable net income of the estate for such taxable year (as defined in section 643) exceeds the sum of—

(i) the amounts for such taxable year specified in paragraphs (1) and (2) of section 661(a) (relating to deductions for distributions, etc.);

(ii) the amount of tax imposed for the taxable year on the estate under chapter 1; and

(iii) the amount of the tax imposed by section 2001 (including interest) paid by the executor during the taxable year (other than any amount paid pursuant to this paragraph).

(C) For purposes of this paragraph, if any stock in a corporation is treated as stock in another corporation by reason of subsection (b)(8)(A), any dividends paid by such other corporation to the corporation shall be treated as paid to the estate of the decedent to the extent attributable to the stock qualifying under subsection (a)(1).

(3) FAILURE TO MAKE PAYMENT OF PRINCIPAL OR INTEREST.—

(A) IN GENERAL.—Except as provided in subparagraph (B), if any payment of principal or interest under this section is not paid on or before the date fixed for its payment by this section (including any extension of time), the unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Secretary.

(B) PAYMENT WITHIN 6 MONTHS.—If any payment of principal or interest under this section is not paid on or before the date determined under subparagraph (A) but is paid within 6 months of such date—

(i) the provisions of subparagraph (A) shall not apply with respect to such payment,

(ii) the provisions of section 6601(j) shall not apply with respect to the determination of interest on such payment, and

(iii) there is imposed a penalty in an amount equal to the product of—

(I) 5 percent of the amount of such payment, multiplied by

(II) the number of months (or fractions thereof) after such date and before payment is made.

The penalty imposed under clause (iii) shall be treated in the same manner as a penalty imposed under subchapter B of chapter 68.

(h) ELECTION IN CASE OF CERTAIN DEFICIENCIES.—

(1) IN GENERAL.—If—

(A) a deficiency in the tax imposed by section 2001 is assessed,

(B) the estate qualifies under subsection (a)(1), and

(C) the executor has not made an election under subsection (a),

the executor may elect to pay the deficiency in installments. This subsection shall not apply if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

(2) TIME OF ELECTION.—An election under this subsection shall be made not later than 60 days after issuance of notice and demand by the Secretary for the payment of the deficiency, and shall be made in such manner as the Secretary shall by regulations prescribe.

(3) EFFECT OF ELECTION ON PAYMENT.—If an election is made under this subsection, the deficiency shall (subject to the limitation provided by subsection (a)(2)) be prorated to the installments which would have been due if an election had been timely made under subsection (a) at the time the estate tax return was filed. The part of the deficiency so prorated to any installment the date for payment of which would have arrived shall be paid at the time of the making of the election under this subsection. The portion of the deficiency so prorated to installments the date for payment of which would not have so arrived shall be paid at the time such installments would have been due if such an election had been made.

(i) SPECIAL RULE FOR CERTAIN DIRECT SKIPS.—To the extent that an interest in a closely held business is the subject of a direct skip (within the meaning of section 2612(c)) occurring at the same time as and as a result of the decedent's death, then for purposes of this section any tax imposed by section 2601 on the transfer of such interest shall be treated as if it were additional tax imposed by section 2001.

(j) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to the application of this section.

(k) CROSS REFERENCES.—

(1) SECURITY.—For authority of the Secretary to require security in the case of an extension under this section, see section 6165.

(2) LIEN.—For special lien (in lieu of bond) in the case of an extension under this section, see section 6324A.

(3) PERIOD OF LIMITATION.—For extension of the period of limitation in the case of an extension under this section, see section 6503(d).

(4) INTEREST.—For provisions relating to interest on tax payable in installments under this section, see subsection (j) of section 6601.

(5) TRANSFERS WITHIN 3 YEARS OF DEATH.—For special rule for qualifying an estate under this section where property has been transferred within 3 years of decedent's death, see section 2035(c)(2).

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CHAPTER 63—ASSESSMENT

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Subchapter B—DEFICIENCY PROCEDURES IN THE CASE OF INCOME, ESTATE, GIFT, AND CERTAIN EXCISE TAXES

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SEC. 6212. NOTICE OF DEFICIENCY.

(a) IN GENERAL.—If the Secretary determines that there is a deficiency in respect of any tax imposed by subtitles A or B or chapter 41, 42, 43, or 44 he is authorized to send notice of such deficiency to the taxpayer by certified mail or registered mail. Such notice shall include a notice to the taxpayer of the taxpayer's right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office.

(b) ADDRESS FOR NOTICE OF DEFICIENCY.—

(1) INCOME AND GIFT TAXES AND CERTAIN EXCISE TAXES.—In the absence of notice to the Secretary under section 6903 of the existence of a fiduciary relationship, notice of a deficiency in respect of a tax imposed by subtitle A, chapter 12, chapter 41, chapter 42, chapter 43, or chapter 44 if mailed to the taxpayer at his last known address, shall be sufficient for purposes of subtitle A, chapter 12, chapter 41, chapter 42, chapter 43, chapter 44, and this chapter even if such taxpayer is deceased,

or is under a legal disability, or, in the case of a corporation, has terminated its existence.

(2) JOINT INCOME TAX RETURN.—In the case of a joint income tax [return filed by husband and wife] *return* , such notice of deficiency may be a single joint notice, except that if the Secretary has been notified by either spouse that separate residences have been established, then, in lieu of the single joint notice, a duplicate original of the joint notice shall be sent by certified mail or registered mail to each spouse at [his last known address] *the last known address of such spouse* .

(3) ESTATE TAX.—In the absence of notice to the Secretary under section 6903 of the existence of a fiduciary relationship, notice of a deficiency in respect of a tax imposed by chapter 11, if addressed in the name of the decedent or other person subject to liability and mailed to his last known address, shall be sufficient for purposes of chapter 11 and of this chapter.

(c) FURTHER DEFICIENCY LETTERS RESTRICTED.—

(1) GENERAL RULE.—If the Secretary has mailed to the taxpayer a notice of deficiency as provided in subsection (a), and the taxpayer files a petition with the Tax Court within the time prescribed in section 6213(a), the Secretary shall have no right to determine any additional deficiency of income tax for the same taxable year, of gift tax for the same calendar year, of estate tax in respect of the taxable estate of the same decedent, of chapter 41 tax for the same taxable year, of chapter 43 tax for the same taxable year, of chapter 44 tax for the same taxable year, of section 4940 tax for the same taxable year, or of chapter 42 tax, (other than under section 4940) with respect to any act (or failure to act) to which such petition relates, except in the case of fraud, and except as provided in section 6214(a) (relating to assertion of greater deficiencies before the Tax Court), in section 6213(b)(1) (relating to mathematical or clerical errors), in section 6851 or 6852 (relating to termination assessments), or in section 6861(c) (relating to the making of jeopardy assessments).

(2) CROSS REFERENCES.—For assessment as a deficiency notwithstanding the prohibition of further deficiency letters, in the case of—

(A) Deficiency attributable to change of treatment with respect to itemized deductions, see section 63(e)(3).

(B) Deficiency attributable to gain on involuntary conversion, see section 1033(a)(2)(C) and (D).

(C) Deficiency attributable to activities not engaged in for profit, see section 183(e)(4).

For provisions allowing determination of tax in title 11 cases, see section 505(a) of title 11 of the United States Code.

(d) AUTHORITY TO RESCIND NOTICE OF DEFICIENCY WITH TAXPAYER'S CONSENT.—The Secretary may, with the consent of the taxpayer, rescind any notice of deficiency mailed to the taxpayer. Any notice so rescinded shall not be treated as a notice of deficiency for purposes of subsection (c)(1) (relating to further deficiency letters restricted), section 6213(a) (relating to restrictions applicable to deficiencies; petition to Tax Court), and section 6512(a) (relating to limitations in case of petition to Tax Court), and the taxpayer shall

have no right to file a petition with the Tax Court based on such notice. Nothing in this subsection shall affect any suspension of the running of any period of limitations during any period during which the rescinded notice was outstanding.

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CHAPTER 66—LIMITATIONS

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Subchapter A—LIMITATIONS ON ASSESSMENT AND COLLECTION

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SEC. 6504. CROSS REFERENCES.

For limitation period in case of—

(1) Adjustments to accrued foreign taxes, see section 905(c).

(2) Change of treatment with respect to itemized deductions where taxpayer and [his spouse] *the taxpayer's spouse* make separate returns, see section 63(e)(3).

(3) Involuntary conversion of property, see section 1033(a)(2)(C) and (D).

(4) Application by fiduciary for discharge from personal liability for estate tax, see section 2204.

(5) Insolvent banks and trust companies, see section 7507.

(6) Service in a combat zone, etc., see section 7508.

(7) Claims against transferees and fiduciaries, see chapter 71.

(8) Assessments to recover excessive amounts paid under section 6420 (relating to gasoline used on farms), 6421 (relating to gasoline used for certain nonhighway purposes or by local transit systems), or 6427 (relating to fuels not used for taxable purposes) and assessments of civil penalties under section 6675 for excessive claims under section 6420, 6421, or 6427, see section 6206.

(9) Assessment and collection of interest, see section 6601(g).

(10) Assessment of civil penalties under section 6694 or 6695, see section 6696(d)(1).

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CHAPTER 76—JUDICIAL PROCEEDINGS

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Subchapter B—PROCEEDINGS BY TAXPAYERS AND THIRD PARTIES

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SEC. 7428. DECLARATORY JUDGMENTS RELATING TO STATUS AND CLASSIFICATION OF ORGANIZATIONS UNDER SECTION 501(C)(3), ETC.

(a) CREATION OF REMEDY.—In a case of actual controversy involving—

(1) a determination by the Secretary—

(A) with respect to the initial qualification or continuing qualification of an organization as an organization described in section 501(c)(3) which is exempt from tax under section 501(a) or as an organization described in section 170(c)(2),

(B) with respect to the initial classification or continuing classification of an organization as a private foundation (as defined in section 509(a)),

(C) with respect to the initial classification or continuing classification of an organization as a private operating foundation (as defined in section 4942(j)(3)),

(D) with respect to the initial classification or continuing classification of a cooperative as an organization described in section 521(b) which is exempt from tax under section 521(a), or

(E) with respect to the initial qualification or continuing qualification of an organization as an organization described in section 501(c) (other than paragraph (3)) or 501(d) and exempt from tax under section 501(a), or

(2) a failure by the Secretary to make a determination with respect to an issue referred to in paragraph (1),

upon the filing of an appropriate pleading, the United States Tax Court, the United States Court of Federal Claims, or the district court of the United States for the District of Columbia may make a declaration with respect to such initial qualification or continuing qualification or with respect to such initial classification or continuing classification. Any such declaration shall have the force and effect of a decision of the Tax Court or a final judgment or decree of the district court or the Court of Federal Claims, as the case may be, and shall be reviewable as such. For purposes of this section, a determination with respect to a continuing qualification or continuing classification includes any revocation of or other change in a qualification or classification.

(b) LIMITATIONS.—

(1) PETITIONER.—A pleading may be filed under this section only by the organization the qualification or classification of which is at issue.

(2) EXHAUSTION OF ADMINISTRATIVE REMEDIES.—A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Court of Federal Claims, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service. An organization requesting the determination of an issue referred to in subsection (a)(1) shall be deemed to have exhausted its administrative remedies with respect to a failure by the Secretary to make a determination with respect to such issue at the expiration of 270 days after the date on which the request for such determination was made if the organization has taken, in a timely manner, all reasonable steps to secure such determination.

(3) TIME FOR BRINGING ACTION.—If the Secretary sends by certified or registered mail notice of his determination with respect to an issue referred to in subsection (a)(1) to the organi-

zation referred to in paragraph (1), no proceeding may be initiated under this section by such organization unless the pleading is filed before the 91st day after the date of such mailing.

(4) NONAPPLICATION FOR CERTAIN REVOCATIONS.—No action may be brought under this section with respect to any revocation of status described in section 6033(j)(1).

(c) VALIDATION OF CERTAIN CONTRIBUTIONS MADE DURING PENDENCY OF PROCEEDINGS.—

(1) IN GENERAL.—If—

(A) the issue referred to in subsection (a)(1) involves the revocation of a determination that the organization is described in section 170(c)(2),

(B) a proceeding under this section is initiated within the time provided by subsection (b)(3), and

(C) either—

(i) a decision of the Tax Court has become final (within the meaning of section 7481), or

(ii) a judgment of the district court of the United States for the District of Columbia has been entered, or

(iii) a judgment of the Court of Federal Claims has been entered,

and such decision or judgment, as the case may be, determines that the organization was not described in section 170(c)(2),

then, notwithstanding such decision or judgment, such organization shall be treated as having been described in section 170(c)(2) for purposes of section 170 for the period beginning on the date on which the notice of the revocation was published and ending on the date on which the court first determined in such proceeding that the organization was not described in section 170(c)(2).

(2) LIMITATION.—Paragraph (1) shall apply only—

(A) with respect to individuals, and only to the extent that the aggregate of the contributions made by any individual to or for the use of the organization during the period specified in paragraph (1) does not exceed $1,000 (for this purpose treating a [husband and wife] *married couple* as one contributor), and

(B) with respect to organizations described in section 170(c)(2) which are exempt from tax under section 501(a) (for this purpose excluding any such organization with respect to which there is pending a proceeding to revoke the determination under section 170(c)(2)).

(3) EXCEPTION.—This subsection shall not apply to any individual who was responsible, in whole or in part, for the activities (or failures to act) on the part of the organization which were the basis for the revocation.

(d) SUBPOENA POWER FOR DISTRICT COURT FOR DISTRICT OF COLUMBIA.—In any action brought under this section in the district court of the United States for the District of Columbia, a subpoena requiring the attendance of a witness at a trial or hearing may be served at any place in the United States.

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Subchapter C—THE TAX COURT

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PART I—ORGANIZATION AND JURISDICTION

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SEC. 7448. ANNUITIES TO SURVIVING SPOUSES AND DEPENDENT CHILDREN OF JUDGES AND SPECIAL TRIAL JUDGES.

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

(1) The term "Tax Court" means the United States Tax Court.

(2) The term "judge" means the chief judge or a judge of the Tax Court, including any individual receiving retired pay (or compensation in lieu of retired pay) under section 7447 whether or not performing judicial duties pursuant to section 7447(c).

(3) The term "chief judge" means the chief judge of the Tax Court.

(4) The term "judge's salary" means the salary of a judge received under section 7443(c), retired pay received under section 7447(d), and compensation (in lieu of retired pay) received under section 7447(c).

(5) The term "special trial judge" means a judicial officer appointed pursuant to section 7443A, including any individual receiving an annuity under chapter 83 or 84 of title 5, United States Code.

(6) The term "special trial judge's salary" means the salary of a special trial judge received under section 7443A(d), any amount received as an annuity under chapter 83 or 84 of title 5, United States Code.

(7) The term "survivors annuity fund" means the Tax Court judges survivors annuity fund established by this section.

(8) The term "surviving spouse" means a surviving spouse of an individual, who either (A) shall have been married to such individual for at least 2 years immediately preceding [his death] *the individual's death* or (B) is a parent of issue by such marriage, and who has not remarried.

(9) The term "dependent child" means an unmarried child, including a dependent stepchild or an adopted child, who is under the age of 18 years or who because of physical or mental disability is incapable of self-support.

(b) ELECTION.—

(1) JUDGES.—Any judge may by written election filed while he is a judge (except that in the case of an individual who is not reappointed following expiration of his term of office, it may be made at any time before the day after the day on which his successor takes office) bring himself within the purview of this section. In the case of any judge other than the chief judge the election shall be filed with the chief judge; in the case of the chief judge the election shall be filed as prescribed by the Tax Court.

(2) SPECIAL TRIAL JUDGES.—Any special trial judge may by written election filed with the chief judge bring himself or herself within the purview of this section. Such election shall be filed not later than the later of 6 months after—

(A) 6 months after the date of the enactment of this paragraph,

(B) the date the judge takes office, or

(C) the date the judge marries.

(c) SURVIVORS ANNUITY FUND.—

(1) SALARY DEDUCTIONS.—There shall be deducted and withheld from the salary of each judge or special trial judge electing under subsection (b) a sum equal to 3.5 percent of such judge's or special trial judge's salary. The amounts so deducted and withheld from such judge's or special trial judge's salary shall, in accordance with such procedure as may be prescribed by the Comptroller General of the United States, be deposited in the Treasury of the United States to the credit of a fund to be known as the "Tax Court judicial officers survivors annuity fund" and said fund is appropriated for the payment of annuities, refunds, and allowances as provided by this section. Each judge or special trial judge electing under subsection (b) shall be deemed thereby to consent and agree to the deductions from his salary as provided in this subsection, and payment less such deductions shall be a full and complete discharge and acquittance of all claims and demands whatsoever for all judicial services rendered by such judge or special trial judge during the period covered by such payment, except the right to the benefits to which he or his survivors shall be entitled under the provisions of this section.

(2) APPROPRIATIONS WHERE UNFUNDED LIABILITY.—

(A) IN GENERAL.—Not later than the close of each fiscal year, there shall be deposited in the Treasury of the United States to the credit of the survivors annuity fund, in accordance with such procedures as may be prescribed by the Comptroller General of the United States, amounts required to reduce to zero the unfunded liability (if any) of such fund. Subject to appropriation Acts, such deposits shall be taken from sums available for such fiscal year for the payment of amounts described in subsection (a)(4) and section 7443A(d), and shall immediately become an integrated part of such fund.

(B) EXCEPTION.—The amount required by subparagraph (A) to be deposited in any fiscal year shall not exceed an amount equal to 11 percent of the aggregate amounts described in subsection (a)(4) and (a)(6) paid during such fiscal year.

(C) UNFUNDED LIABILITY DEFINED.—For purposes of subparagraph (A), the term "unfunded liability" means the amount estimated by the Secretary to be equal to the excess (as of the close of the fiscal year involved) of—

(i) the present value of all benefits payable from the survivors annuity fund (determined on an annual basis in accordance with section 9503 of title 31, United States Code), over

(ii) the sum of—

(I) the present values of future deductions under subsection (c) and future deposits under subsection (d), plus

(II) the balance in such fund as of the close of such fiscal year.

(D) AMOUNTS NOT CREDITED TO INDIVIDUAL ACCOUNTS.—Amounts appropriated pursuant to this paragraph shall not be credited to the account of any individual for purposes of subsection (g).

(d) DEPOSITS IN SURVIVORS ANNUITY FUND.—Each judge or special trial judge electing under subsection (b) shall deposit, with interest at 3 percent per annum, compounded on December 31 of each year, to the credit of the survivors annuity fund, a sum equal to 3.5 percent of [his] *the individual's* judge's or special trial judge's salary and of [his] *the individual's* basic salary, pay, or compensation for service as a Senator, Representative, Delegate, or Resident Commissioner in Congress, and for any other civilian service within the purview of section 8332 of title 5 of the United States Code. Each such judge or special trial judge may elect to make such deposits in installments during the continuance of [his] *the individual's* service as a judge or special trial judge in such amount and under such conditions as may be determined in each instance by the chief judge. Notwithstanding the failure of a judge or special trial judge to make such deposit, credit shall be allowed for the service rendered, but the annuity of the surviving spouse of such judge or special trial judge shall be reduced by an amount equal to 10 percent of the amount of such deposit, computed as of the date of the death of such judge or special trial judge, unless such surviving spouse shall elect to eliminate such service entirely from credit under subsection (n), except that no deposit shall be required from a judge or special trial judge for any year with respect to which deductions from [his] *the individual's* salary were actually made under the civil service retirement laws and no deposit shall be required for any honorable service in the Army, Navy, Air Force, Marine Corps, or Coast Guard of the United States.

(e) INVESTMENT OF SURVIVORS ANNUITY FUND.—The Secretary of the Treasury shall invest from time to time, in interest-bearing securities of the United States or Federal farm loan bonds, such portions of the survivors annuity fund as in his judgment may not be immediately required for the payment of the annuities, refunds, and allowances as provided in this section. The income derived from such investments shall constitute a part of said fund for the purpose of paying annuities and of carrying out the provisions of subsections (g), (h), and (j).

(f) CREDITING OF DEPOSITS.—The amount deposited by or deducted and withheld from the salary of each judge or special trial judge electing to bring himself within the purview of this section for credit to the survivors annuity fund shall be credited to an individual account of such judge or special trial judge.

(g) TERMINATION.—If the service of any judge or special trial judge electing under subsection (b) terminates other than pursuant to the provisions of section 7447 or if any judge or special trial judge ceases to be married after making the election under subsection (b) and revokes (in a writing filed as provided in subsection (b)) such election, the amount credited to his individual account, together with interest at 3 percent per annum, compounded on December 31 of each year, to the date of his relinquishment of office, shall be returned to him. For the purpose of this section, the serv-

ice of any judge or special trial judge electing under subsection (b) who is not reappointed following expiration of his term but who, at the time of such expiration, is eligible for and elects to receive retired pay under section 7447 shall be deemed to have terminated pursuant to said section.

(h) ENTITLEMENT TO ANNUITY.—In case any judge or special trial judge electing under subsection (b) shall die while a judge or special trial judge after having rendered at least 5 years of civilian service computed as prescribed in subsection (n), for the last 5 years of which the salary deductions provided for by subsection (c)(1) or the deposits required by subsection (d) have actually been made or the salary deductions required by the civil service retirement laws have actually been made—

(1) if such judge or special trial judge is survived by a surviving spouse but not by a dependent child, there shall be paid to such surviving spouse an annuity beginning with the day of the death of the judge or special trial judge or following the surviving spouse's attainment of the age of 50 years, whichever is the later, in an amount computed as provided in subsection (m); or

(2) if such judge or special trial judge is survived by a surviving spouse and a dependent child or children, there shall be paid to such surviving spouse an immediate annuity in an amount computed as provided in subsection (m), and there shall also be paid to or on behalf of each such child an immediate annuity equal to the lesser of—

(A) 10 percent of the average annual salary of such judge or special trial judge (determined in accordance with subsection (m)), or

(B) 20 percent of such average annual salary, divided by the number of such children; or

(3) if such judge or special trial judge leaves no surviving spouse but leaves a surviving dependent child or children, there shall be paid to or on behalf of each such child an immediate annuity equal to the lesser of—

(A) 20 percent of the average annual salary of such judge or special trial judge (determined in accordance with subsection (m)), or

(B) 40 percent of such average annual salary, divided by the number of such children.

The annuity payable to a surviving spouse under this subsection shall be terminable upon such surviving spouse's death or such surviving spouse's remarriage before attaining age 55. The annuity payable to a child under this subsection shall be terminable upon (A) his attaining the age of 18 years, (B) his marriage, or (C) his death, whichever first occurs, except that if such child is incapable of self-support by reason of mental or physical disability his annuity shall be terminable only upon death, marriage, or recovery from such disability. In case of the death of a surviving spouse of a judge or special trial judge leaving a dependent child or children of the judge or special trial judge surviving such spouse, the annuity of such child or children shall be recomputed and paid as provided in paragraph (3) of this subsection. In any case in which the annuity of a dependent child is terminated under this subsection, the annuities of any remaining dependent child or children, based upon the

service of the same judge or special trial judge, shall be recomputed and paid as though the child whose annuity was so terminated had not survived such judge or special trial judge.

(i) DETERMINATION OF DEPENDENCY AND DISABILITY.—Questions of dependency and disability arising under this section shall be determined by the chief judge subject to review only by the Tax Court, the decision of which shall be final and conclusive. The chief judge may order or direct at any time such medical or other examinations as he shall deem necessary to determine the facts relative to the nature and degree of disability of any dependent child who is an annuitant or applicant for annuity under this section, and may suspend or deny any such annuity for failure to submit to any examination so ordered or directed.

(j) PAYMENTS IN CERTAIN CASES.—(1) In any case in which—

(A) a judge or special trial judge electing under subsection (b) shall die while in office (whether in regular active service, retired from such service under section 7447, or receiving any annuity under chapter 83 or 84 of title 5, United States Code), before having rendered 5 years of civilian service computed as prescribed in subsection (n), or after having rendered 5 years of such civilian service but without a survivor or survivors entitled to annuity benefits provided by subsection (h), or

(B) the right of all persons entitled to annuity under subsection (h) based on the service of such judge or special trial judge shall terminate before a valid claim therefor shall have been established,

the total amount credited to the individual account of such judge or special trial judge, with interest at 3 percent per annum, compounded on December 31 of each year, to the date of the death of such judge or special trial judge, shall be paid, upon the establishment of a valid claim therefor, to the person or persons surviving at the date title to the payment arises, in the following order of precedence, and such payment shall be a bar to recovery by any other person:

(i) to the beneficiary or beneficiaries whom the judge or special trial judge may have designated by a writing filed prior to his death with the chief judge, except that in the case of the chief judge such designation shall be by a writing filed by him, prior to his death, as prescribed by the Tax Court;

(ii) if there be no such beneficiary, to the surviving spouse of such judge or special trial judge;

(iii) if none of the above, to the child or children of such judge or special trial judge and the descendants of any deceased children by representation;

(iv) if none of the above, to the parents of such judge or special trial judge or the survivor of them;

(v) if none of the above, to the duly appointed executor or administrator of the estate of such judge or special trial judge; and

(vi) if none of the above, to such other next of kin of such judge or special trial judge as may be determined by the chief judge to be entitled under the laws of the domicile of such judge or special trial judge at the time of his death.

Determination as to the surviving spouse, child, or parent of a judge or special trial judge for the purposes of this paragraph shall

be made by the chief judge without regard to the definitions in paragraphs (8) and (9) of subsection (a).

(2) In any case in which the annuities of all persons entitled to annuity based upon the service of a judge or special trial judge shall terminate before the aggregate amount of annuity paid equals the total amount credited to the individual account of such judge or special trial judge, with interest at 3 percent per annum, compounded on December 31 of each year, to the date of the death of such judge or special trial judge, the difference shall be paid, upon establishment of a valid claim therefor, in the order of precedence prescribed in paragraph (1).

(3) Any accrued annuity remaining unpaid upon the termination (other than by death) of the annuity of any person based upon the service of a judge or special trial judge shall be paid to such person. Any accrued annuity remaining unpaid upon the death of any person receiving annuity based upon the service of a judge or special trial judge shall be paid, upon the establishment of a valid claim therefor, in the following order of precedence:

(A) to the duly appointed executor or administrator of the estate of such person;

(B) if there is no such executor or administrator payment may be made, after the expiration of thirty days from the date of the death of such person, to such individual or individuals as may appear in the judgment of the chief judge to be legally entitled thereto, and such payment shall be a bar to recovery by any other individual.

(k) PAYMENTS TO PERSONS UNDER LEGAL DISABILITY.—Where any payment under this section is to be made to a minor, or to a person mentally incompetent or under other legal disability adjudged by a court of competent jurisdiction, such payment may be made to the person who is constituted guardian or other fiduciary by the law of the State of residence of such claimant or is otherwise legally vested with the care of the claimant or his estate. Where no guardian or other fiduciary of the person under legal disability has been appointed under the laws of the State of residence of the claimant, the chief judge shall determine the person who is otherwise legally vested with the care of the claimant or his estate.

(l) METHOD OF PAYMENT OF ANNUITIES.—Annuities granted under the terms of this section shall accrue monthly and shall be due and payable in monthly installments on the first business day of the month following the month or other period for which the annuity shall have accrued. None of the moneys mentioned in this section shall be assignable, either in law or in equity, or subject to execution, levy, attachment, garnishment, or other legal process.

(m) COMPUTATION OF ANNUITIES.—The annuity of the surviving spouse of a judge or special trial judge electing under subsection (b) shall be an amount equal to the sum of (1) 1.5 percent of the average annual salary (whether judge's or special trial judge's salary or compensation for other allowable service) received by such judge or special trial judge for judicial service (including periods in which [he] *such judge or special trial judge* received retired pay under section 7447(d) or any annuity under chapter 83 or 84 of title 5, United States Code) or for any other prior allowable service during the period of 3 consecutive years in which [he] *such judge or special trial judge* received the largest such average annual sal-

ary, multiplied by the sum of [his] *the individual's* years of such judicial service, [his] *the individual's* years of prior allowable service as a Senator, Representative, Delegate, or Resident Commissioner in Congress, [his] *the individual's* years of prior allowable service performed as a member of the Armed Forces of the United States, and [his] *the individual's* years, not exceeding 15, of prior allowable service performed as a congressional employee (as defined in section 2107 of title 5 of the United States Code), and (2) three-fourths of 1 percent of such average annual salary multiplied by [his] *the individual's* years of any other prior allowable service, except that such annuity shall not exceed an amount equal to 50 percent of such average annual salary, nor be less than an amount equal to 25 percent of such average annual salary, and shall be further reduced in accordance with subsection (d) (if applicable). In determining the period of 3 consecutive years referred to in the preceding sentence, there may not be taken into account any period for which an election under section 7447(f)(4) is in effect.

(n) INCLUDIBLE SERVICE.—Subject to the provisions of subsection (d), the years of service of a judge or special trial judge which are allowable as the basis for calculating the amount of the annuity of [his] *the individual's* surviving spouse shall include [his] *the individual's* years of service as a member of the United States Board of Tax Appeals, as a judge or special trial judge of the Tax Court of the United States, and as a judge or special trial judge of the Tax Court, [his] *the individual's* years of service pursuant to any appointment under section 7443A, [his] *the individual's* years of service as a Senator, Representative, Delegate, or Resident Commissioner in Congress, [his] *the individual's* years of active service as a member of the Armed Forces of the United States not exceeding 5 years in the aggregate and not including any such service for which credit is allowed for the purposes of retirement or retired pay under any other provision of law, and [his] *the individual's* years of any other civilian service within the purview of section 8332 of title 5 of the United States Code.

(o) SIMULTANEOUS ENTITLEMENT.—Nothing contained in this section shall be construed to prevent a surviving spouse eligible therefor from simultaneously receiving an annuity under this section and any annuity to which such spouse would otherwise be entitled under any other law without regard to this section, but in computing such other annuity service used in the computation of such spouse's annuity under this section shall not be credited.

(p) ESTIMATES OF EXPENDITURES.—The chief judge shall submit to the President annual estimates of the expenditures and appropriations necessary for the maintenance and operation of the survivors annuity fund, and such supplemental and deficiency estimates as may be required from time to time for the same purposes, according to law. The chief judge shall cause periodic examinations of the survivors annuity fund to be made by an actuary, who may be an actuary employed by another department of the Government temporarily assigned for the purpose, and whose findings and recommendations shall be transmitted by the chief judge to the Tax Court.

(q) TRANSITIONAL PROVISION.—In the case of a judge who dies within 6 months after the date of enactment of this section after having rendered at least 5 years of civilian service computed as

prescribed in subsection (n), but without having made an election as provided in subsection (b), an annuity shall be paid to [his] *such judge's* surviving spouse and surviving dependents as is provided in this section, as if such judge had elected on the day of [his] *such judge's* death [to bring himself] *to come* within the purview of this section but had not made the deposit provided for by subsection (d). An annuity shall be payable under this section computed upon the basis of the actual length of service as a judge and other allowable service of the judge and subject to the reduction required by subsection (d) even though no deposit has been made, as required by subsection (h) with respect to any of such service.

(r) WAIVER OF CIVIL SERVICE BENEFITS.—Any judge electing under subsection (b) shall, at the time of such election, waive all benefits under the civil service retirement laws. Such a waiver shall be made in the same manner and shall have the same force and effect as an election filed under section 7447(e).

(s) INCREASES IN SURVIVOR ANNUITIES.—Each time that an increase is made under section 8340(b) of title 5, United States Code, in annuities payable under subchapter III of chapter 83 of that title, each annuity payable from the survivors annuity fund under this section shall be increased at the same time by the same percentage by which annuities are increased under such section 8340(b).

(t) AUTHORIZATION OF APPROPRIATION.—Funds necessary to carry out the provisions of this section may be appropriated out of any money in the Treasury not otherwise appropriated.

* * * * * * *

CHAPTER 79—DEFINITIONS

* * * * * * *

SEC. 7701. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

(1) PERSON.—The term "person" shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation.

(2) PARTNERSHIP AND PARTNER.—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

(3) CORPORATION.—The term "corporation" includes associations, joint-stock companies, and insurance companies.

(4) DOMESTIC.—The term "domestic" when applied to a corporation or partnership means created or organized in the United States or under the law of the United States or of any State unless, in the case of a partnership, the Secretary provides otherwise by regulations.

(5) FOREIGN.—The term "foreign" when applied to a corporation or partnership means a corporation or partnership which is not domestic.

(6) FIDUCIARY.—The term "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person.

(7) STOCK.—The term "stock" includes shares in an association, joint-stock company, or insurance company.

(8) SHAREHOLDER.—The term "shareholder" includes a member in an association, joint-stock company, or insurance company.

(9) UNITED STATES.—The term "United States" when used in a geographical sense includes only the States and the District of Columbia.

(10) STATE.—The term "State" shall be construed to include the District of Columbia, where such construction is necessary to carry out provisions of this title.

(11) SECRETARY OF THE TREASURY AND SECRETARY.—

(A) SECRETARY OF THE TREASURY.—The term "Secretary of the Treasury" means the Secretary of the Treasury, personally, and shall not include any delegate of his.

(B) SECRETARY.—The term "Secretary" means the Secretary of the Treasury or his delegate.

(12) DELEGATE.—

(A) IN GENERAL.—The term "or his delegate"—

(i) when used with reference to the Secretary of the Treasury, means any officer, employee, or agency of the Treasury Department duly authorized by the Secretary of the Treasury directly, or indirectly by one or more redelegations of authority, to perform the function mentioned or described in the context; and

(ii) when used with reference to any other official of the United States, shall be similarly construed.

(B) PERFORMANCE OF CERTAIN FUNCTIONS IN GUAM OR AMERICAN SAMOA.—The term "delegate," in relation to the performance of functions in Guam or American Samoa with respect to the taxes imposed by chapters 1, 2, and 21, also includes any officer or employee of any other department or agency of the United States, or of any possession thereof, duly authorized by the Secretary (directly, or indirectly by one or more redelegations of authority) to perform such functions.

(13) COMMISSIONER.—The term "Commissioner" means the Commissioner of Internal Revenue.

(14) TAXPAYER.—The term "taxpayer" means any person subject to any internal revenue tax.

(15) MILITARY OR NAVAL FORCES AND ARMED FORCES OF THE UNITED STATES.—The term "military or naval forces of the United States" and the term "Armed Forces of the United States" each includes all regular and reserve components of the uniformed services which are subject to the jurisdiction of the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, or the Secretary of the Air Force, and each term also includes the Coast Guard. The members of such forces include commissioned officers and personnel below the grade of commissioned officers in such forces.

(16) WITHHOLDING AGENT.—The term "withholding agent" means any person required to deduct and withhold any tax under the provisions of section 1441, 1442, 1443, or 1461.

[(17) HUSBAND AND WIFE.—As used in section 2516, if the husband and wife therein referred to are divorced, wherever appropriate to the meaning of such section, the term "wife" shall be read "former wife" and the term "husband" shall be read "former husband"; and, if the payments described in such section are made by or on behalf of the wife or former wife to the husband or former husband instead of vice versa, wherever appropriate to the meaning of such section, the term "husband" shall be read "wife" and the term "wife" shall be read "husband."]

(18) INTERNATIONAL ORGANIZATION.—The term "international organization" means a public international organization entitled to enjoy privileges, exemptions, and immunities as an international organization under the International Organizations Immunities Act (22 U.S.C. 288–288f).

(19) DOMESTIC BUILDING AND LOAN ASSOCIATION.—The term "domestic building and loan association" means a domestic building and loan association, a domestic savings and loan association, and a Federal savings and loan association—

(A) which is subject by law to supervision and examination by State or Federal authority having supervision over such associations;

(B) the business of which consists principally of acquiring the savings of the public and investing in loans; and

(C) at least 60 percent of the amount of the total assets of which (at the close of the taxable year) consists of—

(i) cash,

(ii) obligations of the United States or of a State or political subdivision thereof, and stock or obligations of a corporation which is an instrumentality of the United States or of a State or political subdivision thereof, but not including obligations the interest on which is excludable from gross income under section 103,

(iii) certificates of deposit in, or obligations of, a corporation organized under a State law which specifically authorizes such corporation to insure the deposits or share accounts of member associations,

(iv) loans secured by a deposit or share of a member,

(v) loans (including redeemable ground rents, as defined in section 1055) secured by an interest in real property which is (or, from the proceeds of the loan, will become) residential real property or real property used primarily for church purposes, loans made for the improvement of residential real property or real property used primarily for church purposes, provided that for purposes of this clause, residential real property shall include single or multifamily dwellings, facilities in residential developments dedicated to public use or property used on a nonprofit basis for residents, and mobile homes not used on a transient basis,

(vi) loans secured by an interest in real property located within an urban renewal area to be developed for predominantly residential use under an urban renewal plan approved by the Secretary of Housing and Urban Development under part A or part B of title I of the Housing Act of 1949, as amended, or located within any area covered by a program eligible for assistance under section 103 of the Demonstration Cities and Metropolitan Development Act of 1966, as amended, and loans made for the improvement of any such real property,

(vii) loans secured by an interest in educational, health, or welfare institutions or facilities, including structures designed or used primarily for residential purposes for students, residents, and persons under care, employees, or members of the staff of such institutions or facilities,

(viii) property acquired through the liquidation of defaulted loans described in clause (v), (vi), or (vii),

(ix) loans made for the payment of expenses of college or university education or vocational training, in accordance with such regulations as may be prescribed by the Secretary,

(x) property used by the association in the conduct of the business described in subparagraph (B), and

(xi) any regular or residual interest in a REMIC, but only in the proportion which the assets of such REMIC consist of property described in any of the preceding clauses of this subparagraph; except that if 95 percent or more of the assets of such REMIC are assets described in clauses (i) through (x), the entire interest in the REMIC shall qualify.

At the election of the taxpayer, the percentage specified in this subparagraph shall be applied on the basis of the average assets outstanding during the taxable year, in lieu of the close of the taxable year, computed under regulations prescribed by the Secretary. For purposes of clause (v), if a multifamily structure securing a loan is used in part for nonresidential purposes, the entire loan is deemed a residential real property loan if the planned residential use exceeds 80 percent of the property's planned use (determined as of the time the loan is made). For purposes of clause (v), loans made to finance the acquisition or development of land shall be deemed to be loans secured by an interest in residential real property if, under regulations prescribed by the Secretary, there is reasonable assurance that the property will become residential real property within a period of 3 years from the date of acquisition of such land; but this sentence shall not apply for any taxable year unless, within such 3-year period, such land becomes residential real property. For purposes of determining whether any interest in a REMIC qualifies under clause (xi), any regular interest in another REMIC held by such REMIC shall be treated as a loan described in a preceding clause under principles similar to the principles of

clause (xi); except that, if such REMIC's are part of a tiered structure, they shall be treated as 1 REMIC for purposes of clause (xi).

(20) EMPLOYEE.—For the purpose of applying the provisions of section 79 with respect to group-term life insurance purchased for employees, for the purpose of applying the provisions of sections 104, 105, and 106 with respect to accident and health insurance or accident and health plans, and for the purpose of applying the provisions of subtitle A with respect to contributions to or under a stock bonus, pension, profit-sharing, or annuity plan, and with respect to distributions under such a plan, or by a trust forming part of such a plan, and for purposes of applying section 125 with respect to cafeteria plans, the term "employee" shall include a full-time life insurance salesman who is considered an employee for the purpose of chapter 21.

(21) LEVY.—The term "levy" includes the power of distraint and seizure by any means.

(22) ATTORNEY GENERAL.—The term "Attorney General" means the Attorney General of the United States.

(23) TAXABLE YEAR.—The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the taxable income is computed under subtitle A. "Taxable year" means, in the case of a return made for a fractional part of a year under the provisions of subtitle A or under regulations prescribed by the Secretary, the period for which such return is made.

(24) FISCAL YEAR.—The term "fiscal year" means an accounting period of 12 months ending on the last day of any month other than December.

(25) PAID OR INCURRED, PAID OR ACCRUED.—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the taxable income is computed under subtitle A.

(26) TRADE OR BUSINESS.—The term "trade or business" includes the performance of the functions of a public office.

(27) TAX COURT.—The term "Tax Court" means the United States Tax Court.

(28) OTHER TERMS.—Any term used in this subtitle with respect to the application of, or in connection with, the provisions of any other subtitle of this title shall have the same meaning as in such provisions.

(29) INTERNAL REVENUE CODE.—The term "Internal Revenue Code of 1986" means this title, and the term "Internal Revenue Code of 1939" means the Internal Revenue Code enacted February 10, 1939, as amended.

(30) UNITED STATES PERSON.—The term "United States person" means—

(A) a citizen or resident of the United States,

(B) a domestic partnership,

(C) a domestic corporation,

(D) any estate (other than a foreign estate, within the meaning of paragraph (31)), and

(E) any trust if—

(i) a court within the United States is able to exercise primary supervision over the administration of the trust, and

(ii) one or more United States persons have the authority to control all substantial decisions of the trust.

(31) FOREIGN ESTATE OR TRUST.—

(A) FOREIGN ESTATE.—The term "foreign estate" means an estate the income of which, from sources without the United States which is not effectively connected with the conduct of a trade or business within the United States, is not includible in gross income under subtitle A.

(B) FOREIGN TRUST.—The term "foreign trust" means any trust other than a trust described in subparagraph (E) of paragraph (30).

(32) COOPERATIVE BANK.—The term "cooperative bank" means an institution without capital stock organized and operated for mutual purposes and without profit, which—

(A) is subject by law to supervision and examination by State or Federal authority having supervision over such institutions, and

(B) meets the requirements of subparagraphs (B) and (C) of paragraph (19) of this subsection (relating to definition of domestic building and loan association).

In determining whether an institution meets the requirements referred to in subparagraph (B) of this paragraph, any reference to an association or to a domestic building and loan association contained in paragraph (19) shall be deemed to be a reference to such institution.

(33) REGULATED PUBLIC UTILITY.—The term "regulated public utility" means—

(A) A corporation engaged in the furnishing or sale of—

(i) electric energy, gas, water, or sewerage disposal services, or

(ii) transportation (not included in subparagraph (C)) on an intrastate, suburban, municipal, or interurban electric railroad, on an intrastate, municipal, or suburban trackless trolley system, or on a municipal or suburban bus system, or

(iii) transportation (not included in clause (ii)) by motor vehicle—

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, by a public service or public utility commission or other similar body of the District of Columbia or of any State or political subdivision thereof, or by a foreign country or an agency or instrumentality or political subdivision thereof.

(B) A corporation engaged as a common carrier in the furnishing or sale of transportation of gas by pipe line, if subject to the jurisdiction of the Federal Energy Regulatory Commission.

(C) A corporation engaged as a common carrier (i) in the furnishing or sale of transportation by railroad, if subject to the jurisdiction of the Surface Transportation Board, or

(ii) in the furnishing or sale of transportation of oil or other petroleum products (including shale oil) by pipe line, if subject to the jurisdiction of the Federal Energy Regulatory Commission or if the rates for such furnishing or sale are subject to the jurisdiction of a public service or public utility commission or other similar body of the District of Columbia or of any State.

(D) A corporation engaged in the furnishing or sale of telephone or telegraph service, if the rates for such furnishing or sale meet the requirements of subparagraph (A).

(E) A corporation engaged in the furnishing or sale of transportation as a common carrier by air, subject to the jurisdiction of the Secretary of Transportation.

(F) A corporation engaged in the furnishing or sale of transportation by a water carrier subject to jurisdiction under subchapter II of chapter 135 of title 49.

(G) A rail carrier subject to part A of subtitle IV of title 49, if (i) substantially all of its railroad properties have been leased to another such railroad corporation or corporations by an agreement or agreements entered into before January 1, 1954, (ii) each lease is for a term of more than 20 years, and (iii) at least 80 percent or more of its gross income (computed without regard to dividends and capital gains and losses) for the taxable year is derived from such leases and from sources described in subparagraphs (A) through (F), inclusive. For purposes of the preceding sentence, an agreement for lease of railroad properties entered into before January 1, 1954, shall be considered to be a lease including such term as the total number of years of such agreement may, unless sooner terminated, be renewed or continued under the terms of the agreement, and any such renewal or continuance under such agreement shall be considered part of the lease entered into before January 1, 1954.

(H) A common parent corporation which is a common carrier by railroad subject to part A of subtitle IV of title 49 if at least 80 percent of its gross income (computed without regard to capital gains or losses) is derived directly or indirectly from sources described in subparagraphs (A) through (F), inclusive. For purposes of the preceding sentence, dividends and interest, and income from leases described in subparagraph (G), received from a regulated public utility shall be considered as derived from sources described in subparagraphs (A) through (F), inclusive, if the regulated public utility is a member of an affiliated group (as defined in section 1504) which includes the common parent corporation.

The term "regulated public utility" does not (except as provided in subparagraphs (G) and (H)) include a corporation described in subparagraphs (A) through (F), inclusive, unless 80 percent or more of its gross income (computed without regard to dividends and capital gains and losses) for the taxable year is derived from sources described in subparagraphs (A) through (F), inclusive. If the taxpayer establishes to the satisfaction of the

Secretary that (i) its revenue from regulated rates described in subparagraph (A) or (D) and its revenue derived from unregulated rates are derived from the operation of a single interconnected and coordinated system or from the operation of more than one such system, and (ii) the unregulated rates have been and are substantially as favorable to users and consumers as are the regulated rates, then such revenue from such unregulated rates shall be considered, for purposes of the preceding sentence, as income derived from sources described in subparagraph (A) or (D).

(35) ENROLLED ACTUARY.—The term "enrolled actuary" means a person who is enrolled by the Joint Board for the Enrollment of Actuaries established under subtitle C of the title III of the Employee Retirement Income Security Act of 1974.

(36) TAX RETURN PREPARER.—

(A) IN GENERAL.—The term "tax return preparer" means any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by this title or any claim for refund of tax imposed by this title. For purposes of the preceding sentence, the preparation of a substantial portion of a return or claim for refund shall be treated as if it were the preparation of such return or claim for refund.

(B) EXCEPTIONS.—A person shall not be a "tax return preparer" merely because such person—

(i) furnishes typing, reproducing, or other mechanical assistance,

(ii) prepares a return or claim for refund of the employer (or of an officer or employee of the employer) by whom he is regularly and continuously employed,

(iii) prepares as a fiduciary a return or claim for refund for any person, or

(iv) prepares a claim for refund for a taxpayer in response to any notice of deficiency issued to such taxpayer or in response to any waiver of restriction after the commencement of an audit of such taxpayer or another taxpayer if a determination in such audit of such other taxpayer directly or indirectly affects the tax liability of such taxpayer.

(37) INDIVIDUAL RETIREMENT PLAN.—The term "individual retirement plan" means—

(A) an individual retirement account described in section 408(a), and

(B) an individual retirement annuity described in section 408(b).

(38) JOINT RETURN.—The term "joint return" means a single return made jointly under section 6013 by a [husband and wife] *married couple* .

(39) PERSONS RESIDING OUTSIDE UNITED STATES.—If any citizen or resident of the United States does not reside in (and is not found in) any United States judicial district, such citizen or resident shall be treated as residing in the District of Columbia for purposes of any provision of this title relating to—

(A) jurisdiction of courts, or

(B) enforcement of summons.

(40) INDIAN TRIBAL GOVERNMENT.—

(A) IN GENERAL.—The term "Indian tribal government" means the governing body of any tribe, band, community, village, or group of Indians, or (if applicable) Alaska Natives, which is determined by the Secretary, after consultation with the Secretary of the Interior, to exercise governmental functions.

(B) SPECIAL RULE FOR ALASKA NATIVES.—No determination under subparagraph (A) with respect to Alaska Natives shall grant or defer any status or powers other than those enumerated in section 7871. Nothing in the Indian Tribal Governmental Tax Status Act of 1982, or in the amendments made thereby, shall validate or invalidate any claim by Alaska Natives of sovereign authority over lands or people.

(41) TIN.—The term "TIN" means the identifying number assigned to a person under section 6109.

(42) SUBSTITUTED BASIS PROPERTY.—The term "substituted basis property" means property which is—

(A) transferred basis property, or

(B) exchanged basis property.

(43) TRANSFERRED BASIS PROPERTY.—The term "transferred basis property" means property having a basis determined under any provision of subtitle A (or under any corresponding provision of prior income tax law) providing that the basis shall be determined in whole or in part by reference to the basis in the hands of the donor, grantor, or other transferor.

(44) EXCHANGED BASIS PROPERTY.—The term "exchanged basis property" means property having a basis determined under any provision of subtitle A (or under any corresponding provision of prior income tax law) providing that the basis shall be determined in whole or in part by reference to other property held at any time by the person for whom the basis is to be determined.

(45) NONRECOGNITION TRANSACTION.—The term "nonrecognition transaction" means any disposition of property in a transaction in which gain or loss is not recognized in whole or in part for purposes of subtitle A.

(46) DETERMINATION OF WHETHER THERE IS A COLLECTIVE BARGAINING AGREEMENT.—In determining whether there is a collective bargaining agreement between employee representatives and 1 or more employers, the term "employee representatives" shall not include any organization more than one-half of the members of which are employees who are owners, officers, or executives of the employer. An agreement shall not be treated as a collective bargaining agreement unless it is a bona fide agreement between bona fide employee representatives and 1 or more employers.

(48) OFF-HIGHWAY VEHICLES.—

(A) OFF-HIGHWAY TRANSPORTATION VEHICLES.—

(i) IN GENERAL.—A vehicle shall not be treated as a highway vehicle if such vehicle is specially designed for the primary function of transporting a particular type of load other than over the public highway and because of this special design such vehicle's capability

to transport a load over the public highway is substantially limited or impaired.

(ii) DETERMINATION OF VEHICLE'S DESIGN.—For purposes of clause (i), a vehicle's design is determined solely on the basis of its physical characteristics.

(iii) DETERMINATION OF SUBSTANTIAL LIMITATION OR IMPAIRMENT.—For purposes of clause (i), in determining whether substantial limitation or impairment exists, account may be taken of factors such as the size of the vehicle, whether such vehicle is subject to the licensing, safety, and other requirements applicable to highway vehicles, and whether such vehicle can transport a load at a sustained speed of at least 25 miles per hour. It is immaterial that a vehicle can transport a greater load off the public highway than such vehicle is permitted to transport over the public highway.

(B) NONTRANSPORTATION TRAILERS AND SEMITRAILERS.—A trailer or semitrailer shall not be treated as a highway vehicle if it is specially designed to function only as an enclosed stationary shelter for the carrying on of an off-highway function at an off-highway site.

(49) QUALIFIED BLOOD COLLECTOR ORGANIZATION.—The term "qualified blood collector organization" means an organization which is—

(A) described in section 501(c)(3) and exempt from tax under section 501(a),

(B) primarily engaged in the activity of the collection of human blood,

(C) registered with the Secretary for purposes of excise tax exemptions, and

(D) registered by the Food and Drug Administration to collect blood.

(50) TERMINATION OF UNITED STATES CITIZENSHIP.—

(A) IN GENERAL.—An individual shall not cease to be treated as a United States citizen before the date on which the individual's citizenship is treated as relinquished under section 877A(g)(4).

(B) DUAL CITIZENS.—Under regulations prescribed by the Secretary, subparagraph (A) shall not apply to an individual who became at birth a citizen of the United States and a citizen of another country.

(b) DEFINITION OF RESIDENT ALIEN AND NONRESIDENT ALIEN.—

(1) IN GENERAL.—For purposes of this title (other than subtitle B)—

(A) RESIDENT ALIEN.—An alien individual shall be treated as a resident of the United States with respect to any calendar year if (and only if) such individual meets the requirements of clause (i), (ii), or (iii):

(i) LAWFULLY ADMITTED FOR PERMANENT RESIDENCE.—Such individual is a lawful permanent resident of the United States at any time during such calendar year.

(ii) SUBSTANTIAL PRESENCE TEST.—Such individual meets the substantial presence test of paragraph (3).

(iii) FIRST YEAR ELECTION.—Such individual makes the election provided in paragraph (4).

(B) NONRESIDENT ALIEN.—An individual is a nonresident alien if such individual is neither a citizen of the United States nor a resident of the United States (within the meaning of subparagraph (A)).

(2) SPECIAL RULES FOR FIRST AND LAST YEAR OF RESIDENCY.—

(A) FIRST YEAR OF RESIDENCY.—

(i) IN GENERAL.—If an alien individual is a resident of the United States under paragraph (1)(A) with respect to any calendar year, but was not a resident of the United States at any time during the preceding calendar year, such alien individual shall be treated as a resident of the United States only for the portion of such calendar year which begins on the residency starting date.

(ii) RESIDENCY STARTING DATE FOR INDIVIDUALS LAWFULLY ADMITTED FOR PERMANENT RESIDENCE.—In the case of an individual who is a lawfully permanent resident of the United States at any time during the calendar year, but does not meet the substantial presence test of paragraph (3), the residency starting date shall be the first day in such calendar year on which he was present in the United States while a lawful permanent resident of the United States.

(iii) RESIDENCY STARTING DATE FOR INDIVIDUALS MEETING SUBSTANTIAL PRESENCE TEST.—In the case of an individual who meets the substantial presence test of paragraph (3) with respect to any calendar year, the residency starting date shall be the first day during such calendar year on which the individual is present in the United States.

(iv) RESIDENCY STARTING DATE FOR INDIVIDUALS MAKING FIRST YEAR ELECTION.—In the case of an individual who makes the election provided by paragraph (4) with respect to any calendar year, the residency starting date shall be the 1st day during such calendar year on which the individual is treated as a resident of the United States under that paragraph.

(B) LAST YEAR OF RESIDENCY.—An alien individual shall not be treated as a resident of the United States during a portion of any calendar year if—

(i) such portion is after the last day in such calendar year on which the individual was present in the United States (or, in the case of an individual described in paragraph (1)(A)(i), the last day on which he was so described),

(ii) during such portion the individual has a closer connection to a foreign country than to the United States, and

(iii) the individual is not a resident of the United States at any time during the next calendar year.

(C) CERTAIN NOMINAL PRESENCE DISREGARDED.—

(i) IN GENERAL.—For purposes of subparagraphs (A)(iii) and (B), an individual shall not be treated as present in the United States during any period for which the individual establishes that he has a closer connection to a foreign country than to the United States.

(ii) NOT MORE THAN 10 DAYS DISREGARDED.—Clause (i) shall not apply to more than 10 days on which the individual is present in the United States.

(3) SUBSTANTIAL PRESENCE TEST.—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, an individual meets the substantial presence test of this paragraph with respect to any calendar year (hereinafter in this subsection referred to as the "current year") if—

(i) such individual was present in the United States on at least 31 days during the calendar year, and

(ii) the sum of the number of days on which such individual was present in the United States during the current year and the 2 preceding calendar years (when multiplied by the applicable multiplier determined under the following table) equals or exceeds 183 days:

(B) EXCEPTION WHERE INDIVIDUAL IS PRESENT IN THE UNITED STATES DURING LESS THAN ONE-HALF OF CURRENT YEAR AND CLOSER CONNECTION TO FOREIGN COUNTRY IS ESTABLISHED.—An individual shall not be treated as meeting the substantial presence test of this paragraph with respect to any current year if—

(i) such individual is present in the United States on fewer than 183 days during the current year, and

(ii) it is established that for the current year such individual has a tax home (as defined in section 911(d)(3) without regard to the second sentence thereof) in a foreign country and has a closer connection to such foreign country than to the United States.

(C) SUBPARAGRAPH (B) NOT TO APPLY IN CERTAIN CASES.—Subparagraph (B) shall not apply to any individual with respect to any current year if at any time during such year—

(i) such individual had an application for adjustment of status pending, or

(ii) such individual took other steps to apply for status as a lawful permanent resident of the United States.

(D) EXCEPTION FOR EXEMPT INDIVIDUALS OR FOR CERTAIN MEDICAL CONDITIONS.—An individual shall not be treated as being present in the United States on any day if—

(i) such individual is an exempt individual for such day, or

(ii) such individual was unable to leave the United States on such day because of a medical condition which arose while such individual was present in the United States.

(4) FIRST-YEAR ELECTION.—(A) An alien individual shall be deemed to meet the requirements of this subparagraph if such individual—

(i) is not a resident of the United States under clause (i) or (ii) of paragraph (1)(A) with respect to a calendar year (hereinafter referred to as the "election year"),

(ii) was not a resident of the United States under paragraph (1)(A) with respect to the calendar year immediately preceding the election year,

(iii) is a resident of the United States under clause (ii) of paragraph (1)(A) with respect to the calendar year immediately following the election year, and

(iv) is both—

(I) present in the United States for a period of at least 31 consecutive days in the election year, and

(II) present in the United States during the period beginning with the first day of such 31-day period and ending with the last day of the election year (hereinafter referred to as the "testing period") for a number of days equal to or exceeding 75 percent of the number of days in the testing period (provided that an individual shall be treated for purposes of this subclause as present in the United States for a number of days during the testing period not exceeding 5 days in the aggregate, notwithstanding his absence from the United States on such days).

(B) An alien individual who meets the requirements of subparagraph (A) shall, if he so elects, be treated as a resident of the United States with respect to the election year.

(C) An alien individual who makes the election provided by subparagraph (B) shall be treated as a resident of the United States for the portion of the election year which begins on the 1st day of the earliest testing period during such year with respect to which the individual meets the requirements of clause (iv) of subparagraph (A).

(D) The rules of subparagraph (D)(i) of paragraph (3) shall apply for purposes of determining an individual's presence in the United States under this paragraph.

(E) An election under subparagraph (B) shall be made on the individual's tax return for the election year, provided that such election may not be made before the individual has met the substantial presence test of paragraph (3) with respect to the calendar year immediately following the election year.

(F) An election once made under subparagraph (B) remains in effect for the election year, unless revoked with the consent of the Secretary.

(5) EXEMPT INDIVIDUAL DEFINED.—For purposes of this subsection—

(A) IN GENERAL.—An individual is an exempt individual for any day if, for such day, such individual is—

(i) a foreign government-related individual,

(ii) a teacher or trainee,

(iii) a student, or

(iv) a professional athlete who is temporarily in the United States to compete in a sports event—

(I) which is organized for the primary purpose of benefiting an organization which is described in section 501(c)(3) and exempt from tax under section 501(a),

(II) all of the net proceeds of which are contributed to such organization, and,

(III) which utilizes volunteers for substantially all of the work performed in carrying out such event.

(B) FOREIGN GOVERNMENT-RELATED INDIVIDUAL.—The term "foreign government-related individual" means any individual temporarily present in the United States by reason of—

(i) diplomatic status, or a visa which the Secretary (after consultation with the Secretary of State) determines represents full-time diplomatic or consular status for purposes of this subsection,

(ii) being a full-time employee of an international organization, or

(iii) being a member of the immediate family of an individual described in clause (i) or (ii).

(C) TEACHER OR TRAINEE.—The term "teacher or trainee" means any individual—

(i) who is temporarily present in the United States under subparagraph (J) or (Q) of section 101(15) of the Immigration and Nationality Act (other than as a student), and

(ii) who substantially complies with the requirements for being so present.

(D) STUDENT.—The term "student" means any individual—

(i) who is temporarily present in the United States—

(I) under subparagraph (F) or (M) of section 101(15) of the Immigration and Nationality Act, or

(II) as a student under subparagraph (J) or (Q) of such section 101(15), and

(ii) who substantially complies with the requirements for being so present.

(E) SPECIAL RULES FOR TEACHERS, TRAINEES, AND STUDENTS.—

(i) LIMITATION ON TEACHERS AND TRAINEES.—An individual shall not be treated as an exempt individual by reason of clause (ii) of subparagraph (A) for the current year if, for any 2 calendar years during the preceding 6 calendar years, such person was an exempt person under clause (ii) or (iii) of subparagraph (A). In the case of an individual all of whose compensation is described in section 872(b)(3), the preceding sentence shall be applied by substituting "4 calendar years" for "2 calendar years".

(ii) LIMITATION ON STUDENTS.—For any calendar year after the 5th calendar year for which an individual was an exempt individual under clause (ii) or (iii) of subparagraph (A), such individual shall not be treated as an exempt individual by reason of clause

(iii) of subparagraph (A), unless such individual establishes to the satisfaction of the Secretary that such individual does not intend to permanently reside in the United States and that such individual meets the requirements of subparagraph (D)(ii).

(6) LAWFUL PERMANENT RESIDENT.—For purposes of this subsection, an individual is a lawful permanent resident of the United States at any time if—

(A) such individual has the status of having been lawfully accorded the privilege of residing permanently in the United States as an immigrant in accordance with the immigration laws, and

(B) such status has not been revoked (and has not been administratively or judicially determined to have been abandoned).

An individual shall cease to be treated as a lawful permanent resident of the United States if such individual commences to be treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country, does not waive the benefits of such treaty applicable to residents of the foreign country, and notifies the Secretary of the commencement of such treatment.

(7) PRESENCE IN THE UNITED STATES.—For purposes of this subsection—

(A) IN GENERAL.—Except as provided in subparagraph (B), (C), or (D), an individual shall be treated as present in the United States on any day if such individual is physically present in the United States at any time during such day.

(B) COMMUTERS FROM CANADA OR MEXICO.—If an individual regularly commutes to employment (or self-employment) in the United States from a place of residence in Canada or Mexico, such individual shall not be treated as present in the United States on any day during which he so commutes.

(C) TRANSIT BETWEEN 2 FOREIGN POINTS.—If an individual, who is in transit between 2 points outside the United States, is physically present in the United States for less than 24 hours, such individual shall not be treated as present in the United States on any day during such transit.

(D) CREW MEMBERS TEMPORARILY PRESENT.—An individual who is temporarily present in the United States on any day as a regular member of the crew of a foreign vessel engaged in transportation between the United States and a foreign country or a possession of the United States shall not be treated as present in the United States on such day unless such individual otherwise engages in any trade or business in the United States on such day.

(8) ANNUAL STATEMENTS.—The Secretary may prescribe regulations under which an individual who (but for subparagraph (B) or (D) of paragraph (3)) would meet the substantial presence test of paragraph (3) is required to submit an annual statement setting forth the basis on which such individual

claims the benefits of subparagraph (B) or (D) of paragraph (3), as the case may be.

(9) TAXABLE YEAR.—

(A) IN GENERAL.—For purposes of this title, an alien individual who has not established a taxable year for any prior period shall be treated as having a taxable year which is the calendar year.

(B) FISCAL YEAR TAXPAYER.—If—

(i) an individual is treated under paragraph (1) as a resident of the United States for any calendar year, and

(ii) after the application of subparagraph (A), such individual has a taxable year other than a calendar year,

he shall be treated as a resident of the United States with respect to any portion of a taxable year which is within such calendar year.

(10) COORDINATION WITH SECTION 877.—If—

(A) an alien individual was treated as a resident of the United States during any period which includes at least 3 consecutive calendar years (hereinafter referred to as the "initial residency period"), and

(B) such individual ceases to be treated as a resident of the United States but subsequently becomes a resident of the United States before the close of the 3rd calendar year beginning after the close of the initial residency period,

such individual shall be taxable for the period after the close of the initial residency period and before the day on which he subsequently became a resident of the United States in the manner provided in section 877(b). The preceding sentence shall apply only if the tax imposed pursuant to section 877(b) exceeds the tax which, without regard to this paragraph, is imposed pursuant to section 871.

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

(c) INCLUDES AND INCLUDING.—The terms "includes" and "including" when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined.

(d) COMMONWEALTH OF PUERTO RICO.—Where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, references in this title to possessions of the United States shall be treated as also referring to the Commonwealth of Puerto Rico.

(e) TREATMENT OF CERTAIN CONTRACTS FOR PROVIDING SERVICES, ETC..—For purposes of chapter 1—

(1) IN GENERAL.—A contract which purports to be a service contract shall be treated as a lease of property if such contract is properly treated as a lease of property, taking into account all relevant factors including whether or not—

(A) the service recipient is in physical possession of the property,

(B) the service recipient controls the property,

(C) the service recipient has a significant economic or possessory interest in the property,

(D) the service provider does not bear any risk of substantially diminished receipts or substantially increased expenditures if there is nonperformance under the contract,

(E) the service provider does not use the property concurrently to provide significant services to entities unrelated to the service recipient, and

(F) the total contract price does not substantially exceed the rental value of the property for the contract period.

(2) OTHER ARRANGEMENTS.—An arrangement (including a partnership or other pass-thru entity) which is not described in paragraph (1) shall be treated as a lease if such arrangement is properly treated as a lease, taking into account all relevant factors including factors similar to those set forth in paragraph (1).

(3) SPECIAL RULES FOR CONTRACTS OR ARRANGEMENTS INVOLVING SOLID WASTE DISPOSAL, ENERGY, AND CLEAN WATER FACILITIES.—

(A) IN GENERAL.—Notwithstanding paragraphs (1) and (2), and except as provided in paragraph (4), any contract or arrangement between a service provider and a service recipient—

(i) with respect to—

(I) the operation of a qualified solid waste disposal facility,

(II) the sale to the service recipient of electrical or thermal energy produced at a cogeneration or alternative energy facility, or

(III) the operation of a water treatment works facility, and

(ii) which purports to be a service contract,

shall be treated as a service contract.

(B) QUALIFIED SOLID WASTE DISPOSAL FACILITY.—For purposes of subparagraph (A), the term "qualified solid waste disposal facility" means any facility if such facility provides solid waste disposal services for residents of part or all of 1 or more governmental units and substantially all of the solid waste processed at such facility is collected from the general public.

(C) COGENERATION FACILITY.—For purposes of subparagraph (A), the term "cogeneration facility" means a facility which uses the same energy source for the sequential generation of electrical or mechanical power in combination with steam, heat, or other forms of useful energy.

(D) ALTERNATIVE ENERGY FACILITY.—For purposes of subparagraph (A), the term "alternative energy facility" means a facility for producing electrical or thermal energy if the primary energy source for the facility is not oil, natural gas, coal, or nuclear power.

(E) WATER TREATMENT WORKS FACILITY.—For purposes of subparagraph (A), the term "water treatment works facility" means any treatment works within the meaning of section 212(2) of the Federal Water Pollution Control Act.

(4) PARAGRAPH (3) NOT TO APPLY IN CERTAIN CASES.—

(A) IN GENERAL.—Paragraph (3) shall not apply to any qualified solid waste disposal facility, cogeneration facility, alternative energy facility, or water treatment works facility used under a contract or arrangement if—

(i) the service recipient (or a related entity) operates such facility,

(ii) the service recipient (or a related entity) bears any significant financial burden if there is nonperformance under the contract or arrangement (other than for reasons beyond the control of the service provider),

(iii) the service recipient (or a related entity) receives any significant financial benefit if the operating costs of such facility are less than the standards of performance or operation under the contract or arrangement, or

(iv) the service recipient (or a related entity) has an option to purchase, or may be required to purchase, all or a part of such facility at a fixed and determinable price (other than for fair market value).

For purposes of this paragraph, the term "related entity" has the same meaning as when used in section 168(h).

(B) SPECIAL RULES FOR APPLICATION OF SUBPARAGRAPH (A) WITH RESPECT TO CERTAIN RIGHTS AND ALLOCATIONS UNDER THE CONTRACT.—For purposes of subparagraph (A), there shall not be taken into account—

(i) any right of a service recipient to inspect any facility, to exercise any sovereign power the service recipient may possess, or to act in the event of a breach of contract by the service provider, or

(ii) any allocation of any financial burden or benefits in the event of any change in any law.

(C) SPECIAL RULES FOR APPLICATION OF SUBPARAGRAPH (A) IN THE CASE OF CERTAIN EVENTS.—

(i) TEMPORARY SHUT-DOWNS, ETC..—For purposes of clause (ii) of subparagraph (A), there shall not be taken into account any temporary shut-down of the facility for repairs, maintenance, or capital improvements, or any financial burden caused by the bankruptcy or similar financial difficulty of the service provider.

(ii) REDUCED COSTS.—For purposes of clause (iii) of subparagraph (A), there shall not be taken into account any significant financial benefit merely because payments by the service recipient under the contract or arrangement are decreased by reason of increased production or efficiency or the recovery of energy or other products.

(5) EXCEPTION FOR CERTAIN LOW-INCOME HOUSING.—This subsection shall not apply to any property described in clause (i), (ii), (iii), or (iv) of section 1250(a)(1)(B) (relating to low-income housing) if—

(A) such property is operated by or for an organization described in paragraph (3) or (4) of section 501(c), and

(B) at least 80 percent of the units in such property are leased to low-income tenants (within the meaning of section 167(k)(3)(B)) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990).

(6) REGULATIONS.—The Secretary may prescribe such regulations as may be necessary or appropriate to carry out the provisions of this subsection.

(f) USE OF RELATED PERSONS OR PASS-THRU ENTITIES.—The Secretary shall prescribe such regulations as may be necessary or appropriate to prevent the avoidance of those provisions of this title which deal with—

(1) the linking of borrowing to investment, or

(2) diminishing risks,

through the use of related persons, pass-thru entities, or other intermediaries.

(g) CLARIFICATION OF FAIR MARKET VALUE IN THE CASE OF NONRECOURSE INDEBTEDNESS.—For purposes of subtitle A, in determining the amount of gain or loss (or deemed gain or loss) with respect to any property, the fair market value of such property shall be treated as being not less than the amount of any nonrecourse indebtedness to which such property is subject.

(h) MOTOR VEHICLE OPERATING LEASES.—

(1) IN GENERAL.—For purposes of this title, in the case of a qualified motor vehicle operating agreement which contains a terminal rental adjustment clause—

(A) such agreement shall be treated as a lease if (but for such terminal rental adjustment clause) such agreement would be treated as a lease under this title, and

(B) the lessee shall not be treated as the owner of the property subject to an agreement during any period such agreement is in effect.

(2) QUALIFIED MOTOR VEHICLE OPERATING AGREEMENT DEFINED.—For purposes of this subsection—

(A) IN GENERAL.—The term "qualified motor vehicle operating agreement" means any agreement with respect to a motor vehicle (including a trailer) which meets the requirements of subparagraphs (B), (C), and (D) of this paragraph.

(B) MINIMUM LIABILITY OF LESSOR.—An agreement meets the requirements of this subparagraph if under such agreement the sum of—

(i) the amount the lessor is personally liable to repay, and

(ii) the net fair market value of the lessor's interest in any property pledged as security for property subject to the agreement,

equals or exceeds all amounts borrowed to finance the acquisition of property subject to the agreement. There shall not be taken into account under clause (ii) any property pledged which is property subject to the agreement or property directly or indirectly financed by indebtedness secured by property subject to the agreement.

(C) CERTIFICATION BY LESSEE; NOTICE OF TAX OWNERSHIP.—An agreement meets the requirements of this sub-

paragraph if such agreement contains a separate written statement separately signed by the lessee—

(i) under which the lessee certifies, under penalty of perjury, that it intends that more than 50 percent of the use of the property subject to such agreement is to be in a trade or business of the lessee, and

(ii) which clearly and legibly states that the lessee has been advised that it will not be treated as the owner of the property subject to the agreement for Federal income tax purposes.

(D) LESSOR MUST HAVE NO KNOWLEDGE THAT CERTIFICATION IS FALSE.—An agreement meets the requirements of this subparagraph if the lessor does not know that the certification described in subparagraph (C)(i) is false.

(3) TERMINAL RENTAL ADJUSTMENT CLAUSE DEFINED.—

(A) IN GENERAL.—For purposes of this subsection, the term "terminal rental adjustment clause" means a provision of an agreement which permits or requires the rental price to be adjusted upward or downward by reference to the amount realized by the lessor under the agreement upon sale or other disposition of such property.

(B) SPECIAL RULE FOR LESSEE DEALERS.—The term "terminal rental adjustment clause" also includes a provision of an agreement which requires a lessee who is a dealer in motor vehicles to purchase the motor vehicle for a predetermined price and then resell such vehicle where such provision achieves substantially the same results as a provision described in subparagraph (A).

(i) TAXABLE MORTGAGE POOLS.—

(1) TREATED AS SEPARATE CORPORATIONS.—A taxable mortgage pool shall be treated as a separate corporation which may not be treated as an includible corporation with any other corporation for purposes of section 1501.

(2) TAXABLE MORTGAGE POOL DEFINED.—For purposes of this title—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, a taxable mortgage pool is any entity (other than a REMIC) if—

(i) substantially all of the assets of such entity consists of debt obligations (or interests therein) and more than 50 percent of such debt obligations (or interests) consists of real estate mortgages (or interests therein),

(ii) such entity is the obligor under debt obligations with 2 or more maturities, and

(iii) under the terms of the debt obligations referred to in clause (ii) (or underlying arrangement), payments on such debt obligations bear a relationship to payments on the debt obligations (or interests) referred to in clause (i).

(B) PORTION OF ENTITIES TREATED AS POOLS.—Any portion of an entity which meets the definition of subparagraph (A) shall be treated as a taxable mortgage pool.

(C) EXCEPTION FOR DOMESTIC BUILDING AND LOAN.—Nothing in this subsection shall be construed to treat any

domestic building and loan association (or portion thereof) as a taxable mortgage pool.

(D) TREATMENT OF CERTAIN EQUITY INTERESTS.—To the extent provided in regulations, equity interest of varying classes which correspond to maturity classes of debt shall be treated as debt for purposes of this subsection.

(3) TREATMENT OF CERTAIN REIT'S.—If—

(A) a real estate investment trust is a taxable mortgage pool, or

(B) a qualified REIT subsidiary (as defined in section 856(i)(2)) of a real estate investment trust is a taxable mortgage pool,

under regulations prescribed by the Secretary, adjustments similar to the adjustments provided in section 860E(d) shall apply to the shareholders of such real estate investment trust.

(j) TAX TREATMENT OF FEDERAL THRIFT SAVINGS FUND.—

(1) IN GENERAL.—For purposes of this title—

(A) the Thrift Savings Fund shall be treated as a trust described in section 401(a) which is exempt from taxation under section 501(a);

(B) any contribution to, or distribution from, the Thrift Savings Fund shall be treated in the same manner as contributions to or distributions from such a trust; and

(C) subject to section 401(k)(4)(B) and any dollar limitation on the application of section 402(e)(3), contributions to the Thrift Savings Fund shall not be treated as distributed or made available to an employee or Member nor as a contribution made to the Fund by an employee or Member merely because the employee or Member has, under the provisions of subchapter III of chapter 84 of title 5, United States Code, and section 8351 of such title 5, an election whether the contribution will be made to the Thrift Savings Fund or received by the employee or Member in cash.

(2) NONDISCRIMINATION REQUIREMENTS.—Notwithstanding any other provision of law, the Thrift Savings Fund is not subject to the nondiscrimination requirements applicable to arrangements described in section 401(k) or to matching contributions (as described in section 401(m)), so long as it meets the requirements of this section.

(3) COORDINATION WITH SOCIAL SECURITY ACT.—Paragraph (1) shall not be construed to provide that any amount of the employee's or Member's basic pay which is contributed to the Thrift Savings Fund shall not be included in the term "wages" for the purposes of section 209 of the Social Security Act or section 3121(a) of this title.

(4) DEFINITIONS.—For purposes of this subsection, the terms "Member", "employee", and "Thrift Savings Fund" shall have the same respective meanings as when used in subchapter III of chapter 84 of title 5, United States Code.

(5) COORDINATION WITH OTHER PROVISIONS OF LAW.—No provision of law not contained in this title shall apply for purposes of determining the treatment under this title of the Thrift Savings Fund or any contribution to, or distribution from, such Fund.

(k) TREATMENT OF CERTAIN AMOUNTS PAID TO CHARITY.—In the case of any payment which, except for section 501(b) of the Ethics in Government Act of 1978, might be made to any officer or employee of the Federal Government but which is made instead on behalf of such officer or employee to an organization described in section 170(c)—

(1) such payment shall not be treated as received by such officer or employee for all purposes of this title and for all purposes of any tax law of a State or political subdivision thereof, and

(2) no deduction shall be allowed under any provision of this title (or of any tax law of a State or political subdivision thereof) to such officer or employee by reason of having such payment made to such organization.

For purposes of this subsection, a Senator, a Representative in, or a Delegate or Resident Commissioner to, the Congress shall be treated as an officer or employee of the Federal Government.

(l) REGULATIONS RELATING TO CONDUIT ARRANGEMENTS.—The Secretary may prescribe regulations recharacterizing any multiple-party financing transaction as a transaction directly among any 2 or more of such parties where the Secretary determines that such recharacterization is appropriate to prevent avoidance of any tax imposed by this title.

(m) DESIGNATION OF CONTRACT MARKETS.—Any designation by the Commodity Futures Trading Commission of a contract market which could not have been made under the law in effect on the day before the date of the enactment of the Commodity Futures Modernization Act of 2000 shall apply for purposes of this title except to the extent provided in regulations prescribed by the Secretary.

(n) CONVENTION OR ASSOCIATION OF CHURCHES.—For purposes of this title, any organization which is otherwise a convention or association of churches shall not fail to so qualify merely because the membership of such organization includes individuals as well as churches or because individuals have voting rights in such organization.

(o) CLARIFICATION OF ECONOMIC SUBSTANCE DOCTRINE.—

(1) APPLICATION OF DOCTRINE.—In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if—

(A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and

(B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.

(2) SPECIAL RULE WHERE TAXPAYER RELIES ON PROFIT POTENTIAL.—

(A) IN GENERAL.—The potential for profit of a transaction shall be taken into account in determining whether the requirements of subparagraphs (A) and (B) of paragraph (1) are met with respect to the transaction only if the present value of the reasonably expected pre-tax profit from the transaction is substantial in relation to the

present value of the expected net tax benefits that would be allowed if the transaction were respected.

(B) TREATMENT OF FEES AND FOREIGN TAXES.—Fees and other transaction expenses shall be taken into account as expenses in determining pre-tax profit under subparagraph (A). The Secretary shall issue regulations requiring foreign taxes to be treated as expenses in determining pre-tax profit in appropriate cases.

(3) STATE AND LOCAL TAX BENEFITS.—For purposes of paragraph (1), any State or local income tax effect which is related to a Federal income tax effect shall be treated in the same manner as a Federal income tax effect.

(4) FINANCIAL ACCOUNTING BENEFITS.—For purposes of paragraph (1)(B), achieving a financial accounting benefit shall not be taken into account as a purpose for entering into a transaction if the origin of such financial accounting benefit is a reduction of Federal income tax.

(5) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

(A) ECONOMIC SUBSTANCE DOCTRINE.—The term "economic substance doctrine" means the common law doctrine under which tax benefits under subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose.

(B) EXCEPTION FOR PERSONAL TRANSACTIONS OF INDIVIDUALS.—In the case of an individual, paragraph (1) shall apply only to transactions entered into in connection with a trade or business or an activity engaged in for the production of income.

(C) DETERMINATION OF APPLICATION OF DOCTRINE NOT AFFECTED.—The determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if this subsection had never been enacted.

(D) TRANSACTION.—The term "transaction" includes a series of transactions.

(p) CROSS REFERENCES.—

(1) OTHER DEFINITIONS.—For other definitions, see the following sections of Title 1 of the United States Code:

(1) Singular as including plural, section 1.

(2) Plural as including singular, section 1.

(3) Masculine as including feminine, section 1.

(4) Officer, section 1.

(5) Oath as including affirmation, section 1.

(6) County as including parish, section 2.

(7) Vessel as including all means of water transportation, section 3.

(8) Vehicle as including all means of land transportation, section 4.

(9) Company or association as including successors and assigns, section 5.

(2) EFFECT OF CROSS REFERENCES.—For effect of cross references in this title, see section 7806(a).

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SEC. 7703. DETERMINATION OF MARITAL STATUS.

(a) GENERAL RULE.—For purposes of part V of subchapter B of chapter 1 and those provisions of this title which refer to this subsection—

(1) the determination of whether an individual is married shall be made as of the close of [his taxable year] *the individual's taxable year* ; except that if [his spouse] *the individual's spouse* dies during [his taxable year] *the individual's taxable year* such determination shall be made as of the time of such death; and

(2) an individual legally separated from [his spouse] *the individual's spouse* under a decree of divorce or of separate maintenance shall not be considered as married.

(b) CERTAIN MARRIED INDIVIDUALS LIVING APART.—For purposes of those provisions of this title which refer to this subsection, if—

(1) an individual who is married (within the meaning of subsection (a)) and who files a separate return maintains as [his home] *the individual's home* a household which constitutes for more than one-half of the taxable year the principal place of abode of a child (within the meaning of section 152(f)(1)) with respect to whom such individual is entitled to a deduction for the taxable year under section 151 (or would be so entitled but for section 152(e)),

(2) such individual furnishes over one-half of the cost of maintaining such household during the taxable year, and

(3) during the last 6 months of the taxable year, such individual's spouse is not a member of such household,

such individual shall not be considered as married.

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CHAPTER 80—GENERAL RULES

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Subchapter C—PROVISIONS AFFECTING MORE THAN ONE SUBTITLE

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SEC. 7872. TREATMENT OF LOANS WITH BELOW-MARKET INTEREST RATES.

(a) TREATMENT OF GIFT LOANS AND DEMAND LOANS.—

(1) IN GENERAL.—For purposes of this title, in the case of any below-market loan to which this section applies and which is a gift loan or a demand loan, the forgone interest shall be treated as—

(A) transferred from the lender to the borrower, and

(B) retransferred by the borrower to the lender as interest.

(2) TIME WHEN TRANSFERS MADE.—Except as otherwise provided in regulations prescribed by the Secretary, any forgone interest attributable to periods during any calendar year shall be treated as transferred (and retransferred) under paragraph (1) on the last day of such calendar year.

(b) TREATMENT OF OTHER BELOW-MARKET LOANS.—

(1) IN GENERAL.—For purposes of this title, in the case of any below-market loan to which this section applies and to which subsection (a)(1) does not apply, the lender shall be treated as having transferred on the date the loan was made (or, if later, on the first day on which this section applies to such loan), and the borrower shall be treated as having received on such date, cash in an amount equal to the excess of—

(A) the amount loaned, over

(B) the present value of all payments which are required to be made under the terms of the loan.

(2) OBLIGATION TREATED AS HAVING ORIGINAL ISSUE DISCOUNT.—For purposes of this title—

(A) IN GENERAL.—Any below-market loan to which paragraph (1) applies shall be treated as having original issue discount in an amount equal to the excess described in paragraph (1).

(B) AMOUNT IN ADDITION TO OTHER ORIGINAL ISSUE DISCOUNT.—Any original issue discount which a loan is treated as having by reason of subparagraph (A) shall be in addition to any other original issue discount on such loan (determined without regard to subparagraph (A)).

(c) BELOW-MARKET LOANS TO WHICH SECTION APPLIES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection and subsection (g), this section shall apply to—

(A) GIFTS.—Any below-market loan which is a gift loan.

(B) COMPENSATION-RELATED LOANS.—Any below-market loan directly or indirectly between—

(i) an employer and an employee, or

(ii) an independent contractor and a person for whom such independent contractor provides services.

(C) CORPORATION-SHAREHOLDER LOANS.—Any below-market loan directly or indirectly between a corporation and any shareholder of such corporation.

(D) TAX AVOIDANCE LOANS.—Any below-market loan 1 of the principal purposes of the interest arrangements of which is the avoidance of any Federal tax.

(E) OTHER BELOW-MARKET LOANS.—To the extent provided in regulations, any below-market loan which is not described in subparagraph (A), (B), (C), or (F) if the interest arrangements of such loan have a significant effect on any Federal tax liability of the lender or the borrower.

(F) LOANS TO QUALIFIED CONTINUING CARE FACILITIES.—Any loan to any qualified continuing care facility pursuant to a continuing care contract.

(2) $10,000 DE MINIMIS EXCEPTION FOR GIFT LOANS BETWEEN INDIVIDUALS.—

(A) IN GENERAL.—In the case of any gift loan directly between individuals, this section shall not apply to any day on which the aggregate outstanding amount of loans between such individuals does not exceed $10,000.

(B) DE MINIMIS EXCEPTION NOT TO APPLY TO LOANS ATTRIBUTABLE TO ACQUISITION OF INCOME-PRODUCING ASSETS.—Subparagraph (A) shall not apply to any gift loan directly attributable to the purchase or carrying of income-producing assets.

(C) CROSS REFERENCE.—For limitation on amount treated as interest where loans do not exceed $100,000, see subsection (d)(1).

(3) $10,000 DE MINIMIS EXCEPTION FOR COMPENSATION-RELATED AND CORPORATE-SHAREHOLDER LOANS.—

(A) IN GENERAL.—In the case of any loan described in subparagraph (B) or (C) of paragraph (1), this section shall not apply to any day on which the aggregate outstanding amount of loans between the borrower and lender does not exceed $10,000.

(B) EXCEPTION NOT TO APPLY WHERE 1 OF PRINCIPAL PURPOSES IS TAX AVOIDANCE.—Subparagraph (A) shall not apply to any loan the interest arrangements of which have as 1 of their principal purposes the avoidance of any Federal tax.

(d) SPECIAL RULES FOR GIFT LOANS.—

(1) LIMITATION ON INTEREST ACCRUAL FOR PURPOSES OF INCOME TAXES WHERE LOANS DO NOT EXCEED $100,000.—

(A) IN GENERAL.—For purposes of subtitle A, in the case of a gift loan directly between individuals, the amount treated as retransferred by the borrower to the lender as of the close of any year shall not exceed the borrower's net investment income for such year.

(B) LIMITATION NOT TO APPLY WHERE 1 OF PRINCIPAL PURPOSES IS TAX AVOIDANCE.—Subparagraph (A) shall not apply to any loan the interest arrangements of which have as 1 of their principal purposes the avoidance of any Federal tax.

(C) SPECIAL RULE WHERE MORE THAN 1 GIFT LOAN OUTSTANDING.—For purposes of subparagraph (A), in any case in which a borrower has outstanding more than 1 gift loan, the net investment income of such borrower shall be allocated among such loans in proportion to the respective amounts which would be treated as retransferred by the borrower without regard to this paragraph.

(D) LIMITATION NOT TO APPLY WHERE AGGREGATE AMOUNT OF LOANS EXCEED $100,000.—This paragraph shall not apply to any loan made by a lender to a borrower for any day on which the aggregate outstanding amount of loans between the borrower and lender exceeds $100,000.

(E) NET INVESTMENT INCOME.—For purposes of this paragraph—

(i) IN GENERAL.—The term "net investment income" has the meaning given such term by section 163(d)(4).

(ii) DE MINIMIS RULE.—If the net investment income of any borrower for any year does not exceed $1,000, the net investment income of such borrower for such year shall be treated as zero.

(iii) ADDITIONAL AMOUNTS TREATED AS INTEREST.—In determining the net investment income of a person for any year, any amount which would be included in the gross income of such person for such year by reason of section 1272 if such section applied to all deferred payment obligations shall be treated as interest received by such person for such year.

(iv) DEFERRED PAYMENT OBLIGATIONS.—The term "deferred payment obligation" includes any market discount bond, short-term obligation, United States savings bond, annuity, or similar obligation.

(2) SPECIAL RULE FOR GIFT TAX.—In the case of any gift loan which is a term loan, subsection (b)(1) (and not subsection (a)) shall apply for purposes of chapter 12.

(e) DEFINITIONS OF BELOW-MARKET LOAN AND FORGONE INTEREST.—For purposes of this section—

(1) BELOW-MARKET LOAN.—The term "below-market loan" means any loan if—

(A) in the case of a demand loan, interest is payable on the loan at a rate less than the applicable Federal rate, or

(B) in the case of a term loan, the amount loaned exceeds the present value of all payments due under the loan.

(2) FORGONE INTEREST.—The term "forgone interest" means, with respect to any period during which the loan is outstanding, the excess of—

(A) the amount of interest which would have been payable on the loan for the period if interest accrued on the loan at the applicable Federal rate and were payable annually on the day referred to in subsection (a)(2), over

(B) any interest payable on the loan properly allocable to such period.

(f) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) PRESENT VALUE.—The present value of any payment shall be determined in the manner provided by regulations prescribed by the Secretary—

(A) as of the date of the loan, and

(B) by using a discount rate equal to the applicable Federal rate.

(2) APPLICABLE FEDERAL RATE.—

(A) TERM LOANS.—In the case of any term loan, the applicable Federal rate shall be the applicable Federal rate in effect under section 1274(d) (as of the day on which the loan was made), compounded semiannually.

(B) DEMAND LOANS.—In the case of a demand loan, the applicable Federal rate shall be the Federal short-term rate in effect under section 1274(d) for the period for which the amount of forgone interest is being determined, compounded semiannually.

(3) GIFT LOAN.—The term "gift loan" means any below-market loan where the forgoing of interest is in the nature of a gift.

(4) AMOUNT LOANED.—The term "amount loaned" means the amount received by the borrower.

(5) DEMAND LOAN.—The term "demand loan" means any loan which is payable in full at any time on the demand of the lender. Such term also includes (for purposes other than determining the applicable Federal rate under paragraph (2)) any loan if the benefits of the interest arrangements of such loan are not transferable and are conditioned on the future performance of substantial services by an individual. To the extent

provided in regulations, such term also includes any loan with an indefinite maturity.

(6) TERM LOAN.—The term "term loan" means any loan which is not a demand loan.

[(7) HUSBAND AND WIFE TREATED AS 1 PERSON.—A husband and wife shall be treated as 1 person.]

(7) MARRIED COUPLE TREATED AS 1 PERSON.—A married couple shall be treated as 1 person.

(8) LOANS TO WHICH SECTION 483, 643(I), OR 1274 APPLIES.—This section shall not apply to any loan to which section 483, 643(i), or 1274 applies.

(9) NO WITHHOLDING.—No amount shall be withheld under chapter 24 with respect to—

(A) any amount treated as transferred or retransferred under subsection (a), and

(B) any amount treated as received under subsection (b).

(10) SPECIAL RULE FOR TERM LOANS.—If this section applies to any term loan on any day, this section shall continue to apply to such loan notwithstanding paragraphs (2) and (3) of subsection (c). In the case of a gift loan, the preceding sentence shall only apply for purposes of chapter 12.

(11) TIME FOR DETERMINING RATE APPLICABLE TO EMPLOYEE RELOCATION LOANS.—

(A) IN GENERAL.—In the case of any term loan made by an employer to an employee the proceeds of which are used by the employee to purchase a principal residence (within the meaning of section 121), the determination of the applicable Federal rate shall be made as of the date the written contract to purchase such residence was entered into.

(B) PARAGRAPH ONLY TO APPLY TO CASES TO WHICH SECTION 217 APPLIES.—Subparagraph (A) shall only apply to the purchase of a principal residence in connection with the commencement of work by an employee or a change in the principal place of work of an employee to which section 217 applies.

(g) EXCEPTION FOR CERTAIN LOANS TO QUALIFIED CONTINUING CARE FACILITIES.—

(1) IN GENERAL.—This section shall not apply for any calendar year to any below-market loan made by a lender to a qualified continuing care facility pursuant to a continuing care contract if the lender (or the lender's spouse) attains age 65 before the close of such year.

(2) $90,000 LIMIT.—Paragraph (1) shall apply only to the extent that the aggregate outstanding amount of any loan to which such paragraph applies (determined without regard to this paragraph), when added to the aggregate outstanding amount of all other previous loans between the lender (or the lender's spouse) and any qualified continuing care facility to which paragraph (1) applies, does not exceed $90,000.

(3) CONTINUING CARE CONTRACT.—For purposes of this section, the term "continuing care contract" means a written contract between an individual and a qualified continuing care facility under which—

(A) the individual or individual's spouse may use a qualified continuing care facility for their life or lives,

(B) the individual or individual's spouse—

(i) will first—

(I) reside in a separate, independent living unit with additional facilities outside such unit for the providing of meals and other personal care, and

(II) not require long-term nursing care, and

(ii) then will be provided long-term and skilled nursing care as the health of such individual or individual's spouse requires, and

(C) no additional substantial payment is required if such individual or individual's spouse requires increased personal care services or long-term and skilled nursing care.

(4) QUALIFIED CONTINUING CARE FACILITY.—

(A) IN GENERAL.—For purposes of this section, the term "qualified continuing care facility" means 1 or more facilities—

(i) which are designed to provide services under continuing care contracts, and

(ii) substantially all of the residents of which are covered by continuing care contracts.

(B) SUBSTANTIALLY ALL FACILITIES MUST BE OWNED OR OPERATED BY BORROWER.—A facility shall not be treated as a qualified continuing care facility unless substantially all facilities which are used to provide services which are required to be provided under a continuing care contract are owned or operated by the borrower.

(C) NURSING HOMES EXCLUDED.—The term "qualified continuing care facility" shall not include any facility which is of a type which is traditionally considered a nursing home.

(5) ADJUSTMENT OF LIMIT FOR INFLATION.—In the case of any loan made during any calendar year after 1986, the dollar amount in paragraph (2) shall be increased by an amount equal to—

(A) such amount, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting "calendar year 1985" for "calendar year 2016" in subparagraph (A)(ii) thereof.

Any increase under the preceding sentence shall be rounded to the nearest multiple of $100 (or, if such increase is a multiple of $50, such increase shall be increased to the nearest multiple of $100).

(6) SUSPENSION OF APPLICATION.—Paragraph (1) shall not apply for any calendar year to which subsection (h) applies.

(h) EXCEPTION FOR LOANS TO QUALIFIED CONTINUING CARE FACILITIES.—

(1) IN GENERAL.—This section shall not apply for any calendar year to any below-market loan owed by a facility which on the last day of such year is a qualified continuing care facility, if such loan was made pursuant to a continuing care contract and if the lender (or the lender's spouse) attains age 62 before the close of such year.

(2) CONTINUING CARE CONTRACT.—For purposes of this section, the term "continuing care contract" means a written contract between an individual and a qualified continuing care facility under which—

(A) the individual or individual's spouse may use a qualified continuing care facility for their life or lives,

(B) the individual or individual's spouse will be provided with housing, as appropriate for the health of such individual or individual's spouse—

(i) in an independent living unit (which has additional available facilities outside such unit for the provision of meals and other personal care), and

(ii) in an assisted living facility or a nursing facility, as is available in the continuing care facility, and

(C) the individual or individual's spouse will be provided assisted living or nursing care as the health of such individual or individual's spouse requires, and as is available in the continuing care facility.

The Secretary shall issue guidance which limits such term to contracts which provide only facilities, care, and services described in this paragraph.

(3) QUALIFIED CONTINUING CARE FACILITY.—

(A) IN GENERAL.—For purposes of this section, the term "qualified continuing care facility" means 1 or more facilities—

(i) which are designed to provide services under continuing care contracts,

(ii) which include an independent living unit, plus an assisted living or nursing facility, or both, and

(iii) substantially all of the independent living unit residents of which are covered by continuing care contracts.

(B) NURSING HOMES EXCLUDED.—The term "qualified continuing care facility" shall not include any facility which is of a type which is traditionally considered a nursing home.

(i) REGULATIONS.—

(1) IN GENERAL.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including—

(A) regulations providing that where, by reason of varying rates of interest, conditional interest payments, waivers of interest, disposition of the lender's or borrower's interest in the loan, or other circumstances, the provisions of this section do not carry out the purposes of this section, adjustments to the provisions of this section will be made to the extent necessary to carry out the purposes of this section,

(B) regulations for the purpose of assuring that the positions of the borrower and lender are consistent as to the application (or nonapplication) of this section, and

(C) regulations exempting from the application of this section any class of transactions the interest arrangements of which have no significant effect on any Federal tax liability of the lender or the borrower.

(2) ESTATE TAX COORDINATION.—Under regulations prescribed by the Secretary, any loan which is made with donative intent and which is a term loan shall be taken into account for purposes of chapter 11 in a manner consistent with the provisions of subsection (b).

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VII. MINORITY VIEWS

Committee Republicans would like to point out a few administrative concerns with this legislation in its current form.

In 2013, the Supreme Court in *United States* v. *Windsor*, 570 U.S. 744 (2013) ruled that same-sex married couples cannot be denied Federal benefits, including tax benefits, available to other married couples. Previously, the *Defense of Marriage Act* had prohibited Government entities, including the Internal Revenue Service (the "IRS"), from recognizing or extending Federal benefits based on a same-sex marriage. After the *Windsor* holding, the Obama Treasury Department issued guidance in 2013 that clarified that the IRS will recognize same-sex marriage for federal tax purposes and allowed taxpayers to file amended returns to claim credits or refunds based on marital status. The Internal Revenue Code, however, generally limits the time period for filing amended returns to three years after the original return was filed. Generally, at the time this allowed taxpayers to file amended returns based on marital status back to the 2010 tax year, as long as the couple was married in a State that recognized the marriage.

There are sound policy reasons for the current three-year limitation for filing amended returns. In particular, as time passes, it becomes increasingly difficult for both taxpayers and the IRS to locate all the records that can substantiate a taxpayer's claims. This challenge is only exacerbated by the IRS's policy of routinely destroying taxpayer information. This legislation would allow certain taxpayers to file amended returns dating back to the 2004 tax year. These amended returns filed by taxpayers under this legislation would be subject to IRS audits; however, the ability of the IRS to conduct accurate, thorough audits of amended returns for taxable years of more than 10 years ago is questionable.

Additionally, the IRS would find calculating credit interest a challenge under the legislation in its current form. The legislation does not specify which date should be used for the purposes of calculating interest—the date of the original filing, the date of enactment, etc.—nor does it specify which date from the two original tax returns should be used under that calculation method.

Unfortunately, this bill does not adequately address these significant administrative concerns.

KEVIN BRADY,
Republican Leader, Committee on Ways and Means.