Calendar No. 534

96TH CONGRESS, 1st Session | SENATE | REPORT No. 96-498

TECHNICAL CORRECTIONS ACT OF 1979

REPORT

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ON

H.R. 2797

DECEMBER 13 (legislative day, NOVEMBER 29), 1979.—Ordered to be printed

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Mr. LONG, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 2797]

The Committee on Finance, to which was referred the bill (H.R. 2797) to make technical corrections related to the Revenue Act of 1978, having considered the same, reports favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are shown in the reported bill, with the matter proposed to be striken shown in linetype and the matter proposed to be inserted shown in italic type.

I. SUMMARY

In general, the bill contains technical, clerical, conforming, and clarifying amendments to provisions enacted by the Revenue Act of 1978 and other 1978 tax legislation. These amendments were developed as a result of a review of the application of the tax law changes made by 1978 tax legislation, taking into account comments submitted to the committee from the Treasury Department, the Internal Revenue Service, the staff, tax practitioners, and others from the public. In addition to written statements submitted to the committee, the Subcommittee on Taxation and Debt Management Generally received public testimony on November 7, 1979, on H.R. 2797, as passed by the House of Representatives. The committee subsequently made further amendments to the bill as a result of the testimony and comments received.

The bill is divided into nine general parts. The first part (sec. 2) coordinates the enactment dates of the Revenue Act of 1978 and the Energy Tax Act of 1978; the next seven parts (secs. 101–107) cover technical, clerical, and conforming amendments to the provisions of the first seven titles of the Revenue Act of 1978 (and the Internal Revenue Code provisions amended thereby); and the last part (sec. 108) covers technical, clerical, and conforming amendments to the Foreign Earned Income Act of 1978, the Black Lung Benefits Revenue Act, and the Energy Tax Act of 1978.

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III. GENERAL EXPLANATION OF PROVISIONS

A. TECHNICAL AMENDMENTS TO THE REVENUE ACT OF 1978

1. Coordination of Amendments Made by the Revenue Act of 1978 and the Energy Tax Act of 1978

(Sec. 2 of the Bill and Secs. 46 and 48 of the Code)

Present law

Prior to the Revenue Act of 1978, the present investment tax credit rate of 10 percent was scheduled to decline to 7 percent (4 percent for utility property) on January 1, 1981. Under the Revenue Act of 1978, the 10-percent rate of the credit was made permanent for all taxpayers.

The provisions of the Code (sec. 46(a)(2)) which pertain to the rate of the credit also were amended and restated by the Energy Tax Act of 1978. Although the energy tax amendments were passed by the Congress before the amendments made by the Revenue Act of 1978, these two bills were signed into law by the President in reverse of the order these bills were passed by Congress.[1]

Reasons for change

The order of enactment of the Revenue Act of 1978 and the Energy Tax Act of 1978 technically may have caused the 10-percent credit to again be temporary. The bill corrects this unintended result.

Explanation of provision

The bill directs that, for purposes of applying the amendments made to the investment credit provisions by these two laws, the Energy Tax Act of 1978 will be deemed to have been enacted first. As a result, the 10-percent credit rate will be permanent as was intended by the Revenue Act of 1978.

Effective date

The provision takes effect as if enacted as part of the Revenue Act of 1978.

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[1] The Revenue Act of 1978 (P.L. 95-600) was signed into law first, on November 6, 1978, and the Energy Tax Act of 1978 (P.L. 95-618) was then signed into law on November 9, 1978.

2. Technical Amendments Relating to Individual Income Tax Reductions and Extensions

a. Eligibility for earned income credit for persons claiming section 913 deductions (sec. 101(a)(1) of the bill and sec. 43(c)(1) of the Code)

Present law

Under present law, the earned income credit is not available to taxpayers who are entitled to exclude amounts from income under section 911 (relating to income earned by certain employees in camps) or section 931 (relating to income from sources within the possessions of the United States) for the taxable year. This provision affects only those taxpayers who lived abroad during part of the year since the earned income credit generally is not available to those taxpayers whose principal place of abode for the taxable year is outside the United States.

Reasons for change

The Foreign Earned Income Act of 1978 established a new set of deductions under section 913 of the Code which generally are available to those taxpayers who formerly were entitled to the section 911 exclusion. The committee believes that the credit should continue to be unavailable to the same type of taxpayers who formerly were denied the credit because they qualified for the section 911 exclusion.

Explanation of provision

The bill denies the earned income credit to taxpayers who claim deductions under section 913, as well as to those who claim the benefits of sections 911 or 931.

Effective date

The amendment made by this provision applies to taxable years beginning after December 31, 1977.

b. Treatment of earned income credit as earned income under AFDC and SSI (secs. 101(a)(2) (A) and (B) of the bill and secs. 402 and 1612 of the Social Security Act)

Present law

Under present law, the earned income credit is not taken into account as income for purposes of determining eligibility for, or the amount of, benefits or assistance under any Federal program or State or local program that is financed in whole, or in part, with Federal funds.

Reasons for change

The Revenue Act of 1978 repealed the provisions of present law requiring that the earned income credit be disregarded for purposes of Federal or Federally-aided assistance programs, effective in 1980.

However, conforming changes were not made to the Social Security Act.

Explanation of provision

The bill amends the Social Security Act to provide that the earned income credit would be treated as earned income for purposes of the aid to families with dependent children (AFDC) and supplemental security income (SSI) programs. This treatment applies both to any advance payments made by an employer and to any refund of Federal taxes made by reason of the earned income credit (because the actual credit for a year is larger than the total amount of advance payments for that year). Language is added to the bill as passed by the House of Representatives to make clear that, if advance payments of the earned income credit exceed the actual credit, so that the individual must return the difference, an appropriate reconciling increase in AFDC or SSI benefits would be made by the welfare agency. This increase could be computed, for example, by reducing by this difference the amount of earned income that is taken into account for purposes of these programs in the month the difference is returned; the increase would be equal to the amount of benefits lost in the previous year because of the excess advance payments.

Effective date

The amendments made by these provisions apply to payments for months beginning after December 31, 1979.

c. Correction of effective date for advance payment of earned income credit (sec. 101(a)(2)(C) of the bill and sec. 105(g)(2) of the Act)

Present law

The Revenue Act of 1978 contained a new provision allowing employees to elect to have advance payments of the earned income credit added to their paychecks each pay period. In order to give employers time to implement procedures necessary to accommodate for the advance payment of the earned income credit to their employees, the Congress intended this provision to be effective with respect to wages paid after June 30, 1979.

Reasons for change

Dut to a typographical error, the Act referred to wages paid after June 30, 1978.

Explanation of provision

The bill corrects a typographical error in the Act to provide that the provision is effective with respect to wages paid after June 30, 1979.

The committee believes that the Secretary should interpret the statute in a manner that will address the problems which occur in giving advance payments to agricultural workers in the field. Specifically, the committee believes that employers should not be required to make advance payments to these workers when they are paid on a daily basis because of the administrative difficulties employers would encounter in trying to maintain a list of all workers who had filed advanced payment certificates and, in having each day, every crew leader compare the name of every worker being paid to the names on

this list. Since these workers are not now subject to mandatory income tax withholding, employers are not required to consult similar records (withholding, i.e., allowance certificates) in computing net pay. In view of the potential administrative burden, the committee believes that employers should not be required to make advance payments to these workers paid on a daily basis and not subject to mandatory income tax withholding

Effective date

The amendment made by this provision would be effective upon enactment and would apply with respect to wages paid after June 30, 1979.

d. Clerical amendment to earned income credit (sec. 101(a)(2)(D) of the bill and sec. 43(h) of the Code)

The bill redesignates subsection (h) of section 43 (relating to coordination with advance payments of earned income credit) as subsection (g).

e. Relationship of section 85 of the Code to railroad unemployment compensation (sec. 101(a)(3) of the bill and sec. 128(a)(8) of the Code)

Present law

Prior to the Revenue Act of 1978, unemployment compensation was not includible in gross income. The Act made all types of unemployment compensation paid under government programs includible in gross income for taxpayers with incomes above specified amounts (Code sec. 85), effective for payments of unemployment compensation made after December 31, 1978.

Reasons for change

The Code contains a cross reference indicating that the exclusion of railroad unemployment compensation from gross income is determined by a provision of the Railroad Unemployment Insurance Act. However, because the Congress intended railroad unemployment compensation insurance benefits to be treated in a manner similar to other types of unemployment compensation paid under government programs, this cross reference is no longer accurate.

Explanation of provision

The bill modifies the existing cross reference to make it clear that railroad unemployment compensation benefits are includable in gross income for certain taxpayers in a manner similar to all other unemployment compensation benefits paid under government programs.

Effective date

The amendment made by this provision applies to payments of railroad unemployment compensation insurance benefits made after December 31, 1978.

3. Technical Amendments Relating to Deferred Compensation and ESOP Provisions

a. Extension of deferred compensation rules to certain rural electric cooperatives and their trade organizations (sec. 101 (a)(4) of the bill and sec. 457(d)(9)(B) of the Code)

Present law

The Revenue Act of 1978 provided that employees and independent contractors who provide services for a State or local government, a rural electric cooperative (described in section 501(c)(12)), or an association of such cooperatives, that maintains an eligible deferred compensation plan will be able to defer the inclusion in income of compensation deferral meets certain requirements.

Reasons for change

The 1978 Act provision did not apply to certain rural electric cooperatives in the Tennessee Valley Authority ("TVA") area which are exempt from taxation under section 501(c)(4) (but which, generally because of TVA requirements, cannot meet all the requirements for exemption under section 501(c)(12)). In addition, the provision did not apply to certain national and State associations of rural electric cooperatives because some of their members are not domestic rural electric cooperatives and because some of the organizations are exempt from taxation as social welfare organizations (described in sec. 501(c)(4)) rather than as trade associations (described in sec. 501(c)(6)). The committee believes that these omissions were inadvertent and that the provision should apply to these organizations.

Explanation of provision

The bill provides that the types of rural electric organizations eligible for the deferred compensation rules include (1) any organization which is exempt from tax under section 501(a) and which is engaged primarily in providing electric service on a mutual or cooperative basis,[1] and (2) any organization described in section 501(c)(4) or (6) which is exempt from tax under section 501(a) and at least 80 percent of the members of which are rural electric cooperatives which are eligible for these rules.

Effective date

This provision is effective as if it had been included in section 457 of the Code by section 131 of the Revenue Act of 1978. Thus, any plan to which section 457 applies by virtue of this provision will have until January 1, 1982, to satisfy the plan requirements for classification as an eligible State deferred compensation plan. However, the limitations on amounts that can be deferred under such a plan will apply for all taxable years beginning after December 31, 1978.

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[1] This provision is not intended to have any effect on the issue of whether a rural electric cooperative which is not described in section 501(c)(12) may qualify for tax exempt status under section 501(a) as an organization described in section 501(c)(4).

b. Deferral of effective date of deduction timing rules relating to deferred compensation payments to independent contractors (sec. 101(a)(5)(A) of the bill and secs. 404(b) and (d) of the Code)

Present law

Prior to the Revenue Act of 1978, section 404(a)(5) of the Code provided that where an employer deferred payment of compensation to an employee pursuant to a nonqualified plan, the employer could deduct the compensation only in the year in which the compensation was includible in the employee's gross income. If the payment was not made pursuant to a qualified plan, but pursuant to a "method of employer contributions or compensation [having] the effect of a stock bonus, pension, profit-sharing, or annuity plan, *or similar plan* deferring the receipt of compensation . . .," the deduction-timing limitations of section 404(a) were also applicable (italics added).

Section 133 of the 1978 Act added a new Code section 404(d) which extends the deduction-timing limitation of section 404(a) to payments of deferred compensation made to independent contractors. Section 133 of the 1978 Act also amended section 404(b) by changing the word "or similar plan" to read "or other plan." These amendments apply to deductions for taxable years beginning after December 31, 1978.

Reasons for change

The Lawyers' Title Guaranty Fund (the Fund) is an unincorporated business trust whose members consist of almost 6,000 Florida lawyers. The Fund issues title insurance policies on the basis of title examinations made by the lawyer-members. Under the agreement between the lawyers and the Fund, the payment by the Fund to lawyer-members on account of their issuance of title policies is deferred for 7 years, the period of adverse possession under Florida law. One of the principal reasons for this deferral of payment is that retention of these amounts due for commissions serves to provide a more adequate financial base to provide security to policyholders. In *Lawyers' Title Guaranty Fund* v. *United States*, 508 F. 2d 1 (5th Cir. 1975), the court held that the obligations of the Fund to lawyer-members were deductible by the Fund as ordinary and necessary business expenses in the year of the issuance of the policy. This decision was accepted by the Internal Revenue Service in Rev. Rul. 77–266, 1977–2 C.B. 236.

Nonetheless, the changes made by the 1978 Act would disallow any deduction for amounts due to lawyer-members of the Fund until the amounts are made available to lawyer-members after the 7-year period of limitations in Florida. The resulting tax on these amounts would decrease the necessary reserves of the Fund since it is not possible to increase the premium rates of title insurance to the home buyers for policies sold during 1979. This could adversely affect the security of the home buyers.

Accordingly, the committee believes that it is appropriate to delay the effective date of the change made by the 1978 Act in this case for one year until taxable years beginning after December 31, 1979. This one-year delay will provide the Fund adequate time to restructure their handling of the commissions on title insurance.

Explanation of provision

The bill provides that of the changes made by section 133 of the Revenue Act of 1978 are to apply to taxable years beginning after December 31, 1979, in the case of a qualified title insurance company plan. A qualified title insurance company plan is a plan which defers the payment of amounts credited by a qualified title insurance company to separate accounts for members of the company in consideration of their issuance of policies of title insurance and under which no part of the credited amounts is payable to or withdrawable by the members until after the period for the adverse possession of real property under applicable State law. A qualified title insurance company is defined to mean an unincorporated title insurance company organized as a business trust which is engaged in the business of providing title insurance coverage on interest in and liens upon real property obtained by clients of the members of the company and which is subject to tax under section 831 of the Internal Revenue Code of 1954.

Effective date

This amendment is effective as if it were included in the Revenue Act of 1978.

c. Nondiscriminatory participation requirements for cafeteria plans (sec. 101(a)(6)(A) of the bill and sec. 125(g)(3)(B) of the Code)

Present law

Prior to the Revenue Act of 1978, if a cafeteria plan was in existence on June 27, 1974, a participant in the plan was taxable only to the extent the participant elected taxable benefits under the plan. The 1978 Act made this favorable tax treatment applicable to all cafeteria plans meeting certain nondiscrimination standards, including a standard regarding the maximum number of years of employment which may be required as a condition of plan participation.

Reasons for change

The committee believes that the use of the term "service requirement" in the cafeteria plan participation eligibility rules might lead taxpayers to believe that hours of service must be counted as they are under the qualified retirement plan participation rules (Code sec. 410(a)).

Explanation of provision

The bill makes it clear that the cafeteria plan participation standard is based on years of employment rather than years or hours of service. The committee expects that the Treasury Department will prescribe by regulation what constitutes a year of employment.

Effective date

This provision applies for plan years beginning after December 31, 1978.

d. Effective date of cafeteria plan provisions (sec. 101(a)(6)(B) of the bill and sec. 134(c) of the Act)

Present law

Under the cafeteria plan rules added by the Revenue Act of 1978, amounts required to be included in income by a highly-compensated participant because the plan does not satisfy nondiscrimination standards will be treated as received or accrued in the participant's taxable year in which the plan year ends. The cafeteria plan rules are effective for taxable years beginning after December 31, 1978.

Reasons for change

Because the cafeteria plan rules apply to participants' taxable years beginning after December 31, 1978, amounts contributed during 1978 under a cafeteria plan which has a fiscal plan year and which does not satisfy the new nondiscrimination rules might have to be included in income by certain participants in 1979. Thus, in certain cases, the cafeteria plan rules apply retroactively.

The committee does not believe that the cafeteria plan rules should cause amounts contributed in 1978 under a cafeteria plan which was

in existence on June 27, 1974, to be included in income. In addition, the committee believes that cafeteria plans in existence on June 27, 1974, should not have to be amended retroactively to comply with the new rules contained in the Revenue Act of 1978.

Explanation of provision

The bill makes the cafeteria plan provisions of the Revenue Act of 1978 effective for plan years, rather than for participants' taxable years, beginning after December 31, 1978. Thus, highly compensated participants in fiscal year plans will not have income solely because of the new cafeteria plan rules until 1980. In addition, to comply with the cafeteria plan rules, amendments to plans will not have to be effective before the beginning of the first plan year after 1978.

Effective date

This provision is effective as if it had been included in the Revenue Act of 1978 as enacted.

e. Employee stock ownership plan name change (sec. 101(a)(7)(L) of the bill and secs. 48, 409A, 4975, etc of the Code)

Present law

Under the Revenue Act of 1978, the type of plan previously referred to as a TRASOP (or investment tax credit ESOP) was designated as an ESOP. The type of plan previously referred to as an ESOP or leveraged ESOP was designated as a leveraged employee stock ownership plan.

Reason for change

The committee has determined that the names given the respective tax-qualified employee stock ownership vehicles by the 1978 Act do not adequately describe the types of plans involved. Accordingly, the committee has decided to give each of these plans a new name which it considers more appropriate.

Explanation of provision

Under the bill, an investment tax credit ESOP or ESOP (as defined in the 1978 Act) is renamed "tax credit employee stock ownership plan," (commonly referred to as a TRASOP). Under the bill, a leveraged employee stock ownership plan is renamed "employee stock ownership plan" (commonly referred to as an ESOP).

Effective date

The amendment made by this section is effective as if it had been included in section 141 of the Revenue Act of 1978.

f. Clercial amendments relating to normalization of the investment tax credit for contributions to a tax credit employee stock ownership plan (sec. 101(a)(7)(A) of the bill and sec. 46(f)(9) of the Code)

Section 101(a)(6)(A) of the bill corrects section 46(f)(9) of the Code by striking out "subparagraph (B) of subsection (a)(2)" each place it appears and inserting in lieu thereof "subparagraph (E) of subsection (a)(2)" and by striking out "an employee stock ownership plan which meets the requirements of section 301(d) of the Tax Re-

duction Act of 1975" in subparagraph (A) and inserting in lieu thereof "a tax credit employee stock ownership plan which meets the requirements of section 409A".

g. Effective dates for tax credit employee stock ownership plans and employee stock ownership plans (sec. 101(a)(7)(B) of the bill and sec. 141(g) of the Act)

Present law

Under present law, the rules governing tax credit employee stock ownership plans and employee stock ownership plans, as enacted by the Revenue Act of 1978, are effective with respect to qualified investment for taxable years beginning after December 31, 1978.

Reasons for change

The application of the general effective date was unclear with respect to several of the changes relating to tax credit employee stock ownership plans and employee stock ownership plans.

Explanation of provision

The bill clarifies the operation of the effective date provision of section 141 of the Revenue Act of 1978, which made changes in the law governing tax credit employee stock ownership plans and employee stock ownership plans. The general effective date is retained. Thus, the tax credit employee stock ownership plan changes in the 1978 Act generally apply with respect to qualified investment for taxable years beginning after December 31, 1978. In addition, special effective date provisions apply to the tax credit employee stock ownership plan provisions of the Act relating to (1) voting rights, (2) the right of a tax credit employee stock ownership plan to distribute cash in lieu of employer securities (subject to the right of a participant to demand a distribution in the form of employer securities), and (3) put option requirements.

The voting rights provision applies to plans to which the new tax credit employee stock ownership plan provisions generally apply beginning with the first day of such application. A tax credit employee stock ownership plan is required to follow the new voting rights passthrough rules with respect to all employer securities held by it if additional employer securities were acquired by the tax credit employee stock ownership plan on account of qualified investment made in a taxable year beginning after December 31, 1978.

The right of a tax credit employee stock ownership plan to distribute cash in lieu of employer securities (subject to the right of a participant to demand a distribution in the form of employer securities) applies to tax credit employee stock ownership plan distributions after December 31, 1978, provided that the new tax credit employee stock ownership plan rules have become applicable to the plan.

The tax credit employee stock ownership plan put option requirements apply to employer securities which are not readily tradable on an established market and which are acquired by the tax credit employee stock ownership plan after December 31, 1978, on account of a qualified investment made after that date. Your committee deleted the House-passed provision which provided that the employer is permitted to elect to have the 1978 Act put option rules in the Act apply to all employer securities held by the tax credit employee stock ownership plan which are not readily tradable on an established market.

The House-passed provision provided that the election could be revoked only with the consent of the Secretary. Your committee deleted the House-passed provision, which allows an employer to elect to have the new put option rules apply to all employer securities held by a tax credit employee stock ownership plan which are not readily tradable on an established market, because it understands that the Secretary of the Treasury has existing authority to allow the election and the revocation of the election of the 1978 Act put option rules with respect to employer securities held by a tax credit employee stock ownership plan.

The bill as passed by the House also allows taxpayers to elect irrevocably to accelerate the general effective date by a year. In such a case, the tax credit employee stock ownership plan changes would apply with respect to qualified investment for taxable years beginning after December 31, 1977. The committee amended this provision to require that, with respect to a tax credit employee stock ownership plan in existence on December 31, 1978, if such an election is made, contributions for the year of the election would have to be allocated under the pre-1978 Act rules. The committee was concerned that an election by a tax credit employee stock ownership plan in existence on December 31, 1978, to have the 1978 Act tax credit employee stock ownership plan rules apply one year early would allow an employer to change the allocation formula, with the result that some employees covered by the tax credit employee stock ownership plan who would have been entitled to an allocation of employer securities to their accounts under the pre-1978 Act tax credit employee stock ownership plan rules would be denied the allocation because of the retroactive election of the 1978 Act tax credit employee stock ownership plan rules.

The bill also would provide effective dates for the changes made by the 1978 Act relating to employee stock ownership plans. These changes concern (1) voting rights, (2) put option requirements, and (3) the right of an employee stock ownership plan to distribute cash in lieu of employer securities (subject to the right of a participant to demand a distribution in the form of employer securities).

Under the bill, in the case of qualifying employer securities acquired by an employer stock ownership plan after December 31, 1979, the plan is required (1) to pass through voting rights to plan participants on such securities, under certain circumstances, and (2) to give participants put options on qualifying employer securities which are not readily tradable on an established market. The committee expects that, under regulations prescribed by the Secretary of the Treasury, an employee stock ownership plan could treat qualifying employer securities acquired by it prior to January 1, 1980, under the new voting rights and put option provisions, but is not required to do so.

The right of an employee stock ownership plan to distribute cash in lieu of employer securities (subject to the right of a participant to demand a distribution in the form of employer securities) applies to distributions made after December 31, 1978. (Under the House-passed bill the effective date for such cash distributions from employee stock ownership plans was December 31, 1979.)

Effective date

The amendment made by this section is effective as if it had been included in section 141 of the Revenue Act of 1978.

h. Definition of qualifying employer security for employee stock ownership plans (sec. 101(a)(7)(C) of the bill and sec. 4975 (e)(8) of the Code)

Present law

Under present law, employee stock ownership plans are subject to certain special rules with respect to qualifying employer securities held by the plans.

Reasons for change

The Revenue Act of 1978 made certain changes in the rules governing employee stock ownership plans. Because of these changes, the definition of qualifying employer securities, as it relates to such plans, is unclear.

Explanation of provision

The bill clarifies that, for purposes of the rules governing employee stock ownership plans, the term "qualifying employer securities" is defined in the same manner as the term "employer securities" in the case of tax credit employee stock ownership plans. This definition generally includes readily tradable common stock of the employer and preferred stock convertible into such readily tradable common stock.

Effective date

This provision applies to stock acquired after December 31, 1979.

i. Nonrecognition of gain or loss on contribution to tax credit employee stock ownership plans (sec. 101(a)(7)(D) of the bill and sec. 409A(m) of the Code)

Present law

Generally, under present law, no gain or loss would be recognized by a corporation which makes a required contribution to a tax credit ownership plan of employer securities issued by a related corporation.

Reasons for change

For technical reasons, this rule, as enacted by the Revenue Act of 1978, did not apply to all required contributions of such employer securities to a tax credit employee stock ownership plan.

Explanation of provision

The bill provides that no gain or loss is recognized by an employer on the required transfer of employer securities to a tax credit employee stock ownership plan which it maintains.

Effective date

The amendment is effective with respect to qualified investment for taxable years beginning after December 31, 1978.

j. Employee stock ownership plans may distribute cash in certain cases (sec. 101(a)(7)(E) of the bill and sec. 409A(h)(2) of the Code)

Present law

Under present law, employee stock ownership plans are required to meet certain rules also applicable to tax credit employee stock ownership plans. These rules relate to the pass-through of voting rights to participants and to participants' rights to demand employer securities.

Reasons for change

Under the Revenue Act of 1978, it was not clear whether an employee stock ownership plan which meets these rules may distribute cash in lieu of employer securities to a participant entitled to a distribution from the plan.

Explanation of provision

The bill clarifies that, like a tax credit employee stock ownership plan, an employee stock ownership plan may (subject to a participant's right to require a distribution in the form of employer securities) distribute cash in lieu of employer securities to a participant entitled to a distribution from the plan.

Effective date

This provision is effective with respect to distributions made after December 31, 1978.

k. Matched employer and employee contributions must stay in plan (sec. 101(a)(7)(F) of the bill and sec. 409A(d) of the Code)

Present law

Under present law, employer securities allocated to a participant's account under a tax credit employee stock ownership plan cannot be distributed from that account for an 84-month period. Prior to the Revenue Act of 1978, this rule applied to securities contributed by the employer attributable to the additional one percent investment tax credit and to securities attributable to matched employer and employee contributions under the additional one-half percent investment tax credit rules.

Reasons for change

Under the Revenue Act of 1978, it is unclear whether the rule applies to securities attributable to matched employer and employee contributions.

Explanation of provision

The bill clarifies that the rule requiring matched employer and employee contributions to a tax credit employee stock ownership plan to remain in the plan for an 84-month period is still applicable. This is consistent with the provisions of the 1978 Act which continue the pre-1978 Act rule that employer contributions to a tax credit employee stock ownership plan may be made for the taxable year in which the additional investment tax credit is allowed regardless of when timely matching employee contributions are made.

Effective date

This provision is effective with respect to qualified investment for taxable years beginning after December 31, 1978.

l. Amount of matching employer contributions to a tax credit employee stock ownership plan (sec. 101(a)(7)(G) of the bill and sec. 48(n)(1)(B) of the Code)

Present law

Under present law, a corporate employer is entitled to an additional percentage point of investment tax credit (i.e., 11 percent rather than

10 percent) if it contributes an amount equal to the additional credit to a tax credit employee stock ownership plan. In addition to the one-percent credit, up to ½ percent of extra investment tax credit is allowed where an employer contributes the extra credit amount to the tax credit employee stock ownership plan, and the employer's extra contribution is matched by employee contributions.

Reasons for change

The provisions relating to tax credit employee stock ownership plans, as amended by the Revenue Act of 1978, do not provide for a limitation on the amount of employee contributions which must be matched by the employer as a condition of taking the extra investment tax credit.

Explanation of provision

Under the bill, an employer is eligible for an extra investment tax credit attributable to matching employee contributions if it transfers to the tax credit employee stock ownership plan employer securities having an aggregate value equal to the lesser of (1) the total matching employee contributions or (2) ½ percent of its qualified investment for the taxable year.

Effective date

The amendment made by this section is effective as if it had been included in section 141 of the Revenue Act of 1978.

m. Time for contribution of matching employer contributions to a tax credit employee stock ownership plan (sec. 101(a)(7)(H) of the bill and sec. 48(n)(1)(C) of the Code)

Present law

Under present law, a corporate employer is entitled to an additional percentage point of investment credit (11 percent rather than 10 percent) if it contributes an amount equal to the additional credit to a tax credit employee stock ownership plan. In addition to the one-percent credit, up to ½ percent of extra investment tax credit is allowed where an employer contributes the extra credit amount to the tax credit employee stock ownership plan and the employer's extra contribution is matched by employee contributions.

Generally, to be eligible for the additional tax credit, employee contributions of cash or pledges must be received by the due date (including extensions) for filing the employee's tax return for the taxable year and the employer is required to transfer employer securities or cash to the tax credit employee stock ownership plan not later than 30 days after the due date (including extensions) for filing the employer's return for the taxable year.

Reasons for change

It is unclear whether the employer could transfer employer securities or cash to a tax credit employee stock ownership plan with respect to the extra ½ percent investment tax credit at a time later than 30 days after the due date (including extensions) for filing the employer's return for the taxable year for which the employer claims the additional one-percent credit with respect to employee contributions made after that date.

Explanation of provision

The bill makes it clear that the Secretary may, by regulations, provide that the matching employer contributions to a tax credit employee stock ownership plan could be made later than 30 days after the due date (including extensions) for filing the employer's return for the taxable year for which the employer claims the additional one-percent credit, provided that the employer did not claim a credit for the matching employer contribution for the taxable year and provided that such matching employer contributions are made with respect to matching employee contributions made after the due date for the return.

Effective date

The amendment made by this section is effective as if it had been included in section 141 of the Revenue Act of 1978.

n. Time for establishing a tax credit employee stock ownership plan (sec. 101(a)(7)(I) of the bill and sec. 409A(f)(1) of the Code

Present law

Prior to the Revenue Act of 1978, a tax-qualified plan had to be established by the close of the first taxable year for which the employer maintaining the plan claimed a deduction or credit for a plan contribution. Many tax credit employee stock ownership plans are not established until the income tax filing deadline (including extensions) for the first taxable year for which the employer maintaining the plan first claims an additional investment tax credit with respect to the plan. Prior to the Revenue Act of 1978, this caused many tax credit employee stock ownership plans not to be tax-qualified for the first year of their existence.

The Revenue Act of 1978 required tax credit employee stock ownership plans to be tax-qualified. It also created an exception for tax credit employee stock ownership plans from the general rule requiring tax-qualified plans to be established by the close of the first taxable year for which an employer claims a deduction or credit for a plan contribution.

Reasons for change

While the Revenue Act of 1978 relieved tax credit employee stock ownership plans of the requirement that a tax-qualified plan be established by the close of the first taxable year for which an employer maintaining the plan claims a deduction or credit for a plan contribution, the 1978 Act was not clear as to the date by which a tax credit stock ownership plan does have to be established for the first year of its existence.

Explanation of provision

Under the bill, a tax credit employee stock ownership plan does not have to be established by the close of the first taxable year for which the employer maintaining the plan claims an additional investment tax credit with respect to the plan. However, in order for the tax credit employee stock ownership plan to be tax-qualified for the first year of its existence as required under present law, it must be established

by the income tax filing deadline (including extensions) for the first taxable year for which the employer maintaining the plan claims an additional investment tax credit with respect to the plan.

Effective date

The amendment made by this section is effective as if it had been included in section 141 of the Revenue Act of 1978.

o. Definition of employer securities for tax credit employee stock ownership plan and employee stock ownership plan purposes (sec. 101(a)(7)(J) of the bill and sec. 409A(l) of the Code)

Present law

Under present law, in the case of a tax credit employee stock ownership plan, the only types of employer securities which may be acquired and held by the plan are (1) common stock of the corporation which is readily tradable on an established securities market and (2) noncallable preferred stock of the issuing corporation which is readily convertible into such common stock. The shares acquired by a tax credit employee stock ownership plan, other than shares which are readily tradable on an established securities market, must have a combination of (1) voting rights equivalent to rights possessed by shareholders of the class of common stock of the issuing corporation having the greatest voting rights and (2) dividend rights equivalent to rights possessed by shareholders of that class of stock of the issuing corporation having the greatest dividend rights.

Reasons for change

The committee believes that a technical correction to the definition of qualifying employer securities with respect to tax credit employee stock ownership plans and employee stock ownership plans is necessary to make it clear (1) that where an employer contributes securities which are not readily tradable on an established securities market, the securities must have a combination of voting power and dividend rights equal to or in excess of the greatest voting power and dividend rights of any classes of common stock of the corporation; (2) that preferred stock convertible to such common stock which is not readily tradable could be contributed; and (3) that noncallable preferred stock would include stock which could be called provided that the holder of the stock could receive other employer securities either by conversion or in exchange for the securities surrendered pursuant to the call.

Explanation of provision

The bill makes three changes to the definition of employer securities which are applicable to both tax credit employee stock ownership plans and employee stock ownership plans.

First, the bill makes it clear that where the employer does not have a class of common stock which is readily tradable on an established market, the employer can contribute stock having a combination of voting power and dividend rights at least equal to the greatest voting power and dividend rights of any classes of common stock of the corporation.

Second, the bill makes it clear that the definition of employer securities includes preferred stock which is convertible into such common stock which is not readily tradable.

Third, the bill provides that, under regulations to be issued by the Secretary, preferred stock is to be treated as noncallable if, after the call, the holder of the securities has a reasonable opportunity to convert the securities to common stock. The committee also intends that preferred stock will be treated as noncallable if, pursuant to the call the holder of the securities receives solely employer securities in exchange for the securities.

These changes to the definition of employer securities for the purpose of employee stock ownership plans, as well as the Technical Corrections Act provision which conforms the definition of qualifying employer securities for the purpose of employee stock ownership plans to the definition of employer securities for the purpose of tax credit employee stock ownership plans, are intended to make no change in the status of qualifying employer securities contributed to employee stock ownership plans before December 31, 1979, the general effective date of the 1978 Act changes affecting employee stock ownership plans.

Under the House bill, the definition of employer securities with respect to an employee stock ownership plan is the same as the definition of employer securities with respect to a tax credit employee stock ownership plan.

Effective date

The amendment made by this section is effective as if it had been included in section 141 of the Revenue Act of 1978.

p. Voting rights for participants in employee stock ownership plans (sec. 101(a)(7)(K) of the bill and sec. 4975(e)(7) of the Code)

Present law

Under the Revenue Act of 1978, an employee stock ownership plan is required to pass through to plan participants voting rights with respect to qualifying employer securities held by the plan. If the plan is maintained by an employer which has a registration-type class of securities, the vote pass-through requirement applies generally. If the plan is maintained by an employer which does not have a registration-type class of securities, the vote pass-through requirement applies only with respect to major corporate issues (e.g., mergers, consolidations, sales of substantially all of a corporation's assets).

Also, under the Revenue Act of 1978, a defined contribution plan which is established by an employer the stock of which is not publicly traded is required to pass through to plan participants voting rights on major corporate issues. This vote pass-through applies only if, after December 31, 1979, the plan acquires securities of the employer and, after the acquisition, more than 10 percent of the plan's assets are invested in such securities.

Reasons for change

Under the Revenue Act of 1978, an employee stock ownership plan maintained by an employer the stock of which is not publicly traded

may be subject to vote pass-through rules with respect to employer securities under two separate provisions of the Code. The committee believes that this duplication should be eliminated by deleting the special vote pass-through rule for employee stock ownership plans maintained by an employer which does not have a registration-type class of securities.

Explanation of provision

Under the bill, an employee stock ownership plan maintained by an employer which does not have a registration-type class of securities will be required to pass through voting rights to plan participants only under the vote pass-through rule generally applicable to defined contribution plans. Thus, the vote pass-through will be required only (1) with respect to major corporate issues, (2) if the plan is maintained by an employer the stock of which is not publicly traded, and (3), if after acquiring securities of the employer, more than 10 percent of the plan's assets are in such securities.

Effective date

The amendment made by this section is effective as if it had been included in section 141 of the Revenue Act of 1978.

q. Coordination of deduction for estate tax attributable to income in respect of a decedent and income tax on lump sum distributions from retirement plans (sec. 101(a)(8)(A) of the bill and sec. 691(c)(5) of the Code)

Present law

Under present law, lump sum distributions from qualified pension, profit-sharing, and stock bonus plans are eligible for special income tax treatment. With respect to the portion of the distribution attributable to the employee's participation in the plan after December 31, 1973, a special 10-year averaging formula is provided. With respect to the portion of the distribution attributable to the employee's participation before January 1, 1974, capital gain treatment generally is allowable.

When a beneficiary receiving a lump sum distribution on account of the death of an employee elects to be taxed under the 10-year averaging rules, the distribution is includible in the deceased employee's gross estate and the amount of the distribution is subject to an estate tax. The recipient of the distribution is allowed a separate income tax deduction for the death taxes attributable to that distribution (Code sec. 691(c)).

The Revenue Act of 1978 added a provision which coordinated this deduction for estate taxes with the capital gain deduction so that the amount of any capital gain which is income in respect of a decedent is offset by the deduction for estate taxes before the capital gain deduction is computed.

Reasons for change

The Revenue Act of 1978 did not provide a rule to coordinate the use of the special 10-year forward income averaging method with the deduction for estate taxes.

Explanation of provision

The bill provides that the amount of a death benefit distribution subject to 10-year averaging is reduced by the amount of the death tax deduction attributable to the distribution. This will have the effect of reducing the amount of the distribution eligible for the special 10-year averaging formula by the death tax adjustment. This provision will not affect the computation of the minimum distribution allowance (under Code sec. 402(e) (1) (D)).

Effective date

The provision applies with respect to estates of decedents dying after the date of enactment of the bill.

r. Unrealized appreciation in employer securities (sec. 101(a) (8)(B) of the bill and sec. 2039(f)(2) of the Code)

Present law

Prior to the Revenue Act of 1978, lump sum death benefit distributions from tax-qualified pension, etc., plans were includible in the deceased plan participant's gross estate for Federal estate tax purposes. The 1978 Act provided for an estate tax exclusion for such a distribution provided the recipient elects to forego favorable income tax treatment of the distribution.

Reasons for change

Under the Revenue Act of 1978, it is not clear whether the recipient of a lump sum death benefit distribution from a tax-qualified pension, etc., plan, who elects to forego favorable income tax treatment of the distribution in order for the distribution to be excludible from the deceased plan participant's gross estate for Federal estate tax purposes, may exclude from gross income the net unrealized appreciation on any employer securities distributed from the plan.

Explanation of provision

The bill makes it clear that, if an individual receives a lump sum death benefit distribution from a tax-qualified pension, etc., plan and elects to forego favorable income tax treatment of the distribution in order for the distribution to be excluded from the deceased plan participant's gross estate for Federal estate tax purposes, the election will not preclude the recipient from excluding from gross income the net unrealized appreciation on any employer securities distributed from the plan.

Effective date

The amendment made by this section is effective as if it had been included in section 142 of the Revenue Act of 1978.

s. Clerical amendment relating to voting rights on employer securities held by qualified plans and other clerical amendments (secs. 101(a)(7)(M) and (a)(9) of the bill and secs. 46 (a)(2)(E), 48(n)(2)(B), 48(o)(5), and 401(a)(22) of the Code)

Section 101(a) (7) (M) (i) of the bill corrects section 46(a) (2) (E) of the Code by inserting "and ending on" before "December 31, 1983" each place it appears.

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Section 101(a)(7)(M)(ii) of the bill corrects section 48(n)(2)(B) of the Code by striking clause (ii). The Committee believes this clause is redundant because, under the 1978 Act, tax credit employee stock ownership plans must meet the nondiscrimination requirements applicable to qualified plans.

Section 101(a)(7)(M)(iii) of the bill corrects section 48(o) of the Code by inserting "percentage" after "attributable to the matching employee plan."

Section 101(a)(9) of the bill corrects section 401(a)(22) of the Code by striking "as securities" and inserting in lieu thereof "are securities".

4. Technical Amendments Relating to Retirement Plans

a. Exclusion of certain employees from participation in simplified employee pensions (sec. 101(a)(10)(A) of the bill and sec. 408(k)(2) of the Code)

Present law

The Revenue Act of 1978 created a new type of individual retirement plan, known as a simplified employee pension. Employer contributions to simplified employee pensions must not discriminate in favor of employees who are officers, shareholders, or highly compensated. In testing employer contributions for discrimination, certain employees who are included in a collective bargaining unit or who are nonresident aliens may be excluded from consideration. However, the simplified employee pension rules may have required employers to include these employees in the group of employees who are entitled to share in employer contributions to simplified employee pensions.

Reasons for change

The requirement that certain collective bargaining unit employees or nonresident aliens share in employer contributions to simplified employee pensions even though these employees can be excluded from consideration in testing whether simplified employee pensions are discriminatory is inconsistent with the purpose of the simplified employee pension provisions and with the corresponding provisions of the Internal Revenue Code relating to tax-qualified pension plans.

Explanation of provision

The bill permits certain employees who are included in a collective bargaining unit or who are nonresident aliens to be excluded from the group of employees who are entitled to share in employer contributions to simplified employee pensions.

Effective date

The provision applies to taxable years beginning after December 31, 1978. This is the same effective date as was provided by the Revenue Act of 1978 with respect to simplified employee pensions.

b. Exemption from FICA and FUTA taxes for employer contributions to simplified employee pensions (sec. 101(a)(10)(B) of the bills and secs. 3121(a)(5) and 3306(b)(5) of the Code)

Present law

The Revenue Act of 1978 created a new type of individual retirement plan, known as a simplified employee pension. Under present law, employer contributions to an IRA (individual retirement account, annuity, or retirement bond) of an employee are considered remuneration subject to FICA and FUTA taxes, but employer contributions with respect to an employee to a tax-qualified plan are not

subject to these taxes. The 1978 Act did not specify whether employer contributions to a simplified employee pension were subject to FICA or FUTA taxes.

Reasons for change

Employer contributions to a tax-qualified pension plan on behalf of an employee are exempt from FICA and FUTA taxes. The absence of a corresponding exemption for employer contributions to simplified employee pensions is an unintended barrier to the establishment of simplified employee pensions.

Explanation of provision

Under the bill, an amount paid by an employer to an employee's individual retirement account or annuity is not subject to FICA or FUTA taxes if the account or annuity is a simplified employee pension and it is reasonable to believe that the employee will be entitled to deduct the payments under the IRA rules applicable to simplified employee pensions.

Effective date

This provision applies for payments made on or after January 1, 1979. This is the same effective date as was provided by the 1978 Act with respect to simplified employee pensions.

c. Clarification of rules relating to excess contributions to simplified employee pensions (sec. 101(a)(10)(C) of the bill and sec. 408(d)(5)(A) of the Code)

Present law

The rules relating to individual retirement accounts and annuities permit the withdrawal of an excess contribution (other than a rollover contribution) without the usual 10 percent additional income tax on early distributions to the extent no deduction was allowed for the contribution. The early distribution tax applies, however, if the amount contributed for the year exceeds $1,750 and the excess is not withdrawn by the time for filing the tax return for the year of the excess contribution (including extensions). Under present law, deductible contributions to individual retirement accounts and annuities may not exceed $1,750, except in the case of a simplified employee pension where contributions up to $7,500 may be deductible. No dollar limitation applies to an excess rollover contribution. Consequently, if an excess contribution is made by an employer to an individual retirement account or annuity of an employee under the simplified employee pension rules and the amount of the contribution is greater than $1,750, the 10 percent additional income tax could apply if the excess is not withdrawn in time.

Reasons for change

The $1,750 limit of present law is not appropriate for employer contributions to simplified employee pensions because up to $7,500 of such contributions for a taxable year may be deductible.

Explanation of provision

The bill permits an individual to withdraw excess employer contributions to a simplified employee pension free of the 10-percent addi-

tional income tax where the withdrawal does not exceed the amount of the employer contribution or $7,500, whichever is less. The bill does not affect the treatment of contributions other than excess employer contributions.

Effective date

This provision applies for taxable years beginning after December 31, 1978. This is the same effective date as was provided for simplified employee pensions under the Revenue Act of 1978.

d. Contributions to simplified employee pensions after age 70½ (sec. 101(a)(10)(D) of the bill and sec. 219(b)(7) of the Code)

Present law

The Revenue Act of 1978 created a new type of individual retirement plan, known as a simplified employee pension. Under the rules for simplified employee pensions, an employer may be obligated to contribute to the individual retirement account or annuity of an employee who has attained age 70½. Under the usual rules for individual retirement accounts and annuities, such a contribution is includible in the gross income of the employee but the contribution is not deductible by the employee and is considered an excess IRA contribution.

Reasons for change

Contributions by a corporation, a sole proprietorship, or a partnership to a tax-qualified pension plan on behalf of an individual who has attainged age 70½ are deductible (within limits) under present law. The nondeductibility of employer contributions to the simplified employee pension of an employee who has attained age 70½ is an unintended barrier to the establishment of simplified employee pensions.

Explanation of provision

The bill allows an employee who has attained age 70½ to deduct employer contributions to the employee's individual retirement account or annuity if the account or annuity is a simplified employee pension.

Effective date

This provision applies for taxable years beginning after December 31, 1978. This is the same effective date as was provided for simplified employee pensions under the Revenue Act of 1978.

e. Coordination of H.R. 10 plans and subchapter S corporation plans with simplified employee pensions (secs. 101(a)(10)(E) and (F) of the bill and secs. 404(h)(4) and 408(k) of the Code)

Present law

The Revenue Act of 1978 created a new type of individual retirement plan, known as a simplified employee pension. Under the Act, if an employer maintains a defined contribution H.R. 10 plan for a self-employed individual and contributes to a simplified employee pension for that individual, the limitation on the employer's deduction for the contribution to the H.R. 10 plan is reduced by the deduction allowed for

the contribution to the simplified employee pension so that the limitation on the total deductible amount set aside for that individual is not increased.

Reasons for change

The rules for simplified employee plans do not provide for coordination with the rules for defined benefit plans of self-employed individuals or with rules for plans covering shareholder-employees of subchapter S corporations.

Explanation of provision

Under the bill, the limitation on the amount that may be set aside tax free in a defined contribution plan by a subchapter S corporation on behalf of a shareholder-employee is reduced by the amount deducted by the employer for contributions to the simplified employee pension of that employee. Also, the bill does not allow an employer who maintains a defined benefit plan for self-employed individuals or shareholder-employees to contribute to simplified employee pensions.

Effective date

This provision applies to taxable years beginning after December 31, 1978. This is the same effective date as was provided by the Revenue Act of 1978 for simplified employee pensions.

f. Integration of simplified employee pensions with Social Security (sec. 101(a)(10)(G) of the bill and sec. 408(k)(3) of the Code)

Present law

Under present law, employer contributions to the individual retirement accounts or annuities of employees can qualify as employer contributions to the simplified employee pensions of employees if an employer contribution is made to the individual retirement account or annuity of each employee who is entitled to a contribution.[1] Although the employer's contributions must generally bear a uniform relationship to the total compensation of each employee, these contributions can be integrated with the Social Security system. Under the integration rules, which are generally similar to the rules for integrated H.R. 10 plans, if certain requirements are met, the employer contribution on behalf of an employee is reduced by the amount of Social Security tax to be imposed on the employer with respect to the employee's wages. As under an integrated H.R. 10 plan, contributions for owner-employees are reduced by the amount of the self-employment tax imposed on the individual's earnings and, in the case of a self-employed individual other than an owner-employee, by an amount equal to the Social Security tax which would have been imposed if the individual's earnings from self-employment were wages.

Reasons for change

Under the 1978 Act, it is not clear whether an employer could make integrated contributions to the simplified employee pension of an employee while maintaining an integrated qualified pension, profit-sharing, or stock bonus plan for the same employee (possibly reducing the employee's benefits twice with respect to the same benefits or contributions considered to be provided by the employer under Social Security).

Explanation of provision

The bill clarifies present law by providing that an employer may not make integrated contributions to simplified employee pensions for a year in which the employer maintains an integrated pension, etc., plan. Although it is possible to design rules which would permit partial integration of a simplified employee pension where a partially integrated pension, etc. plan is maintained, the committee believes that the complexity of the rules for partial integration would be inconsistent with the committee's intent in providing for simplified employee pensions. The House bill did not include any similar provision.

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[1] Each employee who has (1) attained age 25 and (2) performed service for the employer during any 3 of the immediately preceding 5 calendar years must be entitled to a contribution.

Effective date

The amendment applies for taxable years beginning after December 31, 1978. This is the same effective date as was provided by the Revenue Act of 1978 for simplified employee pensions.

g. Penalty for failure to file reports (secs. 101(a)(10)(H) and 101(b)(1)(F) of the bill and sec. 6693(a) of the Code)

Present law

The rules relating to simplified employee pensions provide that if an employer contributes to a simplified employee pension, the employer may be required by Treasury regulations to file simplified reports with the Internal Revenue Service and to furnish reports to employees.

Reason for change

It is not clear that present law provides a penalty for an employer's failure to file or furnish the reports with respect to simplified employee pensions.

Explanation of provision

The bill provides that a penalty of $10 per report applies to each failure to furnish a report required under the rules for simplified employee pensions, unless the failure is due to reasonable cause. This is the same penalty that is applicable under present law for a trustee's failure to provide certain reports with respect to individual retirement accounts or annuities. The House bill did not include any similar provision.

Effective date

The amendment applies with respect to failures occurring after the date of enactment of the bill.

h. Aggregation of simplified employee pensions (secs. 101(a)(10)(I) and 101(b)(1)(G) of the bill and sec. 415(e)(5) of the Code)

Present law

The Code provides limits on the annual addition to the account of a participant in a profit-sharing or other defined contribution plan. For this purpose, annual additions consist of employer contributions, reallocated forfeitures, and a portion of employee contributions.

The limits are applied to the aggregate of all defined contribution plans maintained by an employer. If the employer is in a controlled group of companies (whether or not incorporated), the limits are applied to the aggregate of all defined contribution plans maintained by the group. Under the rules, employer contributions to the simplified employee pension of an employee are aggregated with other employer contributions to defined contribution plans only if the employee has direct or indirect control of the employer.

Reasons for change

The committee believes that, under the limitation provisions, it is appropriate to treat employer contributions to simplified employee pensions as employer contributions to a defined contribution plan

maintained by the employer regardless of the ownership of the employer or the employer's trade or business.

Explanation of provision

Under the bill, if an employer contributes to a simplified employee pension, the contribution is taken into account as an employer contribution to a defined contribution plan regardless of the ownership of the employer or of the employer's trade or business. The bill does not change the rule of present law under which employee contributions to an individual retirement account or annuity, or a retirement bond are treated as employer contributions to a defined contribution plan maintained by an employer where the employee has the requisite control of the employer. The House bill did not include any similar provision.

Effective date

The amendment applies for years beginning after the date of enactment of the bill.

i. Clerical amendments relating to simplified employee pensions (sec. 101(a)(10)(K) of the bill, secs. 408(j)(1), 404(h)(2), (3), and (4) of the Code, and sec. 152(g)(2) of the Act)

A clerical amendment is made to section 408(j)(1) to remove an unnecessary reference to section 408(b)(5). Clerical amendments are made to sections 404(h)(2), (3), and (4) to correct an inaccurate reference to section 404(h)(1). A clerical amendment is made to section 152(g)(2) of the Revenue Act of 1978 to correct an inaccurate reference to section 415(a)(2) of the Code.

j. Special limits on benefits under certain defined benefit pension plans (sec. 101(a)(11)(A) of the bill and sec. 415(b)(7) of the Code)

Present law

Under the Code, limits are provided for benefits and contributions under tax-qualified plans, individual retirement plans, and tax-sheltered annuities. Generally, under those rules, benefits under a defined benefit pension plan may not exceed 100 percent of a participant's average high 3-year compensation. An exception to the 100-percent limit was provided by the Revenue Act of 1978 for participants in certain collectively bargained plans.

Reasons for change

The 1978 Act did not provide for situations in which an employee participates in more than one plan maintained by a single employer.

Explanation of provision

Under the bill, the exception to the 100-percent limit is restricted to an employee who is a participant in a collectively bargained plan where the employee does not participate in any other plan (subject to the limits on benefits or contributions) maintained by an employer who maintains the collectively bargained plan.

Effective date

This provision applies for years beginning after December 31, 1978. This is the same as the effective date provided by the 1978 Act for the exception to the 100-percent limitation.

k. Limitations for certain collectively bargained pension plans (sec. 101(a)(11)(B) of the bill and sec. 415(b)(7)(C) of the Code)

Present law

Prior to the Revenue Act of 1978, benefits under a qualified defined benefit pension plan generally were limited to the lesser of 100 percent of pay or $75,000 per year, adjusted for inflation since 1974 ($98,100 for 1979). The Act provides that the 100-percent-of-pay limit is disregarded, and the $75,000 limit is reduced to $37,500 (adjusted for inflation since 1974), in the case of certain large collectively bargained plans under which each employee who serves during a particular year earns the same pension credit. Under the 1978 Act, the pension credit for a participant must be determined without regard to age at retirement or date of retirement.

Reasons for change

It was intended that the factors of age at retirement and date of retirement be permitted to be taken into account by a plan under the exception to the 100-percent-of-pay limit.

Explanation of provision

The bill clarifies that the 100-percent-of-pay limit applies in the case of certain large collectively bargained plans where the amount of the pension credit for a particular employee is based solely on one or more of the following factors: (1) the length of service, (2) the particular years during which service was rendered, (3) the age at retirement, and (4) the date of retirement.

Effective date

The provision applies for years beginning after December 31, 1978. This is the same effective date as was provided by the Revenue Act of 1978 for the exception to the 100-percent-of-pay limit.

l. Clerical amendments regarding tax-sheltered annuities (sec. 101(a)(12) of the bill and sec. 403(b)(7) of the Code)

Section 403(b)(7)(A) is amended by striking "which satisfied" and inserting in lieu thereof "which satisfies".

m. Effective date of section 403(b) annuity rollovers and transitional rule for payments received in 1978 (sec. 101(a)(13) of the bill and sec. 156(d) of the Act)

Present law

Prior to the Revenue Act of 1978, recipients of distributions under a tax-sheltered annuity purchased by certain employers which are tax-exempt organizations or public schools were not eligible to defer tax on those distributions by rolling the distributions over to an individual retirement plan (an individual retirement account or annuity, or a retirement bond). The Act permits the recipient of a lump-sum distribution from a tax-sheltered annuity to defer tax on the distribution by rolling it over within 60 days of receipt to an IRA or to another tax-sheltered annuity. Due to a clerical error, as enacted, the rollover provision applies to distributions or transfers made after December 31, 1978, in taxable years beginning after that date.

Reasons for change

The conferees on the Revenue Act of 1978 intended that the tax-sheltered annuity rollover provisions would be available for lump sum distributions received after December 31, 1977. To carry out the original intent of the conferees, the committee believes it is necessary to provide an extended rollover period for recipients of distributions in 1978 who could not have satisfied the requirement that amounts distributed must be rolled over within 60 days of receipt.

Explanation of provision

The bill makes the tax-sheltered annuity rollover provisions effective for distributions or transfers made after December 31, 1977, in taxable years beginning after that date. In addition, the bill provides that the recipient of a qualifying distribution in 1978 will have until December 31, 1980, to complete a rollover to either an IRA or another tax-sheltered annuity. Upon completion of the rollover, the recipient of a qualifying distribution in 1978 will be able to amend his or her 1978 income tax return to take into account the portion of the distribution originally included in income which is no longer subject to tax because of the rollover.

The bill also makes a clerical amendment to Code sections 403(b)(1) and 4973(c)(1) by inserting "409(b)(3)(C)" in lieu of "409(d)(3)(C)".

Effective date

This provision is effective as if it had been included in the Revenue Act of 1978 as enacted.

n. Clerical amendments regarding IRAs (secs. 101(a)(14)(A) and (B) of the bill, sec. 157(h)(3) of the Act, and secs. 219(b)(4), 220(b)(5), 408(a)(1), 409(a)(4), and 4973(b)(1)(A) of the Code)

Section 101(a)(14)(A) of the bill corrects section 157(h)(3) of the 1978 Act by striking out "the amendments made by this section" each place it appears and inserting in lieu thereof "the amendments made by this subsection".

Section 101(a)(14)(B) of the bill corrects sections 219(b)(4), 220(b)(5), 408(a)(1), 409(a)(4), and 4973(b)(1)(A) of the Code by inserting "402(a)(7)," after "section 402(a)(5),".

o. Spousal rollovers (sec. 101(a)(14)(C) of the bill and sec. 402(a)(7)(A) of the Code)

Present law

Under present law, a surviving spouse who receives a lump sum death benefit distribution from a tax-qualified plan is permitted to make a rollover of the distribution to an IRA. Rollovers, however, are not permitted for complete distributions to surviving spouses upon termination of tax-qualified retirement plans.

Reasons for change

The Revenue Act of 1978, as enacted, did not make clear that a distribution to a surviving spouse upon plan termination is eligible for rollover treatment.

Explanation of provision

The bill clarifies that a lump sum distribution from, or complete distribution upon termination of, a qualified plan which is paid to the surviving spouse of a deceased plan participant, and which is attributable to the participant, is eligible for rollover treatment.

Effective date

This provision applies to distributions completed after December 31, 1978, in taxable years ending after that date.

p. Extension of transitional rule relating to removal of five-year requirement for a rollover (sec. 101(a)(14)(D) of the bill and sec. 157(h)(3)(B) of the Act)

Present law

Under present law, generally an individual who receives a lump sum distribution from a tax-qualified retirement plan is eligible to roll over all or a portion of the distibution without regard to the individual's years of participation under the plan.

However, prior to the Revenue Act of 1978, an individual was required to be a participant in a tax-qualified retirement plan for five years in order to qualify for a rollover to an IRA (or to another tax-qualified retirement plan) of a lump sum distribution from the plan. The 1978 Act eliminated this five-year requirement for taxable years beginning after December 31, 1977, and permitted individuals denied the opportunity for a rollover during 1978, because of the five-year requirement, to complete their rollovers at any time before January 1, 1979.

Reasons for change

The committee believes that individuals denied the opportunity for a rollover during 1978 because of the five-year requirement were not given sufficient time after enactment of the Act to complete a rollover.

Explanation of provision

The bill permits individuals denied rollover treatment of distributions from tax-qualified retirement plans during 1978, solely because of the five-year plan participation requirement, to make such rollovers until the end of 1980.

Effective date

This amendment would apply to payments made in taxable years beginning after December 31, 1977.

q. Clerical amendments regarding IRAs (secs. 101(a)(14)(E)(i) and (ii) of the bill and secs. 402(a)(6)(D) and 408(d)(5)(B) of the Code)

Section 101(a)(14)(E)(i) of the bill corrects section 402(a)(6)(D) of the Code by striking "many designate" and inserting in lieu thereof "may designate".

Section 101(a)(14)(ii) of the bill corrects section 408(d)(5)(B) of the Code by striking all that follows clause (i) and inserting in lieu thereof the following:

"(ii) the information was erronous,

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."

r. Correction of cross references in Code section 401(a)(20) (sec. 101(a)(14)(E)(iii) of the bill and sec. 401(a)(20) of the Code)

Present law

Prior to the enactment of Public Law 95–458, section 401(a)(20) included cross references to sections 402(a)(5) and 403(a)(4) of the Code for the purpose of making it clear that certain total distributions on termination of a tax-qualified pension plan do not result in the disqualification of the plan. Public Law 95–458 amended sections 402(a)(5) and 403(a)(4) of the Code.

Reasons for change

Public Law 95–458 which amended sections 402(a)(5) and 403(a)(4) of the Code did not make conforming amendments to cross references to those sections in section 401(a)(20) of the Code.

Explanation of provision

The bill conforms the cross references to sections 402(a)(5) and 403(a)(4) of the Code in section 401(a)(20) of the Code to reflect the changes made to sections 402(a)(5) and 403(a)(4) of the Code by Public Law 95–458. Thus, the bill makes it clear that certain total distributions on termination of a tax-qualified pension plan do not result in the disqualification of the plan.

Effective date

The amendment made by this section is effective as if it had been included in section 157 of the Revenue Act of 1978.

5. Technical Amendments Relating to Tax Shelter and Partnership Provisions

a. Correction of attribution rules for at risk provision (sec. 102(a)(1)(A) of the bill and sec. 465(a) of the Code)

Present law

Prior to the Revenue Act of 1978, the only types of corporations to which the at risk rules (Code sec. 465) applied were subchapter S corporations and personal holding companies. The 1978 Act extended the application of the at risk rules to certain closely held corporations (even though they would not qualify as personal holding companies and had not made subchapter S elections). The closely held corporations to which these rules were extended included any corporation in which five or fewer individuals owned 50 percent or more of the stock. However, in determining whether this ownership test is met, the attribution rules of Code section 318, rather than those of Code section 544, are to be applied.[1]

In general, the attribution rules of section 318 are much narrower than those of section 544, which, *inter alia*, provide for attribution of one partner's stock to another partner in the same partnership and for broader family and corporate attribution. Under section 544, stock in one corporation (the "subsidiary") owned by another corporation (the "parent") is attributed to the parent's shareholders in proportion to the shareholders' ownership in the parent. However, under section 318, the stock of a subsidiary corporation is considered as owned by a shareholder of the parent corporation only if the shareholder owns 50 percent or more in value of the stock of the parent corporation. Similarly, under section 544, an individual is considered as owning stock owned directly or indirectly by his brothers and sisters, spouse, ancestors, and lineal descendants; however, under section 318, an individual is treated as owning only the stock owned directly or indirectly by his spouse, children, grandchildren, and parents.

Reasons for change

The Act adopted the attribution rules of section 318 primarily because it was thought inappropriate to attribute one partner's stock in a corporation to another partner in the same partnership. However, the adoption of these attribution rules inadvertently provided exemption from the at risk rules where the stock ownership of the corporation clearly warranted application of the at risk rules (e.g., where the corporation was a personal holding company but did not

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[1] Prior to the Act, the reference to personal holding companies resulted in the application of the section 544 personal holding company attribution rules. Of course, no attribution rules are applicable (both before and after the Act) in determining whether a corporation is a subchapter S corporation and, therefore, subject to the at risk rules.

meet the section 318 attribution rules). Also, under the section 318 attribution rules, the stock of a wholly-owned subsidiary corporation engaged in an at risk activity would not be treated as 50 percent or more owned by five or fewer individuals so long as no one individual was considered as owning 50 percent or more of the parent corporation's stock. The committee believes that the attribution rules of section 544, other than the rules attributing stock between partners, are more appropriate than the attribution rules of section 318 for the purpose of determining whether a corporation is to be subject to the at risk rules.

Explanation of provision

The bill provides generally that, in determining whether five or fewer individuals own 50 percent or more of the stock of a corporation under the at risk rules, the attribution rules of section 544 are to be applied. However, those rules of section 544 relating to attribution of stock ownership from one partner to another are not to be applied.

Effective date

This provision is effective for taxable years beginning after December 31, 1978. This is the same effective date as that applicable to the provision of the Revenue Act of 1978 to which this provision relates.

b. Clarification of recapture rules of at risk provision (sec. 102 (a)(1)(B) of the bill and sec. 465(d) of the Code)

Present law

Under a literal interpretation of the law prior to the Revenue Act of 1978, the at risk rules may have only required the taxpayer to be at risk at the end of the taxable year for which losses are claimed. Thus, arguably, subsequent withdrawals of amounts originally placed at risk may have been made without the recapture of previously allowed losses. The Act added provisions which require the recapture of previously allowed losses when, and to the extent, the amount at risk is reduced below zero. The Act provides that this recapture income is treated as income from the activity to which the at risk rule applies and thus can be used to offset additional losses from the activity if the losses are incurred in the year in which the recapture occurs (or are suspended losses which are treated as having been incurred in such year).

Reasons for change

Because recapture income under the recapture of loss rules is considered income from the activity, any losses from the activity for the year of recapture (including losses carried over from previous years) can be offset against the recapture income without taking into account the amount of the at risk basis. Thus, notwithstanding a negative at risk basis, losses during the year of recapture, to the extent of the amount of recapture income, can be deducted. Moreover, the at risk basis is left at a negative amount, instead of being brought back up to zero by the amount of recapture income (the recapture income, instead, having been applied against the loss).

Explanation of provision

The bill provides that such recapture income is not to be treated as income from the activity for purposes of determining whether current losses (or suspended losses) are allowable.

Effective date

This provision is effective for taxable years beginning after December 31, 1978. This is the same effective date as that applicable to the provision of the Revenue Act of 1978 to which this provision relates.

c. Clarification of limitation on recapture of losses under at risk provision (sec. 102(a)(1)(C) of the bill and sec. 465(e)(2)(A) of the Code)

Present law

The Revenue Act of 1978 modified the at risk rules to provide for a recapture of losses where the amount at risk is less than zero. These recapture of loss rules were intended to apply only to losses relating to taxable years beginning after December 31, 1978, and which (pursuant to Code sec. 465(b)(5)) are reflected in reductions to the at risk basis in the activity.

Reasons for change

Because of a possible ambiguity in the provision governing the adjustments which reduce the at risk basis in an activity (Code sec. 465(b)(5)), it is unclear whether the adjustment for losses relating to a taxable year would be made as of the last day of such taxable year or as of the first day of the following taxable year. Consequently, it is unclear whether a loss relating to a taxable year beginning before December 30, 1978, but possibly reflected in an at risk basis adjustment as of the first day of a taxable year beginning after December 31, 1978, would be subject to the recapture of loss rules.

Explanation of provision

The bill clarifies the application of the recapture of loss provision (Code sec. 465(e)(2)) to indicate that it applies only to losses for taxable years beginning after December 31, 1978, and not to at risk basis adjustments possibly made after that date which relate to losses for taxable years beginning before December 31, 1978.

Effective date

This provision is effective for taxable years beginning after December 31, 1978. This is the same effective date as that applicable to the provision of the Revenue Act of 1978 to which this provision relates.

d. Waiver of controlled group rule where there is substantial leasing activity (sec. 102(a)(1)(D) of the bill and sec. 465(c) of the Code)

Present law

Prior to the Revenue Act of 1978, the only types of corporations to which the at risk rules (Code sec. 465) applied were subchapter S corporations and personal holding companies. The Act extended the application of the at risk rules to certain closely held corporations (even though they would not qualify as personal holding companies and had not made subchapter S elections). However, the Act contains an exception to the at risk limitations for closely held corporations actively engaged in equipment leasing operations. To qualify for this exception, more than 50 percent of a corporation's gross receipts must

be derived from equipment leasing. In order to prevent abuse, the Act provided that the 50-percent test is to be applied to the total gross receipts of all the members of a controlled group of corporations.

Reasons for change

The Act applies the at risk limitations to a number of substantial active equipment leasing operations. This has occurred because the gross receipts from equipment leasing of some members of a controlled group of corporations, while substantial in an absolute sense, constitute less than 50 percent of the total gross receipts of all the members of the controlled group. In many of these situations, some of the corporations in the group have significant active leasing activities (as measured by employees, receipts, and number of transactions). The committee concluded that members of a closely held controlled group of corporations which are substantially involved in equipment leasing should be exempted from the at risk rules.

Explanation of provision

Under the bill, if certain tests are met, the leasing gross receipts percentage requirement is not to be applied to the total gross receipts of the controlled group.[1] Instead, the gross receipts requirement, increased to 80 percent, is to be applied separately to each member corporation of the controlled group.

The provisions of the amendment are applied to the quantum of certain activities of the "qualified leasing members" of the controlled group of corporations. A corporation is a qualified leasing member if, in the current and each of the immediately preceding two taxable years, (1) it is a component member of the controlled group of corporations and (2) 80 percent or more of its gross receipts is attributable to equipment leasing.

The controlled group 50 percent requirement would be waived, and, instead, an 80-percent gross receipt corporation-by-corporation requirement would apply, if the qualified leasing members (if any) meet the following tests for the current and two immediately preceding taxable years:

(1) The controlled group had at least three full time employees, substantially all of the services of whom were directly related to the equipment leasing activities of the qualified leasing members;

(2) the qualified leasing members, in the aggregate, entered into at least five separate equipment leasing transactions;[2] and

(3) the qualified leasing members, in the aggregate, had at least $1,000,000 of equipment leasing gross receipts.

An amendment is made to Code section 465(b)(5) (relating to at risk activity basis reductions) in order to make it clear that the loss recapture provisions of section 465(e) (which apply only to previously

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[1] Of course, if the controlled group meets the 50 percent gross receipts requirement of section 465(c)(4), this new provision would not apply.

[2] It is contemplated that separate written lease agreements with the same lessee pertaining to items of equipment which are related parts of what is in substance a single lease "package" would be treated as one equipment leasing transaction.

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allowed deductions reflected in basis reductions required under Code sec. 465(b)(5)) do not apply to exempt leasing activity losses.[3]

Effective date

This provision is effective for taxable years beginning after December 31, 1978. This is the same effective date as that applicable to the provision of the Revenue Act of 1978 to which this provision relates.

e. Certain clerical amendments to procedural provisions (secs. 102(a)(2)(A) and (B) of the bill and secs. 6501 and 6511 of the Code)

A clerical amendment to section 6501 of the Code is made to redesignate subsection (q) of section 6501 as subsection (o) to reflect the amendments made to that section by Public Law 95–628.

A conforming amendment to section 6511 of the Code is made to conform the cross reference in that section to the newly redesignated section 6501(o).

f. Treatment of certain underwriting syndicates or partnerships (sec. 102(a)(2)(C) of the bill and sec. 761(a)(3) of the Code)

Present law

The Revenue Act of 1978 imposed a penalty on a partnership which does not file a partnership return. Historically, partnership returns have not been filed in the case of syndicates of dealers in securities formed for the purpose of underwriting, selling, or distributing a securities issue.

Reasons for change

The committee believes that those syndicates which historically have not been treated as partnerships should be given the opportunity to avail themselves of the election under the Code not to be treated as a partnership for income tax purposes.

Explanation of provision

The bill would allow a syndicate of dealers formed for a short period for the purpose of underwriting, selling, or distributing a particular issue of securities to elect not to be treated as a partnership for income tax purposes.

Effective date

The amendment is effective for taxable years beginning after December 31, 1978.

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[3] This amendment also has the same clarifying effect with respect to exempt real estate activity losses and those losses attributable to partnership liabilities which were not subject to section 704(d) (as in effect before the date of the enactment of the Revenue Act of 1978 by reason of section 213(f)(2) of the Tax Reform Act of 1976).

6. Technical Amendments Relating to the Corporate Tax Rate and to the Investment Tax Credit

a. Computation of tax on income from foreclosure property of REITTs (sec. 103(a)(1) of the bill and sec. 857(b)(4)(A) of the Code)

The Revenue Act of 1978 removed the surtax exemption for corporations and replaced it with a graduated rate schedule. This provision makes a technical amendment to conform the tax imposed on the net income from foreclosure property of a real estate investment trust (REIT) with the repeal of the surtax exemption.

b. Clarification of normalization provisions for purposes of investment tax credit (sec. 103(a)(2)(A) of the bill and sec. 312(c)(2) of the Act)

Present law

The Revenue Act of 1971 added rules to provide for the normalization of the investment tax credit for public utility property which qualified for the investment credit after the credit was restored in 1971. The Revenue Act of 1978 repealed the rules relating to the restoration of the credit in 1971 as "deadwood." These amendments created uncertainty as to whether the normalization rules would now also apply to public utility property placed in service before 1971.

Reasons for change

The repeal, under the Revenue Act of 1978, of the rules relating to the 1971 restoration of the investment credit was not intended to affect the normalization rules which were also enacted in 1971. In order to eliminate difficulties which could arise from a misinterpretation of the 1978 amendments, the bill clarifies the intent of these amendments.

Explanation of provision

The bill clarifies the application of the normalization rules to public utility property so that the normalization provisions would apply only to public utility property for the period to which the restored investment credit applies.

Effective date

The provision is effective as if enacted as part of the Revenue Act of 1978.

c. Clerical amendments to special rules for energy property (sec. 103(a)(2)(B) of the bill and secs. 46 and 6401 of the Code)

(*1*) *Amendments to section 46*(*a*).—Paragraph (10) of section 46 (a) is redesignated as paragraph (9) to maintain the numerical sequence of the paragraphs under section 46(a). The former provisions of section 46(a)(9) were repealed by the Revenue Act of 1978. In

addition, section 46(a)(9), as redesignated, is amended to correct two cross-references in that provision.

(*2*) *Amendments to section 6401(d)*.—A cross reference in section 6401(d) is amended to reflect the redesignation of paragraph 10 of section 46(a) as paragraph (9) of that section (item b., above).

d. Coordination of investment credit rules for pollution control equipment (sec. 103(a)(3) of the bill and sec. 46(c)(5)(B) of the Code)

Present law

The Energy Tax Act of 1978 provides a 10-percent investment credit for investments in certain energy property acquired after September 30, 1978 and before January 1, 1983. This credit is in addition to the 10-percent regular investment credit for which energy property also may qualify. Qualifying energy property includes pollution control equipment which is required to be installed in connection with certain other energy property. However, when energy property, including pollution control equipment, is financed in whole or in part by tax-exempt industrial development bonds, a reduced credit of 5-percent is allowed on the qualified investment.

The Revenue Act of 1978 revised the rules concerning investment credits for pollution control facilities where the taxpayer elects to amortize the cost of pollution control facilities over 5 years. Under these rules, where 5-year amortization is elected for pollution control facilities which also are financed with tax-exempt industrial development bonds, the taxpayer's qualified investment for purposes of investment credits is one-half of the investment which is subject to the 5-year amortization election.

Where pollution-control equipment which is energy property is subject both to the generally applicable rule which limits qualified investment and to the reduction in the energy credit percentage, the effective rate of the energy credit will be only 2.5 percent.

Reasons for change

It was not intended that the interaction of the changes made to the investment credit rules by the Revenue Act of 1978 and the Energy Tax Act of 1978 would cause the energy credit for pollution control equipment to be at an effective rate of only 2.5 percent where such equipment is subject to limitations enacted under each of these two Acts. The bill corrects this unintended result.

Explanation of provision

Under the bill, the generally applicable limitation for investment credits on pollution control equipment which is both financed by tax-exempt industrial development bonds and is subject to 5-year amortization will not apply for purposes of the energy credit. As a result, pollution control equipment which is energy property and is financed by industrial development bonds will receive an energy credit of 5 percent as provided by the limitation applicable to energy property.

Effective date

The provision is effective generally with respect to property acquired after December 31, 1978.

e. Treatment of noncorporate lessors for purposes of the investment credit for rehabilitation expenditures (sec. 103(a)(4)(A) of the bill and sec. 46(e)(3) of the Code)

Present law

Under the investment credit provisions generally, availability of the credit is limited with respect to property of noncorporate lessors. Under this limitation, the credit generally is not available to a noncorporate lessor of property which is otherwise qualified unless either (1) the noncorporate lessor produced the property, or (2) the lease term is less than 50 percent of the useful life of the property and the lessor's ordinary and necessary business expenses in connection with the property are more than 15 percent of the rental income produced by the property during the first 12 months of the lessee's use. This limitation was designed to deal with equipment leasing tax shelters which often involve long-term leases on a net basis (i.e., the lessee pays all expenses incident to the maintenance and operation of the leased property). However, the limitation applies with respect to "property" leased by a noncorporate lessor rather than solely to equipment.

The Revenue Act of 1978 made the investment credit generally available to expenditures incurred after October 31, 1978, for rehabilitating older business and commercial buildings (except those used for residential purposes). The 1978 Act did not contain any provision to coordinate the extension of the credit to building rehabilitations with the noncorporate lessor limitation.

Reasons for change

In the case of the rental of commercial buildings, the use of net lease arrangements is traditional and customary. Typically, the tenant of a commercial building will assume responsibility for taxes, insurance, and maintenance with respect to the building. The application of the noncorporate lessor limitation will deny the investment tax credit in many situations where taxpayers have incurred substantial expenditures in rehabilitating older buildings. This restriction will cause an unintended diminution in the impact of extending the credit to rehabilitated buildings, particularly in urban areas where older buildings are presently vacant and make no contribution to the area's economic base.

Explanation of provision

The bill makes the noncorporate lessor limitation inapplicable for purposes of the investment credit for rehabilitation expenditures in order to correct the unintended result of applying this restriction to such expenditures.

Effective date

The provision applies to taxable years ending after October 31, 1978.

f. Coordination of regular investment credit for rehabilitation expenditures with energy investment credit (sec. 103(a)(4)(B) of the bill and sec. 48(g)(2)(B) of the Code)

Present law

The Revenue Act of 1978 made the regular investment credit available to rehabilitation expenditures for certain buildings which are

at least 20 years old. One of the provisions of the Act excludes from the definition of qualified rehabilitation expenditures those expenditures for property which qualify as investment credit property under other investment credit rules. This provision would exclude from the regular investment credit certain rehabilitation expenditures which also qualify as expenditures for energy property eligible for the energy investment credit.

Reasons for change

The intent of the provision which excludes from the definition of qualifying rehabilitation expenditures those costs which otherwise qualify for the investment credit was to continue the application of existing limitations which may apply to such costs for purposes of the regular investment credit. However, this provision, as enacted in the Revenue Act of 1978, also has the unintended effect of disallowing the energy investment credit on expenditures for energy property (such as solar energy equipment) which is installed as part of a qualifying rehabilitation. The elimination of the energy credit in these situations dilutes the incentive to achieve energy conversion in the course of a building rehabilitation.

Explanation of provision

The bill makes both the energy investment credit and the regular investment credit available where rehabilitation expenditures also qualify as expenditures for energy property.

Effective date

The provision applies to taxable years ending after October 31, 1978.

7. Technical Amendments Relating to the Targeted Jobs Credit and the WIN Credit

a. Rules for work incentive credit and targeted jobs credit for cooperatives (sec. 103(a)(5) of the bill and secs. 50B(f), 52(f), and 52(h) of the Code)

Present law

Prior to the Revenue Act of 1978, special rules applied for purposes of determining the amount of work incentive (WIN) credit and general jobs credit which could be used by cooperatives. These special rules applied the same rules under which the amount of investment credit for cooperatives was determined.

Reasons for change

While the Act revised the rules pertaining to the investment credit for cooperatives, no change was made to the rules pertaining to the WIN and jobs tax credits for cooperatives. The Congress intended that the rules for determining the amounts of WIN and jobs credits for cooperatives should be the same as the new rules for determining the amount of investment credit for cooperatives.

Explanation of provision

The bill extends the new rules for the investment credit of cooperatives to the WIN and jobs credits. Language is added to the House bill to make clear that this provision applies to both the general jobs credit and the targeted jobs credit.

Effective date

This provision applies to taxable years ending after October 31, 1978.

b. Correction of expiration date of targeted jobs credit (sec. 103(a)(6)(A) of the bill and sec. 51(c)(4) of the Code)

Present law

The Revenue Act of 1978 provided for a targeted jobs credit which allows employers to claim a tax credit for employing certain categories of individuals.

Reasons for change

The Congress intended that the targeted jobs credit be available for employers with respect to wages paid or incurred up to and including December 31, 1981. However, due to a clerical error, the Act provides that the targeted jobs credit is to expire with respect to wages paid after December 31, 1980.

Explanation of provision

The bill corrects the clerical error to provide that the credit may be claimed with respect to wages paid or incurred up to and including December 31, 1981.

Effective date

This amendment is effective as if it were included in the Revenue Act of 1978.

c. Clarification of the effective date for election of jobs credit (sec. 103(a)(6)(B) of the bill and sec. 321(d) of the Act)

Present law

The Revenue Act of 1978 provides that the jobs credit is elective, rather than mandatory as under prior law.

Reasons for change

While the Act provided that the jobs credit is elective, it did not contain a special effective date for this provision. The Congress intended that taxpayers should be allowed to make this election retroactively in the case of the prior law general jobs credit.

Explanation of provision

The bill corrects this oversight in the Act to provide that the election provision is effective for taxable years ending after December 31, 1976.

Effective date

This provision applies to taxable years beginning after December 31, 1976.

d. Clarification of effective date for newly targeted groups under jobs credit (sec. 103(a)(6)(C) of the bill and sec. 321(d)(2)(A) of the Act)

Present law

The Code, prior to the Revenue Act of 1978, provided a jobs credit to encourage employers to expand their work forces. In addition, an extra credit was provided for hiring persons referred under vocational rehabilitation programs. The Act amended the jobs credit to provide that, effective for amounts paid or incurred after December 31, 1978, the credit would be available only for the employment of specific target groups of individuals. For individuals in newly targeted groups (*i.e.*, all individuals in target groups except persons referred under vocational rehabilitation programs for whom the taxpayer claimed a credit under prior law), the credit is available only for persons first hired by the employer after September 26, 1978.

Reasons for change

A literal reading of the Act could imply that an employer is not entitled to the general jobs credit with respect to wages paid to a member of a newly targeted group who first begins work for an employer before January 1, 1979, but after September 26, 1978. However, the Congress intended for an employer to be allowed whatever credit was available under prior law for wages paid or incurred before January 1, 1979, with respect to a member of a newly targeted group who first begins work for an employer before January 1, 1979.

Explanation of provision

The bill clarifies that the effective date provision of the Act which relates to newly targeted groups applies only for purposes of amend-

ments made by the Act. Thus, with respect to a member of a newly targeted group who first begins work for an employer before January 1, 1979, the employer is allowed whatever credit was available under prior law for wages paid or incurred before January 1, 1979. For purposes of wages paid or incurred on or after January 1, 1979, credit will be allowed with respect to such an individual only if he or she was first hired after September 26, 1978, and this individual would be treated as beginning work on January 1, 1979.

Effective date

This provision is effective with respect to wages paid or incurred after September 26, 1978.

e. Clarification of transitional rule for fiscal year taxpayers claiming jobs credit (sec. 103(a)(6)(D) of the bill and sec. 321(d)(3) of the Act)

Present law

The Revenue Act of 1978 includes a transitional rule to coordinate the effective date of the targeted jobs credit for 1979 with the expiration of the prior general jobs credit at the end of 1978 for fiscal year taxpayers.

Reasons for change

Although the language in the Act was somewhat unclear, the Congress intended for a taxpayer on a 1978–1979 fiscal year to compute the pre-1979 general jobs credit (without regard to the tax liability limitation) for wages paid in 1978, compute the post-1978 targeted jobs credit under the new law (also without regard to the tax liability limitation) for wages paid in 1979, add the two credits together, and then apply the 100 percent of tax liability limitation.

Explanation of provision

The bill clarifies that, under the transitional rule, a taxpayer with a fiscal year beginning in 1978 will compute his total credit for that fiscal year by (1) determining his general jobs credit under prior law (but without regard to the 100 percent of tax liability limitation) for wages paid in 1978 and his targeted jobs credit under the Act (also without regard to the 100 percent of tax liability limitation) for wages paid in 1979, (2) adding the two amounts together, and then (3) applying the 100 percent of tax liability limitation to the sum.

Effective date

This provision applies in the case of taxable years which begin in 1978 and end after December 31, 1978.

f. Clarification that FUTA wages are to be treated as including remuneration of youths participating in cooperative education programs (sec. 103(a)(6)(E) of the bill and secs. 51(d)(8)(D) and 51(c) of the Code)

Present law

Under present law, one of the targeted groups for purposes of the targeted jobs credit is youth participating in a qualified cooperative education program. In general, wages eligible for the targeted jobs credit are Federal Unemployment Tax Act (FUTA) wages.

Reasons for change

Section 3306(c)(10)(C) excludes services performed by cooperative education students under the age of 22 from coverage under FUTA. Thus, although cooperative education students of ages 16 through 19 would comprise an eligible target group under this bill, employers would not be able to claim a credit with respect to the wages paid to them.

Explanation of provision

The bill clarifies that wages paid to youths participating in cooperative education programs, although not FUTA wages, are eligible for the targeted jobs credit.

Effective date

The amendments made by this provision generally are effective with respect to amounts paid or incurred after December 31, 1978.

g. Definition of youth participating in a qualified cooperative education program for purposes of the targeted jobs credit (secs. 103(a)(6)(F) and (b) of the bill and sec. 51(d)(8) of the Code)

Present law

Under the Revenue Act of 1978, a credit is provided for the hiring of members of certain target groups. The credit, which is elective, is equal to 50 percent of qualified first-year wages and 25 percent of qualified second-year wages. One of the target groups consists of youths who actively participate in qualified cooperative education programs, who have attained the age of 16 but who have not attained the age of 19, and who have not graduated from high school or vocational school.

Reasons for change

When it drafted the Revenue Act of 1978, the Congress was not aware that many of the students in high school cooperative education programs were 19 years old. The intent of including cooperative education students in the targeted jobs credit would be frustrated if wages paid to 19-year old participants continued to be ineligible for the credit.

Explanation of provision

The provision would amend section 51(d)(8)(A)(i) of the Code to provide that the targeted jobs credit would be available for the hiring of youths who actively participate in qualified cooperative education programs, who have attained the age of 16 but who have not attained the age of 20, and who have not graduated from high school or vocational school.

Effective date

This provision would apply with respect to wages paid or incurred on or after November 27, 1979, in taxable years ending on or after such date.

Revenue effect

This provision would reduce budget receipts in fiscal year 1980 by less than $1 million, by less than $5 million per year in fiscal years 1981 and 1982, and by less than $1 million in fiscal year 1983.

h. Clerical corrections to targeted jobs credit (sec. 103(a)(6)(G) of the bill, secs. 44B, 51, 6501, 383, and 6411 of the Code, and secs. 321(d)(2) and (4) of the Act)

(*1*) *Amendment of section 44B(a)*.—Section 44B(a) is amended by replacing the phrase "at the taxpayer" with the phrase "of the taxpayer".

(*2*) *Amendment of section 44B(c)(2)*.—The phrase "may be" in section 44B(c)(2) is replaced by the phrase "may by".

(*3*) *Amendment of section 51(c)(2)*.—The phrase "amounts paid" in section 51(c)(2) is replaced by the phrase "amounts paid or incurred."

(*4*) *Amendment of section 51(d)(1)*.—Section 51(d)(1) is amended by deleting the word "or" at the end of subparagraph (E).

(*5*) *Amendment of section 51(d)(4)(A)(i)*.—Section 51 (d)(4)(A)(i) is amended by substituting the phrase "active duty" for the phrase "active day".

(*6*) *Amendment of section 51(d)(4)(B)*.—Section 51(d)(4)(B) is amended by substituting "preemployment" for "premployment".

(*7*) *Amendment of section 51(d)(5)*.—Section 51(d)(5) is amended by substituting "preemployment" for "pre-employment".

(*8*) *Amendment of section 51(d)(12)*.—Section 51(d)(12) is amended by substituting "employers" for "employer".

(*9*) *Amendment of section 51(e)*.—The last sentence of section 51(e) is amended by inserting the phrase "except as provided in subsection (h)(1)," after "the preceding sentence,".

(*10*) *Amendment of section 6501*.—Section 6501(q), as added by section 321(b)(2) of the Revenue Act of 1978, is redesignated as section 6501(p).

(*11*) *Amendment of section 321(d)(2)(B) of the Revenue Act of 1978*.—Clause (i) of section 321(d)(2)(B) of the Revenue Act of 1978 is deleted and replaced by "(i) such individual meets the requirements of paragraph (1) of section 51(d) of such Code, and". Clause (ii) of section 321(d)(2)(B) is deleted and replaced by "(ii) in the case of an individual meeting the requirements of subparagraph (A) of such paragraph (1), a credit was not claimed for such individual by the taxpayer for a taxable year beginning before January 1, 1979."

(*12*) *Amendment to section 321(d)(4) of the Revenue Act of 1978*.—Section 321(d)(4) of the Revenue Act is amended by inserting "subsection (c)(2)" in lieu of "subsection (u)(2)".

(*13*) *Amendments of sections 383 and 6411(a)*.—The references in sections 383 and 6411(a) to "section 53(c)" are amended to refer to "section 53(b)".

i. Clarification of effective date for WIN-welfare recipient tax credit for fiscal year taxpayers (sec. 103(a)(7)(A) of the bill and sec. 322(e)(1) of the Act)

Present law

Prior to the Revenue Act of 1978, the amount of WIN credit available to any employer was limited to $50,000 of tax liability plus one-half of tax liability in excess of $50,000. The Code contained rules for allocating this amount between married individuals filing separately, among members of a controlled group, and between an estate or trust

and its beneficiaries. The Act increased the limitation on the credit amount to 100 percent of tax liability, effective for taxable years beginning after December 31, 1978.

Reasons for change

Although the change in the tax liability limitation made by the 1978 Act is effective for taxable years beginning after December 31, 1978, it is unclear whether the related rules for apportioning the $50,000 amount are effective during the entire taxable year of fiscal year 1978–79 taxpayers.

Explanation of provision

The bill specifies that, for purposes of applying the prior law tax liability limitation to a taxable year beginning before January 1, 1979, the prior law rules relating to the apportionment of the $50,000 amount shall apply.

Effective date

The provision is effective for taxable years beginning in 1978 and ending after December 31, 1978.

j. Clarification of transitional rule for AFDC recipients and WIN registrants hired after September 26, 1978 (sec. 103(a)(7)(B) of the bill and sec. 332(e)(2) of the Act)

Present law

The Code prior to the Revenue Act of 1978, provided a credit to employers who hired certain AFDC recipients and WIN registrants. The Act amended the credit in several respects, and the amendments generally are effective for work incentive program expenses paid or incurred after December 31, 1978. Under the Act, eligible employees hired after September 26, 1978, are to be treated as having first begun work for the employer no earlier than January 1, 1979.

Reasons for change

The Congress intended that an employer be entitled to whatever credit was available under prior law for wages paid or incurred before January 1, 1979, with respect to AFDC recipients and WIN registrants.

Explanation of provision

The bill clarifies that the effective date provision which relates to AFDC recipients and WIN registrants hired after September 26, 1978, applies only for purposes of the amendments made by the Act. Thus, with respect to such an employee who first begins work for an employer before January 1, 1979, the employer would be allowed whatever credit was available under prior law for wages paid or incurred before January 1, 1979. For the purpose of amounts paid or incurred on or after January 1, 1979, such an employee would be treated as beginning work on January 1, 1979, and any wages paid or incurred after December 31, 1978, with respect to this employee would be considered to be attributable to services rendered after that date.

Effective date

This provision is effective with respect to eligible employees hired after September 26, 1978.

k. WIN credit for child care expenses between October 1, 1978 and December 31, 1978 (sec. 103(a)(7)(C) of the bill and sec. 50B(a)(2)(B) of the Code)

Present law

Whether wages are eligible for the WIN credit as adopted in the Revenue Act of 1978 does not depend on whether the work being performed by the eligible employee involves child care services. As the credit applied before the amendments of the Revenue Act of 1978, wages paid for services in connection with a child day care program were eligible for the credit only if paid for services performed before October 1, 1978.

Reasons for change

Because the amendments made by the 1978 Act were effective only for wages paid or incurred after December 31, 1978, there was an unintended three-month gap in WIN credit coverage for child day care services.

Explanation of provision

The bill extends to January 1, 1979, the October 1, 1978, termination date in the WIN credit child care service provision in effect before the amendments of the 1978 Act.

Effective date

The amendment made by this provision applies to wages paid or incurred for services rendered between October 1, 1978 and December 31, 1978.

l. Clerical corrections to WIN-welfare recipient tax credit (sec. 103(a)(7)(D) of the bill, secs. 50A and 50B of the Code, and sec. 322(d) of the Act)

(1) Amendment of section 50A (a) (4) (C).—Section 50A (a) (4) (C) is amended by replacing " '$6,000' and" with " '$6,000' for".

(2) Amendment of section 50B (g) (2) (B).—Section 50B (g) (2) (B) is amended by inserting the phrase "giving rise to such credit" in lieu of the phrase "giving to such credit".

(3) Amendment of section 50B (h) (1) (A) (i).—Section 50B (h) (1) (A) (i) is amended by inserting "90-day" in lieu of "9-day".

(4) Amendment of section 322(d) of the Revenue Act of 1978.—The second subsection designated as subsection (d) of section 322 of the Act is amended by replacing the word "our" in paragraph (1) (A) thereof with the word "out".

8. Technical Amendments Relating to Other Provisions Primarily Affecting Business Income Tax

a. Clerical amendment to Section 337(a) of the 1978 Act (sec. 103(a)(8) of the bill and sec. 337(a) of the Revenue Act of 1978)

Section 337(a) is amended to correct a typographical error by changing "or a refund profit" to "of a refund profit."

b. Effective date for limit on ordinary loss deduction for small business corporation stock (sec. 103(a)(9) of the bill, sec. 1244 of the Code, and sec. 345(e) of the Act)

Present law

Prior to the Revenue Act of 1978, the Code provided that, if certain individual shareholders realized a loss on the disposition of certain stock (sec. 1244 stock), it would be treated as an ordinary loss. Under prior law, the maximum amount of ordinary loss from the disposition of section 1244 stock that could be claimed in any taxable year was $25,000, except for married taxpayers filing joint returns, in which case ordinary loss treatment was limited to $50,000.

In general, the Act increased the amount of section 1244 stock that a qualified small business corporation could issue, simplified and liberalized some of the conditions which must be satisfied for stock to qualify as section 1244 stock, and increased the amount of loss that certain shareholders could treat as an ordinary loss rather than as a capital loss. Under the Act, the maximum amount that could be treated as an ordinary loss in a taxable year was increased to $50,000; in the case of a husband and wife filing a joint return for the taxable year in which the loss is incurred, the maximum amount that may be treated as an ordinary loss was increased to $100,000.

Reasons for change

Under the Act, these provisions applied to common stock issued after the date of enactment (November 6, 1978). This effective date is appropriate for the changes in requirements for qualifying stock; however, as drafted, the Act did not increase the limitation on the amount of loss on previously issued section 1244 stock which could be treated as an ordinary loss in a taxable year. Rather, it created two separate limitations, one for common stock issued prior to the date of enactment and another for common stock issued after the date of enactment (November 6, 1978).

The committee believes that, for taxable years beginning after December 31, 1978, one set of dollar limitations—the increased dollar limitations—should apply to losses on all section 1244 stock (whether issued before or after November 6, 1978). However, the committee believes that, for taxable years beginning prior to December 31, 1978, it is appropriate to retain the rule that the increased dollar limitation would apply only with respect to losses on section 1244 stock issued

after November 6, 1978, even though this will result in two differing dollar limitations applying during the same taxable year. The retention of this "dual limitation" approach for taxable years beginning in 1978 is necessary to prevent certain taxpayers who relied on the effective date for the increased loss treatment amount from being disadvantaged.

Explanation of provision

This bill amends the effective date of the provisions relating to the limitations on the amount of loss on section 1244 stock which may be treated as an ordinary loss by providing that the amendments relating to the ordinary loss limitations for individuals are applicable to taxable years beginning after December 31, 1978, whether or not the stock was issued before or after the effective date of the Act.

The bill also provides that, for taxable years beginning before December 31, 1978, the increased dollar limitations apply only with respect to losses on section 1244 stock issued after November 6, 1978. The application of the dollar limitation rules with respect to taxable years beginning before December 31, 1978, may be illustrated by the following example. Assume that an individual who reports income on a calendar year basis and files a joint return with his spouse has two blocks of section 1244 stock which became worthless in December of 1978. One block was acquired for $60,000 in cash on January 15, 1978. The other block of stock was acquired for $40,000 in cash on November 7, 1978. Since the first block of stock was issued prior to November 7, 1978, the individual may treat $50,000 of the loss on the first block of stock as an ordinary loss. The individual may also treat the entire $40,000 of loss on the second block of stock as an ordinary loss.

Effective date

The effective date of this provision is discussed in *Explanation of provision*, above.

c. Clarification of the club dues limitation on the nondeductibility of entertainment facility expenses (secs. 103(a)(10)(A) and (B) of the bill and sec. 274(a)(2)(C) of the Code)

Present law

Prior to the Revenue Act of 1978, expenses incurred with respect to entertainment facilities were deductible if they were ordinary and necessary, the facility was used primarily for the furtherance of the taxpayer's business (i.e., more than 50 percent of the time that it was used), and the expense in question was related directly to the active conduct of the taxpayer's business. For this purpose, entertainment facility expenses included dues or fees to any social, athletic, or sporting club or organization.

The Act provided generally that no deduction was allowable for any entertainment facility expense. However, the Act provided an exception from this disallowance rule for country club dues.

Reasons for change

The committee believes that the provisions of the 1978 Revenue Act which relate to the nondeductibility of entertainment facility

expenses should be clarified to conform to the intent of the conferees that the exception apply to other club dues.

Explanation of provision

The bill clarifies the exception from the facility expense deduction disallowance rule provided in the 1978 Revenue Act so that the exception for country club dues which meet the business use test also would apply to all social, athletic, and sporting club dues or fees which satisfy that test.

Effective date

The provision applies to items paid or incurred after December 31, 1978, in taxable years ending after that date.

d. Clarification of the limitation on the deductibility of certain entertainment facility expenses includible in income of persons who are not employees (sec. 103(a)(10)(C) of the bill and sec. 274(e) of the Code)

Present law

Prior to the enactment of the Revenue Act of 1978, expenses incurred with respect to entertainment facilities[1] were deductible if they were ordinary and necessary, the facility was used primarily for the furtherance of the taxpayer's business (i.e., more than 50 percent of the time that it was used), and the expense in question was related directly to the active conduct of the taxpayer's business. For this purpose, entertainment facility expenses included dues or fees paid to any social, athletic, or sporting club or organization. Dues or fees paid to professional associations, civic organizations, or to clubs operated solely to provide meals under circumstances normally considered to be conducive to business discussions generally were not considered to be entertainment facility expenses.

In determining whether an entertainment facility was used primarily for business purposes, all the taxpayer's ordinary and necessary business use of the facility was taken into account. Once it was determined that the facility was used primarily for business, the portion of the expenses which were related directly to the active conduct of the taxpayer's business could be deducted.

The Revenue Act of 1978 provided generally that no deduction was allowable for any entertainment facility expense. However, the Act retained a number of exceptions to the general rule that existed under prior law. One of these relates to expenses treated as employee compensation (sec. 274(e)(3)). Under this exception, expenses for goods, services, and facilities are not subject to the disallowance rules to the extent that the expenses are treated by the taxpayer, with respect to the recipient of the entertainment, as compensation to an employee on the taxpayer's return and as wages to the employee for purposes of income tax withholding. Thus, in the case of facility expenses which satisfy this exception, the Act retained the rules of prior law which formerly had applied to expenses treated as employee compensation.

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[1] An entertainment facility generally is any item of personal or real property owned, rented, or used by a taxpayer during the taxable year for, or in connection with, an activity normally considered to be of an entertainment nature.

Reasons for change

It has come to the attention of the committee that there are situations where a manufacturing company promotes the sales of its products through sales incentive awards with salesmen who are not its employees and, consequently, would not come within the exception for facilities provided to employees. In several cases, the sales incentive award is arranged by another corporation on behalf of the manufacturing company. In both these cases, the amount of the award is includible in the gross income of the recipient of the award. The committee believes that the facilities rule should not apply to expenses incurred in connection with these types of sales incentive award plans where the recipient is required to include an amount in income.

Explanation of provision

The bill provides that disallowance of expenses for entertainment, amusement, or recreation expenses (Code Sec. 274(a)) does not apply to expenses which are includible in the gross income of the recipient of the entertainment, amusement, or recreation as compensation for services or as a prize or award under section 74 of the Code. This exception would not apply to a payor where the amounts paid are required to be furnished by the payor to the payee on information returns (Form 1099) but are not furnished by the payor.

For example, where a manufacturer provides entertainment facilities to one or more of the employees of its dealers as an incentive award and the right to use the facilities to its dealers who in turn award them to certain employees, the manufacturer will not be subject to these limitations if the value of the entertainment facilities are includible in income of the dealer and the manufacturer complies with any required information reporting. Further, the limitations will not apply to the dealer for any amount if the employee is required to include that amount in his income and the dealer complies with the applicable information reporting requirements. Of course, the rules limiting deductions for entertainment, etc., facilities continue to apply to the individual involved to determine the extent to which he is entitled to deduct the entertainment expenses.

The exemption for items includible in income as compensation for services or as a prize or award is not intended to permit entertainment facilities maintained by the taxpayer to be used for entertainment of its customers, suppliers, executives, or guests.

Effective date

The amendment is effective for expenditures paid or incurred after December 31, 1978, in taxable years ending after that date.

e. Amendments relating to deficiency dividend procedure for REITs (sec. 103(a)(11) of the bill and sec. 860 of the Code)

The bill makes three clerical amendments to the provisions relating to the deficiency dividend procedures for real estate investment trusts and regulated investment companies (Code sec. 860).

First, the bill corrects a cross reference in the effective date of the provision in the Revenue Act of 1978.

Second, the bill corrects the spelling of the word "deficiency" in the heading to section 860(f) of the Code.

Finally, the bill adds a parenthesis that was deleted in section 860(f)(2)(A) of the Code.

f. Clarification of treatment of liabilities of controlled corporation (sec. 103(a)(12) of the bill and sec. 357(c)(3) of the Code)

Present law

The Revenue Act of 1978 provided that where a cash basis taxpayer transfers property to a controlled corporation subject to certain liabilities, an "account payable" which would give rise to a deduction is not considered a liability for purposes of determining the amount of gain recognized by the transferor on the transfer. The legislative history indicates that a taxpayer could qualify under this provision where he was using a cash method or a hybrid cash method of accounting. The legislative history also indicates that an "account payable" would include a trade account payable and other liabilities (e.g., interest and taxes) which relate to the transferred trade or business.

Reasons for change

The committee believes that this provision of the 1978 Act should be clarified in order to clearly reflect the intent of Congress as indicated in the legislative history of the provision.

Explanation of provision

The bill deletes the requirement that only taxpayers who compute taxable income under the cash receipts and disbursements method of accounting are eligible to exclude certain liabilities in determining the amount of gain recognized on a transfer to a controlled corporation. The bill also deletes the requirement that the excluded liability must be an account payable.

As a result of these changes, in determining (for purposes of sections 357(c) and 358(d)) the amount of liabilities assumed, or to which the property transferred is subject, in a transfer qualifying under section 351, the amount of certain liabilities are excluded for a transferor. Liabilities excluded under this provision are those liabilities the payment of which by the transferor would give rise to a deduction and those liabilities the payment with respect to which would be described in section 736(a) of the Code.

In general, liabilities the payment of which would give rise to a deduction include trade accounts payable and other liabilities (e.g., interest and taxes) which relate to the transferred trade or business. However, such liabilities may be excluded under this provision only to the extent payment thereof by the transferor would have given rise to a deduction. A liability would not be excluded under this provision to the extent the liability has already been deducted by the transferor. In addition, a liability would not be excluded under this provision to the extent that the incurrence thereof resulted in the creation of, or increase in, the basis of any property.

Effective date

The provision applies to transfers after November 6, 1978.

g. Application of withholding tax to medical reimbursements (sec. 103(a)(13)(A) of the bill and sec. 3041(a)(20) of the Code)

Present law

Prior to the Revenue Act of 1978, medical reimbursements paid to, or on behalf of, an employee under a self-insured medical reimbursement plan of an employer generally were excluded from the employee's gross income and were not subject to withholding tax. Under the Act, such payments may be fully or partly includible in an employee's gross income for a year if the medical reimbursement plan discriminates in favor of highly compensated individuals for the year, and such payments are subject to withholding tax if they are includible.

Reasons for change

In some cases, it may not be possible to make a determination under the medical reimbursement plan rules as to the amount which is includible in gross income until after the year has ended. Consequently, the committee concluded that it is inappropriate for these amounts to be subject to withholding tax.

Explanation of provision

The bill provides an exclusion from withholding tax for amounts paid under a self-insured medical reimbursement plan for an employee. The bill also corrects a clerical error by redesignating one of two paragraphs numbered (18) of Code section 3401(a) as paragraph (19). (The House bill provides an exclusion from withholding tax where it is reasonable to believe that a reimbursement will be excludible from the employee's gross income under section 105.)

Effective date

The amendment applies to amounts reimbursed after December 31, 1979.

h. Clarification of nondiscriminatory eligibility classification for medical reimbursement plans (sec. 103(a)(13)(B) of the bill and sec. 105(h)(3)(A) of the Code)

Present law

Prior to the Revenue Act of 1978, self-insured medical reimbursement plans were not subject to statutory nondiscrimination rules. Under the Act, nondiscrimination rules regarding eligibility were added.

Reasons for change

The 1978 Act was not clear as to whether the group in whose favor discrimination as to eligibility for participation was prohibited consists of all highly compensated individuals employed by an employer or of only those who are plan participants.

Explanation of provision

The bill clarifies that the nondiscrimination rule regarding eligibility for self-insured medical reimbursement plans takes into account all highly compensated individuals employed by the employer.

Effective date

This provision applies to payments made after December 31, 1979.

i. Clarification of excess reimbursement test under medical reimbursement plans (sec. 103(a)(13)(C) of the bill and sec. 105(h)(7)(A) of the Code)

Present law

Prior to the Revenue Act of 1978, medical reimbursements paid to, or on behalf of, an employee under a self-insured medical reimbursement plan of an employer generally were excluded from the employee's gross income. Under the Act, such payments may be fully or partly includible in an employee's gross income for a year if the medical reimbursement plan discriminates in favor of highly compensated individuals for that year.

Reasons for change

Under the 1978 Act, the discrimination tests for measuring the amount of reimbursements under a particular benefit are not the same as the tests for determining whether that particular benefit is discriminatory.

Explanation of provision

The bill conforms the rules for measuring excess reimbursements under a self-insured medical reimbursement plan to the rules prohibiting discrimination in favor of highly compensated individuals under such plans.

Effective date

This provision applies to payments made after December 31, 1979.

j. Clarification of effective date for medical reimbursement plans (sec. 103(a)(13)(D) of the bill and sec. 366(b) of the Act)

Present law

Under the rules provided by the Revenue Act of 1978 for medical reimbursement plans, excess reimbursements made during a plan year are includable in the gross income of a highly compensated individual for the taxable year in which (or with which) the plan year ends.

Reasons for change

Because the rules apply for taxable years beginning after December 31, 1979, excess reimbursements made during 1979, in a plan year beginning after January 1, 1979, and ending after December 31, 1979, will be includable in the 1980 gross income of a highly compensated individual whose taxable year is the calendar year.

Explanation of provision

The bill provides that the medical reimbursement plan rules apply only to reimbursements paid after December 31, 1979. Under the bill, reimbursements made before January 1, 1980 will not be taken into account under the rules for medical reimbursement plans for any purpose. (Under the House bill, payments made during 1979, in a plan year ending in 1980, would be excludible from gross income but would be taken into account in determining whether the plan met the nondiscrimination rules for the plan year.)

Effective date

This provision is effective as if it had been included in section 366 of the 1978 Act.

k. Clerical amendments to other provisions primarily affecting business income tax (secs. 103(a) (14), (15), and (16) of the bill and secs. 172(b)(1), 374(e)(1)(A), and 466(e)(2)(B) of the Code)

The following clerical amendments to provisions affected by Title III of the Revenue Act of 1978 are made:

(1) An amendment to section 374(e) (1) (A) (iv) to correct the transposition of numbers in the date "1967" to read "1976" is made.

(A) A correct reference to the subparagraph of section 172 being amended by section 371 of the Act is made to coordinate with the redesignation of that subparagraph by section 703(p) (4) of the Revenue Act of 1978.

(3) The word "years" is corrected to read "year" in section 466 (e) (2) (B).

9. Technical Amendments Relating to Capital Gains, the Minimum Tax, and the Maximum Tax

a. Clerical amendments relating to capital gains tax changes (secs. 104(a) (1), (3)(C), and (3)(D) of the bill, secs. 593(b)(2)(E)(vi), 877b), and 904b(3) of the Code and sec. 403(c)(4)(B) of the act)

The following clerical and conforming amendments to the capital gains provisions are made:

(1) A clerical amendment to section 877(b) is made to omit the reference to section 1201(b) which was repealed by the Revenue Act.

(2) Section 593(b)(2)(E)(iv) is amended to insert the fraction "18/46" in lieu of "3/8" to reflect the new capital gains and corporate tax rates.

(3) Subparagraph (E) of section 904(b)(3) added by section 403 of the Revenue Act of 1978 is redesignated as (F).

(4) The instructional paragraph of section 403(c)(4)(B) of the Act is corrected.

b. Clarification of the effective date of the increased capital gains deduction (sec. 104(a)(2)(A) of the bill and sec. 1202(c) of the Code)

Present law

The Revenue Act of 1978 increased the capital gains deduction from 50 to 60 percent of the gain effective for sales or exchanges after October 31, 1978. The Act, however, was unclear as to the amount of the deduction which was to be allowed in the case of post-effective date receipts of payments attributable to pre-effective date transactions, such as installment sales.

Reasons for change

The committee believes that the provisions of the 1978 Act should be clarified as to the amount of the capital gains deduction which is allowed in the case of amounts properly taken into account by the taxpayer after October 31, 1978, where the sale or exchange occurred on or before that date.

Explanation of provision

The bill clarifies that the increased capital gain deduction applies to all amounts properly taken into account by the taxpayer after October 31, 1978.

Effective date

This provision is effective for taxable years ending after October 31, 1978.

c. Clarification of the alternative tax for noncorporate capital gains (sec. 104(a)(2)(B) of the bill and sec. 1201 of the Code)

Present law

Prior to the Revenue Act of 1978, a noncorporate taxpayer generally deducted from gross income 50 percent of any net capital gain, and the balance of the gain was taxed at the regularly applicable ordinary income rates. However, a partial alternative tax of 25 percent on the first $50,000 of net capital gain could apply, in lieu of taxing 50 percent of the gain at the regular rates, if it resulted in a lower tax than that which was produced by the regular method.

The Act repealed the noncorporate alternative tax for taxable years beginning after December 31, 1978. However, the Act inadvertently failed to conform the computation of each partial tax (for periods prior to its repeal) to reflect the increase in the capital gains deduction.

Reasons for change

The committee believes that the computation of each partial tax of the noncorporate alternative tax (for periods prior to its repeal) should be conformed to reflect the increase in the capital gains deduction.

Explanation of provision

The bill conforms the calculation of the alternative tax to reflect the Act's increase in the capital gains deduction.

Effective date

This provision applies to taxable years beginning before January 1, 1979.

d. Clarification of the application of the effective date of the capital gains changes to amounts received from certain conduit entities (sec. 104(a)(2)(C) of the bill and secs. 1201(c)(2) and 1202(c)(1) of the Code)

Present law

The Revenue Act of 1978 increased the net capital gains deduction for noncorporate taxpayers from 50 to 60 percent and decreased the corporate alternative tax rate from 30 to 28 percent. The former provision was effective with respect to post-October 31, 1978, gains and losses, and the latter provision was effective for post-December 31, 1978, gains and losses. However, the Act was unclear as to the applicability of these provisions to the capital gains of certain conduits whose income is taxed to another party where the date that the gains are includible in income by such other party is on or after the Act's effective date.

Reasons for change

The committee believes that the application of the provisions of the 1978 Act which relate to the effective dates of the capital gains changes should be clarified for cases where the capital gains of certain conduits are taxed to another.

Explanation of provision

This bill provides that, in applying the increased capital gains deduction or the reduced corporate alternative tax rate, the determination of the period for which gain or loss is properly taken into account

must be made at the entity level. Therefore, in the case of pass-through entities, the proper capital gains deduction of an individual will be determined with reference to the time when those gains were taken into account by an entity rather than when a distribution was made, or was deemed to be made, by the entity to that individual. For purposes of applying this rule, "pass-through entities" are regulated investment companies, real estate investment trusts, electing small business corporations, partnerships, estates, trusts, and common trust funds. This entity level determination would apply to taxable years of the recipient beginning before November 1, 1979 (or January 1, 1980, in the case of a corporation).

Effective date

This provision generally applies to taxable years of the recipient which begin before November 1, 1979 (or January 1, 1980, in the case of a corporation).

e. Clarification of the effective date of the reduced corporate alternative capital gains rate (sec. 104(a)(3)(A) of the bill and sec. 1201(c) of the Code)

Present law

The Revenue Act of 1978 reduced the corporate alternative tax rate for capital gains from 30 to 28 percent effective for sales or exchanges after December 31, 1978. The Act, however, was unclear as to the rate which was to apply in the case of post-effective date receipts of payments attributable to pre-effective date transactions, such as installment sales.

Reasons for change

The committee believes that the provisions of the 1978 Act should be clarified as to the application of the reduced corporate alternative capital gains rate in the case of amounts properly taken into account by the taxpayer after December 31, 1978, where the sale or exchange occurred on or before that date.

Explanation of provision

The bill clarifies that the reduced rate applies to all amounts properly taken into account by a corporate taxpayer after December 31, 1978.

Effective date

This provision is effective for taxable years ending after December 31, 1978.

f. Undistributed capital gains of regulated investment companies (sec. 104(a)(3)(B) of the bill and sec. 852(b) of the Code)

The bill conforms the basis adjustment rules for shareholders of certain regulated investment companies with undistributed capital gains to reflect the decreased corporate alternative tax on capital gains from 30 percent to 28 percent.

g. Clarification that carryovers may not reduce alternative minimum taxable income (sec. 104(a)(4)(A) of the bill and sec. 55(b)(1) of the Code)

Present law

The Revenue Act of 1978 imposed an alternative minimum tax which is payable by an individual to the extent the gross alternative

tax exceeds the regular tax as increased by the "add on" minimum tax. The alternative minimum tax base is generally the sum of an individual's gross income, adjusted itemized deductions, and capital gains, reduced by deductions allowed for the taxable year. In certain circumstances, it is possible that a deduction may reduce the alternative minimum taxable income base for a taxable year and still be available as a carryback or carryover to reduce taxable income in another taxable year.

Reasons for change

The committee believes that a deduction should not be used both to reduce the alternative minimum tax in the current year and be available as a carryover to reduce the taxpayer's tax for another taxable year.

Explanation of provision

The bill denies the use of a deduction against the alternative minimum taxable income base to the extent the deduction is available as a carryover or carryback to another taxable year.[1]

Effective date

The amendment made by this provision applies to taxable years beginning after December 31, 1978.

h. Foreign tax credit allowable against alternative minimum tax (secs. 104(a)(4) (B) and (C) of the bill and sec. 55(c) of the Code)

Present law

The Revenue Act of 1978 imposed an alternative minimum tax but allowed a foreign tax credit against the tax. In general, the regular foreign tax credit rules are applied. However, in determining the allowable credit, the foreign tax credit limitation is to be computed separately on the basis of alternative minimum taxable income. In addition, a number of adjustments are made to the credit rules to take into account the interactions between the alternative minimum tax and the regular tax.

Reasons for change

The committee believes that the rules for computing the foreign tax credit allowable against the alternative minimum tax should be clarified.

Explanation of provision

The bill would revise the foreign tax credit rules applicable to the alternative minimum tax to provide greater clarity, but no substantive changes are made. The bill would make it explicit that the credit may not exceed the amount of the alternative minimum tax. In addition, the definition of alternative minimum taxable income from sources without the United States would be revised to define more clearly the adjustments to be made to gross income.

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[1] This rule is not applicable to the capital gains deduction under section 1202 since that deduction is not taken into account in determining a net operating loss deduction under section 172.

Effective date

The amendments made by this provision are effective for taxable years beginning after 1978.

i. Clarification of alternative minimum taxable income to taxpayers not itemizing deductions (sec. 104(a)(4)(D) of the bill and sec. 55(b) of the Code)

Present law

The Revenue Act of 1978 imposed an alternative minimum tax which is payable by an individual to the extent the gross alternative minimum tax exceeds the regular tax as increased by the "add on" minimum tax. The alternative minimum tax base is generally the sum of an individual's gross income, adjusted itemized deductions, and capital gains preference item reduced by deductions allowed for the taxable year.

In the case of a taxpayer who does not elect to itemize deductions, no itemized deductions are allowed for the taxable year. In computing the regular income tax, a bracket is included in the tax tables to provide the taxpayer the benefit of a "standard deduction." No comparable provision is included in the computation of the alternative minimum tax.

Reasons for change

The committee believes that a taxpayer who does not itemize deductions should have the benefit of the "standard deduction" in computing the alternative minimum tax.

Explanation of provision

The bill provides that a taxpayer who does not elect to itemize deductions will be entitled to a deduction equal to the zero bracket amount (formerly the "standard deduction") in computing the alternative minimum tax.

Effective date

The amendment made by this provision applies to taxable years beginning after December 31, 1978.

j. Exclusion of foreign taxes as an adjusted itemized deduction for purposes of the alternative minimum tax (sec. 104(a)(4)(E) of the bill and sec. 57(b) of the Code)

Present law

The Revenue Act of 1978 added a provision that, for purposes of computing the tax preference for "adjusted itemized deductions" under the alternative minimum tax, deductible State and local taxes, in effect, are treated as an "above the line" deduction. No corresponding provision was made in the case of deductible foreign taxes, although the Act provided that the foreign tax credit is allowable against the alternative minimum tax.

Reasons for change

The committee believes that deductible foreign taxes should be treated in the same manner as State and local taxes for purposes of computing the tax preference for adjusted itemized deductions.

Explanation of provision

The bill clarifies that deductible foreign taxes are treated in the same manner as State and local taxes in computing the tax preference for adjusted itemized deductions.

Effective date

The amendment made by this provision applies to taxable years beginning after December 31, 1978.

k. Adjusted itemized deductions of estate or trust and the alternative minimum tax (sec. 104(a)(4)(F) of the bill and sec. 57(b)(2)(A) of the Code)

Present law

The Tax Reform Act of 1976 broadened the minimum tax on preferences to include a preference for adjusted itemized deductions. The Revenue Act of 1978 made the preference for adjusted itemized deductions subject to the new alternative minimum tax and clarified the application of the adjusted itemized deduction preference to trusts and estates. Generally, the preference for adjusted itemized deductions is equal to the amount by which itemized deductions exceed 60 percent of adjusted gross income. In the case of estates and trusts, the preference is the amount by which all deductions other than deductions allowable in arriving at adjusted gross income and certain other deductions exceed 60 percent of the estate's or trust's adjusted gross income reduced by all deductions. However, under the Act, deductions allowable in arriving at adjusted gross income were subtracted twice. In addition, unlike an (other than who is not a trust or estate), the personal exemption of a trust or estate does reduce the amount of adjusted gross income.

Reasons for change

The Revenue Act inadvertently reduced the income of an estate or trust twice by the taxpayer's "above the line" deductions in computing adjusted itemized deductions. Moreover, the personal exemption of a trust or estate should be treated the same as an individual.

Explanation of provision

The bill modifies the computation of the preference for adjusted itemized deductions of a trust or estate to clarify that deductions allowable in arriving at adjusted gross income are taken into account only once. In addition, your committee adds to the House-passed bill an amendment which provides that the personal exemption of a trust or estate does not reduce the adjusted gross income of the trust or estate for purposes of computing the preference for adjusted itemized deductions of the trust or estate.

Effective date

The amendment made by this provision applies to taxable years beginning after December 31, 1978.

l. Carryover of residential energy credit in connection with alternative minimum tax (sec. 104(a)(4)(G) of the bill and sec. 55(c)(3) of the Code)

Present law

The Revenue Act of 1978 imposed a new alternative minimum tax. Generally, credits are not allowed against the alternative minimum tax. However, the Act contained special rules that would allow the carryover of the jobs credit, the work incentive credit, and the investment credit that otherwise would have been lost because of the alter-

native minimum tax. No comparable rule was provided for the residential energy credit.

Reasons for change

The committee believes that the residential energy credit carryover should not be lost because of the alternative minimum tax.

Explanation of provision

The bill provides a rule similar to the rules applicable to the jobs, work incentive, and investment credits for the residential energy credit that will allow the carryover of the residential energy credit where the taxpayer is subject to the alternative minimum tax.

Effective date

The amendment made by this provision applies to taxable years beginning after December 31, 1978.

m. Clerical amendments relating to the alternative minimum tax (sec. 104(a)(4)(H) of the bill and secs. 5, 55, 443, 453, 666, 871, and 877 of the Code)

The following is an explanation of the clerical amendments regarding the alternative minimum tax:

(*1*) *Amendment to section 5.*—A cross reference in section 5 to the minimum tax is corrected.

(*2*) *Amendment to section 55(a).*—An amendment is made to properly space the final clause of the sentence.

(*3*) *Amendment to section 55(b).*—The definition of "regular tax" is amended to exclude the penalty tax on early redemption of retirement bonds to conform to the treatment of the penalty tax on I.R.A. distributions.

(*4*) *Amendment of section 55(c)(3).*—A cross reference to section 53(b) is corrected.

(*5*) *Amendment of section 443(d).*—Section 443(d)(2) is amended to provide that the annualization of the $10,000 minimum tax exemption applies to all taxpayers.

(*6*) *Amendment of section 453(c).*—The application of section 453(c) is clarified by providing that the computation of the adjustment is made without regard to the alternative minimum tax, as well as the add-on minimum tax.

(*7*) *Amendments to section 871 and 877.*—A clerical amendment is made by deleting the word "section" before "55".

(*8*) *Amendment of section 666(c).*—Section 666(c) relating to the treatment of accumulation distributions from trusts is amended to conform to the rule adopted in section 666(b).

n. Clarification of the treatment of post-October 1978 capital gains for purposes of the maximum tax (sec. 104(a)(5) of the bill, sec. 1348 of the Code, and sec. 441(b)(2) of the Act)

Present law

Prior to the Revenue Act of 1978, the amount of personal service income eligible for the 50 percent maximum tax rate was reduced dollar-for-dollar by an individual's items of tax-preference, including capital gains, for the year. The Act increased the net capital gains deduction from 50 to 60 percent, and provided that post-effective date

capital gains would not reduce the amount of personal service income eligible for the 50 percent maximum tax rate. These changes were effective for sales or exchanges after October 31, 1978. However, it was possible that, in certain situations, gains after October 31, 1978, would reduce the amount eligible for the 50 percent maximum tax rate.

Reasons for change

The committee believes that the provisions of the 1978 Act should be clarified so that post-October 31, 1978 gains do not reduce the amount of personal service income eligible for the 50 percent maximum tax rate.

Explanation of provision

In the case of taxable years beginning before November 1, and ending after October 31, 1978, the bill clarifies that the amount of personal service income which is eligible for the 50 percent maximum tax rate is to be reduced only by 50 percent of the lesser of: (1) the net capital gain for the taxable year or (2) the net capital gain taking into account only gain or loss properly taken into account for the portion of the taxable year before November 1, 1978.[1]

Effective date

This provision is effective for taxable years beginning before November 31, 1978, and ending after October 31, 1978.

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[1] The bill also amends section 441 of the Revenue Act of 1978 by striking out "subparagraph (b)" and inserting in lieu thereof "subparagraph (B)".

10. Technical Amendments Relating to Other Tax Provisions

a. Power of the Chief Judge of the Tax Court to assign small tax cases to commissioners (sec. 105(a)(1) of the bill and secs. 7456(c) and 7463(g) of the Code)

Present law

Under section 7456(c) of the Code, the chief judge of the Tax Court may assign declaratory judgment proceedings to be heard by commissioners of the court and authorize a commissioner to make the decision of the court with respect to such proceedings. In addition, under section 7463(g) of the Code, the chief judge may assign tax controversies involving a deficiency of $5,000 or less to be heard by commissioners of the court and authorize a commissioner to make the decision of the court with respect to such proceedings.

Reasons for change

The committee believes that, in order to avoid duplication in the provisions of the Code, a single provision should be utilized to empower the chief judge of the Tax Court to assign various types of proceedings to the commissioners.

Explanation of provision

The bill would repeal the specific provision granting the chief judge the power to assign small tax cases to commissioners. In place of this provision, the bill would add "small tax cases" to the types of proceedings the chief judge may assign to commissioners.

Effective date

The provision is effective on the date of enactment.

b. Refund adjustments for amounts held under claim of right (sec. 105(a)(2) of the bill and sec. 6411(d)(2) of the Code)

Present law

If a taxpayer receives income under a claim of right and restores it in a later year, he may, under a special method for computing his tax liability (Code sec. 1341(b)(1)) be treated as having made an overpayment of tax on the last day prescribed by law for payment of tax for the year the income is restored. The Revenue Act of 1978 establishes an expedited procedure for a tentative refund of the overpayment. This procedure is similar to that in effect prior to the 1978 Act for tentative refunds resulting from net operating loss carrybacks.

Reasons for change

Under the 1978 Act, the time within which the Treasury must act on the tentative refund application is unclear. Also, the extent to which the Treasury is to follow procedures similar to those applied to applications for tentative refunds resulting from net operating loss carrybacks is unclear.

Explanation of provision

The bill clarifies that the Treasury generally is to act on the tentative refund application within a period of 90 days from the date on which the application is filed or from the date of the overpayment (determined under section 1341(b)(1)), whichever is later. The date of the overpayment is the last day prescribed by law for the payment of tax for the year in which a deduction is allowed for the restoration of income held under a claim of right.

It is also made clear that the Treasury, within the time period prescribed above and in a manner similar to the procedure provided for tentative refund of net operating loss carrybacks, is to (i) review the application, (ii) determine the amount of the overpayment, and (iii) apply, credit, or refund the overpayment. It is thus made clear that the requirement of similarity to tentative refunds of net operating loss carrybacks applies to all three of these actions by Treasury, and not merely the third.

Effective date

The provision is effective with respect to tentative refund claims filed on and after November 6, 1978.

c. Reduction of estate tax value of jointly held property where spouse of decedent materially participated in farm or other business (sec. 105(a)(3)(A) of the bill and sec. 2040(c)(2) of the Code)

Present law

The Revenue Act of 1978 contained a provision (Code sec. 2040(c)) which permitted the efforts of a decedent's spouse to be taken into account in determining the amount of jointly held property used in a farm or other business included in the decedent's gross estate. Generally, under this provision, the value of the gross estate could be reduced (1) by the adjusted consideration of the spouse and (2) by 2 percent of the excess of the value of the property over the total adjusted consideration provided by both spouses for each year that the decedent's spouse materially participated in the operation of the farm or other business in which the property was used. The adjusted consideration is the consideration furnished by a spouse plus interest computed at 6 percent per year from the date the consideration was furnished until the date of the decedent's death.

Reasons for change

Under this formula, it was possible that less than the decedent's adjusted consideration, or the portion of the value attributable to the decedent's adjusted consideration, would be included in the decedent's gross estate where the total appreciation in the property was less than the assumed 6 percent increase in the original consideration.

Explanation of provision

The bill would correct this result by providing that the special rule would not apply if the sum of the adjusted consideration provided by both spouses equals or exceeds the value of the property on the date of the decedent's death.

Effective date

This provision is effective for estates of decedents dying after December 31, 1978.

d. Clerical amendment relating to jointly held property (sec. 105(a)(3)(B) of the bill and sec. 2040(c) of the Code)

As a clerical amendment, the bill amends paragraph (1) of section 2040(c) by correcting a plural reference to "subsection (a)" to a singular reference.

e. Clerical amendments relating to time to amend governing instruments of split interest trusts (sec. 105(a)(4)(A) of the bill and sec. 2055(e)(3) of the Code)

The bill makes two clerical amendments to the provision permitting amendment of governing instruments of split interest charitable trusts (Code sec. 2055(e)(3)).

First, the bill corrects the cross reference to subparagraph (A) of section 2055(e)(2) of the Code by capitalizing the letter "A".

Second, the bill adds the article "the" which was erroneously deleted.

f. Amending governing instruments of charitable split interest trusts (sec. 105(a)(4)(B) of the bill and sec. 514 of the Revenue Act of 1978)

Present law

The Tax Reform Act of 1969 denied an estate tax, gift tax or income tax charitable deduction for the value of a remainder interest passing to charity unless the remainder interest is in a charitable remainder unitrust, charitable remainder annuity trust, or a pooled income fund. In the case of an income interest passing to charity (i.e., a lead trust), a deduction was denied unless the income interest is in the form of a guaranteed annuity or a fixed percentage of the fair market value of the trust (determined annually).

Legislation in 1974 granted a reformation period until December 31, 1975 to redraft wills and other testamentary instruments to conform to the new rules for the estate tax deduction for charitable remainders. The reformation period was extended through December 31, 1977 by the Tax Reform Act of 1976.

The Revenue Act of 1978 extended, through December 31, 1978, the reformation period for purposes of the estate tax charitable deduction for charitable remainders. The 1978 Act also provided a reformation period through December 31, 1978, for purposes of the income and gift tax charitable deductions in the case of charitable remainders and for purposes of the estate, income and gift tax charitable deductions for charitable lead trusts. The 1974 and 1976 legislation was made effective with respect to estates of decedents dying after December 31, 1969. In 1978, a similar effective date provision was omitted.

Reasons for change

The committee believes that reformation of charitable lead trusts and charitable remainder trusts in order to comply with the requirements of the Tax Reform Act of 1969 should be effective for Federal income, gift and estate tax purposes so long as the reformation is done before the deadline for reformations. While the committee believes it

appropriate to allow reformation of trusts to which the requirements of the Tax Reform Act of 1969 apply, it does not believe that the period of limitations should be waived for this purpose.

Explanation of provision

The bill provides that the amendment made by section 514 of the Revenue Act of 1978 applies to transfers in trust and contributions made after July 31, 1969, for Federal income tax purposes; to decedents dying after December 31, 1969, for Federal estate tax purposes; and to transfers after December 31, 1969, for Federal gift tax purposes.

Effective date

The amendment is effective as if it were included in the Revenue Act of 1978.

g. Distribution from estate prior to 1980 of farm valuation property (sec. 105(a)(5) of the bill and sec. 1040 of the Code)

Present law

Under present law, the distribution of property by an estate or trust in satisfaction of a pecuniary bequest is treated as a taxable transaction resulting in the recognition of gain or loss to the estate or trust.

The Revenue Act of 1978 added a provision to clarify that where property is subject to special farm or other business use valuation, the tax will be measured by the difference between the fair market value of the property on the date of distribution (determined without regard to special use valuation) and the fair market value of the property on the date of the decedent's death (also determined without regard to special use valuation). However, the postponement of the carryover basis provisions until 1980 inadvertently resulted in a postponement of this provision.

Reasons for change

The committee wishes to correct the inadvertent postponement of the effective date of the provision added by the Revenue Act clarifying the income tax treatment of the distribution of special use valuation property to satisfy a pecuniary bequest.

Explanation of provision

The bill clarifies that the provision added by the 1978 Act concerning the distribution of special use valuation property in satisfaction of a pecuniary bequest is effective for estates of decedents dying after December 31, 1976.

Effective date

The amendment made by this provision applies to estates of decedents dying after December 31, 1976.

h. Clarification of tax treatment of cooperative housing corporations where stock is acquired in a tax-free transaction or by an estate (sec. 105(a)(6) of the bill and sec. 216(b)(6) of the Code)

Present law

A tenant-stockholder in a cooperative housing corporation is entitled to deduct amounts paid to such a corporation to the extent such

amounts represent his or her proportionate share of allowable real estate taxes and interest relating to the corporation's land and buildings (Code sec. 216). In general, for a corporation to qualify as a cooperative housing corporation (which can pass through these deductions to tenants-shareholders), 80 percent or more of the gross income of the cooperative housing corporation must be derived from individual tenant-stockholders.

Under the Revenue Act of 1978, if a person who conveys a house, apartment-housing, or leasehold thereof, to a cooperative housing corporation acquires stock in the corporation by *purchase* or foreclosure, together with a lease or right to occupy the house or apartment, such person would be treated as a tenant-stockholder for up to three years from the date of acquisition (even if such person were not an individual).

Reasons for change

The general intent of this 1978 change was to allow corporate promoters to form cooperative housing corporations and to own the shares in such corporations during a reasonable period while the shares were being sold to individuals who would qualify as tenant-stockholders under the general rules of section 216 of the Code. The requirement that the stock be acquired "by purchase or foreclosure" may well be interpreted as not being satisfied in situations where the corporate promoter acquires the stock in a tax-free transaction (such as a transfer to a controlled corporation pursuant to the provisions of section 351 of the Code). Also, if an individual has conveyed a house, apartment building, or leasehold thereof, to a cooperative housing corporation in exchange for stock, such an individual would be treated as a tenant-stockholder, but it is not clear that his estate would be treated as a tenant-stockholder if the individual dies after acquiring such stock.

Explanation of provision

The bill amends the provisions added by the 1978 Act to provide that, if an original seller (e.g., a corporate promoter) acquires stock of a cooperative housing corporation either from the corporation or by foreclosure, the original seller shall be treated as a tenant-stockholder for a period of not to exceed three years from the date of the acquisition of the stock. However, except in the case of an acquisition of stock of a cooperative housing corporation, by foreclosure, this rule only applies to stock acquired from the cooperative housing corporation which occurs not later than one year after the date on which the apartments or houses (or leaseholds therein) are transferred by the original seller to the corporation.

The bill also provides that, if an individual original seller dies, the estate of the individual will be treated as a tenant-stockholder for the same period as the individual would have been treated as a tenant-stockholder if he had lived.

The amendments made by these provisions are the same as those in the House bill except that the House bill does not contain the provision relating to the estate of an individual original seller.

Effective date

These provisions apply to stock acquired after November 6, 1978. This is the same effective date as the modifications made to Code section 216 by section 531 of the Revenue Act of 1978.

i. Amendments relating to exclusion of certain cost-sharing payments (secs. 105(a)(7) (A) to (D) of the bill and secs. 126 and 1255 of the Code)

Present law

The Revenue Act of 1978 provided an exclusion from gross income for all or a portion of certain payments received under a number of Federal and State cost-sharing conservation programs. Under these provisions, no deduction or credit could be claimed with respect to amounts excluded under the Act, and the basis of any property acquired or improved with these payments would not reflect the excluded amounts, Also, under the Act, a special rule was provided for the recapture (that is, treatment as ordinary income rather than capital gains) of excluded amounts if the property, or improvements, purchased with the payments are disposed of before the expiration of 20 years.

Reasons for change

Since the provisions of the Act automatically apply to the excludible portion of all cost-sharing payments, there are some circumstances under which a taxpayer could be worse off under this provision than under prior law. Generally, this results from the fact that, under some circumstances, at least some of the payments received under certain of these programs are reimbursements for costs for which a current deduction would otherwise be allowable. Thus, under prior law, a taxpayer would have had a wash (that is, deductions offsetting income) and the recapture rule would not have applied to him. Under the provisions of the Act, such a taxpayer would have the same effect of a wash (by the exclusion of the income and the disallowance of any corresponding deduction) but would be subject to recapture. Also, there are certain other circumstances where, even though the amounts attributable to reimbursements under these cost-sharing programs were not currently deductible, the taxpayer might (by reason of the application of the investment credit, net operating loss limitations, etc.) be better off under prior law than under the exclusion rule.

Explanation of provision

The bill would provide that the exclusion for cost-sharing payments and the recapture provision do not apply to any portion of any payment which is properly attributable to an amount which is allowable as a deduction for the taxable year in which the amount is paid or incurred. The bill would also provide that, if a taxpayer makes an election, the exclusion provision and the recapture provision will not apply to the excludible portion of any government cost-sharing payment. Such an election would be made not later than the due date (including extensions) for filing the taxpayer's income tax return for the taxable year in which the payment was received or accrued.

In addition, an amendment is made to the recapture provision (Code sec. 1255) to coordinate this provision with the other recapture provisions which could potentially result in ordinary income from the disposition of property acquired or improved with excluded cost-sharing payments.[1] (These provisions are section 1251 (relating to recapture of amounts in so-called "Excess Deduction Accounts") and section 1252 (relating to recapture of previously deducted soil and water conservation expenses or land clearing expenses).)

The bill also contains clerical amendments to the cost-sharing payments exclusion provision and the recapture provision. The clerical amendment to the exclusion provision adds the words "or his delegate" immediately after the words "Secretary of the Treasury" in section 126(a)(9), thus allowing the Secretary to delegate certain responsibilities. Section 1255(b)(2) indicates that amounts treated as ordinary income under section 1255 are to be treated in the same manner as ordinary income resulting from depreciation recapture with respect to section 1245 property. A clerical amendment clarifies that this rule is to be applied for purposes of sections 163(d), 170(e), 341(e)(12), 453(d)(4)(B), and 751(c).

Effective date

These provisions apply to grants made after September 30, 1979. This is the same effective date as for the related provisions in the Revenue Act of 1978.

j. Application of exclusion for certain cost-sharing payments to certain local programs (sec. 105(a)(7)(E) of the bill and sec. 126(a)(10) of the Code)

Present law

The Revenue Act of 1978 generally provides that gross income does not incl the excludible portion of payments received under the following programs:

(1) The rural clean water program authorized by section 208(j) of the Federal Water Pollution Control Act;

(2) The rural abandoned mine program authorization by section 406 of the Surface Mining Control and Reclamation Act of 1977;

(3) The water bank program authorized by the Water Bank Act;

(4) The emergency conservation measures program authorized by title IV of the Agricultural Credit Act of 1978;

(5) The agricultural conservation program authorized by the Soil Conservation and Domestic Allotment Act;

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[1] Under this amendment, the amount recaptured under this section cannot exceed the amount of gain realized on disposition of the property reduced by the sum of the amounts treated as ordinary income by reason of sections 1231 through 1254. For example, assume that a parcel of real property is sold at a gain of $100,000, that $40,000 of such gain is treated as ordinary income under section 1250, and that $75,000 in cost-sharing payments had been excluded from gross income under section 126 with respect to this property within the preceding 10 years. Under these circumstances, $60,000 would be recaptured under section 1255. However, if the amount treated as ordinary income under section 1250 were only $10,000, then the amount recaptured under section 1255 would be the full $75,000.

(6) The great plains conservation program authorized by section 16 of the Soil Conservation and Domestic Policy Act;

(7) The resource conservation and development program authorized by the Bankhead-Jones Farm Tenant Act and by the Soil Conservation and Domestic Allotment Act;

(8) The forestry incentive program authorized by section 4 of the Cooperative Forestry Assistance Act of 1978;

(9) Any small watershed program administered by the Secretary of Agriculture which is determined by the Secretary of the Treasury to be substantially similar to the type of programs described in items (1) through (8); and

(10) Any State program under which payments are made to individuals primarily for the purpose of conserving soil, protecting or restoring the environment, improving forests, or providing a habitat for wildlife.

However, for a payment (or portion thereof) to be excluded from income under this provision, two conditions must be met. First, a determination must be made by the Secretary of Agriculture that the payment is made primarily for the purpose of conserving soil and water resources, protecting or restoring the environment, improving forests, or providing a habitat for wildlife. Second, the Secetary of the Treasury must determine that the payment does not result in a substantial increase in the annual income derived from the property with respect to which the payment is made.

Reasons for change

Under present law, it is not clear whether the exclusion would apply to payments received under local programs for conservation purposes.

Explanation of provision

The bill provides that the exclusion for cost-sharing payments applies to payments primarily for the purpose of conserving soil, protecting or restoring the environment, improving forests, or providing a habitat for wildlife under programs of a State, possession of the United States, a political subdivision of any of the foregoing, or the District of Columbia.

Effective date

This provision applies to grants made after September 30, 1979. This is the same effective date as for the related provisions in the Revenue Act of 1978.

11. Amendments Relating to General Stock Ownership Corporations (sec. 106 of the bill and sec. 1391 of the Code)

The Revenue Act of 1978 authorized a State to establish a General Stock Ownership Corporation (GSOC) for the benefit of its citizens. A GSOC must be chartered by an act of the State legislature or as a result of a referendum and must provide for issuance of shares of stock to all the residents of the State (other than those electing not to receive a share). The income of the GSOC would be taxed directly to the shareholders.

The following clerical amendments to the GSOC provisions are made by the bill:

a. Amendments to section 172(b)(1).—The 1978 Act added two subparagraphs (H) to section 172(b)(1). The bill redesignates the subparagraph (H) relating to GSOCs as subparagraph (I) and makes conforming amendments.

b. Amendments to section 1016(a).—Paragraph (21) of section 1016 (a) is redesignated as paragraph (22).

c. Amendments to section 1391.—Several punctuation errors are corrected.

d. Amendment to section 1392.—The word "where" is corrected to read "when".

12. Amendments Relating to Technical Corrections to the Tax Reform Act of 1976

a. Computation of adjusted itemized deductions in case of estates and trusts (sec. 107(a)(1)(A) of the bill and sec. 57(b)(2)(C) of the Code)

Present law

Under the Revenue Act of 1978, the alternative minimum tax is imposed on the adjusted itemized deductions preference. The charitable contributions deduction is an itemized deduction that normally may result in the adjusted itemized deductions preference. However, the Act provided an exception in the case of certain charitable deductions of trusts and estates. One exception arises where all the unexpired interests in the trust are devoted to religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals (i.e., the purposes described in section 170(c)(2)(B) of the Code). Another exception arises where all of the income interests in the trust are devoted to religious, charitable, etc., purposes (i.e., purposes described in section 170(c)(2)(B) of the Code), and the grantor had a power to revoke the trust at his death. Neither of the two exceptions applies where the interests in the trust are for purposes other than religious, charitable, etc., purposes (i.e., those purposes described in section 170(c)(2)(B) of the Code) but for which a charitable deduction is nonetheless allowable (i.e., those purposes described in Code sections 170(c)(1), (3), (4) and (5)).

Reasons for change

The committee believes that the preference for adjusted itemized deductions attributable to a charitable contribution deduction should not apply in the case of a trust devoted entirely to purposes for which a charitable deduction is allowed.

Explanation of provision

The bill modifies the exceptions for charitable contributions as an item of adjusted itemized deductions preference so that they apply to all interests in the trust devoted to purposes for which a charitable deduction is allowed to the trust.

Effective date

The amendment made by this provision applies to taxable years beginning after December 31, 1975.

b. Allocation of tax preference items in case of trusts and estates (sec. 107(a)(1)(C) of the bill and sec. 58(c)(1) of the Code)

Present law

The Revenue Act of 1978 imposed a new alternative minimum tax on individuals including trusts and estates.

In the case of a trust or estate, the items of tax preference are apportioned between the estate or trust and the beneficiaries on the basis of income of the estate or trust allocated to each.

Reasons for change

The committee believes that the Treasury should have authority to allocate the tax preferences between a trust or estate and the beneficiaries other than on the basis of income to properly reflect which of the parties received the tax benefit of the preference.

Explanation of provision

The provision allows the Treasury Department to issue regulations to provide rules for apportioning the items of tax preference between a trust or estate and its beneficiaries.

Effective date

This amendment is effective for taxable years beginning after December 31, 1975.[1]

c. Recapture of depreciation of certain subsidized low-income housing (sec. 107(a)(1)(D) of the bill and sec. 1250(a)(1)(B) of the Code)

Present law

The Revenue Act of 1978 added a provision clarifying that the recapture of depreciation on property on which rehabilitation expenditures were amortized under Code section 191 is to be made under Code section 1250 rather than Code section 1245.

The 1978 Act amended Code section 1250(b)(4) to clarify that the amount of "straight line" depreciation is to be computed without regard to the 5-year useful life under Code section 191. This clarification inadvertently may have caused additional recapture to apply to certain subsidized low-income housing (described in clauses (i), (ii), and (iv) of Code sec. 1250(a)(1)(B)).

Reasons for change

This committee believes that the normal recapture rules of Code section 1250 should apply to subsidized low-income housing on which 5-year amortization under Code section 191 has been taken.

Explanation of provision

The amendment provides that the special 100-month recapture phase-out rules for subsidized low-income housing may apply even though rehabilitation expenditures for that housing have been amortized under Code section 191.

Effective date

The amendment applies to additions to capital account made after June 14, 1976 and before June 15, 1981.

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[1] An identical provision was included in H.R. 6715 (95th Congress), the Technical Corrections bill, as passed by the House of Representatives and reported by the Finance Committee. The provision was also included in H.R. 13511 (95th Congress), the Revenue Act of 1978, as passed by the Senate. However, it was inadvertently deleted from the conference report on that bill.

d. Employee of grantor or beneficiary treated as related person for purposes of the tax on generation-skipping transfers (sec. 107(a)(2)(B)(i) of the bill and sec. 2613(e) of the Code)

Present law

Under the generation-skipping provisions added by the Tax Reform Act of 1976, an individual is a beneficiary of a trust if he has a present or future power or interest in it. "Power" means "any power to establish or alter beneficial enjoyment of the corpus or income of the trust." A person has an "interest" if the person has either "a right to receive income or corpus from the trust" or "is a permissible recipient of such income or corpus." Thus, one can be a beneficiary by satisfying either or both of the tests. However, the Tax Reform Act of 1976 excluded certain independent trustees from being treated as beneficiaries solely because of powers which they held to distribute trust corpus and income.

The Revenue Act of 1978 expanded the categories of individuals to whom independent trustees could make distributions without being treated as beneficiaries. Specifically, the 1978 Act excluded from the group of independent trustees any person who is an employee of a corporation in which the stockholdings of the grantor, the trust, and the beneficiaries of the trust are significant from the viewpoint of voting control, an employee of a corporation in which the grantor or any beneficiary of a trust is an executive, and an employee of a partnership in which the grantor or any beneficiary of the trust is a partner. However, the provision did not exclude a person who is directly employed by the grantor or any beneficiary of the trust.

Reasons for change

The committee believes that a person who is directly employed by the grantor or any beneficiary of the trust should not be considered an independent trustee for purposes of the generation-skipping tax.

Explanation of provision

The bill provides that employees of the grantor or any beneficiary of the trust are excluded from the persons who can qualify as an independent trustee for purposes of the tax on generation-skipping transfers.

Effective date

The amendment is effective for any generation-skipping transfer made after June 11, 1976.

e. Certain powers of independent trustees not treated as a power for purposes of the tax on generation-skipping transfers (sec. 107(a)(2)(B)(ii) of the bill and sec. 2613(e) of the Code)

Present law

Under the generation-skipping provisions that were added by the Tax Reform Act of 1976, an individual is a beneficiary of a trust if he has a present or future power or interest in it. "Power" means "any power to establish or alter beneficial enjoyment of the corpus or income of the trust." A person has an "interest" if the person has either "a right to receive income or corpus from the trust" or "is a permissible recipient of such income or corpus." Thus, one can be a beneficiary by satisfying either or both of the tests. The Tax Reform

Act of 1976 excluded certain independent trustees from being treated as beneficiaries solely because of powers which they held to distribute trust corpus and income.

Section 702(n)(2) of the Revenue Act of 1978 expanded the categories of individuals to whom independent trustees could make distributions without being treated as beneficiaries. Under the 1978 Act amendment, an individual will not be treated as having a power if such an individual "is a trustee who has no *interest* in the trust" (emphasis added). Thus, an individual trustee who is the permissible appointee of trust assets under an unexercised power of appointment held by another would be deemed to have an interest in the trust and would therefore be treated as having a power over the trust. The trustee would be a beneficiary of the trust and the independent trustee exemption would be negated. However, the legislative history of the Revenue Act of 1978 states that an individual trustee will not be treated as a beneficiary if "he has no interest in the trust other than as a potential appointee under a power of appointment held by another."

Reasons for change

The committee believes that the position taken in the legislative history technically needs to be incorporated in the Internal Revenue Code.

Explanation of provision

The bill provides that, solely for purposes of the independent trustee exemption, a trustee will not be treated as having an interest in the trust if his only interest is as a permissible appointee under an unexercised power of appointment held by another.

Effective date

The amendment is effective for any generation-skipping transfer made after June 11, 1976.

f. Estate tax treatment of gifts made within 3 years of death (sec. 107(a)(2)(F) of the bill and sec. 2035 of the Code)

Present law

Prior to the Tax Reform Act of 1976, the gross estate of a decedent included all gifts made in contemplation of death that occurred less than 3 years before the date of the decedent's death. Under this rule, the Internal Revenue Service, for administrative purposes, generally required that only gifts in excess of $1,000 need be included in the estate tax return.

The Tax Reform Act of 1976 provided that all gifts made within 3 years of the decedent's death are to be included in the gross estate of the decedent, regardless of whether the gift was made in contemplation of death. However, the 1976 Act contained an exception to this inclusion rule for gifts to which the annual $3,000 gift tax exclusion applied. The legislative history was somewhat ambiguous and could be read to mean that this exception resulted in the inclusion of only the excess of the estate value of all gifts over the amount excludible under the gift tax annual exclusion.

The Technical Corrections bill, which was added to the 1978 Act, clarified the exception so that only gifts (other than transfer with

respect to a life insurance policy) which were made within 3 years of death and were not required to be included in a gift tax return were not to be included in a decedent's gross estate. Under this rule, the entire amount of the gift (and not just the excess of the value of the gift over $3,000) is includible in the gross estate where the aggregate annual gifts to a donee were in excess of $3,000. This clarification was to apply to gifts made after December 31, 1976.

Reasons for change

Because of the ambiguity that existed prior to the committee's action on this issue in October 1977, it is possible that gifts could have been made in excess of $3,000 based upon the assumption that only the excess of the value over $3,000 would be included in the gross estate as transfers within 3 years of death. Therefore, the committee believes that the "subtraction out" concept should be allowed with respect to gifts made before the adoption of the clarifying change by the Ways and Means Committee.

Explanation of provision

The amendment allows executors of decedents to elect with respect to all gifts made in *1977* (other than transfer with respect to a life insurance policy) to *all donees* to include in the decedent's gross estate only the excess of the death time value over the amount excluded in computing taxable gifts by reason of the $3,000 annual exclusion under section 2503(b). If an executor elects the application of the provision, there will be included in the decedent's gross estate the death time value less the amount excluded under section 2503(b) with respect to such gifts. If this election is made, it will apply to all gifts (other than transfers to respect to a of life insurance policy) made by the decedent during 1977 which were made within 3 years of death.

The election by the executor must be made by the due date of the estate tax return (including extensions), or, if later, within 120 days after the date of the enactment of this bill.

Effective date

The amendment made by this provision applies with respect to estates of decedents who made gifts during 1977 which were made within 3 years of death.

Effective date

The provision applies to involuntary conversions after December 31, 1976. This is the same effective date as section 4 of Public Law 95-472.

g. Clerical and conforming amendments (sec. 107(a) of the bill and secs. 46(f), 103, 911, 1014(a), 1016(a), 2613, and 6698 of the Code)

The following clerical and conforming amendments to the Technical Corrections to the Tax Reform Act of 1976 are made by this provision:

(*1*) *Amendments to section 911*.—The effective date of an amendment to section 911 is conformed to the effective date under section 209 of the Foreign Earned Income Act of 1978; the reference to "Subsection (c)" in section 701(a)(3) of the Revenue Act is corrected to read "Subsection (e)"; and the redesignation of paragraph (8) of section 911(c) is repealed.

(*2*) *Amendment to section 1014(a)*.—A typographical error in the reference to "section 2032A" is corrected.

(*3*) *Amendments to section 2613.*—Section 2613(e)(2)(B) is corrected by striking out clause (vi) which is identical to another clause.

(*4*) *Amendment to section 1016(a)*.—The redesignation of paragraph (23) is repealed.

(*5*) *Amendment to section 6698.*—Section 6698 relating to carryover basis is redesignated as section 6698A.

(*6*) *Amendment to section 46(f)*.—A cross reference in section 46(f) is corrected to read "subsection (a)(7)(C)".

(*7*) *Amendment to section 103.*—A reference to "section 103(d)" is corrected to read "section 103(e)".

B. TECHNICAL AMENDMENTS TO OTHER 1978 TAX LEGISLATION

1. Technical Amendments Relating to the Foreign Earned Income Act of 1978

a. Use of tax tables by individuals excluding foreign earned income (sec. 108(a)(1)(A) of the bill and sec. 3 of the Code)

Present law

Prior to the Tax Reform Act of 1976, certain individuals working abroad were allowed to exclude from gross income up to $20,000 annually ($25,000 in some cases). The Tax Reform Act of 1976 amended this provision so that these individuals were taxed on their other income at the higher rate brackets which would have applied if the excluded earned income were not so excluded (i.e., the exclusion was "off the bottom"). This amendment made the use of tax tables inappropriate for these individuals and, under the Tax Reduction and Simplification Act of 1977, they are not permitted to use the tables.

The Foreign Earned Income Act of 1978 made a number of changes in the foreign earned income exclusion. Among these is a rule that the excluded income is not taken into account in computing the tax on the taxpayer's other income (i.e., the exclusion is "off the top").

Reasons for change

Because the foreign earned income exclusion is taken "off the top" under the 1978 Act, the committee believes that the use of tax tables by taxpayers electing the exclusion is appropriate.

Explanation of provision

The bill would permit individuals who exclude foreign earned income to use the tax tables.

Effective date

The provision is generally effective for taxable years beginning after December 31, 1977. It does not apply, however, to any taxable year for which an individual elects to be taxed under the Tax Reform Act of 1976.

b. Definition of "earned income" for purposes of the deduction for excess foreign living costs (sec. 108(a)(1)(B) of the bill and sec. 913(j)(1)(A) of the Code)

Present law

The Foreign Earned Income Act of 1978 established a deduction for excess foreign living costs for Americans working abroad. The aggregate amount deductible under this provision cannot exceed the taxpayer's foreign "earned income," and his earned income also is relevant in the calculation of the excess housing costs, one element of the deduction. For purposes of determining earned income under present law, compensation received in the year after the services are per-

formed generally is considered received, and thus earned income, in the year in which the services were performed rather than the next year when the compensation is received. However, compensation received more than one year after the services were performed is not included in earned income for purposes of the housing deductions or the earned income limitation.

Reasons for change

Compensation arrangements for Americans working abroad may defer payment beyond the year following the year in which services are performed. If these payments are not taken into account in the performance year, the individual's earned income for that year and his base housing amount are reduced. This inflates the taxpayer's deduction for excess foreign housing costs and creates the potential for manipulation of the housing deduction.

Explanation of provision

The bill modifies the treatment of deferred compensation in computing the housing element of the excess living cost deduction under section 913.

First, for purposes of computing the housing element of the deduction, deferred compensation is taken into account in the year it is included in income, not the year in which the services giving rise to the compensation were performed. Accordingly, the bill eliminates the requirement of present law that the housing deduction for a year be recomputed and an amended return be filed in situations where the compensation for services performed that year is not taken into income until the following year. However, under the bill, deferred compensation received more than one taxable year after the taxable year in which services are performed is taken into account for purposes of computing the housing deduction, rather than being disregarded as under present law. (The bill continues the rule that compensation deferred for more than one year is not taken into account in computing the earned income limitation.)

Second, the bill provides a new recapture rule to deal with situations where a taxpayer defers compensation from a year in which he claims a deduction under section 913 for excess foreign housing costs (the "performance year") to a year in which he does not have an excess housing cost deduction. This recapture rule only applies where the compensation ("after-received compensation") is deferred for no more than 3 years after the year in which the services are performed. For purposes of determining the amount of recapture (if any), the taxpayer recomputes the qualified housing expense for both the performance year and the year of receipt as though the deferred compensation were received in the performance year rather than the year of receipt. Any decrease in the amount of the aggregate qualified housing expense deduction as a result of this recomputation will be recaptured by including an amount equal to such decrease in income (but not in "housing income") in the year of receipt.

The amount of the recapture is determined by aggregating the housing deduction for the present and all prior taxable years and subtracting from that total the aggregate of the recomputed housing

deduction for the present and all prior taxable years for which a housing deduction has been allowed. The recomputed housing deduction is determined by treating after-received compensation as housing income for the performance year instead of the year of receipt. The excess of the aggregate housing deductions actually taken in these years over the recomputed housing deduction for these years will be taken into income in the year the after-received compensation is received. However, any amount recaptured in one year shall not give rise to recapture in a subsequent year.

The computation of the recapture of excess housing deductions is illustrated by the following examples.

Example 1

In 1979, the taxpayer had $200 of housing income and $70 of housing expense. In 1980, he had $300 of housing income attributable to 1980, $100 of housing income that was after-received compensation attributable to 1979, and $90 of housing expenses.

Set forth below are the computations of the taxpayer's actual housing deduction for these two years and also the housing deductions for the two years as recomputed for purposes of determining the recapture amount:

	Actual		*Recomputed*	
	1979	*1980*	*1979*	*1980*
Housing income	$200	$400	[1] $300	[2] $300
Less housing expenses	70	90	70	90
	$130	$310	$230	$210
	×20%	×20%	×20%	×20%
Base housing amount	$26	$62	$46	$42
Housing expenses	$70	$90	$70	$90
Base housing amount	26	62	46	42
Housing deduction	$44	$28	$24	$48

[1] $200 of housing income attributable to 1979 plus $100 of deferred compensation attributable to 1979.

[2] $300 of housing income attributable to 1980.

The aggregate actual housing deductions for the two years is $72 and the aggregate recomputed housing deduction for the two years is $72. Since the actual deduction does not exceed the recomputed deduction, there is no excess housing deduction to be recaptured.

This example illustrates the result that, if the taxpayer takes a housing deduction in the year the after-received compensation is received, there will be no recapture under this provision. This is because the after-received compensation will have been fully taken into account in computing the current year housing deduction, thus having increased the base housing amount by 20% of such compensation, and, correspondingly, reducing the housing deduction for the current year by 20% of the after-received compensation.

Where the taxpayer does not take a housing deduction in the current year, there will be recapture if the taxpayer took a housing deduction in the performance year. This is because the full measure of the after-received compensation was not included in the computation of the housing deduction for the current year. The following example illustrates the recapture computation in this situation:

Example 2

Assume the same facts as in example 1 except that the taxpayer's housing expenses in 1980 were $60. The taxpayer's actual and recomputed housing expense in the two years would be as follows:

	Actual		*Recomputed*	
	1979	*1980*	*1979*	*1980*
Housing income	$200	$400	$300	$300
Less housing expenses	70	60	70	60
	$130	$340	$230	$240
	×20%	×20%	×20%	×20%
Base housing amount	$26	$68	$46	$48
Housing expenses	$70	$60	$70	$60
Base housing amount	26	68	46	48
Housing deduction	$44	0	$24	$12

The aggregate actual housing deductions for the two years is $44 while the aggregate recomputed housing deductions is $36. Since the actual housing deductions exceed the recomputed housing deduction by $8, the taxpayer is required to recapture the $8 as income in 1980.

Effective date

The provision is generally effective for taxable years beginning after December 31, 1977. It does not apply, however, to any taxable year for which an individual elects to be taxed under the Tax Reform Act of 1976.

c. Clerical amendment to section 911(a)(2) (sec. 108(a)(1)(C) of the bill and sec. 911(a)(2) of the Code)

Section 911(a)(2) is amended to refer to "a foreign country or countries" rather than to "qualified foreign countries".

d. Disallowance of deductions attributable to excluded foreign earned income (sec. 108(a)(1)(D) of the bill and sec. 911(a) of the Code)

Present law

Under the law prior to the Foreign Earned Income Act of 1978, an individual who excluded foreign earned income could not claim any deductions, or take a credit for any foreign income taxes, to the extent properly allocable to or chargeable against the excluded income. This provision (Code sec. 911(a)) was carried over under the 1978 Act but the words "any deduction" inadvertently were omitted with the result

that it was less clear that deductions, as well as foreign tax credits, allocable to exclude foreign earned income are to be disallowed.

Reasons for change

The committee believes that it should be made clear that deductions attributable to amounts excluded under the 1978 Act are to be disallowed.

Explanation of provision

The bill amends section 911(a) of the Code to make it clear that deductions, as well as credits, allocable to or chargeable against excluded earned income are not allowable.

Effective date

The provision is generally effective for taxable years beginning after December 31, 1977. It does not apply, however, to any taxable year for which an individual elects to be taxed under the Tax Reform Act of 1976.

e. Clerical amendment to section 3(b) (sec. 108(a)(1)(E) of the bill and sec. 3(b) of the Code)

Section 3(b)(1) of the Code is amended by redesignating subparagraphs (B) and (C) as subparagraphs (A) and (B) respectively.

f. Definition of "qualified home leave expenses" for purposes of the deduction for excess foreign living costs (sec. 108(a)(1)(F) of the bill and sec. 913(g) of the Code)

Present law

The Foreign Earned Income Act of 1978 established a deduction for excess foreign living costs for Americans working abroad. One element of the deduction consists of the taxpayer's "qualified home leave expenses." These are defined by the 1978 Act to mean the reasonable amounts paid or incurred by or on behalf of an individual for the transportation of that individual, his spouse, and each dependent from the location of the individual's tax home outside the United States to (i) the individual's present (or, if none, most recent) principal residence in the United States, or (ii) if that rule does not apply to the individual, the nearest port of entry in the continental United States (excluding Alaska), and return.

Reasons for change

Under the 1978 Act, it is unclear whether the rule allowing a deduction for travel to the nearest U.S. port of entry applies to all individuals who do not return to their present (or most recent) U.S. principal residence or only to those individuals who never had a U.S. principal residence. Also, it is unclear whether a deduction is allowable if the taxpayer departs from, or returns to, a location abroad other than his tax home. The committee believes that both these points require clarification.

The nearest-port-of-entry rule under the 1978 Act excludes Alaska and Hawaii. This was intended to permit U.S. taxpayers in the Far East to deduct the cost of travel to the 48 contiguous states and not to be confined to the cost of travel to Alaska or Hawaii, if nearer. The committee believes that individuals should be allowed to elect to include

Alaskan and Hawaiian ports of entry so as to permit deduction of the costs of travel to the nearest of those ports.

Explanation of provision

The bill would make it clear that the qualified home leave expenses generally mean the travel costs from any point outside the United States to the individual's principal domestic residence, and from the individual's principal domestic residence to any point outside the United States. However, the amount of the deduction may not exceed the reasonable amount for round-trip transportation between the location of his tax home outside the United States and his principal domestic residence. For these purposes, his principal domestic residence is the location of his present (or, if none, most recent) principal residence in the United States.

The taxpayer need not return to the same foreign location from which he departed. If he ends one foreign assignment and begins another in conjunction with his home leave, acquiring a new foreign tax home, the limitation on the cost of travel to the United States is to be applied with respect to the old foreign tax home and the limitation on the cost of travel from the United States is to be applied with respect to the new foreign tax home.

If the individual's travel in the United States is not travel to and from his principal domestic residence, or if he never had a principal domestic residence, these rules are to be applied by substituting the nearest port of entry in the United States for the individual's principal domestic residence. As under the 1978 Act, the taxpayer may not deduct as qualified home leave expenses the cost of bringing his family abroad to visit him and of returning them to the United States. The travel must originate abroad and be to and from the United States.

The taxpayer may elect to include ports of entry in Alaska and Hawaii among U.S. ports of entry. Thus, if the taxpayer does not travel to his domestic principal residence, he may base his deduction under the nearest-port-of-entry rule on the cost of travel to the nearest port including ports in Alaska and Hawaii.

Effective date

The provision is generally effective for taxable years beginning after December 31, 1977. It does not apply, however, to any taxable year for which an individual elects to be taxed under the Tax Reform Act of 1976.

g. Clerical amendment to section 119 (sec. 108(a)(1)(G) of the bill and sec. 119 of the Code)

The heading of section 119(a) of the Code (relating to meals or lodging furnished for the convenience of the employer) is corrected.

2. Technical Amendments Relating to the Black Lung Benefits Revenue Act

a. Correction of provisions related to Tax Court jurisdiction (sec. 108(b)(1) of the bill and secs. 6503, 6511, 6862, and 7422 of the Code)

(*1*) *Amendment of section 6503(g)*.—In section 6503(g) of the Code, the references to the black lung benefit trust excise taxes on self-dealing and taxable expenditures are corrected to be sections 4951 and 4952, instead of sections 4985 and 4986.

(*2*) *Amendment of section 6511(f)*.—In section 6511(f) of the Code, references to section 4975 (excise tax on certain qualified pension, etc., plan prohibited transactions) are added to references to private foundation excise taxes and black lung benefit trust excise taxes.

(*3*) *Amendment of section 6862*.—In section 6862 of the Code, references to sections 4951 and 4952 (black lung benefit trust excise taxes) "certain excise taxes."

(*4*) *Amendment of section 7422*.—In section 7422 of the Code, references to sections 4951 and 4952 (black lung benefit trust excise taxes), are added to references to private foundation excise taxes.

b. Correction of references to black lung legislation (sec. 108(b)(2) of the bill and secs. 192(e) and 501(c)(21) of the Code)

(*1*) *Amendment of P.L. 95–227*.—The references in section 3 of the Black Lung Benefit Revenue Act of 1977, P.L. 95–227, are corrected to be the Federal Mine Safety and Health Act of 1977, instead of the Federal Coal Mine Health and Safety Act of 1969.

(*2*) *Amendment of sections 192(e) and 501(c)(21)*.—The references in sections 192(e) and 501(c)(21) of the Code are corrected to be the Federal Mine Safety and Health Act of 1977, instead of the Federal Coal Mine Health and Safety Act of 1969.

c. Clerical amendment (sec. 108(b)(3)(A) of the bill and sec. 3 of P.L. 95–227)

In section 3(c)(1) of the Black Lung Benefits Revenue Act of 1977, P.L. 95–227, the reference to "subsection (a)(4)" is corrected to "subsection (a)(5)."

d. Correction of cross reference in Code section 7454(b) (sec. 108(b)(3)(B) of the bill and sec. 7454(b) of the Code)

The bill corrects a cross reference in Code section 7454(b) to Code section 501(c)(21) which was incorrectly referenced to Code section 502(c)(21).

3. Technical Amendments Relating to the Energy Tax Act of 1978

a. Repayment of tax on gasoline used in commercial fishing vessels (sec. 108(c)(1) of the bill and sec. 6421(d)(2) of the Code)

Present law

The Code provides that gasoline, diesel fuel, and special motor fuels purchased for use in commmercial fishing vessels may be purchased free of the 4-cents-a-gallon Federal excise taxes on these fuels. In addition, prior to the Energy Tax Act of 1978, the Code provided for a 2-cents-a-gallon reduction (through refund, credit, or exemption) of the excise taxes on gasoline, diesel fuel, and special motor fuel, and the refund (or credit) of the 6-cents-a-gallon tax on lubricating oil, with respect to gasoline, special fuels, and lubricating oil used (1) for nonbusiness, off-highway purposes (such as lawnmowers, snowmobiles, etc.) and (2) in motor boats (whether or not such use is business use). These reductions were eliminated by the Energy Tax Act; however, by cross-references the Act provided that articles sold as supplies for vessels employed in the fisheries or whaling business are not subject to the excise taxes on fuels or lubricating oil. These references made it clear that no change was intended with respect to the excise tax exemptions for commercial fishing vessels. If the sale of gasoline and lubricating oil is made to the fishermen other than by the manufacturer, producer, or importer, the Code provides for a refund (or credit) of the tax when the item is sold for use or is used as supplies for such vessels (Code secs. 6416 (a) and (b)(2)(B)).

Reasons for change

In some circumstances, it appears that persons purchasing gasoline for use in commercial fishing vessels have been made worse off by the provisions of the Energy Tax Act, and this does not appear to be consistent with Congressional intent. This results from the elimination of the ability of the ultimate purchaser to obtain a 2-cents-a-gallon payment or credit directly from the Treasury for gasoline used in commercial fishing vessels. Although the 4-cents-a-gallon tax can be fully avoided by tax-free purchase, refund, or credit, this approach requires cooperation of the seller and all other persons in the chain of purchase back to the manufacturer, producer, or importer.[1] Apparently, in certain cases, cooperation from such parties is not available, and thus, denial of the 2-cents-a-gallon payment or credit may create a problem for certain taxpayers engaged in commercial fishing. A similar problem occurs with respect to lubricating oil; although a credit or refund can be obtained by a procedure which requires the cooperation of the seller (and the producer), the

[1] See Rev. Rul. 79-48, 1979-1 C.B. 434.

provision which provided for a direct payment to the vessel operator (Code sec. 6424(a)) was indirectly amended to preclude such a payment.

Explanation of provision

The bill provides that the 2-cent-a-gallon payment (or credit) for certain non-highway uses can be obtained with respect to gasoline used in a vessel employed in the fisheries or in the whaling business. Also, the bill provides that a direct payment or credit of the 6-cent-a-gallon tax on lubricating oil can be obtained with respect to lubricating oil used in such vessels.

Effective date

This provision applies to uses after December 31, 1978. This is the same effective date as applies to related provisions which were added by section 222 of the Energy Tax Act of 1978.

b. Tires used in the manufacture of buses (sec. 108(c)(2) of the bill and secs. 4071(e), 6416(b)(3)(C), and 6416(b)(4)(B) of the Code)

Present law

Prior to the Energy Tax Act of 1978, a 10-percent manufacturers excise tax was imposed on the sale of buses having a gross vehicle weight of more than 10,000 pounds, with certain exceptions (Code sec. 4061(a)). Another provision (Code sec. 4071) imposes excise taxes on tires, inner tubes, and tread rubber. These taxes generally apply to tires and inner tubes used on buses (as well as other tires, inner tubes, and tread rubber).

The Energy Tax Act repealed the excise tax on buses. In the case of excise taxes on highway tires, inner tubes, and tread rubber, the Energy Tax Act also provided an exemption for sales by a manufacturer, producer, or importer of such items "sold for use" by the purchaser on or in connection with an intercity, local, or school bus.

Reasons for change

Present law allows any bus to be sold free of the 10-percent manufacturers excise tax that had previously been imposed on bus bodies and chassis. Also, the owner of an "intercity, local or school bus" can purchase tires, inner tubes, or tread rubber for use on such a bus free of the excise taxes on such items (by exemption, credit, or refund). Tires and inner tubes also may be purchased tax free by a vehicle manufacturer to be placed on a chassis which is to be sold (among other things) to a State or local government or a private nonprofit school. If purchased tax-paid and then so used, a credit or refund of tax is available to the vehicle manufacturer. However, if a manufacturer purchases tires or inner tubes to be placed on a bus which is for domestic use by other than a State or local government or by a nonprofit school, the excise taxes on tires and inner tubes are imposed, and there is no provision for credit or refund of such taxes. Since the basic excise tax on bus bodies and chassis has been repealed, the committee believes that tires and tubes purchased by a manufacturer and placed on every new bus should be exempt from the excise tax on tires and tubes (as well as the excise tax on buses).

Explanation of provisions

The bill provides that, if tires or inner tubes are sold on a tax-paid basis to a manufacturer of bus chassis or bodies, the tire tax is to be credited or refunded to the bus manufacturer upon the sale of the chassis or body.

Effective date

This provision applies to tires and inner tubes which are to be used on a bus which is sold on or after April 20, 1977. This effective date is essentially the same as the effective date of section 231 of the Energy Tax Act of 1978, which repealed the excise tax on bus bodies and chassis effective for sales on or after April 20, 1977.

c. Refund of tax on lubricating oil used in producing rerefined oil (sec. 108(c)(3) of the bill and sec. 6416 of the Code).

Present law

Under present law, a six-cent-per-gallon manufacturers excise tax is imposed on lubricating oil (other than cutting oils) sold in the U.S. by a manufacturer or producer, or used by a manufacturer or producer. The sale of recycled oil is not subject to the tax. However, prior to the Energy Tax Act, the excise tax was imposed on lubricating oil mixed with the used oil.

Section 404 of the Energy Tax Act exempted the sale of new lubricating oil from the excise tax where the oil is sold for use in a blend with previously used or waste lubricating oil which has been cleaned, renovated, or refined. Such a blend is designated as "rerefined oil."

The exemption applies if the blend contains 25 percent or more of waste oil. All of the new oil in a mixture is exempt from the tax if the blend contains 55 percent or less of new oil. If it contains more than 55 percent new oil, the exemption applies only to so much of the new oil as do not exceed 55 percent of the blend. However, no provision was made for refunds of the excise tax where tax-paid new oil is mixed with waste oil.

Reason for change

The committee believes that a tax refund should be permitted to the extent that new oil sold for use and used in rerefined oil would be exempt from the manufacturers excise tax.

Explanation of provision

The bill provides for credit or refund of tax paid with respect to new oil in rerefined oil to the extent that the blend of new and waste oil would be exempt from the manufacturers excise tax. As a result, refunds will be available for the tax paid on up to 55 percent of a blend of new and waste lubricating oil which contains at least 25 percent of waste oil. However, refunds would not be available until the blend is used or sold.

Effective date

Credit or refund is to be available for new oil mixed with waste oil on or after December 1, 1978 (and sold or used after that date), the effective date of section 404 of the Energy Tax Act of 1978.

d. Credit or refund of tax on truck bodies or chassis used in the manufacture of buses (sec. 108(c)(4) of the bill and sec. 6416 (b)(3) of the Code)

Present law

Prior to the Energy Tax Act of 1978, with certain exceptions, a 10-percent manufacturers excise tax was imposed on the sale of truck or bus bodies or chassis for use on a vehicle having a gross vehicle weight of more than 10,000 pounds (Code sec. 4061(a)).

The Energy Tax Act repealed the excise tax on bus bodies and chassis, but not the excise tax on truck bodies and chassis.

Reason for change

The committee believes it is consistent with the policy of the Energy Tax Act to provide for a credit or refund of tax in situations where a person converts a truck body or chassis (on which tax has been paid) to a bus.

Explanation of provision

The bill permits a person who modifies a truck chassis or truck body into a bus to obtain a credit or refund of the tax paid with respect to the truck chassis or body.

Effective date

This provision applies, in general, to the sale of truck bodies and chassis on or after April 20, 1977, in the same manner as if this provision had been included in section 231(a) of the Energy Tax Act of 1978.

e. Excise tax exemption for bus parts (sec. 108(c)(5) of the bill and sec. 4221(e)(6) of the Code)

Present law

Prior to the Energy Tax Act of 1978, an 8-percent manufacturers excise tax was imposed on parts and accessories (other than tires and inner tubes which are taxed separately under Code sec. 4071) of the type used on buses and trucks (Code sec. 4061(b)).

The Energy Tax Act of 1978 repealed the 8-percent manufacturers excise tax on bus parts and accessories. Under regulations prescribed by the Secretary of the Treasury, the parts and accessories tax was not to apply to any part or accessory which is "sold for use" by the purchaser on or in connection with a bus. It was contemplated that such parts and accessories would be sold tax-free by the manufacturer, producer, or importer for use on or in connection with a bus only if appropriate evidence of exemption were furnished by the purchaser. If the sale of the parts and accessories is made other than by the manufacturer, producer, or importer, the Act provided for a refund of the 8-percent tax where the part or accessory is "sold for use" by the purchaser on or in connection with a bus. Thus, parts and accessories that may be interchangeable between trucks and buses continued to be subject to the parts tax if they are not "sold for use" with respect to buses.

Reasons for change

Present law requires that the excise tax be paid on bus parts where such parts are sold to distributors and to subsequent purchasers in the marketing chain. An application is then filed and a rebate is applied for once the ultimate user of the bus part purchases it.

The committee believes that this procedure is unnecessary and that it is appropriate to allow a tax-free sale for resale of bus parts in certain circumstances.

Explanation of provision

The bill provides that, under regulations prescribed by the Treasury, a manufacturer may make a tax-free sale of bus parts to a purchaser for resale to the consumer or to a second purchaser for resale by such second purchaser to the consumer. The provision for tax-free sales may be made only where permitted by Treasury regulations because, in many instances, it is difficult for a manufacturer (or the Treasury) to determine at the point of sale whether certain parts will be used on a bus (and thus be tax-free) or on a truck (and thus be subject to tax). Thus, this grant of authority to the Treasury is designed to allow the Treasury to permit the use of the tax-free sale procedure to the extent feasible without requiring such a procedure where the Treasury does not have reasonable assurances that the parts ultimately will be used on a bus.

The House bill does not contain a comparable provision.

Effective date

The provision is effective for sales by the manufacturer, producer, or importer on or after the first day of the first calendar month beginning more than 10 days after the date of enactment.

f. Clerical amendment relating to denial of investment credit for certain boilers (sec. 108(c)(6) of the bill and sec. 48(a)(10)(B) of the Code)

This amendment corrects a cross-reference in Code section 48(a)(10)(B) to read "section 46(f)(5)" instead of "section 46(f)(51)."

4. Technical Amendment to Public Law 95–472

Security for recapture of estate tax reduction from special use valuation where property has been involuntarily converted (sec. 108(d) of the bill and sec. 6324B(c) of the Code)

Present law

The Tax Reform Act of 1976 provided that certain property used for farming or in a closely held business may be valued for estate tax purposes at its current use value instead of its highest and best use value. However, if the property is disposed of within a 15-year period, all or part of the estate tax benefit is recaptured. A lien is placed on the property for the amount of the potential recapture tax.

Section 4 of Public Law 95–472 provides that if an involuntary conversion of qualified real property takes place, no recapture of the estate tax benefit will occur if the property is replaced by other real property of at least equal value acquired for the same use.

Reasons for change

Present law generally requires that the replacement property be treated in the same manner as the property which was subject to special use valuation. Thus, if the replacement property is sold during the recapture period, the recapture tax would apply in the same general manner as if the involuntarily converted property had been sold.

Present law is unclear as to whether the lien that was placed on the involuntarily converted property is transferred to the replacement property.

Explanation of provision

The bill makes it clear that the lien that applies to special use valuation property which is involuntarily converted applies to qualified replacement property.

IV. EFFECT OF THE BILL ON THE BUDGET AND VOTE OF THE COMMITTEE IN REPORTING THE BILL

Budget Effect

In compliance with section 252(a) of the Legislative Reorganization Act of 1970, the following statement is made about the effect on the budget of this bill, H.R. 2797, as reported by the committee. The committee estimates that the bill will have a negligible net effect on budget receipts in fiscal year 1980; will reduce budget receipts by less than $5 million in fiscal years 1981 and 1982, and by less than $1 million in fiscal year 1983; and have a negligible effect on budget receipts in fiscal year 1984.

The Treasury Department agrees with this statement.

New Budget Authority and Tax Expenditures

In accordance with section 308 of the Budget Act, after consultation with the Director of the Congressional Budget Office, the committee states that the changes made to existing law by this bill involve no new budget authority or new tax expenditures, and would affect existing tax expenditures as follows: the provision relating to definition of youth under the targeted jobs tax credit would increase tax expenditures by a negligible amount in fiscal year 1980, less than $5 million in fiscal years 1981 and 1982, and less than $1 million in fiscal year 1983.

Consultation with Congressional Budget Office on Budget Estimates

In accordance with section 403 of the Budget Act, the committee advises that the Director of the Congressional Budget Office has examined the committee's budget estimates (as indicated above) and agrees with the methodology used and the resulting revenue estimates for the bill as reported.

Vote of the Committee

In compliance with section 133 of the Legislative Reorganization Act of 1946, the following statement is made about the vote of the committee on the motion to report the bill, as amended. The bill, H.R. 2797, as amended, was ordered favorably reported by voice vote.

V. REGULATORY IMPACT OF THE BILL

Pursuant to paragraph 5 of Rule XXIX of the Standing Rules of the Senate, the committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the provisions of H.R. 2797, as reported by the committee.

A. Numbers of individuals and businesses who would be regulated.—The provisions of this bill are primarily to make technical, conforming, clarifying and clerical amendments in order to make corrections or clarifying changes in certain income and estate and gift tax provisions of the Revenue Act of 1978, and of the 1978 tax legislation.

B. Economic impact of regulation on individuals, consumers, and businesses affected.—The provisions will make it easier for affected taxpayers to understand and comply with the tax code changes made by the Revenue Act of 1978 and other 1978 tax legislation.

C. Impact on personal privacy.—The bill makes negligible changes in those provisions of Federal law relating to the personal privacy of taxpayers.

D. Determination of the amount of paperwork.—The bill will involve little, if any, additional paperwork for taxpayers. It will reduce the uncertainties and paperwork for some taxpayers affected by the tax law changes made by the Revenue Act of 1978 and other 1978 tax legislation.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL AS REPORTED

In the opinion of the committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill, H.R. 2797, as reported by the committee).