98TH CONGRESS
2d Session

HOUSE OF REPRESENTATIVES

REPORT
98-861

DEFICIT REDUCTION ACT OF 1984

THE COMMITTEE OF CONFERENCE

SUBMITTED THE FOLLOWING

CONFERENCE REPORT

[To accompany H.R. 4170]

JUNE 23, 1984.—Ordered to be printed

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Mr. ROSTENKOWSKI, from the committee of conference, submitted the following

CONFERENCE REPORT

[To accompany H.R. 4170]

The committee of conference on the disagreeing votes of the two Houses on the amendment of the House to the amendments of the Senate to the bill (H.R. 4170) to provide for tax reform, and for other purposes, having met, after full and free conference, having agreed to recommend and do recommend to their respective Houses as follows:

That the Senate recede from its disagreement to the amendment of the House to the amendment of the Senate to the text of the bill and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the House amendment insert the following:

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

(a) SHORT TITLE.—This Act may be cited as the "Deficit Reduction Act of 1984".

(b) ACT DIVIDED INTO 2 DIVISIONS.—This Act consists of 2 divisions as follows:

(1) DIVISION A.—Tax Reform Act of 1984.

(2) DIVISION B.—Spending Reduction Act of 1984.

DIVISION A—TAX REFORM ACT OF 1984

SEC. 5. SHORT TITLE, ETC.

(a) SHORT TITLE.—This division may be cited as the "Tax Reform Act of 1984".

(b) AMENDMENT OF 1984 CODE.—Except as otherwise expressly provided, whenever in this division an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other

35-426 O

provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

SEC. 10. TABLE OF CONTENTS.

TITLE IV—TAX SIMPLIFICATION

Subtitle A—Revision and Simplification of Estimated Income Tax for Individuals

Subtitle B—Domestic Relations

Subtitle C—Revision of At-Risk Rules

Subtitle D—Miscellaneous Treasury Administrative Provisions

PART I—PROVISIONS NOT RELATING TO DISTILLED SPIRITS TAX

PART II—PROVISIONS RELATING TO DISTILLED SPIRITS

Subtitle E—Tax Court Provisions

Subtitle F—Simplification of Income Tax Credits

TITLE VI—TAX-EXEMPT BOND PROVISIONS

Subtitle A—Mortgage Subsidy Bonds

Subtitle B—Private Activity Bonds

PART I—GENERAL RESTRICTIONS

PART II—ARBITRAGE LIMITATIONS

PART III—OTHER RESTRICTIONS

Subtitle C—Miscellaneous Provisions

TITLE VII—TECHNICAL CORRECTIONS

Subtitle A—Amendments Related to the Tax Equity and Fiscal Responsibility Act of 1982

Subtitle B—Amendments Related to Subchapter S Revision Act of 1982; Etc.

Subtitle C—Amendments Relating to Highway Revenue Act of 1982

TITLE VIII—FOREIGN SALES CORPORATIONS

Subtitle C—Estate and Gift Tax Provisions

Subtitle D—Charitable Contributions and Exempt Organizations

Subtitle E—Income Tax Credits

Subtitle F—Miscellaneous Housing Provisions

Subtitle G—Extension of Existing Provisions and Transition Rules

Subtitle H—Additional Provisions

Subtitle I—Studies

Subtitle A—Deferral of Certain Tax Reductions

PART I—INCOME TAX PROVISIONS

SEC. 11. AMOUNT OF USED PROPERTY ELIGIBLE FOR INVESTMENT TAX CREDIT.

(a) GENERAL RULE.—Subparagraph (A) of section 48(c)(2) (relating to dollar limitation on amount of used section 38 property) is amended—

(1) by striking out "$150,000 ($125,000 for taxable years beginning in 1981, 1982, 1983, or 1984)" and inserting in lieu thereof "$125,000 ($150,000 for taxable years beginning after 1987)", and

(2) by striking out "$150,000 (or $125,000" each place it appears and inserting in lieu thereof "$125,000 (or $150,000".

(b) TECHNICAL AMENDMENT.—Subparagraph (B) of section 48(c)(2) is amended by striking out "$75,000 ($62,500 for taxable years beginning in 1981, 1982, 1983, or 1984)" and inserting in lieu thereof "$62,500 ($75,000 for taxable years beginning after 1987)".

SEC. 12. FINANCE LEASE PROVISIONS.

(a) FOUR-YEAR DEFERRAL OF FINANCE LEASE PROVISIONS.—

(1) IN GENERAL.—Subparagraph (A) of section 209(d)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 is amended by striking out "December 31, 1983" and inserting in lieu thereof "December 31, 1987".

(2) FINANCE LEASE PROVISIONS CONTINUE TO APPLY TO FARM PROPERTY.—Clause (i) of section 209(d)(1)(B) of such Act is amended by striking out "January 1, 1984" and inserting in lieu thereof "January 1, 1988".

(3) TECHNICAL AMENDMENTS.—

(A) Subclause (I) of section 168(f)(8)(B)(ii) (relating to requirement that only 40 percent of lessee's property may be treated as qualified), as amended by section 209 of the Tax Equity and Fiscal Responsibility Act of 1982, is amended by striking out "1986" and inserting in lieu thereof "1990".

(B) Paragraph (4) of section 168(i) (relating to limitations), as so amended, is amended by striking out "1985" each place it appears and inserting in lieu thereof "1989".

(b) TERMINATION OF SAFE HARBOR LEASING RULES.—Paragraph (8) of section 168(f) of the Internal Revenue Code of 1954 (relating to special rules for leasing), as in effect after the amendments made by section 208 of the Tax Equity and Fiscal Responsibility Act of 1982 but before the amendments made by section 209 of such Act, shall not apply to agreements entered into after December 31, 1983. The preceding sentence shall not apply to property described in paragraph (3)(G) or (5) of section 208(d) of such Act.

(c) TRANSITIONAL RULES.—

(1) IN GENERAL.—The amendments made by subsection (a) shall not apply with respect to any property if—

(A) a binding contract to acquire or to construct such property was entered into by or for the lessee before March 7, 1984, or

(B) such property was acquired by the lessee, or the construction of such property was begun, by or for the lessee, before March 7, 1984.

(2) SPECIAL RULE FOR CERTAIN AUTOMOTIVE PROPERTY.—

(A) IN GENERAL.—The amendments made by subsection (a) shall not apply to property which is placed in service before January 1, 1988—

(i) which is automotive manufacturing property, and

(ii) with respect to which the lessee is a qualified lessee (within the meaning of section 208(d)(6) of the Tax Equity and Fiscal Responsibility Act of 1982).

(B) $150,000,000 LIMITATION.—The provisions of subparagraph (A) shall not apply to any agreement if the sum of—

(i) the cost basis of the property subject to the agreement, plus

(ii) the cost basis of any property subject to an agreement to which subparagraph (A) previously applied and with respect to which the lessee was the lessee under the agreement described in clause (i) (or any related person within the meaning of section 168(e)(4)(D) of the Internal Revenue Code of 1954),

exceeds $150,000,000.

(C) AUTOMOTIVE MANUFACTURING PROPERTY.—For purposes of this paragraph, the term "automotive manufacturing property" means—

(i) property used principally by the taxpayer directly in connection with the trade or business of the taxpayer of the manufacturing of automobiles or trucks (other than truck tractors) with a gross vehicle weight of 13,000 pounds or less,

(ii) machinery, equipment, and special tools of the type included in former depreciation range guideline classes 37.11 and 37.12, and

(iii) any special tools owned by the taxpayer which are used by a vendor solely for the production of component parts for sale to the taxpayer.

(3) SPECIAL RULE FOR CERTAIN CONGENERATION FACILITIES.—The amendments made by subsection (a) shall not apply with respect to any property which is part of a coal-fired cogeneration facility—

(A) for which an application for certification was filed with the Federal Energy Regulatory Commission on December 30, 1983,

(B) for which an application for a construction permit was filed with a State environmental protection agency on February 20, 1984, and

(C) which is placed in service before January 1, 1988.

SEC. 13. ELECTION TO EXPENSE CERTAIN DEPRECIABLE BUSINESS ASSETS.

Paragraph (1) of section 179(b) (relating to dollar limitation) is amended by striking out the table contained therein and inserting in lieu thereof the following:

"If the taxable year begins in:	*The applicable amount is:*
1983, 1984, 1985, 1986, or 1987	*$5,000*
1988 or 1989	*7,500*

"If the taxable year begins in:	*The applicable amount is:*
1990 or thereafter	*10,000."*

SEC. 14. EMPLOYEE STOCK OWNERSHIP CREDIT.

Subparagraph (B) of section 44G(a)(2) (relating to employee stock ownership credit), as in effect before the amendments made by title IV of this Act, is amended by striking out the table contained therein and inserting in lieu thereof the following:

"For aggregate compensation paid or accrued during a portion of the taxable year occurring in callendar year:	*The applicable percentage is:*
1983, 1984, 1985, 1986, or 1987	*0.5*
1988 or thereafter	*0."*

SEC. 15. COST-OF-LIVING ADJUSTMENTS IN PENSION PLAN LIMITATIONS.

(a) GENERAL RULE.—Paragraph (3) of section 415(d) (relating to freeze on adjustment to defined contribution and benefit plan limits) is amended by striking out "January 1, 1986" and inserting in lieu thereof "January 1, 1988".

(b) TECHNICAL AMENDMENT.—Subparagraph (A) of section 415(d)(2) (defining base periods), as amended by section 235(b)(2)(B) of the Tax Equity and Fiscal Responsibility Act of 1982, is amended by striking out "October 1, 1984" and inserting in lieu thereof "October 1, 1986".

SEC. 16. REPEAL OF PARTIAL INTEREST EXCLUSION.

(a) GENERAL RULE.—Subsections (a) and (c) of section 302 of the Economic Recovery Tax Act of 1981 are hereby repealed, and the Internal Revenue Code of 1954 shall be applied and administered as if such subsections (and the amendments made by such subsections) had not been enacted.

(b) CONFORMING AMENDMENT.—Paragraph (1) of section 57(a) is amended to read as follows:

"(1) EXCLUSION OF DIVIDENDS.—Any amount excluded from gross income for the taxable year under section 116."

SEC. 17. FOREIGN EARNED INCOME OF INDIVIDUALS.

Subparagraph (A) of section 911(b)(2) (relating to limitation on foreign earned income) is amended by striking out the table contained therein and inserting in lieu thereof the following:

"In the case of taxable years beginning in:	*The annual rate is:*
1983, 1984, 1985, 1986, or 1987	*$80,000*
1988	*85,000*
1989	*90,000*
1990 and thereafter	*95,000."*

SEC. 18. EFFECTIVE DATE.

(a) GENERAL RULE.—The amendments made by this part shall apply to taxable years ending after December 31, 1983.

(b) SPECIAL RULE FOR SECTION 14.—The amendment made by section 14 shall not apply in the case of a tax credit employee stock ownership plan if—

(1) such plan was favorably approved on September 23, 1983, by employees, and

(2) not later than January 11, 1984, the employer of such employees was 100 percent owned by such plan.

PART II—ESTATE AND GIFT TAX RATES

SEC. 21. MAXIMUM RATE.

(a) GENERAL RULE.—Paragraph (2) of section 2001(c) (relating to phase-in of 50 percent maximum rate) is amended—

(1) by striking out "1985", in subparagraph (A) and inserting in lieu thereof "1988", and

(2) by striking out "1984" each place it appears in subparagraph (D) and inserting in lieu thereof "1984, 1985, 1986, or 1987."

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to the estates of decedents dying after, and gifts made after, December 31, 1983.

PART III—EXCISE TAXES

SEC. 25. TAX RATE ON NEWLY DISCOVERED OIL.

(a) GENERAL RULE.—Subparagraph (B) of section 4987(b)(3) (relating to rate of tax on newly discovered oil) is amended by striking out the table contained therein and inserting in lieu thereof the following:

"For taxable periods beginning in:	*The applicable percentage is:*
1984, 1985, 1986, or 1987	*22½*
1988	*20*
1989 and thereafter	*15."*

(b) CONTINUATION OF PERCENTAGE DEPLETION FOR OIL AND GAS FROM SECONDARY OR TERTIARY PROCESS.—

(1) Paragraph (2) of section 613A(c) (relating to exemption for independent producers and royalty owners) is amended by striking out the last sentence.

(2) Subparagraph (A) of section 613A(c)(3) (defining depletable oil quantity) is amended by adding at the end thereof the following new sentence:

"Clause (ii) shall not apply after December 31, 1983."

(3) Subparagraph (E) of section 613A(c)(7) is amended by adding at the end thereof the following new sentence: "This subparagraph shall not apply after December 31, 1983."

(4) Subparagraph (A) of section 613A(c)(9) (relating to transfer of oil or gas property) is amended by striking out "paragraph (1)" and inserting in lieu thereof "this subsection".

(c) Effective Dates.—

(1) SUBSECTION (a).—The amendment made by subsection (a) shall apply to taxable periods beginning after December 31, 1983.

(2) SUBSECTION (b).—The amendments made by subsection (b) shall take effect on January 1, 1984.

SEC. 26. EXCISE TAX ON COMMUNICATIONS SERVICES.

Paragraph (2) of section 4251(b) (relating to rate of tax on communications services) is amended by striking out the table contained therein and inserting in lieu thereof the following:

"With respect to amount paid pursuant to bills first rendered:	*The applicable percentage is:*
During 1983, 1984, 1985, 1986, or 1987	*3*
During 1988 or thereafter	*0."*

Sec. 27. EXCISE TAX ON DISTILLED SPIRITS.

(a) IMPOSITION OF TAX.—

(1) IN GENERAL.—Paragraphs (1) and (3) of section 5001(a) (relating to rate of tax on distilled spirits) are each amended by striking out "$10.50" and inserting in lieu thereof "$12.50".

(2) TECHNICAL AMENDMENT.—Paragraphs (1) and (2) of section 5010(a) (relating to credit for wine content and for flavors content) are each amended by striking out "$10.50" and inserting in lieu thereof "$12.50".

(b) FLOOR STOCKS TAXES ON DISTILLED SPIRITS.—

(1) IMPOSITION OF TAX.—On distilled spirits on which tax was imposed under section 5001 or 7652 of the Internal Revenue Code of 1954 before October 1, 1985, and which were held on such date for sale by any person, there shall be imposed a tax at the rate of $2.00 for each proof gallon and a proportionate tax at the like rate on all fractional parts of a proof gallon.

(2) EXCEPTION FOR CERTAIN SMALL WHOLESALE OR RETAIL DEALERS.—No tax shall be imposed by paragraph (1) on distilled spirits held on October 1, 1985, by any dealer if—

(A) the aggregate liquid volume of distilled spirits held by such dealer on such date does not exceed 500 wine gallons, and

(B) such dealer submits to the Secretary (at the time and in the manner required by the Secretary) such information as the Secretary shall require for purposes of this paragraph.

(3) CREDIT AGAINST TAX.—Each dealer shall be allowed as a credit against the taxes imposed by paragraph (1) an amount equal to $800. Such credit shall not exceed the amount of taxes imposed by paragraph (1) for which the dealer is liable.

(4) LIABILITY FOR TAX AND METHOD OF PAYMENT.—

(A) LIABILITY FOR TAX.—A person holding distilled spirits on October 1, 1985, to which the tax imposed by paragraph (1) applies shall be liable for such tax.

(B) METHOD OF PAYMENT.—The tax imposed by paragraph (1) shall be paid in such manner as the Secretary shall by regulations prescribe.

(C) TIME FOR PAYMENT.—

(i) IN GENERAL.—Except as provided in clause (ii), the tax imposed by paragraph (1) shall be paid on or before April 1, 1986.

(ii) INSTALLMENT PAYMENT OF TAX IN CASE OF SMALL OR MIDDLE-SIZED DEALERS.—In the case of any small or middle-sized dealer, the tax imposed by paragraph (1) may be paid in 3 equal installments due as follows:

(I) The first installment shall be paid on or before April 1, 1986.

(II) The second installment shall be paid on or before July 1, 1986.

(III) The third installment shall be paid on or before October 1, 1986.

If the taxpayer does not pay any installment under this clause on or before the date prescribed for its payment, the whole of the unpaid tax shall be paid upon notice and demand from the Secretary.

(iii) SMALL OR MIDDLE-SIZED DEALER.—For purposes of clause (ii), the term "small or middle-sized dealer" means any dealer if the aggregate gross sales receipts of such dealer for its most recent taxable year ending before October 1, 1985, does not exceed $500,000.

(5) CONTROLLED GROUPS.—

(A) CONTROLLED GROUPS OF CORPORATIONS.—In the case of a controlled group—

(i) the 500 wine gallon amount specified in paragraph (2),

(ii) the $800 amount specified in paragraph (3), and

(iii) the $500,000 amount specified in paragraph (4)(C)(iii),

shall be apportioned among the dealers who are component members of such group in such manner as the Secretary shall by regulations prescribe. For purposes of the preceding sentence, the term "controlled group" has the meaning given to such term by subsection (a) of section 1563 of the Internal Revenue Code of 1954; except that for such purposes the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in such subsection.

(B) NONINCORPORATED DEALERS UNDER COMMON CONTROL.—Under regulations prescribed by the Secretary, principles similar to the principles of subparagraph (A) shall apply to a group of dealers under common control where 1 or more of such dealers is not a corporation.

(6) OTHER LAWS APPLICABLE.—All provisions of law, including penalties, applicable with respect to the taxes imposed by section 5001 of the Internal Revenue Code of 1954 shall, insofar as applicable and not inconsistent with the provisions of this subsection, apply in respect of the taxes imposed by paragraph (1) to the same extent as if such taxes were imposed by such section 5001.

(7) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

(A) DEALER.—The term "dealer" means—

(i) any wholesale dealer in liquors (as defined in section 5112(b) of the Internal Revenue Code of 1954), and

(ii) any retail dealer in liquors (as defined in section 5122(a) of such Code).

(B) DISTILLED SPIRITS.—The term "distilled spirits" has the meaning given such term by section 5002(a)(8) of the Internal Revenue Code of 1954.

(C) PERSON.—The term "person" includes any State or political subdivision thereof, or any agency or instrumentality of a State or political subdivision thereof.

(D) SECRETARY.—The term "Secretary" means the Secretary of the Treasury or his delegate.

(E) TREATMENT OF IMPORTED PERFUMES CONTAINING DISTILLED SPIRITS.—Any article described in section 5001(a)(3) of such Code shall be treated as distilled spirits; except that the tax imposed by paragraph (1) shall be imposed on a wine gallon basis in lieu of a proof gallon basis. To the

extent provided in regulations prescribed by the Secretary, the preceding sentence shall not apply to any article held on October 1, 1985, on the premises of a retail establishment.

(c) REQUIREMENT OF ELECTRONIC FUNDS TRANSFER FOR ALCOHOL AND TOBACCO EXCISE TAXES.—

(1) ALCOHOL TAXES.—Section 5061 (relating to method of collecting tax on distilled spirits) is amended by adding at the end thereof the following new subsection:

"(e) PAYMENT BY ELECTRONIC FUND TRANSFER.—

"(1) IN GENERAL.—Any person who in any 12-month period ending December 31, was liable for a gross amount equal to or exceeding $5,000,000 in taxes imposed on distilled spirits, wines, or beer by sections 5001, 5041, and 5051 (or 7652), respectively, shall pay such taxes during the succeeding calendar year by electronic fund transfer to a Federal Reserve Bank.

"(2) ELECTRONIC FUND TRANSFER.—The term 'electronic fund transfer' means any transfer of funds, other than a transaction originated by check, draft, or similar paper instrument, which is initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape so as to order, instruct, or authorize a financial institution to debit or credit an account."

(2) TOBACCO TAXES.—Subsection (b) of section 5703 (relating to method of payment of tobacco taxes) is amended by adding at the end thereof the following new paragraph:

"(3) PAYMENT BY ELECTRONIC FUND TRANSFER.—Any person who in any 12-month period, ending December 31, was liable for a gross amount equal to or exceeding $5,000,000 in taxes imposed on tobacco products and cigarette papers and tubes by section 5701 (or 7652) shall pay such taxes during the succeeding calendar year by electronic fund transfer (as defined in section 5061(e)(2)) to a Federal Reserve Bank."

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall take effect on October 1, 1985.

(2) ELECTRONIC TRANSFER PROVISIONS.—The amendments made by subsection (c) shall apply to taxes required to be paid on or after September 30, 1984.

Subtitle B—Tax-Exempt Entity Leasing

SEC. 31. DENIAL OF TAX INCENTIVES FOR PROPERTY LEASED TO GOVERNMENTS AND OTHER TAX-EXEMPT ENTITIES.

(a) GENERAL RULE.—Section 168 (relating to accelerated cost recovery system) is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) PROPERTY LEASED TO GOVERNMENTS AND OTHER TAX-EXEMPT ENTITIES.—

"(1) IN GENERAL.—Notwithstanding any other provision of this section, the deduction allowed under subsection (a) (and any other deduction allowable for depreciation or amortization)

for any taxable year with respect to tax-exempt use property shall be determined—

"(A) by using the straight-line method (without regard to salvage value), and

"(B) by using a recovery period determined under the following table:

"In the case of:	***The recovery period shall be:***
(I) Property not described in subclause (II) or subclause (III).	*The present class life*
(II) Personal property with no present class life.	*12 years*
(III) 15-year real property ..	*40 years*

"(2) OPERATING RULES.—

"(A) RECOVERY PERIOD MUST AT LEAST EQUAL 125 PERCENT OF LEASE TERM.—In the case of any tax-exempt use property, the recovery period used for purposes of paragraph (1) shall not be less than 125 percent of the lease term.

"(B) CONVENTIONS.—

"(i) PROPERTY OTHER THAN 15-YEAR REAL PROPERTY.—In the case of property other than 15-year real property, the half-year convention shall apply for purposes of paragraph (1).

"(ii) 15-YEAR REAL PROPERTY.—In the case of 15-year real property, the amount determined under paragraph (1) shall be determined on the basis of the number of months in the year in which the property is in service.

"(C) EXCEPTION WHERE LONGER RECOVERY PERIOD APPLIES.—Paragraph (1) shall not apply to any recovery property if the recovery period which applies to such property (without regard to this subsection) exceeds the recovery period for such property determined under this subsection.

"(D) DETERMINATION OF CLASS FOR REAL PROPERTY WHICH IS NOT RECOVERY PROPERTY.—In the case of any real property which is not recovery property, for purposes of this subsection, the determination of whether such property is 15-year real property shall be made as if such property were recovery property.

"(E) COORDINATION WITH SUBSECTION (f)(12).—Paragraph (12) of subsection (f) shall not apply to any tax-exempt use property to which this subsection applies.

"(F) 18-YEAR REAL PROPERTY.—For purposes of this section, the term '15-year real property' includes '18-year real property'.

"(3) TAX-EXEMPT USE PROPERTY.—For purposes of this subsection—

"(A) PROPERTY OTHER THAN 15-YEAR REAL PROPERTY.—Except as otherwise provided in this subsection, the term 'tax-exempt use property' means that portion of any tangible property (other than 15-year real property) leased to a tax-exempt entity.

"(B) 15-YEAR REAL PROPERTY.—

"(i) IN GENERAL.—In the case of 15-year real property, the term 'tax-exempt use property' means that por-

tion of the property leased to a tax-exempt entity in a disqualified lease.

"(ii) DISQUALIFIED LEASE.—For purposes of this subparagraph, the term 'disqualified lease' means any lease of the property to a tax-exempt entity, but only if—

"(I) part or all of the property was financed (directly or indirectly) by an obligation the interest on which is exempt from tax under section 103 and such entity (or a related entity) participated in such financing,

"(II) under such lease there is a fixed or determinable price purchase or sale option which involves such entity (or a related entity) or there is the equivalent of such an option,

"(III) such lease has a lease term in excess of 20 years, or

"(IV) such lease occurs after a sale (or other transfer) of the property by, or lease of the property from, such entity (or a related entity) and such property has been used by such entity (or a related entity) before such sale (or other transfer) or lease.

"(iii) 35-PERCENT THRESHOLD TEST.—Clause (i) shall apply to any property only if the portion of such property leased to tax-exempt entities in disqualified leases is more than 35 percent of the property.

"(iv) TREATMENT OF IMPROVEMENTS.—For purposes of this subparagraph, improvements to a property (other than land) shall not be treated as a separate property.

"(v) LEASEBACKS DURING 1ST 3 MONTHS OF USE NOT TAKEN INTO ACCOUNT.—Subclause (IV) of clause (ii) shall not apply to any property which is leased within 3 months after the date such property is first used by the tax-exempt entity (or a related entity).

"(C) EXCEPTION FOR SHORT-TERM LEASES.—

"(i) IN GENERAL.—Property shall not be treated as tax-exempt use property merely by reason of a short-term lease.

"(ii) SHORT-TERM LEASE.—For purposes of clause (i), the term 'short-term lease' means any lease the term of which is—

"(I) less than 3 years, and

"(II) less than the greater of 1 year or 30 percent of the property's present class life.

In the case of 15-year real property and property with no present class life, subclause (II) shall not apply.

"(D) EXCEPTION WHERE PROPERTY USED IN UNRELATED TRADE OR BUSINESS.—The term 'tax-exempt use property' shall not include any portion of a property if such portion is predominantly used by the tax-exempt entity (directly or through a partnership of which such entity is a partner) in an unrelated trade or business the income of which is subject to tax under section 511.

"(4) TAX-EXEMPT ENTITY.—

"(A) IN GENERAL.—For purposes of this subsection, the term 'tax-exempt entity' means—

"(i) the United States, any State or political subdivision thereof, any possession of the United States, or any agency or instrumentality of any of the foregoing,

"(ii) an organization (other than a cooperative described in section 521) which is exempt from tax imposed by this chapter, and

"(iii) any foreign person or entity.

"(B) EXCEPTIONS FOR CERTAIN PROPERTY USED BY FOREIGN PERSON OR ENTITY.—

"(i) INCOME FROM PROPERTY SUBJECT TO UNITED STATES TAX.—Clause (iii) of subparagraph (A) shall not apply with respect to any property if more than 50 percent of the gross income for the taxable year derived by the foreign person or entity from the use of such property is—

"(I) subject to tax under this chapter, or

"(II) included under section 951 in the gross income of a United States shareholder for the taxable year with or within which ends the taxable year of the controlled foreign corporation in which such income was derived.

For purposes of the preceding sentence, any exclusion or exemption shall not apply for purposes of determining the amount of the gross income so derived, but shall apply for purposes of determining the portion of such gross income subject to tax under this chapter.

"(ii) MOVIES AND SOUND RECORDINGS.—Clause (iii) of subparagraph (A) shall not apply with respect to any qualified film (as defined in section 48(k)(1)(B)) or any sound recording (as defined in section 48(r)).

"(C) FOREIGN PERSON OR ENTITY.—For purposes of this paragraph, the term 'foreign person or entity' means—

"(i) any foreign government, any international organization, or any agency or instrumentality of any of the foregoing, and

"(ii) any person who is not a United States person.

Such term does not include any foreign partnership or other foreign pass-thru entity.

"(D) TREATMENT OF CERTAIN TAXABLE INSTRUMENTALITIES.—For purposes of this subsection and paragraph (5) of section 48(a), a corporation shall not be treated as an instrumentality of the United States or of any State or political subdivision thereof if—

"(i) all of the activities of such corporation are subject to tax under this chapter, and

"(ii) a majority of the board of directors of such corporation is not selected by the United States or any State or political subdivision thereof.

"(E) CERTAIN PREVIOUSLY TAX-EXEMPT ORGANIZATIONS.—

"(i) IN GENERAL.—For purposes of this subsection and paragraph (4) of section 48(a), an organization

shall be treated as an organization described in subparagraph (A)(ii) with respect to any property of which such organization is the lessee if such organization was an organization (other than a cooperative described in section 521) exempt from tax imposed by this chapter at any time during the 5-year period ending on the date such property was first leased to such organization. The preceding sentence shall not apply to the Federal Home Loan Mortgage Corporation.

"(ii) ELECTION NOT TO HAVE CLAUSE (i) APPLY.—

"(I) IN GENERAL.—In the case of an organization formerly exempt from tax under section 501(a) as an organization described in section 501(c)(12), clause (i) shall not apply to such organization with respect to any property of which such organization is the lessee if such organization elects not to be exempt from tax under section 501(a) during the tax-exempt use period with respect to such property.

"(II) TAX-EXEMPT USE PERIOD.—For purposes of subclause (I), the term 'tax-exempt use period' means the period beginning with the taxable year in which the property described in subclause (I) is placed in service and ending with the close of the 15th taxable year following the last taxable year of the recovery period of such property.

"(III) ELECTION.—Any election under subclause (I), once made, shall be irrevocable.

"(iii) TREATMENT OF SUCCESSOR ORGANIZATIONS.—Any organization which is engaged in activities substantially similar to those engaged in by a predecessor organization shall succeed to the treatment under this subparagraph of such predecessor organization.

"(5) SPECIAL RULES FOR CERTAIN HIGH TECHNOLOGY EQUIPMENT.—

"(A) EXEMPTION WHERE LEASE TERM IS 5 YEARS OR LESS.—For purposes of this subsection, the term 'tax-exempt use property' shall not include any qualified technological equipment if the lease to the tax-exempt entity has a lease term of 5 years or less.

"(B) RECOVERY PERIOD WHERE LEASE TERM IS GREATER THAN 5 YEARS.—In the case of any qualified technological equipment not described in subparagraph (A) and which is not property to which subsection (f)(2) applies, the recovery period used for purposes of paragraph (1) shall be 5 years.

"(C) QUALIFIED TECHNOLOGICAL EQUIPMENT.—For purposes of this paragraph—

"(i) IN GENERAL.—Except as otherwise provided in this subparagraph, the term 'qualified technological equipment' means—

"(I) any computer or peripheral equipment,

"(II) any high technology telephone station equipment installed on the customer's premises, and

"(III) any high technology medical equipment,

"(ii) EXCEPTION FOR CERTAIN PROPERTY.—The term 'qualified technological equipment' shall not include any property leased to a tax-exempt entity if—

"(I) part or all of the property was financed (directly or indirectly) by an obligation the interest on which is exempt from tax under section 103,

"(II) such lease occurs after a sale (or other transfer) of the property by, or lease of such property from, such entity (or related entity) and such property has been used by such entity (or a related entity) before such sale (or other transfer) or lease, or

"(III) such tax-exempt entity is the United States or any agency or instrumentality of the United States.

"(iii) LEASEBACKS DURING 1ST 3 MONTHS OF USE NOT TAKEN INTO ACCOUNT.—Subclause (II) of clause (ii) shall not apply to any property which is leased within 3 months after the date such property is first used by the tax-exempt entity (or a related entity).

"(iv) PROPERTY NOT SUBJECT TO RAPID OBSOLESCENCE MAY BE EXCLUDED.—The term 'qualified technological equipment' shall not include any equipment described in subclause (II) or (III) of clause (i)—

"(I) which the Secretary determines by regulations is not subject to rapid obsolescence, and

"(II) which is placed in service after the date on which final regulations implementing such determination are published in the Federal Register.

"(D) COMPUTER OR PERIPHERAL EQUIPMENT DEFINED.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'computer or peripheral equipment' means—

"(I) any computer, and

"(II) any related peripheral equipment.

"(ii) COMPUTER.—The term 'computer' means a programmable electronically activated device which—

"(I) is capable of accepting information, applying prescribed processes to the information, and supplying the results of these processes with or without human intervention, and

"(II) consists of a central processing unit containing extensive storage, logic, arithmetic, and control capabilities.

"(iii) RELATED PERIPHERAL EQUIPMENT.—The term 'related peripheral equipment' means any auxiliary machine (whether on-line or off-line) which is designed to be placed under the control of the central processing unit of a computer.

"(iv) EXCEPTIONS.—The term 'computer or peripheral equipment' shall not include—

"(I) any equipment which is an integral part of other property which is not a computer,

"(II) typewriters, calculators, adding and accounting machines, copiers, duplicating equipment, and similar equipment, and

"(III) equipment of a kind used primarily for amusement or entertainment of the user.

"(E) HIGH TECHNOLOGY MEDICAL EQUIPMENT.—For purposes of this paragraph, the term 'high technology medical equipment' means any electronic, electromechanical, or computer-based high technology equipment used in the screening, monitoring, observation, diagnosis, or treatment of patients in a laboratory, medical, or hospital environment.

"(6) OTHER SPECIAL RULES.—For purposes of this subsection—

"(A) LEASE.—The term 'lease' includes any grant of a right to use property.

"(B) LEASE TERM.—In determining a lease term—

"(i) there shall be taken into account options to renew, and

"(ii) 2 or more successive leases which are part of the same transaction (or a series of related transactions) with respect to the same or substantially similar property shall be treated as 1 lease.

"(C) SPECIAL RULE FOR FAIR RENTAL OPTIONS ON 15-YEAR REAL PROPERTY.—For purposes of clause (i) of subparagraph (B), in the case of 15-year real peoperty, there shall not be taken into account any option to renew at fair market value, determined at the time of renewal.

"(7) RELATED ENTITIES.—For purposes of this subsection—

"(A)(i) Each governmental unit and each agency or instrumentality of a governmental unit is related to each other such unit, agency, or instrumentality which directly or indirectly derives its powers, rights, and duties in whole or in part from the same sovereign authority.

"(ii) For purposes of clause (i), the United States, each State, and each possession of the United States shall be treated as a separate sovereign authority.

"(B) Any entity not described in subparagraph (A)(i) is related to any other entity if the 2 entities have—

"(i) significant common purposes and substantial common membership, or

"(ii) directly or indirectly substantial common direction or control.

"(C)(i) An entity is related to another entity if either entity owns (directly or through 1 or more entities) a 50 percent or greater interest in the capital or profits of the other entity.

"(ii) For purposes of clause (i), entities treated as related under subparagraph (A) or (B) shall be treated as 1 entity.

"(D) An entity is related to another entity with respect to a transaction if such transaction is part of an attempt by such entities to avoid the application of this subsection, section 46(e), paragraph (4) or (5) of section 48(a), or clause (vi) of section 48(g)(2)(B).

"(8) TAX-EXEMPT USE OF PROPERTY LEASED TO PARTNERSHIPS, ETC., DETERMINED AT PARTNER LEVEL.—For purposes of this subsection and paragraphs (4) and (5) of section 48(a)—

"(A) IN GENERAL.—In the case of any property which is leased to a partnership, the determination of whether any portion of such property is tax-exempt use property shall be made by treating each tax-exempt entity partner's proportionate share (determined under paragraph (9)(C)) of such property as being leased to such partner.

"(B) OTHER PASS-THRU ENTITIES; TIERED ENTITIES.—Rules similar to the rules of subparagraph (A) shall also apply in the case of any pass-thru entity other than a partnership and in the case of tiered partnerships and other entities.

"(C) PRESUMPTION WITH RESPECT TO FOREIGN ENTITIES.—Unless it is otherwise established to the satisfaction of the Secretary, it shall be presumed that the partners of a foreign partnership (and the beneficiaries of any other foreign pass-thru entity) are persons who are not United States persons.

"(9) TREATMENT OF PROPERTY OWNED BY PARTNERSHIPS, ETC.—

"(A) IN GENERAL.—For purposes of this subsection and paragraphs (4) and (5) of section 48(a), if—

"(i) any property which (but for this subparagraph) is not tax-exempt use property is owned by a partnership which has both a tax-exempt entity and a person who is not a tax-exempt entity as partners, and

"(ii) any allocation to the tax-exempt entity of partnership items is not a qualified allocation,

an amount equal to such tax-exempt entity's proportionate share of such property shall (except as provided in paragraph (3)(D)) be treated as tax-exempt use property.

"(B) QUALIFIED ALLOCATION.—For purposes of subparagraph (A), the term 'qualified allocation' means any allocation to a tax-exempt entity which—

"(i) is consistent with such entity's being allocated the same distributive share of each item of income, gain, loss deduction, credit, and basis and such share remains the same during the entire period the entity is a partner in the partnership, and

"(ii) has substantial economic effect within the meaning of section 704(b)(2).

For purposes of this subparagraph, items allocated under section 704(c) shall not be taken into account.

"(C) DETERMINATION OF PROPORTIONATE SHARE.—

"(i) IN GENERAL.—For purposes of subparagraph (A), a tax-exempt entity's proportionate share of any property owned by a partnership shall be determined on the basis of such entity's share of partnership items of income or gain (excluding gain allocated under section 704(c)), whichever results in the largest proportionate share.

"(ii) DETERMINATION WHERE ALLOCATIONS VARY.—For purposes of clause (i), if a tax-exempt entity's share of partnership items of income or gain (excluding gain allocated under section 704(c)) may vary during the period such entity is a partner in the partnership, such share shall be the highest share such entity may receive.

"(D) OTHER PASS-THRU ENTITIES; TIERED ENTITIES.—Rules similar to the rules of subparagraphs (A), (B), and (C) shall also apply in the case of any pass-thru entity other than a partnership and in the case of tiered partnerships and other entities.

"(E) REGULATIONS.—For purposes of determining whether there is a qualified allocation under subparagraph (B), the regulations prescribed under paragraph (10) for purposes of this paragraph—

"(i) shall set forth the proper treatment for partnership guaranteed payments, and

"(ii) may provide for the exclusion or segregation of items.

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

(b) DENIAL OF INVESTMENT TAX CREDIT FOR PROPERTY USED BY FOREIGN GOVERNMENTS AND OTHER FOREIGN PERSONS.—Paragraph (5) of section 48(a) (relating to property used by governmental units) is amended to read as follows:

"(5) PROPERTY USED BY GOVERNMENTAL UNITS OR FOREIGN PERSONS OR ENTITIES.—

"(A) IN GENERAL.—Property used—

"(i) by the United States, any State or political subdivision thereof, any possession of the United States, or any agency or instrumentality of any of the foregoing, or

"(ii) by any foreign person or entity (as defined in section 168(j)(4)(C)), but only with respect to property to which section 168(j)(4)(A)(iii) applies (determined after the application of section 168(j)(4)(B)),

shall not be treated as section 38 property.

"(B) EXCEPTION FOR SHORT-TERM LEASES.—

"(i) IN GENERAL.—This paragraph and paragraph (4) shall not apply to any property by reason of use under a lease with a term of less than 6 months (determined under section 168(j)(6)).

"(ii) EXCEPTION FOR CERTAIN OIL DRILLING PROPERTY AND CERTAIN CONTAINERS.—For purposes of this paragraph and paragraph (4), clause (i) shall be applied by substituting the lease term limitation in section 168(j)(3)(C)(ii) for the lease term limitation in clause (i) in the case of property which is leased to a foreign person or entity and—

"(I) which is used in offshore drilling for oil and gas (including drilling vessels, barges, platforms,

and drilling equipment) and support vessels with respect to such property, and

"(II) which is a container described in section 48(a)(2)(B)(vi) (without regard to whether such container is used outside the United States) or container chassis or trailer but only if such container, chassis, or trailer has a present class life of not more than 6 years.

"(iii) EXCEPTION FOR CERTAIN AIRCRAFT.—

"(I) IN GENERAL.—In the case of any aircraft to which section 47(a)(7) applies and which is leased to a foreign person or entity before January 1, 1990, clause (i) shall be applied by substituting '3 years' for '6 months'.

"(II) RECAPTURE PERIOD EXTENDED.—For purposes of applying subparagraph (B) of section 47(a)(5) and paragraph (1) of section 47(a), there shall not be taken into account any period of the lease to which subclause (I) applies.

"(C) EXCEPTION FOR QUALIFIED REHABILITATED BUILDINGS LEASED TO GOVERNMENTS, ETC.—If any qualified rehabilitated building is leased to a governmental unit (or a foreign person or entity), this paragraph shall not apply to that portion of the basis of such building which is attributable to qualified rehabilitation expenditures.

"(D) CROSS REFERENCE.—

"For provisions providing special rules for the application of this paragraph and paragraph (4), see section 168(j)."

(c) REHABILITATION CREDIT NOT TO APPLY WHERE PROPERTY USED BY TAX-EXEMPT ENTITY.—

(1) IN GENERAL.—Subparagraph (B) of section 48(g)(2) (relating to certain expenditures not treated as qualified rehabilitation expenditures) is amended by adding at the end thereof the following new clause:

"(vi) TAX-EXEMPT USE PROPERTY.—

"(I) IN GENERAL.—Any expenditure in connection with the rehabilitation of a building which is allocable to that portion of such building which is (or may reasonably be expected to be) tax-exempt use property (within the meaning of section 168(j)(3)).

"(II) CLAUSE NOT TO APPLY FOR PURPOSES OF PARAGRAPH (1)(C).—This clause shall not apply for purposes of determining under paragraph (1)(C) whether a building has been substantially rehabilitated."

(2) TECHNICAL AMENDMENT.—Clause (i) of section 48(g)(2)(B) is amended by adding at the end thereof the following new sentence: "The preceding sentence shall not apply to any expenditure to the extent subsection (f)(12) or (j) of section 168 applies to such expenditure."

(d) AUTHORITY TO PRESCRIBE PRESENT CLASS LIFE FOR CERTAIN PROPERTY.—Paragraph (2) of section 168(g) (defining present class life) is amended by adding at the end thereof the following new sentence: "If any property (other than section 1250 class property) does

not have a present class life within the meaning of the preceding sentence, the Secretary may prescribe a present class life for such property which reasonably reflects the anticipated useful life of such property to the industry or other group."

(e) TREATMENT OF CERTAIN CONTRACTS FOR PROVIDING SERVICES, ETC.—Section 7701 (relating to definitions), as amended by this Act, is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) TREATMENT OF CERTAIN CONTRACTS FOR PROVIDING SERVICES, ETC.—For purposes of chapter 1—

"(1) IN GENERAL.—A contract which purports to be a service contract shall be treated as a lease of property if such contract is properly treated as a lease of property, taking into account all relevant factors including whether or not—

"(A) the service recipient is in physical possession of the property,

"(B) the service recipient controls the property,

"(C) the service recipient has a significant economic or possessory interest in the property,

"(D) the service provider does not bear any risk of substantially diminished receipts or substantially increased expenditures if there is nonperformance under the contract,

"(E) the service provider does not use the property concurrently to provide significant services to entities unrelated to the service recipient, and

"(F) the total contract price does not substantially exceed the rental value of the property for the contract period.

"(2) OTHER ARRANGEMENTS.—An arrangement (including a partnership or other pass-thru entity) which is not described in paragraph (1) shall be treated as a lease if such arrangement is properly treated as a lease, taking into account all relevant factors including factors similar to those set forth in paragraph (1).

"(3) SPECIAL RULES FOR CONTRACTS OR ARRANGEMENTS INVOLVING SOLID WASTE DISPOSAL, ENERGY, AND CLEAN WATER FACILITIES.—

"(A) IN GENERAL.—Notwithstanding paragraphs (1) and (2), and except as provided in paragraph (4), any contract or arrangement between a service provider and a service recipient—

"(i) with respect to—

"(I) the operation of a qualified solid waste disposal facility,

"(II) the sale to the service recipient of electrical or thermal energy produced at a cogeneration or alternative energy facility, or

"(III) the operation of a water treatment works facility, and

"(ii) which purports to be a service contract, shall be treated as a service contract.

"(B) QUALIFIED SOLID WASTE DISPOSAL FACILITY.—For purposes of subparagraph (A), the term 'qualified solid waste disposal facility' means any facility if such facility provides solid waste disposal services for residents of part

or all of 1 or more governmental units and substantially all of the solid waste processed at such facility is collected from the general public.

"(5) DEFINITIONS.—For purposes of paragraph (3)—

"(A) QUALIFIED SOLID WASTE DISPOSAL FACILITY.—The term 'qualified solid waste disposal facility' means any facility if such facility provides solid waste disposal services for residents of part or all of 1 or more governmental units and substantially all of the solid waste processed at such facility is collected from the general public.

"(C) COGENERATION FACILITY.—The term 'cogeneration facility' means a facility which uses the same energy source for the sequential generation of electrical or mechanical power in combination with steam, heat, or other forms of useful energy.

"(D) ALTERNATIVE ENERGY FACILITY.—The term 'alternative energy facility' means a facility for producing electrical or thermal energy if the primary energy source for the facility is not oil, natural gas, coal, or nuclear power.

"(E) WATER TREATMENT WORKS FACILITY.—The term 'water treatment works facility' means any treatment works within the meaning of section 212(2) of the Federal Water Pollution Control Act.

"(4) PARAGRAPH (3) NOT TO APPLY IN CERTAIN CASES.—

"(A) IN GENERAL.—Paragraph (3) shall not apply to any qualified solid waste disposal facility used under a contract or arrangement if—

"(i) the service recipient (or a related entity) operates such facility,

"(ii) the service recipient (or a related entity) bears any significant financial burden if there is nonperformance under the contract or arrangement (other than for reasons beyond the control of the service provider),

"(iii) the service recipient (or a related entity) receives any significant financial benefit if the operating costs of such facility are less than the standards of performance or operation under the contract or arrangement, or

"(iv) the service recipient (or a related entity) has an option to purchase, or may be required to purchase, all or a part of such facility at a fixed and determinable price (other than for fair market value).

"(B) SPECIAL RULES FOR APPLICATION OF SUBPARAGRAPH (A) WITH RESPECT TO CERTAIN RIGHTS AND ALLOCATIONS UNDER THE CONTRACT.—For purposes of subparagraph (A), there shall not be taken into account—

"(i) any right of a service recipient to inspect any facility, to exercise any sovereign power the service recipient may possess, or to act in the event of a breach of contract by the service provider, or

"(ii) any allocation of any financial burden or benefits in the event of any change in any law.

"(C) SPECIAL RULES FOR APPLICATION OF SUBPARAGRAPH (A) IN THE CASE OF CERTAIN EVENTS.—

"(i) TEMPORARY SHUT-DOWNS, ETC.—For purposes of clause (ii) of subparagraph (A), there shall not be taken into account any temporary shut-down of the facility for repairs, maintenance, or capital improvements, or any financial burden caused by the bankruptcy or similar financial difficulty of the service provider.

"(ii) REDUCED COSTS.—For purposes of clause (iii) of subparagraph (A), there shall not be taken into account any significant financial benefit merely because payments by the service recipient under the contract or arrangement are decreased by reason of increased production or efficiency or the recovery of energy or other products.

"(5) EXCEPTION FOR CERTAIN LOW-INCOME HOUSING.—This subsection shall not apply to any low-income housing (within the meaning of section 168) if—

"(A) such property is operated by or for an organization described in paragraph (3) or (4) of section 501(c), and

"(B) at least 80 percent of the units in such property are leased to low-income tenants (within the meaning of section 167(k)(3)(B)).

"(6) REGULATIONS.—The Secretary may prescribe such regulations as may be necessary or appropriated to carry out the provisions of this subsection."

(f) INVESTMENT TAX CREDIT FOR PROPERTY LEASED BY CERTAIN PERSONS NOT TO EXCEED CREDIT ALLOWED IF SUCH PERSONS OWNED PROPERTY.—Section 46(e) (relating to limitations with respect to certain persons) is amended by adding at the end thereof the following new paragraph:

"(4) SPECIAL RULES WHERE SECTION 593 ORGANIZATION IS LESSEE.—

"(A) IN GENERAL.—For purposes of paragraph (1)(A), if an organization described in section 593 is the lessee of any section 38 property, the lessor of such property shall be treated as an organization described in section 593 with respect to such property.

"(B) EXCEPTION FOR SHORT-TERM LEASES.—This paragraph shall not apply to any property by reason of use under a lease with a term of less than 6 months (determined under section 168(j)(6)).

"(C) ELECTION NOT TO HAVE SUBPARAGRAPH (A) APPLY.—Subparagraph (A) shall not apply for any taxable year to an organization described in section 593 if such organization elects to compute for such year and all subsequent taxable years the amount of the deduction for a reasonable addition to a reserve for bad debts on the basis of actual experience. Any such election shall apply to any successor organization engaged in substantially similar activities and, once made, shall be irrevocable."

(g) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply—

(A) to property placed in service by the taxpayer after May 23, 1983, in taxable years ending after such date, and

(B) to property placed in service by the taxpayer on or before May 23, 1983, if the lease to the tax-exempt entity is entered into after May 23, 1983.

(2) LEASES ENTERED INTO ON OR BEFORE MAY 23, 1983.—The amendments made by this section shall not apply with respect to any property leased to a tax-exempt entity if the property is leased pursuant to—

(A) a lease entered into on or before May 23, 1983 (or a sublease under such a lease), or

(B) any renewal or extension of a lease entered into on or before May 23, 1983, if such renewal or extension is pursuant to an option exercisable by the tax-exempt entity which was held by the tax-exempt entity on May 23, 1983.

(3) BINDING CONTRACTS, ETC.—

(A) The amendments made by this section shall not apply with respect to any property leased to a tax-exempt entity if such lease is pursuant to 1 or more written binding contracts which, on May 23, 1983, and at all times thereafter, required—

(i) the taxpayer (or his predecessor in interest under the contract) to acquire, construct, reconstruct, or rehabilitate such property, and

(ii) the tax-exempt entity (or a tax-exempt predecessor thereof) to be the lessee of such property.

(B) The amendments made by this section shall not apply with respect to any property owned by a partnership if—

(i) such property was acquired by such partnership on or before October 21, 1983, or

(ii) such partnership entered into a written binding contract which, on October 21, 1983, and at all times thereafter, required the partnership to acquire or construct such property.

(C) The amendments made by this section shall not apply with respect to any property leased to a tax-exempt entity (other than any foreign person or entity)—

(i) if—

(I) on or before May 23, 1983, the taxpayer (or his predecessor in interest under the contract) or the tax-exempt entity entered into a written binding contract to acquire, construct, reconstruct, or rehabilitate such property and such property had not previously been used by the tax-exempt entity, or

(II) the taxpayer or the tax-exempt entity acquired the property after June 30, 1982, and on or before May 23, 1983, or completed the construction, reconstruction, or rehabilitation of the property after December 31, 1982, and on or before May 23, 1983, and

(ii) if such lease is pursuant to a written binding contract entered into before January 1, 1985, which requires the tax-exempt entity to be the lessee of such property.

(4) OFFICIAL GOVERNMENTAL ACTION ON OR BEFORE NOVEMBER 1, 1983.—

(A) IN GENERAL.—*The amendments made by this section shall not apply with respect to any property leased to a tax-exempt entity (other than the United States, any agency or instrumentality thereof, or any foreign person or entity) if—*

(i) on or before November 1, 1983, there was significant official governmental action with respect to the project or its design, and

(ii) the lease to the tax-exempt entity is pursuant to a written binding contract entered into before January 1, 1985, which requires the tax-exempt entity to be the lessee of the property.

(B) SIGNIFICANT OFFICIAL GOVERNMENTAL ACTION.—*For purposes of subparagraph (A), the term "significant official governmental action" does not include granting of permits, zoning changes, environmental impact statements, or similar governmental actions.*

(5) MASS COMMUTING VEHICLES.—*The amendments made by this section shall not apply to any qualified mass commuting vehicle (as defined in section 103(b)(9) of the Internal Revenue Code of 1954) which is financed in whole or in part by obligations the interest on which is excludable from gross income under section 103(a) of such Code if—*

(A) such vehicle is placed in service before January 1, 1988, or

(B) such vehicle is placed in service on or after such date—

(i) pursuant to a binding contract or commitment entered into before April 1, 1983, and

(ii) solely because of conditions which, as determined by the Secretary of the Treasury or his delegate, are not within the control of the lessor or lessee.

(6) CERTAIN TURBINES AND BOILERS.—*The amendments made by this section shall not apply to any property described in section 208(d)(3)(E) of the Tax Equity and Fiscal Responsibility Act of 1982.*

(7) CERTAIN FACILITIES FOR WHICH RULING REQUESTS FILED ON OR BEFORE MAY 23, 1983.—*The amendments made by this section shall not apply with respect to any facilities described in clause (ii) of section 168(f)(12)(C) of the Internal Revenue Code of 1954 (relating to certain sewage or solid waste disposal facilities), as in effect on the day before the date of the enactment of this Act, if a ruling request with respect to the lease of such facility to the tax-exempt entity was filed with the Internal Revenue Service on or before May 23, 1983.*

(8) RECOVERY PERIOD FOR CERTAIN QUALIFIED SEWAGE FACILITIES.—

(A) IN GENERAL.—*In the case of any property (other than 15-year real property) which is part of a qualified sewage facility, the recovery period used for purposes of paragraph (1) of section 168(j) of the Internal Revenue Code of 1954 (as added by this section) shall be 12 years.*

(B) QUALIFIED SEWAGE FACILITY.—For purposes of subparagraph (A), the term "qualified sewage facility" means any facility which is part of the sewer system of a city, if—

(i) on June 15, 1983, the City Council approved a resolution under which the city authorized the procurement of equity investments for such facility, and

(ii) on July 12, 1983, the Industrial Development Board of the city approved a resolution to issue a $100,000,000 industrial development bond issue to provide funds to purchase such facility.

(9) PROPERTY USED BY THE POSTAL SERVICE.—In the case of property used by the United States Postal Service, paragraphs (1) and (2) shall be applied by substituting "October 31" for "May 23".

(10) EXISTING APPROPRIATIONS.—The amendments made by this section shall not apply to personal property leased to or used by the United States if—

(A) an express appropriation has been made for rentals under such lease for the fiscal year 1983 before May 23, 1983, and

(B) the United States or an agency or instrumentality thereof has not provided an indemnification against the loss of all or a portion of the tax benefits claimed under the lease or service contract.

(11) SPECIAL RULE FOR CERTAIN PARTNERSHIPS.—

(A) PARTNERSHIPS FOR WHICH QUALIFYING ACTION EXISTED BEFORE OCTOBER 21, 1983.—Paragraph (9) of section 168(j) of the Internal Revenue Code of 1954 (as added by this section) shall not apply to any property acquired, directly or indirectly, before January 1, 1985, by any partnership described in subparagraph (B).

(B) APPLICATION FILED BEFORE OCTOBER 21, 1983.—A partnership is described in this subparagraph if—

(i) before October 21, 1983, the partnership was organized, a request for exemption with respect to such partnership was filed with the Department of Labor, and a private placement memorandum stating the maximum of units in the partnership that would be offered had been circulated,

(ii) the interest in the property to be acquired, directly or indirectly (including through acquiring an interest in another partnership) by such partnership was described in such private placement memorandum, and

(iii) the marketing of partnership units in such partnership is completed not later than two years after the later of the date of the enactment of this Act or the date of publication in the Federal Register of such exemption by the Department of Labor and the aggregate number of units in such partnership sold does not exceed the amount described in clause (i).

(C) PARTNERSHIPS FOR WHICH QUALIFYING ACTION EXISTED BEFORE MARCH 6, 1984.—Paragraph (9) of section 168(j) of the Internal Revenue Code of 1954 (as added by this section) shall not apply to any property acquired direct-

ly or indirectly, before January 1, 1986, by any partnership described in subparagraph (D). For purposes of this subparagraph, property shall be deemed to have been acquired prior to January 1, 1986, if the partnership had entered into a written binding contract to acquire such property prior to January 1, 1986 and the closing of such contract takes place within 6 months of the date of such contract (24 months in the case of new construction).

(D) PARTNERSHIP ORGANIZED BEFORE MARCH 6, 1984.—A partnership is described in this subparagraph if—

(i) before March 6, 1984, the partnership was organized and publicly announced the maximum amount (as shown in the registration statement, prospectus or partnership agreement, whichever is greater) of interests which would be sold in the partnership, and

(ii) the marketing or partnership interests in such partnership was completed not later than the 90th day after the date of the enactment of this Act and the aggregate amount of interest in such partnership sold does not exceed the maximum amount described in clause (i).

(12) SPECIAL RULE FOR AMENDMENT MADE BY SUBSECTION (c)(2).—The amendment made by subsection (c)(2) to the extent it relates to subsection (f)(12) of section 168 of the Internal Revenue Code of 1954 shall take effect as if it had been included in the amendments made by section 216(a) of the Tax Equity and Fiscal Responsibility Act of 1982.

(13) SPECIAL RULE FOR SERVICE CONTRACTS NOT INVOLVING TAX-EXEMPT ENTITIES.—In the case of a service contract or other arrangement described in section 7701(e) of the Internal Revenue Code of 1954 (as added by this section) with respect to which no party is a tax-exempt entity, such section 7701(e) shall not apply to—

(A) such contract or other arrangement if such contract or other arrangement was entered into before November 5, 1983, or

(B) any renewal or other extension of such contract or other arrangement pursuant to an option contained in such contract or other arrangement on November 5, 1983.

(14) PROPERTY LEASED TO SECTION 593 ORGANIZATIONS.—For purposes of the amendment made by subsection (f), paragraphs (1), (2), and (4) shall be applied by substituting—

(A) "November 5, 1983" for "May 23, 1983" and "November 1, 1983", as the case may be, and

(B) "organization described in section 593 of the Internal Revenue Code of 1954" for "tax-exempt entity".

(15) SPECIAL RULES RELATING TO FOREIGN PERSONS OR ENTITIES—

(A) IN GENERAL.—In the case of tax-exempt use property which is used by a foreign person or entity, the amendments made by this section shall not apply to any property which—

(i) is placed in service before January 1, 1984, and

(ii) is used by such foreign person or entity pursuant to a lease entered into before January 1, 1984.

(B) SPECIAL RULE FOR SUBLEASES.—If tax-exempt use property is being used by a foreign person or entity pursuant to a sublease under a lease described in subparagraph (A)(ii), subparagraph (A) shall apply to such property only if such property was used before January 1, 1984, by any foreign person or entity pursuant to such lease.

(C) BINDING CONTRACTS, ETC.—The amendments made by this section shall not apply with respect to any property (other than aircraft described in subparagraph (D)) leased to a foreign person or entity—

(i) if—

(I) on or before May 23, 1983, the taxpayer (or a predecessor in interest under the contract) or the foreign person or entity entered into a written binding contract to acquire, construct, or rehabilitate such property and such property had not previously been used by the foreign person or entity, or

(II) the taxpayer or the foreign person or entity acquired the property or completed the construction, reconstruction, or rehabilitation of the property after December 31, 1982 and on or before May 23, 1983, and

(ii) if such lease is pursuant to a written binding contract entered into before January 1, 1984, which requires the foreign person or entity to be the lessee of such property.

(D) CERTAIN AIRCRAFT.—The amendments made by this section shall not apply with respect to any wide-body, four-engine, commercial passenger aircraft used by a foreign person or entity if—

(i) on or before November 1, 1983, the foreign person or entity entered into a written binding contract to acquire such aircraft, and

(ii) such aircraft is placed in service before January 1, 1986.

(E) USE AFTER 1983.—Qualified container equipment placed in service before January 1, 1984, which is used before such date by a foreign person shall not, for purposes of section 47 of the Internal Revenue Code of 1954, be treated as ceasing to be section 38 property by reason of the use of such equipment before January 1, 1985, by a foreign person or entity. For purposes of this subparagraph, the term "qualified container equipment" means any container, container chassis, or container trailer of a United States person with a present class life of not more than 6 years.

(16) ORGANIZATIONS ELECTING EXEMPTION FROM RULES RELATING TO PREVIOUSLY TAX-EXEMPT ORGANIZATIONS MUST ELECT TAXATION OF EXEMPT ARBITRAGE PROFITS.—

(A) IN GENERAL.—An organization may make the election under section 168(j)(4)(E)(ii) of the Internal Revenue Code of 1954 (relating to election not to have rules relating to previously tax-exempt organizations apply) only if such organiza-

tion elects the tax treatment of exempt arbitrage profits described in subparagraph (B).

(B) TAXATION OF EXEMPT ARBITRAGE PROFITS.—

(i) IN GENERAL.—In the case of an organization which elects the application of this subparagraph, there is hereby imposed a tax on the exempt arbitrage profits of such organization.

(ii) RATE OF TAX, ETC.—The tax imposed by clause (i)—

(I) shall be the amount of tax which would be imposed by section 11 of such Code if the exempt arbitrage profits were taxable income (and there were no other taxable income), and

(II) shall be imposed for the first taxable year of the tax-exempt use period (as defined in section 168(j)(4)(E)(ii) of such Code).

(C) EXEMPT ARBITRAGE PROFITS.—

(i) IN GENERAL.—For purposes of this paragraph, the term exempt arbitrage profits means the aggregate amount described in clauses (i) and (ii) of subparagraph (D) of section 103(c)(6) of such Code for all taxable years for which the organization was exempt from tax under section 501(a) of such Code with respect to obligations—

(I) associated with property described in section 168(j)(4)(E)(i)(I), and

(II) issued before January 1, 1985.

(ii) APPLICATION OF SECTION 103(b)(6).—For purposes of this paragraph, section 103(b)(6) of such Code shall apply to obligations issued before January 1, 1985, but the amount described in clauses (i) and (ii) of subparagraph (D) thereof shall be determined without regard to clauses (i)(II) and (ii) of subparagraph (F) thereof.

(D) OTHER LAWS APPLICABLE.—

(i) IN GENERAL.—Except as provided in clause (ii), all provisions of law, including penalties, applicable with respect to the tax imposed by section 11 of such Code shall apply with respect to the tax imposed by this paragraph.

(ii) NO CREDITS AGAINST TAX, ETC.—The tax imposed by this paragraph shall not be treated as imposed by section 11 of such Code for purposes of—

(I) part VI of subchapter A of chapter 1 of such Code (relating to minimum tax for tax preferences), and

(II) determining the amount of any credit allowable under subpart A of part IV of such subchapter.

(E) ELECTION.—Any election under subparagraph (A)—

(i) shall be made at such time and in such manner as the Secretary may prescribe,

(ii) shall apply to any successor organization which is engaged in substantially similar activities, and

(iii) once made, shall be irrevocable.

(17) CERTAIN TRANSITIONAL LEASED PROPERTY.—The amendments made by this section shall not apply to property described in section 168(c)(1)(D) of the Internal Revenue Code of 1954, as in effect on the day before the date of the enactment of this Act, and which is described in any of the following subparagraphs:

(A) Property is described in this subparagraph if such property is leased to a university, and—

(i) on June 16, 1983, the Board of Administrators of the university adopted a resolution approving the rehabilitation of the property in connection with an overall campus development program; and

(ii) the property houses a basketball arena and university offices.

(B) Property is described in this subparagraph if such property is leased to a charitable organization, and—

(i) on August 21, 1981, the charitable organization acquired the property, with a view towards rehabilitating the property; and

(ii) on June 12, 1982, an arson fire caused substantial damage to the property, delaying the planned rehabilitation.

(C) Property is described in this subparagraph if such property is leased to a corporation that is described in section 501(c)(3) of the Internal Revenue Code of 1954 (relating to organizations exempt from tax) pursuant to a contract—

(i) which was entered into on August 3, 1983; and

(ii) under which the corporation first occupied the property on December 22, 1983.

(D) Property is described in this subparagraph if such property is leased to an educational institution for use as an Arts and Humanities Center and with respect to which—

(i) in November 1982, an architect was engaged to design a planned renovation;

(ii) in January 1983, the architectural plans were completed;

(iii) in December 1983, a demolition contract was entered into; and

(iv) in March 1984, a renovation contract was entered into.

(E) Property is described in this subparagraph if such property is used by a college as a dormitory, and—

(i) in October 1981, the college purchased the property with a view towards renovating the property;

(ii) renovation plans were delayed because of a zoning dispute; and

(iii) in May 1983, the court of highest jurisdiction in the State in which the college is located resolved the zoning dispute in favor of the college.

(F) Property is described in this subparagraph if such property is a fraternity house related to a university with respect to which—

(i) in August 1982, the university retained attorneys to advise the university regarding the rehabilitation of the property;

(ii) on January 21, 1983, the governing body of the university established a committee to develop rehabilitation plans;

(iii) on January 10, 1984, the governor of the state in which the university is located approved historic district designation for an area that includes the property; and

(iv) on February 2, 1984, historic preservation certification applications for the property were filed with a historic landmarks commission.

(g) Property is described in this subparagraph if such property is leased to a retirement community with respect to which—

(i) on January 5, 1977, a certificate of incorporation was filed with the appropriate authority of the state in which the retirement community is located; and

(ii) on November 22, 1983, the Board of Trustees adopted a resolution evidencing the intention to begin immediate construction of the property.

(H) Property is described in this subparagraph if such property is used by a university, and—

(i) in July 1982, the Board of Trustees of the university adopted a master plan for the financing of the property; and

(ii) as of August 1, 1983, at least $60,000 in private expenditures had been expended in connection with the property.

(I) Property is described in this subparagraph if such property is used by a university as a fine arts center and the Board of Trustees of such university authorized the sale-leaseback agreement with respect to such property on March 7, 1984.

(J) Property is described in this subparagraph if such property is used by a tax-exempt entity as an international trade center, and

(i) prior to 1982, an environmental impact study for such property was completed;

(ii) on June 24, 1981, a developer made a commitment to provide one-third of the financing for the development of such property; and

(iii) on October 20, 1983, such developer was approved by the Board of Directors of the tax-exempt entity.

(K) Property is described in this subparagraph if such property is used by university of osteopathic medicine and health sciences, and on or before December 31, 1983, the Board of Trustees of such university approved the construction of such property.

(L) Property is described in this subparagraph if such property is used by a tax-exempt entity, and—

(i) such use is pursuant to a lease with a taxpayer which placed substantial improvements in service;

(ii) on May 23, 1983, there existed architectural plans and specifications (within the meaning of sec. 48(g)(1)(C)(ii) of the Internal Revenue Code) in existence; and

(iii) prior to May 23, 1983, at least 10 percent of the total cost of such improvements was actually paid or incurred.

(M) property is described in this subparagraph if such property is used as a convention center, on June 2, 1983, the City Council of the city in which the center is located provided for over $6 million for the project.

(18) SPECIAL RULE FOR AMENDMENT MADE BY SUBSECTION (c)(1).—

(A) IN GENERAL.—The amendment made by subsection (c)(1) shall not apply to property—

(i) leased by the taxpayer on or before November 1, 1983, or

(ii) leased by the taxpayer after November 1, 1983, if on or before such date the taxpayer entered into a written binding contract requiring the taxpayer to lease such property.

(B) LIMITATION.—Subparagraph (A) shall apply to the amendment made by subsection (c)(1) only to the extent such amendment relates to property described in subclause (II), (III), or (IV) of section 168(j)(3)(B)(ii) of the Internal Revenue Code of 1954 (as added by this section).

(19) SPECIAL RULE FOR CERTAIN ENERGY MANAGEMENT CONTRACTS.—

(A) IN GENERAL.—The amendments made by subsection (e) shall not apply to property used pursuant to an energy management contract that was entered into prior to May 1, 1984.

(B) DEFINITION OF ENERGY MANAGEMENT CONTRACT.—For purposes of subparagraph (A), the term "energy management contract" means a contract for the providing of energy conservation or energy management services.

(20) DEFINITIONS.—For purposes of this subsection—

(A) TAX-EXEMPT ENTITY.—The term "tax-exempt entity" has the same meaning as when used in section 168(j) of the Internal Revenue Code of 1954 (as added by this section), except that such term shall include any related entity (within the meaning of such section).

(B) TREATMENT OF IMPROVEMENTS.—

(i) IN GENERAL.—For purposes of this subsection, an improvement to property shall not be treated as a separate property unless such improvement is a substantial improvement with respect to such property.

(ii) SUBSTANTIAL IMPROVEMENT.—For purposes of clause (i), the term "substantial improvement" has the meaning given such term by section 168(f)(1)(C) of such Code determined—

(I) by substituting "20 percent" for "25 percent" in clause (ii) thereof, and

(II) without regard to clause (iii) thereof.

(C) FOREIGN PERSON OR ENTITY.—*The term "foreign person or entity" has the meaning given to such term by subparagraph (C) of section 168(j)(4) of such Code (as added by this section). For purposes of this subparagraph and subparagraph (A), such subparagraph (C) shall be applied without regard to the last sentence thereof.*

(D) LEASES AND SUBLEASES.—*The determination of whether there is a lease or sublease shall take into account sections 168(j)(6)(A) and 7701(e) of the Internal Revenue Code of 1954 (as added by this section).*

SEC. 32. MOTOR VEHICLE OPERATING LEASES.

(a) IN GENERAL.—*Section 168(f) (relating to special rules) is amended by adding at the end thereof the following new paragraph:*

"(13) MOTOR VEHICLE OPERATING LEASES.—

"(A) IN GENERAL.—*For purposes of this title, in the case of a qualified motor vehicle operating agreement which contains a terminal rental adjustment clause—*

"(i) such agreement shall be treated as a lease if (but for such terminal rental adjustment clause) such agreement would be treated as a lease under this title, and

"(ii) the leasee shall not be treated as the owner of the property subject to an agreement during any period such agreement is in effect.

"(B) QUALIFIED MOTOR VEHICLE OPERATING AGREEMENT DEFINED.—*For purposes of this paragraph—*

"(i) IN GENERAL.—*The term 'qualified motor vehicle operating agreement' means any agreeement with respect to a motor vehicle (including a trailer) which meets the requirements of clauses (ii), (iii), and (iv) of this subparagraph.*

"(ii) MINIMUM LIABILITY OF LESSOR.—*An agreement meets the requirements of this clause if under such agreement the sum of—*

"(I) the amount the lessor is personally liable to repay, and

"(II) the net fair market value of the lessor's interest in any property pledged as security for property subject to the agreement,

equals or exceeds all amounts borrowed to finance the acquisition of property subject to the agreement. There shall not be taken into account under subclause (II) any property pledged which is property subject to the agreement or property directly or indirectly financed by indebtedness secured by property subject to the agreement.

"(iii) CERTIFICATION BY LESSEE; NOTICE OF TAX OWNERSHIP.—*An agreement meets the requirements of this clause if such agreement contains a separate written statement separately signed by the lessee—*

"(I) under which the lessee certifies, under penalty of perjury, that it intends that more than 50 percent of the use of the property subject to such

agreement is to be in a trade or business of the lessee, and

"(ii) which clearly and legibly states that the lessee has been advised that it will not be treated as the owner of the property subject to the agreement for Federal income tax purposes.

"(iv) LESSOR MUST HAVE NO KNOWLEDGE THAT CERTIFICATION IS FALSE.—An agreement meets the requirements of this clause if the lessor does not know that the certification described in clause (iii)(I) is false.

"(C) TERMINAL RENTAL ADJUSTMENT CLAUSE DEFINED.—

"(i) IN GENERAL.—For purposes of this paragraph, the term 'terminal rental adjustment clause' means a provision of an agreement which permits or requires the rental price to be adjusted upward or downward by reference to the amount realized by the lessor under the agreement upon sale or other disposition of such property.

"(ii) SPECIAL RULE FOR LESSEE DEALERS.—The term 'terminal rental adjustment clause' also includes a provision of an agreement which requires a lessee who is a dealer in motor vehicles to purchase the motor vehicle for a predetermined price and then resell such vehicle where such provision achieves substantially the same results as a provision described in clause (i)."

(b) TERMINATION OF SECTION 210.—Section 210(a) of the Tax Equity and Fiscal Responsibility Act of 1982 is amended by inserting "entered into on or before the 90th day after the date of the enactment of the Tax Reform Act of 1984" after "agreement" the first place it appears.

(c) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to agreements described in section 168(f)(13) of the Internal Revenue Code of 1954 (as added by subsection (a)) entered into more than 90 days after the date of the enactment of this Act.

Subtitle C—Treatment of Bonds and Other Debt Instruments

SEC. 41. TREATMENT OF BONDS AND OTHER DEBT INSTRUMENTS.

(a) GENERAL RULE.—Subchapter P of chapter 1 (relating to special rules for capital gains and losses) is amended by adding at the end thereof the following new part:

"PART V—SPECIAL RULES FOR BONDS AND OTHER DEBT INSTRUMENTS

"Subpart A. Original issue discount.
"Subpart B. Market discount.
"Subpart C. Discount on short-term obligations.
"Subpart D. Miscellaneous provisions.

"Subpart A—Original Issue Discount

"Sec. 1271. Treatment of amounts received on retirement or sale or exchange of debt instruments.

"SEC. 1271. TREATMENT OF AMOUNTS RECEIVED ON RETIREMENT OR SALE OR EXCHANGE OF DEBT INSTRUMENTS.

"(a) GENERAL RULE.—For purposes of this title—

"(1) RETIREMENT.—Amounts received by the holder on retirement of any debt instrument shall be considered as amounts received in exchange therefor.

"(2) ORDINARY INCOME ON SALE OR EXCHANGE WHERE INTENTION TO CALL BEFORE MATURITY.—

"(A) IN GENERAL.—If at the time of original issue there was an intention to call a debt instrument before maturity, any gain realized on the sale or exchange thereof which does not exceed an amount equal to—

"(i) the original issue discount, reduced by

"(ii) the portion of original issue discount previously includible in the gross income of any holder (without regard to subsection (a)(6) or (b)(4) of section 1272 (or the corresponding provisions of prior law)),

shall be treated as ordinary income.

"(B) EXCEPTIONS.—This paragraph (and paragraph (2) of subsection (c)) shall not apply to—

"(i) any tax-exempt obligation, or

"(ii) any holder who has purchased the debt instrument at a premium.

"(3) CERTAIN SHORT-TERM GOVERNMENT OBLIGATIONS.—

"(A) IN GENERAL.—On the sale or exchange of any short-term Government obligation, any gain realized which does not exceed an amount equal to the ratable share of the acquisition discount shall be treated as ordinary income.

"(B) SHORT-TERM GOVERNMENT OBLIGATION.—For purposes of this paragraph, the term 'short-term Government obligation' means any obligation of the United States or any of its possessions, or of a State or any political subdivision thereof, or of the District of Columbia which is—

"(i) issued on a discount basis, and

"(ii) payable without interest at a fixed maturity date not more than 1 year from the date of issue.

Such term does not include any tax-exempt obligation.

"(C) ACQUISITION DISCOUNT.—For purposes of this paragraph, the term 'acquisition discount' means the excess of the stated redemption price at maturity over the taxpayer's basis for the obligation.

"(D) RATABLE SHARE.—For purposes of this paragraph, the ratable share of the acquisition discount is an amount which bears the same ratio to such discount as—

"(i) the number of days which the taxpayer held the obligation, bears to

"(ii) the number of days after the date the taxpayer acquired the obligation and up to (and including) the date of its maturity.

"(b) Exceptions.—This section shall not apply to—

"(1) Natural persons.—Any obligation issued by a natural person.

"(2) Obligations issued before July 2, 1982, by certain issuers.—Any obligation issued before July 2, 1982, by an issuer which—

"(A) is not a corporation, and

"(B) is not a government or political subdivision thereof.

"(c) Transition Rules.—

"(1) Special rule for certain obligations issued before January 1, 1955.—Paragraph (1) of subsection (a) shall apply to a debt instrument issued before January 1, 1955, only if such instrument was issued with interest coupons or in registered form, or was in such form on March 1, 1954.

"(2) Special rule for certain obligations with respect to which original issue discount not currently includible.—

"(A) In general.—On the sale or exchange of debt instruments issued by a government or political subdivision thereof after December 31, 1954, and before July 2, 1982, or by a corporation after December 31, 1954, and on or before May 27, 1969, any gain realized which does not exceed—

"(i) an amount equal to the original issue discount, or

"(ii) if at the time of original issue there was no intention to call the debt instrument before maturity, an amount which bears the same ratio to the original issue discount as the number of complete months that the debt instrument was held by the taxpayer bears to the number of complete months from the date of original issue to the date of maturity, shall be considered as ordinary income.

"(B) Subsection (a)(2)(A) not to apply.—Subsection (a)(2)(A) shall not apply to any debt instrument referred to in subparagraph (A) of this paragraph.

"(C) Cross reference.—

"For current inclusion of original issue discount, see section 1272.

"(d) Double Inclusion in Income Not Required.—This section and sections 1272 and 1286 shall not require the inclusion of any amount previously includible in gross income.

"SEC. 1272. CURRENT INCLUSION IN INCOME OF ORIGINAL ISSUE DISCOUNT.

"(a) Original Issue Discount on Debt Instruments Issued After July 1, 1982, Included in Income on Basis of Constant Interest Rate.—

"(1) General rule.—For purposes of this title, there shall be included in the gross income of the holder of any debt instrument having original issue discount issued after July 1, 1982, an amount equal to the sum of the daily portions of the original issue discount for each day during the taxable year on which such holder held such debt instrument.

"(2) Exceptions.—Paragraph (1) shall not apply to—

"(A) TAX-EXEMPT OBLIGATIONS.—Any tax-exempt obligation.

"(B) UNITED STATES SAVINGS BONDS.—Any United States savings bond.

"(C) SHORT-TERM OBLIGATIONS.—Any debt instrument which has a fixed maturity date not more than 1 year from the date of issue.

"(D) OBLIGATIONS ISSUED BY NATURAL PERSONS BEFORE MARCH 2, 1984.—Any obligation issued by a natural person before March 2, 1984.

"(E) LOANS BETWEEN NATURAL PERSONS.—

"(i) IN GENERAL.—Any loan made by a natural person to another natural person if—

"(I) such loan is not made in the course of a trade or business of the lender, and

"(II) the amount of such loan (when increased by the outstanding amount of prior loans by such natural person to such other natural person) does not exceed $10,000.

"(ii) CLAUSE (i) NOT TO APPLY WHERE TAX AVOIDANCE A PRINCIPAL PURPOSE.—Clause (i) shall not apply if the loan has as 1 of its principal purposes the avoidance of any Federal tax.

"(iii) TREATMENT OF HUSBAND AND WIFE.—For purposes of this subparagraph, a husband and wife shall be treated as 1 person. The preceding sentence shall not apply where the spouses lived apart at all times during the taxable year in which the loan is made.

"(3) DETERMINATION OF DAILY PORTIONS.—For purposes of paragraph (1), the daily portion of the original issue discount on any debt instrument shall be determined by allocating to each day in any accrual period its ratable portion of the increase during such accrual period in the adjusted issue price of the debt instrument. For purposes of the preceding sentence, the increase in the adjusted issue price for any accrual period shall be an amount equal to the excess (if any) of—

"(A) the product of—

"(i) the adjusted issue price of the debt instrument at the beginning of such accrual period, and

"(ii) the yield to maturity (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period), over

"(B) the sum of the amounts payable as interest on such debt instrument during such accrual period.

"(4) ADJUSTED ISSUE PRICE.—For purposes of this subsection, the adjusted issue price of any debt instrument at the beginning of any accrual period is the sum of—

"(A) the issue price of such debt instrument, plus

"(B) the adjustments under this subsection to such issue price for all periods before the first day of such accrual period.

"(5) ACCRUAL PERIOD.—Except as otherwise provided in regulations prescribed by the Secretary, the term 'accrual period'

means a 6-month period (or shorter period from the date of original issue of the debt instrument) which ends on a day in the calendar year corresponding to the maturity date of the debt instrument or the date 6 months before such maturity date.

"(6) REDUCTION WHERE SUBSEQUENT HOLDER PAYS ACQUISITION PREMIUM.—

"(A) REDUCTION.—For purposes of this subsection, in the case of any purchase after its original issue of a debt instrument to which this subsection applies, the daily portion for any day shall be reduced by an amount equal to the amount which would be the daily portion for such day (without regard to this paragraph) multiplied by the fraction determined under subparagraph (B).

"(B) DETERMINATION OF FRACTION.—For purposes of subparagraph (A), the fraction determined under this subparagraph is a fraction—

"(i) the numerator of which is the excess (if any) of—

"(I) the cost of such debt instrument incurred by the purchaser, over

"(II) the issue price of such debt instrument, increased by the portion of original issue discount previously includible in the gross income of any holder (computed without regard to this paragraph), and

"(ii) the denominator of which is the sum of the daily portions for such debt instrument for all days after the date of such purchase and ending on the stated maturity date (computed without regard to this paragraph).

"(b) RATABLE INCLUSION RETAINED FOR CORPORATE DEBT INSTRUMENTS ISSUED BEFORE JULY 2, 1982.—

"(1) GENERAL RULE.—There shall be included in the gross income of the holder of any debt instrument issued by a corporation after May 27, 1969, and before July 2, 1982—

"(A) the ratable monthly portion of original issue discount, multiplied by

"(B) the number of complete months (plus any fractional part of a month determined under paragraph (3)) such holder held such debt instrument during the taxable year.

"(2) DETERMINATION OF RATABLE MONTHLY PORTION.—Except as provided in paragraph (4), the ratable monthly portion of original issue discount shall equal—

"(A) the original issue discount, divided by

"(B) the number of complete months from the date of original issue to the stated maturity date of the debt instrument.

"(3) MONTH DEFINED.—For purposes of this subsection—

"(A) COMPLETE MONTH.—A complete month commences with the date of original issue and the corresponding day of each succeeding calendar month (or the last day of a calendar month in which there is no corresponding day).

"(B) TRANSFERS DURING MONTH.—In any case where a debt instrument is acquired on any day other than a day determined under subparagraph (A), the ratable monthly

portion of original issue discount for the complete month (or partial month) in which such acquisition occurs shall be allocated between the transferor and the transferee in accordance with the number of days in such complete (or partial) month each held the debt instrument.

"(4) REDUCTION WHERE SUBSEQUENT HOLDER PAYS ACQUISITION PREMIUM.—

"(A) REDUCTION.—For purposes of this subsection, the ratable monthly portion of original issue discount shall not include its share of the acquisition premium.

"(B) SHARE OF ACQUISITION PREMIUM.—For purposes of subparagraph (A), any month's share of the acquisition premium is an amount (determined at the time of the purchase) equal to—

"(i) the excess of—

"(I) the cost of such debt instrument incurred by the holder, over

"(II) the issue price of such debt instrument, increased by the portion of original issue discount previously includible in the gross income of any holder (computed without regard to this paragraph),

"(ii) divided by the number of complete months (plus any fractional part of a month) from the date of such purchase to the stated maturity date of such debt instrument.

"(c) EXCEPTIONS.—This section shall not apply to any holder—

"(1) who has purchased the debt instrument at a premium, or

"(2) which is a life insurance company to which section 811(b) applies.

"(d) DEFINITION AND SPECIAL RULE.—

"(1) PURCHASE DEFINED.—For purposes of this section, the term 'purchase' means—

"(A) any acquisition of a debt instrument, where

"(B) the basis of the debt instrument is not determined in whole or in part by reference to the adjusted basis of such debt instrument in the hands of the person from whom acquired.

"(2) BASIS ADJUSTMENT.—The basis of any debt instrument in the hands of the holder thereof shall be increased by the amount included in his gross income pursuant to this section.

"SEC. 1273. DETERMINATION OF AMOUNT OF ORIGINAL ISSUE DISCOUNT.

"(a) GENERAL RULE.—For purposes of this subpart—

"(1) IN GENERAL.—The term 'original issue discount' means the excess (if any) of—

"(A) the stated redemption price at maturity, over

"(B) the issue price.

"(2) STATED REDEMPTION PRICE AT MATURITY.—The term 'stated redemption price at maturity' means the amount fixed by the last modification of the purchase agreement and includes interest and other amounts payable at that time (other than any interest based on a fixed rate, and payable uncondi-

tionally at fixed periodic intervals of 1 year or less during the entire term of the debt instrument).

"(3) 1/4 OF 1 PERCENT DE MINIMIS RULE.—If the original issue discount determined under paragraph (1) is less than—

"(A) 1/4 of 1 percent of the stated redemption price at maturity, multiplied by

"(B) the number of complete years to maturity,

then the original issue discount shall be treated as zero.

"(b) ISSUE PRICE.—For purposes of this subpart—

"(1) PUBLICLY OFFERED DEBT INSTRUMENTS NOT ISSUED FOR PROPERTY.—In the case of any issue of debt instruments—

"(A) publicly offered, and

"(B) not issued for property,

the issue price is the initial offering price to the public (excluding bond houses and brokers) at which price a substantial amount of such debt instruments was sold.

"(2) OTHER DEBT INSTRUMENTS NOT ISSUED FOR PROPERTY.—In the case of any issue of debt instruments not issued for property and not publicly offered, the issue price of each such instrument is the price paid by the first buyer of such debt instrument.

"(3) DEBT INSTRUMENTS ISSUED FOR PROPERTY WHERE THERE IS PUBLIC TRADING.—In the case of a debt instrument which is issued for property and which—

"(A) is part of an issue a portion of which is traded on an established securities market, or

"(B) is issued for stock or securities which are traded on an established securities market,

the issue price of such debt instrument shall be the fair market value of such property.

"(4) OTHER CASES.—Except in any case—

"(A) to which paragraph (1), (2), or (3) of this subsection applies, or

"(B) to which section 1274 applies,

the issue price of a debt instrument which is issued for property shall be the stated redemption price at maturity.

"(5) PROPERTY.—In applying this subsection, the term 'property' includes services and the right to use property, but such term does not include money.

"(c) SPECIAL RULES FOR APPLYING SUBSECTION (b).—For purposes of subsection (b)—

"(1) INITIAL OFFERING PRICE; PRICE PAID BY THE FIRST BUYER.—The terms 'initial offering price' and 'price paid by the first buyer' include the aggregate payments made by the purchaser under the purchase agreement, including modifications thereof.

"(2) TREATMENT OF INVESTMENT UNITS.—In the case of any debt instrument and an option, security, or other property issued together as an investment unit—

"(A) the issue price for such unit shall be determined in accordance with the rules of this subsection and subsection (b) as if it were a debt instrument,

"(B) the issue price determined for such unit shall be allocated to each element of such unit on the basis of the relationship of the fair market value of such element to the fair market value of all elements in such unit, and

"(C) the issue price of any debt instrument included in such unit shall be the portion of the issue price of the unit allocated to the debt instrument under subparagraph (B).

"SEC. 1274. DETERMINATION OF ISSUE PRICE IN THE CASE OF CERTAIN DEBT INSTRUMENTS ISSUED FOR PROPERTY.

"(a) IN GENERAL.—In the case of any debt instrument to which this section applies, for purposes of this subpart, the issue price shall be—

"(1) where there is adequate stated interest, the stated principal amount, or

"(2) in any other case, the imputed principal amount.

"(b) IMPUTED PRINCIPAL AMOUNT.—For purposes of this section—

"(1) IN GENERAL.—Except as provided in paragraph (3), the imputed principal amount of any debt instrument shall be equal to the sum of the present values of all payments due under such debt instrument.

"(2) DETERMINATION OF PRESENT VALUE.—For purposes of paragraph (1), the present value of a payment shall be determined in the manner provided by regulations prescribed by the Secretary—

"(A) as of the date of the sale or exchange, and

"(B) by using a discount rate equal to 120 percent of the applicable Federal rate, compounded semiannually.

"(3) FAIR MARKET VALUE RULE IN POTENTIALLY ABUSIVE SITUATIONS.—

"(A) IN GENERAL.—In the case of any potentially abusive situation, the imputed principal amount of any debt instrument received in exchange for property shall be the fair market value of such property adjusted to take into account other consideration involved in the transaction.

"(B) POTENTIALLY ABUSIVE SITUATION DEFINED.—For purposes of subparagraph (A), the term 'potentially abusive situation' means—

"(i) a tax shelter (as defined in section 6661(b)(2)(C)(ii)), and

"(ii) any other situation which, by reason of—

"(I) recent sales transactions,

"(II) nonrecourse financing,

"(III) financing with a term in excess of the economic life of the property, or

"(IV) other circumstances,

is of a type which the Secretary specifies by regulations as having potential for tax avoidance.

"(c) DEBT INSTRUMENTS TO WHICH SECTION APPLIES.—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, this section shall apply to any debt instrument given in consideration for the sale or exchange of property if—

"(A) the stated redemption price at maturity for such debt instrument exceeds—

"(i) where there is adequate stated interest, the stated principal amount, or

"(ii) in any other case, the testing amount, and

"(B) some or all of the payments due under such debt instrument are due more than 6 months after the date of such sale or exchange.

"(2) ADEQUATE STATED INTEREST.—For purposes of this section, there is adequate stated interest with respect to any debt instrument if the stated principal amount for such debt instrument is less than the testing amount.

"(3) TESTING AMOUNT.—For purposes of this section, the term 'testing amount' means, with respect to any debt instrument, the imputed principal amount of such debt instrument which would be determined under subsection (b) (including paragraph (3) thereof) if a discount rate equal to 110 percent of the applicable Federal rate were used.

"(2) EXCEPTIONS.—This section shall not apply to—

"(A) SALES FOR LESS THAN $1,000,000 OF FARMS BY INDIVIDUALS OR SMALL BUSINESSES.—

"(i) IN GENERAL.—Any debt instrument arising from the sale or exchange of a farm (within the meaning of section 6420(c)(2))—

"(I) by an individual, estate, or testamentary trust,

"(II) by a corporation which as of the date of the sale or exchange is a small business corporation (as defined in section 1244(c)(3)), or

"(III) by a partnership which as of the date of the sale or exchange meets requirements similar to those of section 1244(c)(3).

"(ii) $1,000,000 LIMITATION.—Clause (i) shall apply only if it can be determined at the time of the sale or exchange that the sales price cannot exceed $1,000,000. For purposes of the preceding sentence, all sales and exchanges which are part of the same transaction (or a series of related transactions) shall be treated as 1 sale or exchange.

"(B) SALES OF PRINCIPAL RESIDENCES.—Any debt instrument arising from the sale or exchange by an individual of his principal residence (within the meaning of section 1034).

"(C) SALES INVOLVING TOTAL PAYMENTS OF $250,000 OR LESS.—

"(i) IN GENERAL.—Any debt instrument arising from the sale or exchange of property if the sum of the following amounts does not exceed $250,000:

"(I) the aggregate amount of the payments due under such debt instrument and all other debt instruments received as consideration for the sale or exchange, and

"(II) the aggregate amount of any other consideration to be received for the sale or exchange.

"(ii) CONSIDERATION OTHER THAN DEBT INSTRUMENT TAKEN INTO ACCOUNT AT FAIR MARKET VALUE.—For

purposes of clause (i), any consideration (other than a debt instrument) shall be taken into account at its fair market value.

"(iii) AGGREGATION OF TRANSACTIONS.—For purposes of this subparagraph, all sales and exchanges which are part of the same transaction (or a series of related transactions) shall be treated as 1 sale or exchange.

"(D) DEBT INSTRUMENTS WHICH ARE PUBLICLY TRADED OR ISSUED FOR PUBLICLY TRADED PROPERTY.—Any debt instrument to which section 1273(b)(3) applies.

"(E) CERTAIN SALES OF PATENTS.—In the case of any transfer described in section 1235(a) (relating to sale or exchange of patents), any amount contingent on the productivity, use, or disposition of the property transferred.

"(F) SALES OR EXCHANGES TO WHICH SECTION 483(e) APPLIES.—Any debt instrument to the extent section 483(e) (relating to certain land transfers between related persons) applies to such instrument.

"(d) DETERMINATION OF APPLICABLE FEDERAL RATE.—For purposes of this section—

"(1) APPLICABLE FEDERAL RATE.—

"(A) IN GENERAL.—

"In the case of a debt instrument with a term of:	The applicable Federal rate is:
Not over 3 years	The Federal short-term rate.
Over 3 years but not over 9 years	The Federal mid-term rate.
Over 9 years	The Federal long-term rate.

"(B) DETERMINATION OF RATES.—Within 15 days after the close of—

"(i) the 6-month period ending on September 30 of any calendar year, or

"(ii) the 6-month period ending on March 31 of any calendar year,

the Secretary shall determine the Federal short-term rate, mid-term rate, and long-term rate for such 6-month period.

"(C) EFFECTIVE DATE OF DETERMINATION.—Any Federal rate determined under subparagraph (A) shall—

"(i) apply during the 6-month period beginning on January 1 of the succeeding calendar year in the case of a determination made under subparagraph (B)(i), and

"(ii) apply during the 6-month period beginning on July 1 of the calendar year in the case of a determination made under subparagraph (B)(ii).

"(D) FEDERAL RATE FOR ANY 6-MONTH PERIOD.—For purposes of this paragraph—

"(i) FEDERAL SHORT-TERM RATE.—The Federal short-term rate for any 6-month period shall be the rate determined by the Secretary based on the average market yield (during such 6-month period) on outstanding

marketable obligations of the United States with remaining periods to maturity of 3 years or less.

"(ii) FEDERAL MID-TERM AND LONG-TERM RATES.—The Federal mid-term rate and long-term rate shall be determined in accordance with the principles of clause (i).

"(2) RATE APPLICABLE TO ANY SALE OR EXCHANGE.—In the case of any sale or exchange, the determination of the applicable Federal rate shall be made as of the first day on which there is a binding contract in writing for the sale or exchange.

"(3) TERM OF DEBT INSTRUMENT.—In determining the term of a debt instrument for purposes of this subsection, under regulations prescribed by the Secretary, there shall be taken into account options to renew or extend.

"SEC. 1275. OTHER DEFINITIONS AND SPECIAL RULES.

"(a) DEFINITIONS.—For purposes of this subpart—

"(1) DEBT INSTRUMENT.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'debt instrument' means a bond, debenture, note, or certificate or other evidence of indebtedness.

"(B) EXCEPTION FOR CERTAIN ANNUITY CONTRACTS.—The term 'debt instrument' shall not include any annuity contract to which section 72 applies and which—

"(i) depends (in whole or in substantial part) on the life expectancy of 1 or more individuals, or

"(ii) is issued by an insurance company subject to tax under subchapter L—

"(I) in a transaction in which there is no consideration other than cash or another annuity contract meeting the requirements of this clause,

"(II) pursuant to the exercise of an election under an insurance contract by a beneficiary thereof on the death of the insured party under such contract, or

"(III) in a transaction involving a qualified pension or employee benefit plan.

"(2) ISSUE DATE.—

"(A) PUBLICLY OFFERED DEBT INSTRUMENTS.—In the case of any debt instrument which is publicly offered, the term 'date of original issue' means the date on which the issue was first issued to the public.

"(B) ISSUES NOT PUBLICLY OFFERED AND NOT ISSUED FOR PROPERTY.—In the case of any debt instrument to which section 1273(b)(2) applies, the term 'date of original issue' means the date on which the debt instrument was sold by the issuer.

"(C) OTHER DEBT INSTRUMENTS.—In the case of any debt instrument not described in subparagraph (A) or (B), the term 'date of original issue' means the date on which the debt instrument was issued in a sale or exchange.

"(3) TAX-EXEMPT OBLIGATION.—The term 'tax-exempt obligation' means any obligation if—

"(A) the interest on such obligation is not includible in gross income under section 103, or

"(B) the interest on such obligation is exempt from tax (without regard to the identity of the holder) under any other provision of law.

"(4) SPECIAL RULE FOR DETERMINATION OF ISSUE PRICE IN CASE OF EXCHANGE OF DEBT INSTRUMENTS IN REORGANIZATIONS.—

"(A) IN GENERAL.—If—

"(i) any debt instrument is issued pursuant to a plan of reorganization (within the meaning of section 368(a)(1)) for another debt instrument (hereinafter in this paragraph referred to as the 'old debt instrument'), and

"(ii) the amount which (but for this paragraph) would be the issue price of the debt instrument so issued is less than the adjusted issue price of the old debt instrument,

then the issue price of the debt instrument so issued shall be treated as equal to the adjusted issue price of the old debt instrument.

"(B) DEFINITIONS.—For purposes of this paragraph—

"(i) DEBT INSTRUMENT.—The term 'debt instrument' includes an investment unit.

"(ii) ADJUSTED ISSUE PRICE.—

"(I) IN GENERAL.—The adjusted issue price of the old debt instrument is its issue price, increased by the portion of any original issue discount previously includible in the gross income of any holder (without regard to subsection (a)(6) or (b)(4) of section 1272 (or the corresponding provisions of prior law)).

"(II) SPECIAL RULE FOR APPLYING SECTION 163(e).—For purposes of section 163(e), the adjusted issue price of the old debt instrument is its issue price, increased by any original issue discount previously allowed as a deduction.

"(b) TREATMENT OF BORROWER IN THE CASE OF CERTAIN LOANS FOR PERSONAL USE.—

"(1) SECTIONS 1274 AND 483 NOT TO APPLY.—In the case of the obligor under any debt instrument given in consideration for the sale or exchange of property, sections 1274 and 483 shall not apply if such property is personal use property.

"(2) ORIGINAL ISSUE DISCOUNT DEDUCTED ON CASH BASIS IN CERTAIN CASES.—In the case of any debt instrument, if—

"(A) such instrument—

"(i) is incurred in connection with the acquisition or carrying of personal use property, and

"(ii) has original issue discount (determined after the application of paragraph (1)), and

"(B) the obligor under such instrument uses the cash receipts and disbursements method of accounting,

notwithstanding section 163(e), the original issue discount on such instrument shall be deductible only when paid.

"(3) PERSONAL USE PROPERTY.—For purposes of this subsection, the term 'personal use property' means any property substantially all of the use of which by the taxpayer is not in connection with a trade or business of the taxpayer or an activity described in section 212. The determination of whether property is described in the preceding sentence shall be made as of the time of issuance of the debt instrument.

"(c) INFORMATION REQUIREMENTS.—

"(1) INFORMATION REQUIRED TO BE SET FORTH ON INSTRUMENT.—

"(A) IN GENERAL.—In the case of any debt instrument having original issue discount, the Secretary may by regulations require that—

"(i) the amount of the original issue discount, and

"(ii) the issue date,

be set forth on such instrument.

"(B) SPECIAL RULE FOR INSTRUMENTS NOT PUBLICLY OFFERED.—In the case of any issue of debt instruments not publicly offered, the regulations prescribed under subparagraph (A) shall not require the information to be set forth on the debt instrument before any disposition of such instrument by the first buyer.

"(2) INFORMATION REQUIRED TO BE SUBMITTED TO SECRETARY.—In the case of any issue of publicly offered debt instruments having original issue discount, the issuer shall (at such time and in such manner as the Secretary shall by regulation prescribe) furnish the Secretary the following information:

"(A) The amount of the original issue discount.

"(B) The issue date.

"(C) Such other information with respect to the issue as the Secretary may by regulations require.

For purposes of the preceding sentence, any person who makes a public offering of stripped bonds (or stripped coupons) shall be treated as the issuer of a publicly offered debt instrument having original issue discount.

"(3) EXCEPTIONS.—This subsection shall not apply to any obligation referred to in section 1272(a)(2) (relating to exceptions from current inclusion of original issue discount).

"(4) CROSS REFERENCE.—

"For civil penalty for failure to meet requirements of this subsection, see section 6706.

"(d) REGULATION AUTHORITY.—The Secretary may prescribe regulations providing that where, by reason of varying rates of interest, put or call options, indefinite maturities, contingent payments, assumptions of debt instruments, or other circumstances, the tax treatment under this subpart (or section 163(e)) does not carry out the purposes of this subpart (or section 163(e)), such treatment shall be modified to the extent appropriate to carry out the purposes of this subpart (or section 163(e)).

"Subpart B—Market Discount on Bonds

"Sec. 1278. Definitions and special rules.

"SEC. 1276. DISPOSITION GAIN REPRESENTING ACCRUED MARKET DISCOUNT TREATED AS ORDINARY INCOME.

"(a) ORDINARY INCOME.—

"(1) IN GENERAL.—Except as otherwise provided in this section, gain on the disposition of any market discount bond shall be treated as ordinary income to the extent it does not exceed the accrued market discount on such bond. Such gain shall be recognized notwithstanding any other provision of this subtitle.

"(2) DISPOSITIONS OTHER THAN SALES, ETC.—For purposes of paragraph (1), a person disposing of any market discount bond in any transaction other than a sale, exchange, or involuntary conversion shall be treated as realizing an amount equal to the fair market value of the bond.

"(3) GAIN TREATED AS INTEREST FOR CERTAIN PURPOSES.—Except for purposes of sections 871(a), 881, 1441, 1442, and 6049 (and such other provisions as may be specified in regulations), any amount treated as ordinary income under paragraph (1) shall be treated as interest for purposes of this title.

"(b) ACCRUED MARKET DISCOUNT.—For purposes of this section—

"(1) RATABLE ACCRUAL.—Except as otherwise provided in this subsection or subsection (c), the accrued market discount on any bond shall be an amount which bears the same ratio to the market discount on such bond as—

"(A) the number of days which the taxpayer held the bond, bears to

"(B) the number of days after the date the taxpayer acquired the bond and up to (and including) the date of its maturity.

"(2) ELECTION OF ACCRUAL ON BASIS OF CONSTANT INTEREST RATE (IN LIEU OF RATABLE ACCRUAL).—

"(A) IN GENERAL.—At the election of the taxpayer with respect to any bond, the accrued market discount on such bond shall be the aggregate amount which would have been includible in the gross income of the taxpayer under section 1272(a) with respect to such bond for all periods during which the bond was held by the taxpayer if such bond had been—

"(i) originally issued on the date on which such bond was acquired by the taxpayer,

"(ii) for an issue price equal to the basis of the taxpayer in such bond immediately after its acquisition.

"(B) COORDINATION WHERE BOND HAS ORIGINAL ISSUE DISCOUNT.—In the case of any bond having original issue discount, for purposes of applying subparagraph (A)—

"(i) the stated redemption price at maturity of such bond shall be treated as equal to its revised issue price, and

"(ii) the determination of the portion of the original issue discount which would have been includible in the gross income of the taxpayer under section 1272(a) shall be made under regulations prescribed by the Secretary.

"(C) ELECTION IRREVOCABLE.—An election under subparagraph (A), once made with respect to any bond, shall be irrevocable.

"(c) TREATMENT OF NONRECOGNITION TRANSACTIONS.—Under regulations prescribed by the Secretary—

"(1) TRANSFERRED BASIS PROPERTY.—If a market discount bond is transferred in a nonrecognition transaction and such bond is transferred basis property in the hands of the transferee, for purposes of determining the amount of the accrued market discount with respect to the transferee—

"(A) the transferee shall be treated as having acquired the bond on the date on which it was acquired by the transferor for an amount equal to the basis of the transferor, and

"(B) proper adjustments shall be made for gain recognized by the transferor on such transfer (and for any original issue discount or market discount included in the gross income of the transferor).

"(2) EXCHANGED BASIS PROPERTY.—If any market discount bond is disposed of by the taxpayer in a nonrecognition transaction and paragraph (1) does not apply to such transaction, any accrued market discount determined with respect to the property disposed of to the extent not theretofore treated as ordinary income under subsection (a)—

"(A) shall be treated as accrued market discount with respect to the exchanged basis property received by the taxpayer in such transaction if such property is a market discount bond, and

"(B) shall be treated as ordinary income on the disposition of the exchanged basis property received by the taxpayer in such exchange if such property is not a market discount bond.

"(3) PARAGRAPH (1) TO APPLY TO CERTAIN DISTRIBUTIONS BY CORPORATIONS OR PARTNERSHIPS.—For purposes of paragraph (1), if the basis of any market discount bond in the hands of a transferee is determined under section 334(c), 732(a), or 732(b), such property shall be treated as transferred basis property in the hands of such transferee.

"(d) SPECIAL RULES.—Under regulations prescribed by the Secretary—

"(1) rules similar to the rules of subsection (b) of section 1245 shall apply for purposes of this section; except that—

"(A) paragraph (1) of such subsection shall not apply, and

"(B) an exchange qualifying under section 354(a), 355(a), or 356(a) (determined without regard to subsection (a) of this section) shall be treated as an exchange described in paragraph (3) of such subsection, and

"(2) appropriate adjustments shall be made to the basis of any property to reflect gain recognized under subsection (a).

"(e) SECTION NOT TO APPLY TO MARKET DISCOUNT BONDS ISSUED ON OR BEFORE DATE OF ENACTMENT OF SECTION.—This section shall not apply to any market discount bond issued on or before the date of the enactment of this section.

"SEC. 1277. DEFERRAL OF INTEREST DEDUCTION ALLOCABLE TO ACCRUED MARKET DISCOUNT.

"(a) GENERAL RULE.—Except as otherwise provided in this section, the net direct interest expense with respect to any market discount bond shall be allowed as a deduction for the taxable year only to the extent that such expense exceeds the portion of the market discount allocable to the days during the taxable year on which such bond was held by the taxpayer (as determined under the rules of section 1276(b)).

"(b) DISALLOWED DEDUCTION ALLOWED FOR LATER YEARS.—

"(1) ELECTION TO TAKE INTO ACCOUNT IN LATER YEAR WHERE NET INTEREST INCOME FROM BOND.—

"(A) IN GENERAL.—If—

"(i) there is net interest income for any taxable year with respect to any market discount bond, and

"(ii) the taxpayer makes an election under this subparagraph with respect to such bond,

any disallowed interest expense with respect to such bond shall be treated as interest paid or accrued by the taxpayer during such taxable year to the extent such disallowed interest expense does not exceed the net interest income with respect to such bond.

"(B) DETERMINATION OF DISALLOWED INTEREST EXPENSE.—For purposes of subparagraph (A), the amount of the disallowed interest expense—

"(i) shall be determined as of the close of the preceding taxable year, and

"(ii) shall not include any amount previously taken into account under subparagraph (A).

"(C) NET INTEREST INCOME.—For purposes of this paragaph, the term 'net interest income' means the excess of the amount determined under paragraph (2) of subsection (c) over the amount determined under paragraph (1) of subsection (c).

"(2) REMAINDER OF DISALLOWED INTEREST EXPENSE ALLOWED FOR YEAR OF DISPOSITION.—

"(A) IN GENERAL.—Except as otherwise provided in this paragraph, the amount of the disallowed interest expense with respect to any market discount bond shall be treated as interest paid or accrued by the taxpayer in the taxable year in which such bond is disposed of.

"(B) NONRECOGNITION TRANSACTIONS.—If any market discount bond is disposed of in a nonrecognition transaction—

"(i) the disallowed interest expense with respect to such bond shall be treated as interest paid or accrued in the year of disposition only to the extent of the amount of gain recognized on such disposition, and

"(ii) the disallowed interest expense with respect to such property (to the extent not so treated) shall be treated as disallowed interest expense—

"(I) in the case of a transaction described in section 1276(c)(1), of the transferee with respect to the transferred basis property, or

"(II) in the case of a transaction described in section 1276(c)(2), with respect to the exchanged basis property.

"(C) DISALLOWED INTEREST EXPENSE REDUCED FOR AMOUNTS PREVIOUSLY TAKEN INTO ACCOUNT UNDER PARAGRAPH (1).—For purposes of this paragraph, the amount of the disallowed interest expense shall not include any amount previously taken into account under paragraph (1).

"(3) DISALLOWED INTEREST EXPENSE.—For purposes of this subsection, the term 'disallowed interest expense' means the aggregate amount disallowed under subsection (a) with respect to the market discount bond.

"(c) NET DIRECT INTEREST EXPENSE.—For purposes of this section, the term 'net direct interest expense' means, with respect to any market discount bond, the excess (if any) of—

"(1) the amount of interest paid or accrued during the taxable year on indebtedness which is incurred or continued to purchase or carry such bond, over

"(2) the aggregate amount of interest (including original issue discount) includible in gross income for the taxable year with respect to such bond.

In the case of any financial institution to which section 585 or 593 applies, the determination of whether interest is described in paragraph (1) shall be made under principles similar to the principles of section 291(e)(1)(B)(ii). Under rules similar to the rules of section 265(5), short sale expenses shall be treated as interest for purposes of determining net direct interest expense.

"(d) SPECIAL RULE FOR GAIN RECOGNIZED ON DISPOSITION OF MARKET DISCOUNT BONDS ISSUED ON OR BEFORE DATE OF ENACTMENT OF SECTION.—In the case of a market discount bond issued on or before the date of the enactment of this section, any gain recognized by the taxpayer on any disposition of such bond shall be treated as ordinary income to the extent the amount of such gain does not exceed the amount allowable with respect to such bond under subsection (b)(2) for the taxable year in which such bond is disposed of.

"SEC. 1278. DEFINITIONS AND SPECIAL RULES.

"(a) IN GENERAL.—For purposes of this part—

"(1) MARKET DISCOUNT BOND.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'market discount bond' means any bond having market discount.

"(B) EXCEPTIONS.—The term 'market discount bond' shall not include—

"(i) SHORT-TERM OBLIGATIONS.—Any obligation with a fixed maturity date not exceeding 1 year from the date of issue.

"(ii) TAX-EXEMPT OBLIGATIONS.—Any tax-exempt obligation (as defined in section 1275(a)(3)).

"(iii) UNITED STATES SAVINGS BONDS.—Any United States savings bond.

"(iv) INSTALLMENT OBLIGATIONS.—Any installment obligation to which section 453B applies.

"(2) Market discount.—

"(A) In general.—The term 'market discount' means the excess (if any) of—

"(i) the stated redemption price of the bond at maturity, over

"(ii) the basis of such bond immediately after its acquisition by the taxpayer.

"(B) Coordination where bond has original issue discount.—In the case of any bond having original issue discount, for purposes of subparagraph (A), the stated redemption price of such bond at maturity shall be treated as equal to its revised issue price.

"(C) De minimis rule.—If the market discount is less than 1/4 of 1 percent of the stated redemption price of the bond at maturity multiplied by the number of complete years to maturity (after the taxpayer acquired the bond), then the market discount shall be considered to be zero.

"(3) Bond.—The term 'bond' means any bond, debenture, note, certificate, or other evidence of indebtedness.

"(4) Revised issue price.—The term 'revised issue price' means of the sum of—

"(A) the issue price of the bond, and

"(B) the aggregate amount of the original issue discount includible in the gross income of all holders for periods before the acquisition of the bond by the taxpayer (determined without regard to section 1272 (a)(6) or (b)(4)).

"(5) Original issue discount, etc.—The terms 'original issue discount', 'stated redemption price at maturity', and 'issue price' have the respective meanings given such terms by subpart A of this part.

"(b) Election To Include Market Discount Currently.—

"(1) In general.—If the taxpayer makes an election under this subsection—

"(A) sections 1276 and 1277 shall not apply, and

"(B) market discount on any market discount bond shall be included in the gross income of the taxpayer for the taxable years to which it is attributable (as determined under the rules of subsection (b) of section 1276).

Except for purposes of sections 871(a), 881, 1441, 1442, and 6049 (and such other provisions as may be specified in regulations), any amount included in gross income under subparagraph (B) shall be treated as interest for purposes of this title.

"(2) Scope of election.—An election under this subsection shall apply to all market discount bonds acquired by the taxpayer on or after the 1st day of the 1st taxable year to which such election applies.

"(3) Period to which election applies.—An election under this subsection shall apply to the taxable year for which it is made and for all subsequent taxable years, unless the taxpayer secures the consent of the Secretary to the revocation of such election.

"(c) Regulations.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subpart.

"Subpart C—Discount on Short-Term Obligations

"SEC. 1281. CURRENT INCLUSION IN INCOME OF DISCOUNT ON CERTAIN SHORT-TERM OBLIGATIONS.

"(a) IN GENERAL.—In the case of any short-term obligation to which this section applies, for purposes of this title, there shall be included in the gross income of the holder an amount equal to the sum of the daily portions of the acquisition discount for each day during the taxable year on which such holder held such obligation.

"(b) SHORT-TERM OBLIGATIONS TO WHICH SECTION APPLIES.—

"(1) IN GENERAL.—This section shall apply to any short-term obligation which—

"(A) is held by a taxpayer using an accrual method of accounting,

"(B) is held primarily for sale to customers in the ordinary course of the taxpayer's trade or business,

"(C) is held by a bank (as defined in section 581),

"(D) is held by a regulated investment company or a common trust fund, or

"(E) is identified by the taxpayer under section 1256(e)(2) as being part of a hedging transaction.

"(2) TREATMENT OF OBLIGATIONS HELD BY PASS-THRU ENTITIES.—

"(A) IN GENERAL.—This section shall apply also to—

"(i) any short-term obligation which is held by a pass-thru entity which is formed or availed of for purposes of avoiding the provisions of this section, and

"(ii) any short-term obligation which is acquired by a pass-thru entity (not described in clause (i)) during the required accrual period.

"(B) REQUIRED ACCRUAL PERIOD.—For purposes of subparagraph (A), the term 'required accrual period' means the period—

"(i) which begins with the first taxable year for which the ownership test of subparagraph (C) is met with respect to the pass-thru entity (or a predecessor), and

"(ii) which ends with the first taxable year after the taxable year referred to in clause (i) for which the ownership test of subparagraph (C) is not met and with respect to which the Secretary consents to the termination of the required accrual period.

"(C) OWNERSHIP TEST.—The ownership test of this subparagraph is met for any taxable year if, on at least 90 days during the taxable year, 20 percent or more of the value of the interests in the pass-thru entity are held by persons described in paragraph (1) or by other pass-thru entities to which subparagraph (A) applies.

"(D) PASS-THRU ENTITY.—The term 'pass-thru entity' means any partnership, S corporation, trust, or other pass-thru entity.

"(c) CROSS REFERENCE.—

"For special rules limiting the application of this section to original issue discount in the case of nongovernmental obligations, see section 1283(c).

"SEC. 1282. DEFERRAL OF INTEREST DEDUCTION ALLOCABLE TO ACCRUED DISCOUNT.

"(a) GENERAL RULE.—Except as otherwise provided in this section, the net direct interest expense with respect to any short-term obligation shall be allowed as a deduction for the taxable year only to the extent that such expense exceeds the sum of the daily portions of the acquisition discount for each day during the taxable year on which the taxpayer held such obligation.

"(b) SECTION NOT TO APPLY TO OBLIGATIONS TO WHICH SECTION 1281 APPLIES.—

"(1) IN GENERAL.—This section shall not apply to any short-term obligation to which section 1281 APPLIES.

"(2) ELECTION TO HAVE SECTION 1281 APPLY TO ALL OBLIGATIONS.—

"(A) IN GENERAL.—A taxpayer may make an election under this paragraph to have section 1281 apply to all short-term obligations acquired by the taxpayer on or after the 1st day of the 1st taxable year to which such election applies.

"(B) PERIOD TO WHICH ELECTION APPLIES.—An election under this paragraph shall apply to the taxable year for which it is made and for all subsequent taxable years, unless the taxpayer secures the consent of the Secretary to the revocation of such election.

"(c) CERTAIN RULES MADE APPLICABLE.—Rules similar to the rules of subsections (b) and (c) of section 1277 shall apply for purposes of this section.

"(d) CROSS REFERENCE.—

"For special rules limiting the application of this section to original issue discount in the case of nongovernmental obligations, see section 1283(c).

"SEC. 1283. DEFINITIONS AND SPECIAL RULES.

"(a) DEFINITIONS.—For purposes of this subpart—

"(1) SHORT-TERM OBLIGATION.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'short-term obligation' means any bond, debenture, note, certificate, or other evidence of indebtedness which has a fixed maturity date not more than 1 year from the date of issue.

"(B) EXCEPTIONS FOR TAX-EXEMPT OBLIGATIONS.—The term 'short-term obligation' shall not include any tax-exempt obligation (as defined in section 1275(a)(3)).

"(2) ACQUISITION DISCOUNT.—The term 'acquisition discount' means the excess of—

"(A) the stated redemption price at maturity (as defined in section 1273), over

"(B) the taxpayer's basis for the obligation.

"(b) DAILY PORTION.—For purposes of this subpart—

"(1) RATABLE ACCRUAL.—Except as otherwise provided in this subsection, the daily portion of the acquisition discount is an amount equal to—

"(A) the amount of such discount, divided by

"(B) the number of days after the day on which the taxpayer acquired the obligation and up to (and including) the day of its maturity.

"(2) ELECTION OF ACCRUAL ON BASIS OF CONSTANT INTEREST RATE (IN LIEU OF RATABLE ACCRUAL).—

"(A) IN GENERAL.—At the election of the taxpayer with respect to any obligation, the daily portion of the acquisition discount for any day is the portion of the acquisition discount accruing on such day determined (under regulations prescribed by the Secretary) on the basis of—

"(i) the taxpayer's yield to maturity based on the taxpayer's cost of acquiring the obligation, and

"(ii) compounding daily.

"(B) ELECTION IRREVOCABLE.—An election under subparagraph (A), once made with respect to any obligation, shall be irrevocable.

"(c) SPECIAL RULES FOR NONGOVERNMENTAL OBLIGATIONS.—

"(1) IN GENERAL.—In the case of any short-term obligation which is not a short-term Government obligation (as defined in section 1271(a)(3)(B))—

"(A) sections 1281 and 1282 shall be applied by taking into account original issue discount in lieu of acquisition discount, and

"(B) appropriate adjustments shall be made in the application of subsection (b) of this section.

"(2) ELECTION TO HAVE PARAGRAPH (1) NOT APPLY.—

"(A) IN GENERAL.—A taxpayer may make an election under this paragraph to have paragraph (1) not apply to all obligations acquired by the taxpayer on or after the first day of the first taxable year to which such election applies.

"(B) PERIOD TO WHICH ELECTION APPLIES.—An election under this paragraph shall apply to the taxable year for which it is made and for all subsequent taxable years, unless the taxpayer secures the consent of the Secretary to the revocation of such election.

"(d) OTHER SPECIAL RULES.—

"(1) BASIS ADJUSTMENTS.—The basis of any short-term obligation in the hands of the holder thereof shall be increased by the amount included in his gross income pursuant to section 1281.

"(2) DOUBLE INCLUSION IN INCOME NOT REQUIRED.—Section 1281 shall not require the inclusion of any amount previously includible in gross income.

"(3) COORDINATION WITH OTHER PROVISIONS.—Section 454(b) and section 1271(a)(3) shall not apply to any short-term obligation to which section 1281 applies.

"Subpart D—Miscellaneous Provisions

"SEC. 1286. TAX TREATMENT OF STRIPPED BONDS.

"(a) INCLUSION IN INCOME AS IF BOND AND COUPONS WERE ORIGINAL ISSUE DISCOUNT BONDS.—If any person purchases after July 1, 1982, a stripped bond or a stripped coupon, then such bond or coupon while held by such purchaser (or by any other person whose basis is determined by reference to the basis in the hands of such purchaser) shall be treated for purposes of this part as a bond originally issued on the purchase date and having an original issue discount equal to the excess (if any) of—

"(1) the stated redemption price at maturity (or, in the case of coupon, the amount payable on the due date of such coupon), over

"(2) such bond's or coupon's ratable share of the purchase price.

For purposes of paragraph (2), ratable shares shall be determined on the basis of their respective fair market values on the date of purchase.

"(b) TAX TREATMENT OF PERSON STRIPPING BOND.—For purposes of this subtitle, if any person strips 1 or more coupons from a bond and after July 1, 1982, disposes of the bond or such coupon—

"(1) such person shall include in gross income an amount equal to the interest accrued on such bond while held by such person and before the time that such coupon or bond was disposed of (to the extent such interest has not theretofore been included in such person's gross income),

"(2) the basis of the bond and coupons shall be increased by the amount of the accrued interest described in paragraph (1),

"(3) the basis of the bond and coupons immediately before the disposition (as adjusted pursuant to paragraph (2)) shall be allocated among the items retained by such person and the items disposed of by such person on the basis of their respective fair market values, and

"(4) for purposes of subsection (a), such person shall be treated as having purchased on the date of such disposition each such item which he retains for an amount equal to the basis allocated to such item under paragraph (3).

A rule similar to the rule of paragraph (4) shall apply in the case of any person whose basis in any bond or coupon is determined by reference to the basis of the person described in the preceding sentence.

"(c) RETENTION OF EXISTING LAW FOR STRIPPED BONDS PURCHASED BEFORE JULY 2, 1982.—If a bond issued at any time with interest coupons—

"(1) is purchased after August 16, 1954, and before January 1, 1958, and the purchaser does not receive all the coupons which first become payable more than 12 months after the date of the purchase, or

"(2) is purchased after December 31, 1957, and before July 2, 1982, and the purchaser does not receive all the coupons which first become payable after the date of the purchase,

then the gain on the sale or other disposition of such bond by such purchaser (or by a person whose basis is determined by reference to the basis in the hands of such purchaser) shall be considered as ordinary income to the extent that the fair market value (determined as of the time of the purchase) of the bond with coupons attached exceeds the purchase price. If this subsection and section 1271(a)(2)(A) apply with respect to gain realized on the sale or exchange of any evidence of indebtedness, then section 1271(a)(2)(A) shall apply with respect to that part of the gain to which this subsection does not apply.

"(d) SPECIAL RULES FOR TAX-EXEMPT OBLIGATIONS.—In the case of any tax-exempt obligation (as defined in section 1275(a)(3))—

"(1) subsections (a) and (b)(1) shall not apply,

"(2) the rules of subsection (b)(4) shall apply for purposes of subsection (c), and

"(3) subsection (c) shall be applied without regard to the requirement that the bond be purchased before July 2, 1982.

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

"(1) BOND.—The term 'bond' means a bond, debenture, note, or certificate or other evidence of indebtedness.

"(2) STRIPPED BOND.—The term 'stripped bond' means a bond issued at any time with interest coupons where there is a separation in ownership between the bond and any coupon which has not yet become payable.

"(3) STRIPPED COUPON.—The term 'stripped coupon' means any coupon relating to a stripped bond.

"(4) STATED REDEMPTION PRICE AT MATURITY.—The term 'stated redemption price at maturity' has the meaning given such term by section 1273(a)(2).

"(5) COUPON.—The term 'coupon' includes any right to receive interest on a bond (whether or not evidenced by a coupon). This paragraph shall apply for purposes of subsection (c) only in the case of purchases after July 1, 1982.

"(6) PURCHASE.—The term 'purchase' has the meaning given such term by section 1272(d)(1).

"(f) REGULATION AUTHORITY.—The Secretary may prescribe regulations providing that where, by reason of varying rates of interest, put or call options, or other circumstances, the tax treatment under this section does not accurately reflect the income of the holder of a stripped coupon or stripped bond, or of the person disposing of such bond or coupon, as the case may be, for any period, such treatment shall be modified to require that the proper amount of income be included for such period.

"SEC. 1287. DENIAL OF CAPITAL GAIN TREATMENT FOR GAINS ON CERTAIN OBLIGATIONS NOT IN REGISTERED FORM.

"(a) IN GENERAL.—If any registration-required obligation is not in registered form, any gain on the sale or other disposition of such obligation shall be treated as ordinary income (unless the issuance of such obligation was subject to tax under section 4701).

"(b) DEFINITIONS.—For purposes of subsection (a)—

"(1) REGISTRATION-REQUIRED OBLIGATION.—The term 'registration-required obligation' has the meaning given to such term *by section 163(f)(2) except that clause (iv) of subparagraph (A), and subparagraph (B), of such section shall not apply.*

"(2) REGISTERED FORM.—The term 'registered form' has the same meaning as when used in section 163(f).

"SEC. 1288. TREATMENT OF ORIGINAL ISSUE DISCOUNT ON TAX-EXEMPT OBLIGATIONS.

"(a) GENERAL RULE.—Original issue discount on any tax-exempt obligation shall be treated as accruing—

"(1) for purposes of section 163, in the manner provided by section 1272(a) (determined without regard to paragraph (6) thereof), and

"(2) for purposes of determining the adjusted basis of the holder, in the manner provided by section 1272(a) (determined with regard to paragraph (6) thereof).

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

"(1) ORIGINAL ISSUE DISCOUNT.—The term 'original issue discount' has the meaning given to such term by section 1273(a) without regard to paragraph (3) thereof. In applying section 483 or 1274, under regulations prescribed by the Secretary, appropriate adjustments shall be made to the applicable Federal rate to take into account the tax exemption for interest on the obligation.

"(2) TAX-EXEMPT OBLIGATION.—The term 'tax-exempt obligation' has the meaning given to such term by section 1275(a)(3).

"(3) SHORT-TERM OBLIGATIONS.—In applying this section to obligations with maturity of 1 year or less, rules similar to the rules of section 1283(b) shall apply."

(b) AMENDMENT OF SECTION 483.—Section 483 (relating to interest on certain deferred payments) is amended to read as follows:

"SEC. 483. INTEREST ON CERTAIN DEFERRED PAYMENTS.

"(a) AMOUNT CONSTITUTING INTEREST.—For purposes of this title, in the case of any payment—

"(1) under any contract for the sale or exchange of any property, and

"(2) to which this section applies,

there shall be treated as interest that portion of the total unstated interest under such contract which, as determined in a manner consistent with the method of computing interest under section 1272(a), is properly allocable to such payment.

"(b) TOTAL UNSTATED INTEREST.—For purposes of this section, the term 'total unstated interest' means, with respect to a contract for the sale or exchange of property, an amount equal to the excess of—

"(1) the sum of the payments to which this section applies which are due under the contract, over

"(2) the sum of the present values of such payments and the present values of any interest payments due under the contract.

For purposes of the preceding sentence, the present value of a payment shall be determined under the rules of section 1274(b)(2) using a discount rate equal to 120 percent of the applicable Federal rate determined under section 1274(d).

"(c) PAYMENTS TO WHICH SUBSECTION (a) APPLIES.—

"(1) IN GENERAL.—Except as provided in subsection (d), this section shall apply to any payment on account of the sale or exchange of property which constitutes part or all of the sales price and which is due more than 6 months after the date of such sale or exchange under a contract—

"(A) under which some or all of the payments are due more than 1 year after the date of such sale or exchange, and

"(B) under which, using a discount rate equal to 110 percent of the applicable Federal rate determined under section 1274(d), there is total unstated interest.

"(2) TREATMENT OF OTHER DEBT INSTRUMENTS.—For purposes of this section, a debt instrument of the purchaser which is given in consideration for the sale or exchange of property shall not be treated as a payment, and any payment due under such debt instrument shall be treated as due under the contract for the sale or exchange.

"(3) DEBT INSTRUMENT DEFINED.—For purposes of this subsection, the term 'debt instrument' has the meaning given such term by section 1275(a)(1).

"(d) EXCEPTIONS AND LIMITATIONS.—

"(1) COORDINATION WITH ORIGINAL ISSUE DISCOUNT RULES.—This section shall not apply to any debt instrument to which section 1272 applies.

"(2) SALES PRICES OF $3,000 OR LESS.—This section shall not apply to any payment on account of the sale or exchange of property if it can be determined at the time of such sale or exchange that the sales price cannot exceed $3,000.

"(3) CARRYING CHARGES.—In the case of the purchaser, the tax treatment of amounts paid on account of the sale or exchange of property shall be made without regard to this section if any such amounts are treated under section 163(b) as if they included interest.

"(4) CERTAIN SALES OF PATENTS.—In the case of any transfer described in section 1235(a) (relating to sale or exchange of patents), this section shall not apply to any amount contingent on the productivity, use, or disposition of the property transferred.

"(e) MAXIMUM RATE OF INTEREST ON CERTAIN TRANSFERS OF LAND BETWEEN RELATED PARTIES.—

"(1) IN GENERAL.—In the case of any qualified sale, the discount rate used in determining the total unstated interest rate under subsection (b) shall not exceed 7 percent, compounded semiannually.

"(2) QUALIFIED SALE.—For purposes of this subsection, the term 'qualified sale' means any sale or exchange of land by an individual to a member of such individual's family (within the meaning of section 267(c)(4)).

"(3) $500,000 LIMITATION.—Paragraph (1) shall not apply to any qualified sale between individuals made during any calendar year to the extent that the sales price for such sale (when added to the aggregate sales price for prior qualified sales between such individuals during the calendar year) exceeds $500,000.

"(4) NONRESIDENT ALIEN INDIVIDUALS.—Paragraph (1) shall not apply to any sale or exchange if any party to such sale or exchange is a nonresident alien individual.

"(f) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section including regulations providing for the application of this section in the case of—

"(1) any contract for the sale or exchange of property under which the liability for, or the amount or due date of, a payment cannot be determined at the time of the sale or exchange, or

"(2) any change in the liability for, or the amount or due date of, any payment (including interest) under a contract for the sale or exchange of property.

"(g) CROSS REFERENCE.—

"For special rules in the case of the borrower under certain loans for personal use, see section 1275(b)."

(c) PENALTY FOR FAILURE TO MEET INFORMATION REQUIREMENTS.—

(1) IN GENERAL.—Subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end thereof the following new section:

"SEC. 6706. ORIGINAL ISSUE DISCOUNT INFORMATION REQUIREMENTS.

"(a) FAILURE TO SHOW INFORMATION ON DEBT INSTRUMENT.—In the case of a failure to set forth on a debt instrument the information required to be set forth on such instrument under section 1275(c)(1), unless it is shown that such failure is due to reasonable cause and not to willful neglect, the issuer shall pay a penalty of $50 for each instrument with respect to which such a failure exists.

"(b) FAILURE TO FURNISH INFORMATION TO SECRETARY.—Any issuer who fails to furnish information required under section 1275(c)(2) with respect to any issue of debt instruments on the date prescribed therefor (determined with regard to any extension of time for filing) shall pay a penalty equal to 1 percent of the aggregate issue price of such issue, unless it is shown that such failure is due to reasonable cause and not willful neglect. The amount of the penalty imposed under the preceding sentence with respect to any issue of debt instruments shall not exceed $50,000 for such issue.

"(c) DEFICIENCY PROCEDURES NOT TO APPLY.—Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes) shall not apply in respect of the assessment or collection of any penalty imposed by this section."

(2) CLERICAL AMENDMENT.—The table of sections for subchapter B of chapter 68 is amended by adding at the end thereof the following new item:

"Sec. 6706. Original issue discount information requirements."

SEC. 42. TECHNICAL AND CONFORMING AMENDMENTS RELATED TO ORIGINAL ISSUE DISCOUNT CHANGES.

(a) IN GENERAL.—

(1) Sections 1232, 1232A, and 1232B are hereby repealed.

(2) Clause (i) of section 103A(i)(2)(C) (defining yield on the issue) is amended by striking out "section 1232(b)(2)" and inserting in lieu thereof "sections 1273(b) and 1274".

(3) Subsection (e) of section 163 (relating to original issue discount) is amended to read as follows:

"(e) *ORIGINAL ISSUE DISCOUNT.*—

"(1) *IN GENERAL.*—*In the case of any debt instrument issued after July 1, 1982, the portion of the original issue discount with respect to such debt instrument which is allowable as a deduction to the issuer for any taxable year shall be equal to the aggregate daily portions of the original issue discount for days during such taxable year.*

"(2) *DEFINITIONS AND SPECIAL RULES.*—*For purposes of this subsection*—

"(A) *DEBT INSTRUMENT.*—*The term 'debt instrument' has the meaning given such term by section 1275(a)(1).*

"(B) *DAILY PORTIONS.*—*The daily portion of the original issue discount for any day shall be determined under section 1272(a) (without regard to paragraph (6) thereof and without regard to section 1273(a)(3)).*

"(C) *SHORT-TERM OBLIGATIONS.*—*In the case of an obligor of a short-term obligation (as defined in section 1283(a)(1)(A)) who uses the cash receipts and disbursements method of accounting, the original issue discount on such obligation shall be deductible only when paid.*

"(3) *EXCEPTIONS.*—*This subsection shall not apply to any debt instrument described in*—

"(A) *subparagraph (D) of section 1272(a)(2) (relating to obligations issued by natural persons before March 2, 1984), and*

"(B) *subparagraph (E) of section 1272(a)(2) (relating to loans between natural persons).*

"(4) *CROSS REFERENCES.*—

"For provision relating to deduction of original issue discount on tax-exempt obligation, see section 1288.

"For special rules in the case of the borrower under certain loans for personal use, see section 1275(b)."

(4) Paragraph (3) of section 165(j) (relating to denial of deductions for losses on certain obligations not in registered form) is amended by striking out "subsection (d) of section 1232" and inserting in lieu thereof "section 1287".

(5) Paragraph (1) of section 249(b) (relating to limitation on deduction of bond premium on repurchase) is amended by striking out "section 1232(b)" and inserting in lieu thereof "sections 1273(b) and 1274".

(6) Paragraph (1) of section 405(d) (relating to taxability of beneficiary of qualified bond purchase plan) is amended by striking out "section 1232 (relating to bonds and other evidences of indebtedness)" and inserting in lieu thereof "section 1271 (relating to treatment of amounts received on retirement or sale or exchange of debt instruments)".

(7) Paragraph (1) of section 409(b) (relating to income tax treatment of bonds) is amended by striking out "section 1232 (relating to bonds and other evidences of indebtedness)" and inserting in lieu thereof "section 1271 (relating to treatment of amounts received on retirement or sale or exchange of debt instruments)".

(8) Paragraph (3) of section 811(b) (relating to amortization of premium and accrual of discount), as amended by this Act, is

amended by striking out "section 1232(b)" and inserting in lieu thereof "section 1273".

(9) Subparagraph (A) of section 871(a)(1) (relating to income other than capital gains) is amended by striking out "section 1232(b)" and inserting in lieu thereof "section 1273".

(10) Paragraph (1) of section 881(a) (relating to imposition of tax) is amended by striking out "section 1232(b)" and inserting in lieu thereof "section 1273".

(11) Subsection (b) of section 1037 (relating to application of section 1232) is amended—

(A) by striking out "section 1232(a)(2)(B)" in paragraph (1) and inserting in lieu thereof "section 1271(c)(2)",

(B) by striking out "section 1232" in paragraphs (1) and (2) and inserting in lieu thereof "subpart A of part V of subchapter P", and

(C) by striking out "SECTION 1232" in the subsection heading and inserting in lieu thereof "ORIGINAL ISSUE DISCOUNT RULES".

(12) Subsection (h) of section 1351 (relating to special rule for evidences of indebtedness) is amended by striking out "section 1232(a)(2)" and inserting in lieu thereof "section 1273(a)".

(13) Subsection (b) of section 1441 (relating to withholding of tax on nonresident alien) is amended by striking out "section 1232(b)" and inserting in lieu thereof "section 1273".

(14) Paragraph (6) of section 6049(d) (relating to treatment of original issue discount) is amended—

(A) by striking out "section 1232A" each place it appears in subparagraph (A) and inserting in lieu thereof "section 1272", and

(B) by striking out "section 1232(b)(1)" and inserting in lieu thereof "section 1273(a)".

(b) CLERICAL AMENDMENTS.—

(1) The table of parts for subchapter P of chapter 1 is amended by adding at the end thereof the following new item:

"PART V. Special rules for bonds and other debt instruments."

(2) The table of sections for part IV of subchapter P of chapter 1 is amended by striking out the items relating to sections 1232, 1232A, and 1232B.

SEC. 43. TECHNICAL AND CONFORMING AMENDMENTS RELATED TO TREATMENT OF MARKET DISCOUNT AND ACQUISITION DISCOUNT.

(a) DEFINITION OF SUBSTITUTED BASIS PROPERTY; ETC.—

(1) IN GENERAL.—Section 7701(a) (relating to definitions) is amended by adding at the end thereof the following new paragraphs:

"(42) SUBSTITUTED BASIS PROPERTY.—The term 'substituted basis property' means property which is—

"(A) transferred basis property, or

"(B) exchanged basis property.

"(43) TRANSFERRED BASIS PROPERTY.—The term 'transferred basis property' means property having a basis determined under any provision of subtitle A (or under any corresponding provision of prior income tax law) providing that the basis shall be

determined in whole or in part by reference to the basis in the hands of the donor, grantor, or other transferor.

"(44) EXCHANGED BASIS PROPERTY.—The term 'exchanged basis property' means property having a basis determined under any provision of subtitle A (or under any corresponding provision of prior income tax law) providing that the basis shall be determined in whole or in part by reference to other property held at any time by the person for whom the basis is to be determined.

"(45) NONRECOGNITION TRANSACTION.—The term 'nonrecognition transaction' means any disposition of property in a transaction in which gain or loss is not recognized in whole or in part for purposes of subtitle A."

(2) TECHNICAL AMENDMENT.—Subsection (b) of section 1016 is amended by striking out the last sentence.

(b) ELECTIONS MADE IN MANNER PRESCRIBED BY SECRETARY.—Section 7805 (relating to rules and regulations) is amended by adding at the end thereof the following new subsection:

"(d) MANNER OF MAKING ELECTIONS PRESCRIBED BY SECRETARY.—Except to the extent otherwise provided by this title, any election under this title shall be made at such time and in such manner as the Secretary shall by regulations or forms prescribe."

(c) OTHER TECHNICAL AMENDMENTS.—

(1) Paragraph (12) of section 341(e) (related to nonapplication of section 1254(a)) is amended by striking out "and 1254(a)" and inserting in lieu thereof "1254(a), and 1276(a)".

(2) Paragraph (2) of section 453B(d) (relating to liquidations to which section 337 applies) is amended by striking out "or 1254(a)" and inserting in lieu thereof "1254(a), or 1276(a)".

(3) Subsection (c) of section 751 (defining unrealized receivables) is amended by adding at the end thereof the following new sentence: "For purposes of this section and sections 731, 736, and 741, such term also includes any market discount bond (as defined in section 1278) and any short-term obligation (as defined in section 1283) but only to the extent of the amount which would be treated as ordinary income if (at the time of the transaction described in this section or section 731, 736, or 741, as the case may be) such property had been sold by the partnership."

SEC. 44. EFFECTIVE DATES.

(a) GENERAL RULE.—Except as otherwise provided in this section, the amendments made by this subtitle shall apply to taxable years ending after the date of the enactment of this Act.

(b) TREATMENT OF DEBT INSTRUMENTS RECEIVED IN EXCHANGE FOR PROPERTY.—

(1) IN GENERAL.—

(A) Except as otherwise provided in this subsection, section 1274 of the Internal Revenue Code of 1954 (as added by section 41) and the amendment made by section 41(b) (relating to amendment of section 483) shall apply to sales or exchanges after December 31, 1984.

(B) Section 1274 of such Code and the amendment made by section 41(b) shall not apply to any sale or exchange pur-

suant to a written contract which was binding on March 1, 1984, and at all times thereafter before the sale or exchange.

(2) REVISION OF SECTION 482 REGULATIONS.—Not later than 180 days after the date of the enactment of this Act, the Secretary of the Treasury or his delegate shall modify the safe harbor interest rates applicable under the regulations prescribed under section 482 of the Internal Revenue Code of 1954 so that such rates are consistent with the rates applicable under section 483 of such Code by reason of the amendments made by section 41.

(3) CLARIFICATION OF INTEREST ACCRUAL; FAIR MARKET VALUE RULE IN CASE OF POTENTIALLY ABUSIVE SITUATIONS.—

(A) IN GENERAL.—

(i) CLARIFICATION OF INTEREST ACCRUAL.—In the case of any sale or exchange—

(I) after March 1, 1984, and before January 1, 1985, nothing in section 483 of the Internal Revenue Code of 1954 shall permit any interest to be deductible before the period to which such interest is properly allocable, or

(II) after June 8, 1984, and before January 1, 1985, notwithstanding section 483 of the Internal Revenue Code of 1954 or any other provision of law, no interest shall be deductible before the period to which such interest is properly allocable.

(ii) FAIR MARKET RULE.—In the case of any sale or exchange after March 1, 1984, and before January 1, 1985, such section 483 shall be treated as including provisions similar to the provisions of section 1274(b)(3) of such Code (as added by section 41).

(B) EXCEPTION FOR BINDING CONTRACTS.—Subparagraph (A) shall not apply to any sale or exchange pursuant to a written contract which was binding on March 1, 1984, and at all times thereafter before the sale or exchange.

(C) INTEREST ACCRUAL RULE NOT TO APPLY WHERE SUBSTANTIALLY EQUAL ANNUAL PAYMENTS.—Clause (i) of subparagraph (A) shall not apply to any debt instrument with substantially equal annual payments.

(c) MARKET DISCOUNT RULES.—

(1) ORDINARY INCOME TREATMENT.—Section 1276 of the Internal Revenue Code of 1954 (as added by section 41) shall apply to obligations issued after the date of the enactment of this Act in taxable years ending after such date.

(2) INTEREST DEFERRAL RULES.—Section 1277 of such Code (as added by section 41) shall apply to obligations acquired after the date of the enactment of this Act in taxable years ending after such date.

(d) RULES RELATING TO DISCOUNT ON SHORT-TERM OBLIGATIONS.—Subpart C of part V of subchapter P of chapter 1 of such Code (as added by section 41) shall apply to obligations acquired after the date of the enactment of this Act.

(e) 5-YEAR SPREAD OF ADJUSTMENTS REQUIRED BY REASON OF ACCRUAL OF DISCOUNT ON CERTAIN SHORT-TERM OBLIGATIONS.—

(1) ELECTION TO HAVE SECTION 1281 APPLY TO ALL OBLIGATIONS HELD DURING TAXABLE YEAR.—A taxpayer may elect for his first taxable year ending after the date of the enactment of this Act to have section 1281 of the Internal Revenue Code of 1954 apply to all short-term obligations described in subsection (b) of such section which were held by the taxpayer at any time during such first taxable year.

(2) 5-YEAR SPREAD.—

(A) IN GENERAL.—In the case of any taxpayer who makes an election under paragraph (1)—

(i) the provisions of section 1281 of the Internal Revenue Code of 1954 (as added by section 41) shall be treated as a change in the method of accounting of the taxpayer,

(ii) such change shall be treated as having been made with the consent of the Secretary, and

(iii) the net amount of the adjustments required by section 481(a) of such Code to be taken into account by the taxpayer in computing taxable income (hereinafter in this paragraph referred to as the "net adjustments") shall be taken into account during the spread period with the amount taken into account in each taxable year in such period determined under subparagraph (B).

(B) AMOUNT TAKEN INTO ACCOUNT DURING EACH YEAR OF SPREAD PERIOD.—

(i) FIRST YEAR.—The amount taken into account for the first taxable year in the spread period shall be the sum of—

(I) one-fifth of the net adjustments, and

(II) the excess (if any) of—

(a) the cash basis income over the accrual basis income, over

(b) one-fifth of the net adjustments.

(ii) FOR SUBSEQUENT YEARS IN SPREAD PERIOD.—The amount taken into account in the second or any succeeding taxable year in the spread period shall be the sum of—

(I) the portion of the net adjustments not taken into account in the preceding taxable year of the spread period divided by the number of remaining taxable years in the spread period (including the year for which the determination is being made), and

(II) the excess (if any) of—

(a) the excess of the cash basis income over the accrual basis income, over

(b) One-fifth of the net adjustments, multiplied by 5 minus the number of years remaining in the spread period (not including the current year).

The excess described in subparagraph (B)(ii)(II)(a) shall be reduced by any amount taken into account *under this subclause or clause (i)(II) in any prior year.*

(C) SPREAD PERIOD.—For purposes of this paragraph, the term "spread period" means the period consisting of the 5 taxable years beginning with the year for which the election is made under paragraph (1).

(D) CASH BASIS INCOME.—For purposes of this paragraph, the term "cash basis income" means for any taxable year the aggregate amount which would be includible in the gross income of the taxpayer with respect to short-term obligations described in subsection (b) of section 1281 of such Code if the provisions of section 1281 of such Code did not apply to such taxable year and all prior taxable years within the spread period.

(E) ACCRUAL BASIS INCOME.—For purposes of this paragraph, the term "accrual basis income" means for any taxable year the aggregate amount includible in gross income under section 1281(a) of such Code for such a taxable year and all prior taxable years within the spread period.

(f) TREATMENT OF ORIGINAL ISSUE DISCOUNT ON TAX-EXEMPT OBLIGATIONS.—Section 1288 of such Code (as added by section 41) shall apply to obligations issued after September 3, 1982, and acquired after March 1, 1984.

(g) REPEAL OF CAPITAL ASSET REQUIREMENT.—Section 1272 of such Code (as added by section 41) shall not apply to any obligation issued before December 31, 1984, which is not a capital asset in the hands of the taxpayer.

(h) REPORTING REQUIREMENTS.—Section 1275(c) of such Code (as added by section 41) and the amendments made by section 41(c) shall take effect on the day 30 days after the date of the enactment of this Act.

(i) OTHER MISCELLANEOUS CHANGES.—

(1) ACCRUAL PERIOD.—In the case of any obligation issued after July 1, 1982, and before January 1, 1985, the accrual period, for purposes of section 1272(a) of the Internal Revenue Code of 1954 (as amended by section 41(a)), shall be a 1-year period (or shorter period to maturity) beginning on the day in the calendar year which corresponds to the date of original issue of the obligation.

(2) CHANGE IN REDUCTION FOR PURCHASE AFTER ORIGINAL ISSUE.—Section 1272(a)(6) of such Code (as so amended) shall not apply to any purchase on or before the date of the enactment of this Act, and the rules of section 1232A(a)(6) of such Code (as in effect on the day before the date of the enactment of this Act) shall continue to apply to such purchase.

(j) CLARIFICATION THAT PRIOR EFFECTIVE DATE RULES NOT AFFECTED.—Nothing in the amendment made by section 41(a) shall affect the application of any effective date provision (including any transitional rule) for any provision which was a predecessor to any provision contained in part V of subchapter P of chapter 1 of the Internal Revenue Code of 1954 (as added by section 41).

Subtitle D—Corporate Provisions

PART I—LIMITATIONS ON DIVIDENS RECEIVED DEDUCTION

SEC. 51. DIVIDENDS RECEIVED DEDUCTION REDUCED WHERE PORTFOLIO STOCK IS DEBT FINANCED.

(a) GENERAL RULE.—Part VIII of subchapter B of chapter 1 (relating to special deductions for corporations) is amended by inserting after section 246 the following new section:

"SEC. 246A. DIVIDENDS RECEIVED DEDUCTION REDUCED WHERE PORTFOLIO STOCK IS DEBT FINANCED.

"(a) GENERAL RULE.—In the case of any dividend on debt-financed portfolio stock, there shall be substituted for the percentage which (but for this subsection) would be used in determining the amount of the deduction allowable under section 243, 244, or 245 a percentage equal to the product of—

"(1) 85 percent, and

"(2) 100 percent minus the average indebtedness percentage.

"(b) SECTION NOT TO APPLY TO DIVIDENDS FOR WHICH 100 PERCENT DIVIDENDS RECEIVED DEDUCTION ALLOWABLE.—Subsection (a) shall not apply to—

"(1) qualifying dividends (as defined in section 243(b) without regard to section 243(c)(4)), and

"(2) dividends received by a small business investment company operating under the Small Business Investment Act of 1958.

"(c) DEBT FINANCED PORTFOLIO STOCK.—For purposes of this section—

"(1) IN GENERAL.—The term 'debt financed portfolio stock' means any portfolio stock if at some time during the base period there is portfolio indebtedness with respect to such stock.

"(2) PORTFOLIO STOCK.—The term 'portfolio stock' means any stock of a corporation unless—

"(A) as of the beginning of the ex-dividend date, the taxpayer owns stock of such corporation—

"(i) possessing at least 50 percent of the total voting power of the stock of such corporation, and

"(ii) having a value equal to at least 50 percent of the total value of the stock of such corporation, or

"(B) as of the beginning of the ex-dividend date—

"(i) the taxpayer owns stock of such corporation which would meet the requirements of subparagraph (A) if '20 percent' were substituted for '50 percent' each place it appears in such subparagraph, and

"(ii) stock meeting the requirements of subparagraph (A) is owned by 5 or fewer corporate shareholders.

"(3) SPECIAL RULE FOR STOCK IN A BANK OR BANK HOLDING COMPANY.—

"(A) IN GENERAL.—If, as of the beginning of the ex-dividend date, the taxpayer owns stock of any bank or bank holding company having a value equal to at least 80 percent of the total value of the stock of such bank or bank holding company, for purposes of paragraph (2)(A)(i), the taxpayer shall be treated as owning any stock of such bank

or bank holding company which the taxpayer has an option to acquire.

"(B) DEFINITIONS.—For purposes of subparagraph (A)—

"(i) BANK.—The term 'bank' has the meaning given such term by section 581.

"(ii) BANK HOLDING COMPANY.—The term 'bank holding company' means a bank holding company (within the meaning of section 2(a) of the Bank Holding Company Act of 1956).

"(4) TREATMENT OF CERTAIN PREFERRED STOCK.—For purposes of determining whether the requirements of subparagraph (A) or (B) of paragraph (2) or of subparagraph (A) of paragraph (3) are met, stock described in section 1504(a)(4) shall not be taken into account.

"(d) AVERAGE INDEBTEDNESS PERCENTAGE.—For purposes of this section—

"(1) IN GENERAL.—Except as provided in paragraph (2), the term 'average indebtedness percentage' means the percentage obtained by dividing—

"(A) the average amount (determined under regulations prescribed by the Secretary) of the portfolio indebtedness with respect to the stock during the base period, by

"(B) the average amount (determined under regulations prescribed by the Secretary) of the adjusted basis of the stock during the base period.

"(2) SPECIAL RULE WHERE STOCK NOT HELD THROUGHOUT BASE PERIOD.—In the case of any stock which was not held by the taxpayer throughout the base period, paragraph (1) shall be applied as if the base period consisted only of that portion of the base period during which the stock was held by the taxpayer.

"(3) PORTFOLIO INDEBTEDNESS.—

"(A) IN GENERAL.—The term 'portfolio indebtedness' means any indebtedness directly attributable to investment in the portfolio stock.

"(B) CERTAIN AMOUNTS RECEIVED FROM SHORT SALE TREATED AS INDEBTEDNESS.—For purposes of subparagraph (A), any amount received from a short sale shall be treated as indebtedness for the period beginning on the day on which such amount is received and ending on the day the short sale is closed.

"(4) BASE PERIOD.—The term 'base period' means, with respect to any dividend, the shorter of—

"(A) the period beginning on the ex-dividend date for the most recent previous dividend on the stock and ending on the day before the ex-dividend date for the dividend involved, or

"(B) the 1-year period ending on the day before the ex-dividend date for the dividend involved.

"(e) REDUCTION IN DIVIDENDS RECEIVED DEDUCTION NOT TO EXCEED ALLOCABLE INTEREST.—Under regulations prescribed by the Secretary, any reduction under this section in the amount allowable as a deduction under section 243, 244, or 245 with respect to any dividend shall not exceed the amount of any interest deduction (in-

cluding any deductible short sale expense) allocable to such dividend.

"(f) REGULATIONS.—The regulations prescribed for purposes of this section under section 7701(f) shall include regulations providing for the disallowance of interest deductions or other appropriate treatment (in lieu of reducing the dividend received deduction) where the obligor of the indebtedness is a person other than the person receiving the dividend."

(b) CLERICAL AMENDMENT.—The table of sections for part VIII of subchapter B of chapter 1 is amended by inserting after the item relating to section 246 the following new item:

"Sec. 246A. Dividends received deduction reduced where portfolio stock is debt financed."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to stock the holding period for which begins after the date of the enactment of this Act in taxable years ending after such date.

SEC. 52. TREATMENT OF DIVIDENDS FROM REGULATED INVESTMENT COMPANIES.

(a) INCREASE IN REQUIRED AMOUNT OF DIVIDENDS.—Paragraph (1) of section 854(b) (relating to other dividends) is amended to read as follows:

"(1) AMOUNT TREATED AS DIVIDEND.—

"(A) DEDUCTION UNDER SECTION 243.—In any case in which—

"(i) a dividend is received from a regulated investment company (other than a dividend to which subsection (a) applies), and

"(ii) such investment company meets the requirements of section 852(a) for the taxable year during which it paid such dividend,

then, in computing any deduction under section 243, there shall be taken into account only that portion of such dividend designated under this subparagraph by the regulated investment company.

"(B) EXCLUSION UNDER SECTION 116.—If the aggregate dividends received by a regulated investment company during any taxable year are less than 95 percent of its gross income, then, in computing the exclusion under section 116, rules similar to the rules of subparagraph (A) shall apply.

"(C) LIMITATION.—The aggregate amount which may be designated as dividends under subparagraph (A) or (B) shall not exceed the aggregate dividends received by the company for the taxable year."

(b) CERTAIN DIVIDENDS NOT TAKEN INTO ACCOUNT FOR PURPOSES OF COMPUTING DEDUCTION UNDER SECTION 243.—Subsection (b) of section 854 is amended by adding at the end thereof the following new paragraph:

"(4) SPECIAL RULE FOR COMPUTING DEDUCTION UNDER SECTION 243.—For purposes of subparagraph (A) of paragraph (1), an amount shall be treated as a dividend for the purpose of paragraph (1) only if a deduction would have been allowable under section 243 to the regulated investment company determined—

"(A) as if section 243 applied to dividends received by a regulated investment company,

"(B) after the application of section 246 (but without regard to subsection (b) thereof), and

"(C) after the application of section 246A."

(c) GROSS INCOME INCLUDES NET SHORT-TERM CAPITAL GAIN.—Paragraph (3)(A) of section 854(b) is amended to read as follows:

"(A) In the case of 1 or more sales or other dispositions of stock and securities, the term 'gross income' includes only the excess of—

"(i) the net short-term capital gain from such sales or dispositions, over

"(ii) the net long-term capital loss from such sales or dispositions."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of regulated investment companies beginning after the date of the enactment of this Act.

PART II—TREATMENT OF CERTAIN DISTRIBUTIONS

SEC. 53. CORPORATE SHAREHOLDER'S BASIS IN STOCK REDUCED BY NONTAXED PORTION OF EXTRAORDINARY DIVIDENDS.

(a) GENERAL RULE.—Part IV of subchapter O of chapter 1 (relating to special rules for gain or loss on disposition of property) is amended by redesignating section 1059 as section 1060 and by inserting after section 1058 the following new section:

"SEC. 1059. CORPORATE SHAREHOLDER'S BASIS IN STOCK REDUCED BY NONTAXED PORTION OF EXTRAORDINARY DIVIDENDS.

"(a) GENERAL RULE.—If any corporation—

"(1) receives an extraordinary dividend with respect to any share of stock, and

"(2) sells or otherwise disposes of such stock before such stock has been held for more than 1 year,

the basis of such corporation in such stock shall be reduced by the nontaxed portion of such dividend. If the nontaxed portion of such dividend exceeds such basis, such excess shall be treated as gain from the sale or exchange of such stock.

"(b) NONTAXED PORTION.—For purposes of this section—

"(1) IN GENERAL.—The nontaxed portion of any dividend is the excess (if any) of—

"(A) the amount of such dividend, over

"(B) the taxable portion of such dividend.

"(2) TAXABLE PORTION.—The taxable portion of any dividend is—

"(A) the portion of such dividend includible in gross income, reduced by

"(B) the amount of any deduction allowable with respect to such dividend under section 243, 244, or 245.

"(c) EXTRAORDINARY DIVIDEND DEFINED.—For purposes of this section—

"(1) IN GENERAL.—The term 'extraordinary dividend' means any dividend with respect to a share of stock if the amount of such dividend equals or exceeds the threshold percentage of the

taxpayer's adjusted basis in such share of stock (determined without regard to this section).

"(2) THRESHOLD PERCENTAGE.—The term 'threshold percentage' means—

"(A) 5 percent in the case of stock which is preferred as to dividends, and

"(B) 10 percent in the case of any other stock.

"(3) AGGREGATION OF DIVIDENDS.—

"(A) AGGREGATION WITHIN 85-DAY PERIOD.—All dividends—

"(i) which are received by the taxpayer (or a person described in subparagraph (C)) with respect to any share of stock, and

"(ii) which have ex-dividend dates within the same period of 85 consecutive days,

shall be treated as 1 dividend.

"(B) AGGREGATION WITHIN 1 YEAR WHERE DIVIDENDS EXCEED 20 PERCENT OF ADJUSTED BASIS.—All dividends—

"(i) which are received by the taxpayer (or a person described in subparagraph (C)) with respect to any share of stock, and

"(ii) which have ex-dividend dates during the same period of 365 consecutive days,

shall be treated as extraordinary dividends if the aggregate of such dividends exceeds 20 percent of the taxpayer's adjusted basis in such stock (determined without regard to this section).

"(C) SUBSTITUTED BASIS TRANSACTIONS.—In the case of any stock, a person is described in this subparagraph if—

"(i) the basis of such stock in the hands of such person is determined in whole or in part by reference to the basis of such stock in the hands of the taxpayer, or

"(ii) the basis of such stock in the hands of the taxpayer is determined in whole or in part by reference to the basis of such stock in the hands of such person.

"(d) SPECIAL RULES.—For purposes of this section—

"(1) TIME FOR REDUCTION.—Any reduction in basis under subsection (a) by reason of any distribution which is an extraordinary dividend shall occur at the beginning of the ex-dividend date for such distribution.

"(2) DISTRIBUTIONS IN KIND.—To the extent any dividend consists of property other than cash, the amount of such dividend shall be treated as the fair market value of such property (as of the date of the distribution) reduced as provided in section 301(b)(2).

"(3) DETERMINATION OF HOLDING PERIOD.—For purposes of determining the holding period of stock under subsection (a)(2), rules similar to the rules of paragraphs (3) and (4) of section 246(c) shall apply; except that '1 year' shall be substituted for the number of days specified in subparagraph (B) of section 246(c)(3).

"(4) EX-DIVIDEND DATE.—The term 'ex-dividend date' means the date on which the share of stock becomes ex-dividend.

"(5) EXTENSION TO CERTAIN PROPERTY DISTRIBUTIONS.—In the case of any distribution of property (other than cash) to which section 301 applies—

"(A) such distribution shall be treated as a dividend without regard to whether the corporation has earnings and profits, and

"(B) the amount so treated shall be reduced by the amount of any reduction in basis under section 301(c)(2) by reason of such distribution.

"(e) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this section, including regulations providing for the application of this section in the case of stock dividends, stock splits, reorganizations, and other similar transactions."

(b) HOLDING PERIODS.—

(1) 45-DAY HOLDING PERIOD.—Subsection (c) of section 246(c) (relating to the exclusion of certain dividends) is amended by striking out "15" each place it appears and inserting in lieu thereof "45".

(2) RULES FOR COMPUTING HOLDING PERIODS.—Subsection (c) of section 246 (relating to the exclusion of certain dividends) is amended by adding at the end thereof the following new paragraphs:

"(4) HOLDING PERIOD REDUCED FOR PERIODS WHERE RISK OF LOSS DIMINISHED.—The holding periods determined under paragraph (3) shall be appropriately reduced (in the manner provided in regulations prescribed by the Secretary) for any period (during such periods) in which—

"(A) the taxpayer has an option to sell, is under a contractual obligation to sell, or has made (and not closed) a short sale of, substantially identical stock or securities,

"(B) the taxpayer is the grantor of an option to buy substantially identical stock or securities, or

"(C) under regulations prescribed by the Secretary, a taxpayer has diminished his risk of loss by holding 1 or more other positions with respect to substantially similar or related property.

The preceding sentence shall not apply in the case of any qualified covered call (as defined in section 1092(c)(4) but without regard to the requirement that gain or loss with respect to the option not be ordinary income or loss)."

(3) Subparagraph (B) of section 246(c)(1) is amended to read as follows:

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

(4) Paragraph (3) of section 246(c) is amended by striking out the last sentence.

(c) APPLICATION OF RELATED PERSON RULES TO SECTION 246(c) AND CERTAIN OTHER PROVISIONS.—Section 7701, is amended by redesignating subsection (f) as (g) and by inserting after subsection (e) the following new subsection:

"(f) USE OF RELATED PERSONS OR PASS-THRU ENTITIES.—The Secretary shall prescribe such regulations as may be necessary or appropriate to prevent the avoidance of those provisions of this title which deal with—

"(1) the linking of borrowing to investment, or

"(2) diminishing risks,

through the use of related persons, pass-thru entities, or other intermediaries."

(d) CONFORMING AMENDMENTS.—

(1) The table of sections for part IV of subchapter O of chapter 1 is amended by striking out the item relating to section 1059 and inserting in lieu thereof the following new items:

"Sec. 1059. Corporate shareholder's basis in stock reduced by nontaxed portion of extraordinary dividends.
"Sec. 1060. Cross references."

(2) Paragraph (1) of section 246(b) (relating to limitation on aggregate amount of deduction) is amended by striking out "and without regard" and inserting in lieu thereof "without regard to any adjustment under section 1059, and without regard".

(3) Section 1016(a) (relating to adjustments to basis) is amended by striking out "and" at the end of paragraph (24), by striking out the period at the end of paragraph (25) and inserting in lieu thereof ", and" and by adding at the end thereof the following new paragraph:

"(26) to the extent provided in section 1059 (relating to reduction in basis for extraordinary dividends)."

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in this subsection, the amendments made by this section shall apply to distributions after March 1, 1984, in taxable years ending after such date.

(2) SUBSECTION (b).—The amendments made by subsection (b) shall apply to stock acquired after the date of the enactment of this Act in taxable years ending after such date.

(3) RELATED PERSON PROVISIONS.—The amendment made by subsection (c) shall take effect on the date of the enactment of this Act.

SEC. 54. DISTRIBUTIONS OF APPRECIATED PROPERTY BY CORPORATIONS.

(a) GAIN RECOGNIZED ON DISTRIBUTIONS OF APPRECIATED PROPERTY.—

(1) IN GENERAL.—Paragraph (1) of section 311(d) (relating to appreciated property used to redeem stock) is amended to read as follows:

"(1) IN GENERAL.—If—

"(A) a corporation distributes property (other than an obligation of such corporation) to a shareholder in a distribution to which subpart A applies, and

"(B) the fair market value of such property exceeds its adjusted basis (in the hands of the distributing corporation),

then gain shall be recognized to the distributing corporation in an amount equal to such excess as if the property distributed had been sold at the time of the distribution. This subsection shall be applied after the application of subsections (b) and (c)."

(2) EXCEPTIONS.—

(A) Paragraph (2) of section 311(d) is amended by striking out subparagraphs (A) and (B) and inserting in lieu thereof the following:

"(A) a distribution which is made with respect to qualified stock if—

"(i) section 302(b)(4) applies to such distribution, or

"(ii) such distribution is a qualified dividend;".

(B) Paragraph (2) of section 311(d) is amended by redesignating subparagraphs (C), (D), (E), and (F) as subparagraphs (B), (C), (D), and (E), respectively.

(C) Subsection (e) of section 311 is amended by adding at the end thereof the following new paragraph:

"(3) QUALIFIED DIVIDEND.—The term 'qualified dividend' means any distribution of property to a shareholder other than a corporation if—

"(A) such distribution is a dividend,

"(B) such property was used by the distributing corporation in the active conduct of a qualified business (as defined in paragraph (2)), and

"(C) such property is not property described in paragraph (1) or (4) of section 1221."

(3) CLERICAL AMENDMENT.—The subsection heading of subsection (d) of section 311 is amended to read as follows:

"(d) DISTRIBUTIONS OF APPRECIATED PROPERTY.—".

(b) HOLDING PERIOD OF CORPORATE DISTRIBUTEE OF APPRECIATED PROPERTY.—Section 301 (relating to distributions of property) is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) SPECIAL RULE FOR HOLDING PERIOD OF APPRECIATED PROPERTY DISTRIBUTED TO CORPORATION.—For purposes of this subtitle—

"(1) WHERE GAIN RECOGNIZED UNDER SECTION 311(d).—If—

"(A) property is distributed to a corporation, and

"(B) gain is recognized on such distribution under paragraph (1) of section 311(d),

then such corporation's holding period in the distributed property shall begin on the date of such distribution.

"(2) WHERE GAIN NOT RECOGNIZED UNDER SECTION 311(d).—If—

"(A) property is distributed to a corporation,

"(B) gain is not recognized on such distribution under paragraph (1) of section 311(d), and

"(C) the basis of such property in the hands of such corporation is determined under subsection (d)(2)(B),

then (except for purposes of section 1248(f)(2)) such corporation shall not be treated as holding the distributed property during any period before the date on which such corporation's holding period in the stock began."

(c) CROSS REFERENCE.—Paragraph (13) of section 1223 (relating to holding period of property) is amended to read as follows:

"(13) CROSS REFERENCES.—

"(A) For special holding period provision relating to certain partnership distributions, see section 735(b).

"(B) For special holding period provision relating to distributions of appreciated property to corporations, see section 301(e)."

35-426 O 84 6

(d) EFFECTIVE DATES.—

(1) SUBSECTION (a).—Except as otherwise provided in this subsection, the amendments made by subsection (a) shall apply to distributions declared on or after June 14, 1984, in taxable years ending after such date.

(2) SUBSECTION (b).—The amendment made by subsection (b) shall apply to distributions after the date of the enactment of this Act in taxable years ending after such date.

(3) EXCEPTION FOR DISTRIBUTIONS BEFORE JANUARY 1, 1985, TO 80-PERCENT CORPORATE SHAREHOLDERS.—

(A) IN GENERAL.—The amendments made by subsection (a) shall not apply to any distribution before January 1, 1985, to an 80-percent corporate shareholder if the basis of the property distributed is determined under section 301(d)(2) of the Internal Revenue Code of 1954.

(B) 80-PERCENT CORPORATE SHAREHOLDER.—The term "80-percent corporate shareholder" means, with respect to any distribution, any corporation which owns—

(i) stock in the corporation making the distribution possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote, and

(ii) at least 80 percent of the total number of shares of all other classes of stock of the distributing corporation (except nonvoting stock which is limited and preferred as to dividends).

(C) SPECIAL RULE FOR AFFILIATED GROUP FILING CONSOLIDATED RETURN.—For purposes of this paragraph and paragraph (4), all members of the same affiliated group (as defined in section 1504 of the Internal Revenue Code of 1954) which file a consolidated return for the taxable year which includes the date of the distribution shall be treated as 1 corporation.

(4) EXCEPTION FOR CERTAIN DISTRIBUTIONS WHERE TENDER OFFER COMMENCED ON MAY 23, 1984.—

(A) IN GENERAL.—The amendments made by subsection (a) shall not apply to any distribution made before September 1, 1986, if—

(i) such distribution consists of qualified stock held (directly or indirectly) on June 15, 1984, by the distributing corporation,

(ii) control of the distributing corporation (as defined in section 368(c) of the Internal Revenue Code of 1954) is acquired other than in a tax-free transaction after January 1, 1984, but before January 1, 1985,

(iii) a tender offer for the shares of the distributing corporation was commenced on May 23, 1984, and was amended on May 24, 1984, and

(iv) the distributing corporation and the distributee corporation are members of the same affiliated group (as defined in section 1504 of such Code) which filed a consolidated return for the taxable year which includes the date of the distribution.

If the common parent of any affiliated group filing a consolidated return meets the requirements of clauses (ii) and (iii), each other member of such group shall be treated as meeting such requirements.

(B) QUALIFIED STOCK.—For purposes of subparagraph (A), the term "qualified stock" means any stock in a corporation which on June 15, 1984, was a member of the same affiliated group as the distributing corporation and which filed a consolidated return with the distributing corporation for the taxable year which included June 15, 1984.

(5) EXCEPTION FOR CERTAIN DISTRIBUTIONS.—

(A) IN GENERAL.—The amendments made by this section shall not apply to distributions before February 1, 1986, if—

(i) the distribution consists of property held on March 7, 1984 (or property acquired thereafter in the ordinary course of a trade or business) by—

(I) the controlled corporation, or

(II) any subsidiary controlled corporation,

(ii) a group of 1 or more shareholders (acting in concert)—

(I) acquired, during the 1-year period ending on February 1, 1984, at least 10 percent of the outstanding stock of the controlled corporation,

(II) held at least 10 percent of the outstanding stock of the common parent on February 1, 1984, and

(III) submitted a proposal for distributions of interests in a royalty trust from the common parent or the controlled corporation, and

(iii) the common parent acquired control of the controlled corporation during the 1-year period ending on February 1, 1984.

(B) DEFINITIONS.—For purposes of this paragraph—

(i) The term "common parent" has the meaning given such term by section 1504(a) of the Internal Revenue Code of 1954.

(ii) The term "controlled corporation" means a corporation with respect to which 50 percent or more of the outstanding stock of its common parent is tendered for pursuant to a tender offer outstanding on March 7, 1984.

(iii) The term "subsidiary controlled corporation" means any corporation with respect to which the controlled corporation has control (within the meaning of section 368(c) of such Code) on March 7, 1984.

(6) EXCEPTION FOR CERTAIN DISTRIBUTION OF PARTNERSHIP INTERESTS.—The amendments made by this section shall not apply to any distribution before February 1, 1986, of an interest in a partnership the interests of which were being traded on a national securities exchange on March 7, 1984, if—

(A) such interest was owned by the distributing corporation (or any member of an affiliated group within the

meaning of section 1504(a) of such Code of which the distributing corporation was a member) on March 7, 1984,

(B) the distributing corporation (or any such affiliated member) owned more than 80 percent of the interests in such partnership on March 7, 1984, and

(C) more than 10 percent of the interests in such partnership was offered for sale to the public during the 1-year period ending on March 7, 1984.

SEC. 55. EXTENSION OF HOLDING PERIOD FOR LOSSES ATTRIBUTABLE TO CAPITAL GAIN DIVIDENDS OF REGULATED INVESTMENT COMPANIES OR REAL ESTATE INVESTMENT TRUSTS.

(a) REGULATED INVESTMENT COMPANIES.—

(1) IN GENERAL.—Subparagraph (A) of section 852(b)(4) (relating to loss attributable to capital gain dividend) is amended to read as follows:

"(A) LOSS ATTRIBUTABLE TO CAPITAL GAIN DIVIDEND.—If—

"(i) subparagraph (B) or (D) of paragraph (3) provides that any amount with respect to any share is to be treated as long-term capital gain, and

"(ii) such share is held by the taxpayer for 6 months or less,

then any loss (to the extent not disallowed under subparagraph (B)) on the sale or exchange of such share shall, to the extent of the amount described in clause (i), be treated as a long-term capital loss."

(2) DETERMINATION OF HOLDING PERIODS.—Subparagraph (C) of section 852(b)(4) is amended to read as follows:

"(C) DETERMINATION OF HOLDING PERIODS.—For purposes of this paragraph, the rules of paragraphs (3) and (4) of section 246(c) shall apply in determining the period for which the taxpayer held any share of stock; except that for the number of days specified in subparagraph (B) of section 246(c)(3) there shall be substituted—

"(i) '6 months' for purposes of subparagraph (A), and

"(ii) '30 days' for purposes of subparagraph (B)."

(3) EXCEPTION FOR LOSSES INCURRED UNDER PERIODIC LIQUIDATION PLANS.—Paragraph (4) of section 852(b) is amended by adding at the end thereof the following new subparagraph:

"(D) LOSSES INCURRED UNDER A PERIODIC LIQUIDATION PLAN.—To the extent provided in regulations, subparagraph (A) shall not apply to losses incurred on the sale or exchange of shares of stock in a regulated investment company pursuant to a plan which provides for the periodic liquidation of such shares."

(b) REAL ESTATE INVESTMENT TRUST.—Paragraph (7) of section 857(b) (relating to loss on sale or exchange of stock in real estate investment trust) is amended to read as follows:

"(7) LOSS ON SALE OR EXCHANGE OF STOCK HELD 6 MONTHS OR LESS.—

"(A) IN GENERAL.—If—

"(i) subparagraph (B) of paragraph (3) provides that any amount with respect to any share or beneficial interest is to be treated as a long-term capital gain, and

"(ii) the taxpayer has held such share or interest for 6 months or less,

then any loss on the sale or exchange of such share or interest shall, to the extent of the amount described in clause (i), be treated as a long-term capital loss.

"(B) DETERMINATION OF HOLDING PERIOD.—For purposes of this paragraph, the rules of paragraphs (3) and (4) of section 246(c) shall apply in determining the period for which the taxpayer has held any share of stock or beneficial interest; except that '6 months' shall be substituted for the number of days specified in subparagraph (B) of section 246(c)(3).

"(C) EXCEPTION FOR LOSSES INCURRED UNDER PERIODIC LIQUIDATION PLANS.—To the extent provided in regulations, subparagraph (A) shall not apply to any loss incurred on the sale or exchange of shares of stock of, or beneficial interest in, a real estate investment trust pursuant to a plan which provides for the periodic liquidation of such shares or interests."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to losses incurred with respect to shares of stock and beneficial interests with respect to which the taxpayer's holding period begins after the date of the enactment of this Act.

PART III—MISCELLANEOUS PROVISIONS

SEC. 56. DENIAL OF DEDUCTIONS FOR CERTAIN EXPENSES INCURRED IN CONNECTION WITH SHORT SALES.

(a) SHORT SALE PAYMENTS ATTRIBUTABLE TO DIVIDENDS.—Section 263 (relating to capital expenditures) is amended by adding at the end thereof the following new subsection:

"(h) PAYMENTS IN LIEU OF DIVIDENDS IN CONNECTION WITH SHORT SALES.—

"(1) IN GENERAL.—If—

"(A) a taxpayer makes any payment with respect to any stock used by such taxpayer in a short sale and such payment is in lieu of a dividend payment on such stock, and

"(B) the closing of such short sale occurs on or before the 45th day after the date of such short sale,

then no deduction shall be allowed for such payment. The basis of the stock used to close the short sale shall be increased by the amount not allowed as a deduction by reason of the preceding sentence.

"(2) LONGER PERIOD IN CASE OF EXTRAORDINARY DIVIDENDS.—If the payment described in paragraph (1)(A) is in respect of an extraordinary dividend, paragraph (1)(B) shall be applied by substituting 'the day 1 year after the date of such short sale' for 'the 45th day after the date of such short sale'.

"(3) EXTRAORDINARY DIVIDEND.—For purposes of this subsection, the term 'extraordinary dividend' has the meaning given to such term by section 1059(c); except that such section shall be applied by treating the amount realized by the taxpayer in the short sale as his adjusted basis in the stock.

"(4) SPECIAL RULE WHERE RISK OF LOSS DIMINISHED.—The running of any period of time applicable under paragraph (1)(B) (as modified by paragraph (2)) shall be suspended during any period in which—

"(A) the taxpayer holds, has an option to buy, or is under a contractual obligation to buy, substantially identical stock or securities, or

"(B) under regulations prescribed by the Secretary, a taxpayer has diminished his risk of loss by holding 1 or more other positions with respect to substantially similar or related property.

"(5) DEDUCTION ALLOWABLE TO EXTENT OF ORDINARY INCOME FROM AMOUNTS PAID BY LENDING BROKER FOR USE OF COLLATERAL.—

"(A) IN GENERAL.—Paragraph (1) shall apply only to the extent that the payments or distributions with respect to any short sale exceed the amount which—

"(i) is treated as ordinary income by the taxpayer, and

"(ii) is received by the taxpayer as compensation for the use of any collateral with respect to any stock used in such short sale.

"(B) EXCEPTION NOT TO APPLY TO EXTRAORDINARY DIVIDENDS.—Subparagraph (A) shall not apply if one or more payments or distributions is in respect of an extraordinary dividend.

"(6) APPLICATION OF THIS SUBSECTION WITH SUBSECTION (g).—In the case of any short sale, this subsection shall be applied before subsection (g)."

(b) INVESTMENT INTEREST TO INCLUDE CERTAIN EXPENSES INVOLVING SHORT SALES.—Subparagraph (D) of section 163(d)(3) (defining investment interest) is amended to read as follows:

"(D) INVESTMENT INTEREST.—

"(i) IN GENERAL.—The term 'investment interest' means interest paid or accrued on indebtedness incurred or continued to purchase or carry property held for investment.

"(ii) CERTAIN EXPENSES INCURRED IN CONNECTION WITH SHORT SALES.—For purposes of clause (i), the term 'interest' includes any amount allowable as a deduction in connection with personal property used in a short sale."

(c) APPLICATION OF SECTION 265(2) TO SHORT SALES.—Section 265 (relating to denial of deduction of interest relating to tax-exempt income) is amended by adding at the end thereof the following new paragraph:

"(5) SPECIAL RULES FOR APPLICATION OF PARAGRAPH (2) IN THE CASE OF SHORT SALES.—For purposes of paragraph (2)—

"(A) IN GENERAL.—The term 'interest' includes any amount paid or incurred—

"(i) by any person making a short sale in connection with personal property used in such short sale, or

"(ii) by any other person for the use of any collateral with respect to such short sale.

"(B) EXCEPTION WHERE NO RETURN ON CASH COLLATERAL.—If—

"(i) the taxpayer provides cash as collateral for any short sale, and

"(ii) the taxpayer receives no material earnings on such cash during the period of the sale,

subparagraph (A)(i) shall not apply to such short sale."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to short sales after the date of the enactment of this Act in taxable years ending after such date.

SEC. 57. NONRECOGNITION OF GAIN OR LOSS BY CORPORATION ON OPTIONS WITH RESPECT TO ITS STOCK.

(a) GENERAL RULE.—Subsection (a) of section 1032 (relating to exchange of stock of property) is amended by adding at the end thereof the following new sentence: "No gain or loss shall be recognized by a corporation with respect to any lapse or acquisition of an option to buy or sell its stock (including treasury stock)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to options acquired or lapsed after the date of the enactment of this Act in taxable years ending after such date.

SEC. 58. AMENDMENTS TO ACCUMULATED EARNINGS TAX.

(a) CLARIFICATION THAT TAX APPLIES TO CORPORATIONS WHICH ARE NOT CLOSELY HELD.—Section 532 (relating to corporations subject to accumulated earnings tax) is amended by adding at the end thereof the following new subsection:

"(c) APPLICATION DETERMINED WITHOUT REGARD TO NUMBER OF SHAREHOLDERS.—The application of this part to a corporation shall be determined without regard to the number of shareholders of such corporation."

(b) TREATMENT OF CAPITAL GAINS AND LOSSES.—Subsection (b) of section 535 (defining accumulated taxable income) is amended by striking out paragraphs (5), (6), and (7) and inserting in lieu thereof the following:

"(5) CAPITAL LOSSES.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), there shall be allowed as a deduction an amount equal to the net capital loss for the taxable year (determined without regard to paragraph (7)(A)).

"(B) RECAPTURE OF PREVIOUS DEDUCTIONS FOR CAPITAL GAINS.—The aggregate amount allowable as a deduction under subparagraph (A) for any taxable year shall be reduced by the lesser of—

"(i) the nonrecaptured capital gains deductions, or

"(ii) the amount of the accumulated earnings and profits of the corporation as of the close of the preceding taxable year.

"(C) NONRECAPTURED CAPITAL GAINS DEDUCTIONS.—For purposes of subparagraph (B), the term 'nonrecaptured capital gains deductions' means the excess of—

"(i) the aggregate amount allowable as a deduction under paragraph (6) for preceding taxable years beginning after the date of the enactment of the Tax Reform Act of 1984, over *"(ii) the aggregate of the reductions under subparagraph (B) for preceding taxable years.*

"(6) NET CAPITAL GAINS.—

"(A) IN GENERAL.—There shall be allowed as a deduction—

"(i) the net capital gain for the taxable year (determined with the application of paragraph (7)), reduced by

"(ii) the taxes attributable to such net capital gain.

"(B) ATTRIBUTABLE TAXES.—For purposes of subparagraph (A), the taxes attributable to the net capital gain shall be an amount equal to the difference between—

"(i) the taxes imposed by this subtitle (except the tax imposed by this part) for the taxable year, and

"(ii) such taxes computed for such year without including in taxable income the net capital gain for the taxable year (determined without the application of paragraph (7)).

"(7) CAPITAL LOSS CARRYOVERS.—

"(A) UNLIMITED CARRYFORWARD.—The net capital loss for any taxable year shall be treated as a short-term capital loss in the next taxable year.

"(B) SECTION 1212 INAPPLICABLE.—No allowance shall be made for the capital loss carryback or carryforward provided in section 1212.

"(8) SPECIAL RULES FOR MERE HOLDING OR INVESTMENT COMPANIES.—In the case of a mere holding or investment company—

"(A) CAPITAL LOSS DEDUCTION, ETC., NOT ALLOWED.—Paragraphs (5) and (7)(A) shall not apply.

"(B) DEDUCTION FOR CERTAIN OFFSETS.—There shall be allowed as a deduction the net short-term capital gain for the taxable year to the extent such gain does not exceed the amount of any capital loss carryover to such taxable year under section 1212 (determined without regard to paragraph (7)(B)).

"(C) EARNINGS AND PROFITS.—For purposes of subchapter C, the accumulated earnings and profits at any time shall not be less than they would be if this subsection had applied to the computation of earnings and profits for all taxable years beginning after the date of the enactment of the Tax Reform Act of 1984."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 59. REPEAL OF STOCK FOR DEBT EXCEPTIONS FOR PURPOSES OF DETERMINING INCOME FROM DISCHARGE OF INDEBTEDNESS.

(a) GENERAL RULE.—Subsection (e) of section 108 (relating to income from discharge of indebtedness) is amended by adding at the end thereof the following new paragraph:

"(10) INDEBTEDNESS SATISFIED BY CORPORATION'S STOCK.—

"(A) IN GENERAL.—For purposes of determining income of a debtor from discharge of indebtedness, if a debtor corpo-

ration transfers stock to a creditor in satisfaction of its indebtedness, such corporation shall be treated as having satisfied the indebtedness with an amount of money equal to the fair market value of the stock.

"(B) EXCEPTION FOR TITLE 11 CASES AND INSOLVENT DEBTORS.—Subparagraph (A) shall not apply in the case of a debtor in a title 11 case or to the extent the debtor is insolvent."

(b) EXCEPTION FOR CERTAIN WORKOUTS.—

(1) IN GENERAL.—Paragraph (10) of section 108(e) (as added by subsection (a)) is amended by adding at the end thereof the following new subparagraph:

"(C) EXCEPTION FOR TRANSFERS IN CERTAIN WORKOUTS.—

"(i) IN GENERAL.—Subparagraph (A) shall not apply to any transfer of stock in a qualified workout.

"(ii) QUALIFIED WORKOUT.—For purposes of clause (i), the term 'qualified workout' means any plan under which stock is transferred to creditors in satisfaction of indebtedness if—

"(I) because of cash flow and credit problems, the corporation making such transfer will have trouble in meeting liabilities coming due during the next 12 months to such an extent that there is a substantial threat of involuntary proceedings relating to insolvency or bankruptcy,

"(II) such corporation in any report to its shareholders for the period during which such transfer occurs includes a statement that such corporation believes it meets the requirement of subclause (I) and that it is availing itself of the workout provisions of this subparagraph,

"(III) the holders of more than 50 percent of the total indebtedness of the corporation approve such plan, and

"(IV) at least 25 percent of the total indebtedness of the corporation is extinguished by transfers pursuant to such plan."

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall take effect as if it had been included in the amendments made by subsections (e) and (f) of section 806 of the Tax Reform Act of 1976.

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendment made by subsection (a) shall apply to transfers after the date of the enactment of this Act in taxable years ending after such date.

(2) TRANSITIONAL RULE.—The amendment made by subsection (a) shall not apply to the transfer by a corporation of its stock in exchange for debt of the corporation after the date of the enactment of this Act if such transfer is—

(A) pursuant to a written contract requiring such transfer which was binding on the corporation at all times on June 7, 1984, and at all times after such date but only if the

(1) In general.—Except as otherwise provided in this subsection, the amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1984.

(2) SPECIAL RULE FOR CORPORATIONS AFFILIATED ON JUNE 22, 1984.—In the case of a corporation which on June 22, 1984, is a member of an affiliated group which files a consolidated return for such corporation's taxable year which includes June 22, 1984, for purposes of determining whether such corporation continues to be a member of such group for taxable years beginning before January 1, 1988, the amendment made by subsection (a) shall not apply.

(3) Special rule not to apply to sell-downs after June 22, 1984. If—

(A) the requirements of subsection (b)(2) are satisfied with respect to a corporation,

(B) more than a de minimis amount of the stock of such corporation is sold or exchanged (including in a redemption), or issued (other than in the ordinary course of business) after June 22, 1984, and

(C) the requirements of the amendment made by subsection (a) are not satisfied after such sale, exchange, or issuance, then the amendments made by subsection (a) shall apply for purposes of determining whether such corporation continues to be a member of such group.

(4) EXCEPTION FOR CERTAIN SELL-DOWNS.—Subsection (b)(2) (and not subsection (b)(3)) will apply to a corporation if such corporation issues or sells stock after June 22, 1984, pursuant to a registration statement filed with the Securities and Exchange Commission on or before June 22, 1984, but only if the requirements of the amendment made by subsection (a) (substituting "more than 50 percent" for "at least 80 percent" in paragraph (2)(B) of section 1504(a) of the Internal Revenue Code of 1954) are satisfied immediately after such issuance or sale and at all times thereafter until the first day of the first taxable year beginning after December 31, 1987.

(5) NATIVE CORPORATIONS.—The amendments made by subsection (a) shall not apply to any Native Corporation established under the Alaska Native Claims Settlement Act (43 U.S.C. 1601 et seq.) during any taxable year beginning before 1992 or any part thereof in which such Corporation is subject to the provisions of section 7 (h)(1) of such Act (43 U.S.C. 1606 (h)(1)).

SEC. 61. PROVISIONS RELATING TO EARNINGS AND PROFITS.

(a) ADJUSTMENTS TO EARNINGS AND PROFITS.—

(1) IN GENERAL.—Section 312 (relating to effect on earnings and profits) is amended by adding at the end thereof the following new subsection:

"(n) ADJUSTMENTS TO EARNINGS AND PROFITS TO MORE ACCURATELY REFLECT ECONOMIC GAIN AND LOSS.—For purposes of computing the earnings and profits of a corporation, the following adjustments shall be made:

"(1) CONSTRUCTION PERIOD CARRYING CHARGES.—

"(A) IN GENERAL.—*In the case of any amount paid or incurred for construction period carrying charges—*

"(i) *no deduction shall be allowed with respect to such amount, and*

"(ii) *the basis of the property with respect to which such charges are allocable shall be increased by such amount.*

"(B) CONSTRUCTION PERIOD CARRYING CHARGES DEFINED.—*For purposes of this paragraph, the term 'construction period carrying charges' means all—*

"(i) *interest paid or accrued on indebtedness incurred or continued to acquire, construct, or carry property,*

"(ii) *property taxes, and*

"(iii) *similar carrying charges,*

to the extent such interest, taxes, or charges are attributable to the construction period for such property and would be allowable as a deduction in determining taxable income under this chapter for the taxable year in which paid or incurred (determined without regard to section 189).

"(C) CONSTRUCTION PERIOD.—*The term 'construction period' has the meaning given such term by section 189(e)(2) (determined without regard to any real property limitation).*

"(2) INTANGIBLE DRILLING COSTS AND MINERAL EXPLORATION AND DEVELOPMENT COSTS.—

"(A) INTANGIBLE DRILLING COSTS.—*Any amount allowable as a deduction under section 263(c) in determining taxable income (other than costs incurred in connection with a nonproductive well)—*

"(i) *shall be capitalized, and*

"(ii) *shall be allowed as a deduction ratably over the 60-month period beginning with the month in which the production from the well begins.*

"(B) MINERAL EXPLORATION AND DEVELOPMENT COSTS.—*Any amount allowable as a deduction under section 616(a) or 617 in determining taxable income—*

"(i) *shall be capitalized, and*

"(ii) *shall be allowed as a deduction ratably over the 120-month period beginning with the later of—*

"(I) *the month in which production from the deposit begins, or*

"(II) *the month in which such amount was paid or incurred.*

"(3) CERTAIN AMORTIZATION PROVISIONS NOT TO APPLY.—*Sections 173, 177, and 248 shall not apply.*

"(4) CERTAIN UNTAXED APPRECIATION OF DISTRIBUTED PROPERTY.—*In the case of any distribution of property by a corporation described in section 311(d), earnings and profits shall be increased by the amount of any gain which would be includible in gross income for any taxable year if section 311(d)(2) did not apply.*

"(5) LIFO INVENTORY ADJUSTMENTS.—*Earnings and profits shall be increased or decreased by the amount of any increase or decrease in the LIFO recapture amount (determined under section 336(b)(3)) as of the close of each taxable year; except that* *any decrease below the LIFO recapture amount as of the close of the taxable year preceding the first taxable year to which this paragraph applies to the taxpayer shall be taken into account only to the extent provided in regulations prescribed by the Secretary.*

"(6) INSTALLMENT SALES.—In the case of any installment sale, earnings and profits shall be computed as if the corporation did not use the installment method.

"(7) COMPLETED CONTRACT METHOD OF ACCOUNTING.—In the case of a taxpayer who uses the completed contract method of accounting, earnings and profits shall be computed as if such taxpayer used the percentage of completion method of accounting.

"(8) REDEMPTIONS.—If a corporation distributes amounts in a redemption to which section 302(a) or 303 applies, the part of such distribution which is properly chargeable to earnings and profits shall be an amount which is not in excess of the ratable share of the earnings and profits of such corporation accumulated after February 28, 1913, attributable to the stock so redeemed.

"(9) SPECIAL RULE FOR CERTAIN FOREIGN CORPORATIONS.—In the case of a foreign corporation described in subsection (k)(4), paragraphs (5), (6), and (7) shall apply only in the case of taxable years beginning after December 31, 1985."

(2) CONFORMING AMENDMENTS.—

(A) Section 312(j) (relating to earnings and profits of foreign investment companies) is amended by striking out paragraph (3).

(B) Subsection (e) of section 312 is hereby repealed.

(b) ADJUSTMENT TO EFFECT OF DEPRECIATION ON EARNINGS AND PROFITS.—The table contained in section 312(k)(3)(A) (relating to recovery property), as amended by this Act, is amended by striking out "35 years" in the item relating to 15-year real property and 20-year real property and inserting in lieu thereof "40 years".

(c) DISTRIBUTIONS OF OBLIGATIONS HAVING ORIGINAL ISSUE DISCOUNT.—

(1) EFFECT ON EARNINGS AND PROFITS.—

(A) Paragraph (2) of section 312(a) (relating to effect of earnings and profits) is amended to read as follows:

"(2) the principal amount of the obligations of such corporation (or, in the case of obligations having original issue discount, the aggregate issue price of such obligations), and".

(B) Section 312, as amended by subsection (a), is amended by adding at the end thereof the following new subsection:

"(o) DEFINITION OF ORIGINAL ISSUE DISCOUNT AND ISSUE PRICE FOR PURPOSES OF SUBSECTION (a)(2).—For purposes of subsection (a)(2), the terms 'original issue discount' and 'issue price' have the same respective meanings as when used in subpart A of part V of subchapter P of this chapter."

(2) TREATMENT UNDER ORIGINAL ISSUE DISCOUNT RULES.—Subsection (a) of section 1275 (relating to other definitions and special rules), as added by this Act, is amended by adding at the end thereof the following new paragraph:

"(4) TREATMENT OF OBLIGATIONS DISTRIBUTED TO CORPORATIONS.—Any debt obligation of a corporation distributed by such corporation with respect to its stock shall be treated as if it had been issued by such corporation for property."

(d) SPECIAL RULE IN CASE OF DISTRIBUTIONS RECEIVED BY 20 PERCENT CORPORATE SHAREHOLDER.—Section 301 (relating to distributions of property) is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection:

"(f) SPECIAL RULE FOR CERTAIN DISTRIBUTIONS RECEIVED BY 20 PERCENT CORPORATE SHAREHOLDER.—

"(1) IN GENERAL.—Except to the extent otherwise provided in regulations, solely for purposes of determining the taxable income of any 20 percent corporate shareholder (and its adjusted basis in the stock of the distributing corporation), section 312 shall be applied with respect to the distributing corporation as if it did not contain subsection (n) thereof.

"(2) 20 PERCENT CORPORATE SHAREHOLDER.—For purposes of this subsection, the term '20 percent corporate shareholder' means, with respect to any distribution, any corporation which owns (directly or through the application of section 318)—

"(A) stock in the corporation making the distribution possessing at least 20 percent of the total combined voting power of all classes of stock entitled to vote, or

"(B) at least 20 percent of the total value of all stock of the distributing corporation (except nonvoting stock which is limited and preferred as to dividends),

but only if, but for this subsection, the distributee corporation would be entitled to a deduction under section 243, 244, or 245 with respect to such distribution.

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

(e) EFFECTIVE DATES.—

(1) ADJUSTMENTS TO EARNINGS AND PROFITS.—

(A) PARAGRAPHS (1), (2), AND (3) OF SECTION 312(n).—The provisions of paragraphs (1), (2), and (3) of section 312(n) of the Internal Revenue Code of 1954 (as added by subsection (a)) shall apply to amounts paid or incurred in taxable years beginning after September 30, 1984.

(B) PARAGRAPH (4) OF SECTION 312(n).—The provisions of paragraph (4) of section 312(n) of such Code (as so added) shall apply to distributions after September 30, 1984; except that such provisions shall not apply to any distribution to which the amendments made by section 54(a) of this Act do not apply.

(C) LIFO INVENTORY.—The provisions of paragraph (5) of section 312(n) of such Code (as so added) shall apply to taxable years beginning after September 30, 1984.

(D) INSTALLMENT SALES.—The provisions of paragraph (6) of section 312(n) of such Code (as so added) shall apply to sales after September 30, 1984, in taxable years ending after such date.

(E) COMPLETED CONTRACT METHOD.—The provisions of paragraph (7) of section 312(n) of such Code (as so added) shall apply to contracts entered into after September 30, 1984, in taxable years ending after such date.

(2) SUBSECTION (b).—The amendments made by subsection (b) shall apply to property placed in service in taxable years beginning after September 30, 1984.

(3) SUBSECTION (c).—The amendments made by subsection (c) shall apply with respect to distributions declared after March 15, 1984, in taxable years ending after such date.

(4) SUBSECTION (d).—The amendment made by subsection (d) shall apply to distributions after the date of the enactment of this Act in taxable years ending after such date.

SEC. 62. 2-YEAR DELAY IN APPLICATION OF THE NET OPERATING LOSS RULES ADDED BY THE TAX REFORM ACT OF 1976.

(a) IN GENERAL.—Subsection (g) of section 806 of the Tax Reform Act of 1976 (26 U.S.C. 382 note) (relating to effective dates for the amendments to sections 382 and 383 of the Internal Revenue Code of 1954) is amended—

(1) by striking out "June 30, 1984" in paragraph (2) and inserting in lieu thereof "December 31, 1985";

(2) by striking out "January 1, 1984" in paragraph (2)(B) and inserting in lieu thereof "January 1, 1986"; and

(3) by striking out "January 1, 1984" in paragraph (3) and inserting in lieu thereof "January 1, 1986".

(b) TECHNICAL AMENDMENT.—

(1) Paragraph (1) of section 382(b) (as amended by the Tax Reform Act of 1976) is amended by striking out "section 368(a)(1) (A), (B), (C), (D) (but only if the requirements of section 354(b)(1) are met), or (F)" and inserting in lieu thereof "subparagraph (A), (B), (C), or (F) of section 368(a)(1) or subparagraph (D) or (G) of section 368(a)(1) (but only if the requirements of section 354(b)(1) are met)".

(2) The amendment made by paragraph (1) shall take effect as if included in the amendments made by section 4 of the Bankruptcy Tax Act of 1980.

SEC. 63. TARGET CORPORATION MUST DISTRIBUTE ASSETS AFTER REORGANIZATION DESCRIBED IN SECTION 368(a)(1)(C).

(a) IN GENERAL.—Paragraph (2) of section 368(a) (relating to special rules for paragraph (1)) is amended by adding at the end thereof the following new subparagraph:

"(G) DISTRIBUTION REQUIREMENT FOR PARAGRAPH (1)(C).—

"(i) IN GENERAL.—A transaction shall fail to meet the requirements of paragraph (1)(C) unless the acquired corporation distributes the stock, securities, and other properties it receives, as well as its other properties, in pursuance of the plan of reorganization.

"(ii) EXCEPTION.—The Secretary may waive the application of clause (i) to any transaction subject to any conditions the Secretary may prescribe."

(b) ALLOCATION IN CERTAIN CORPORATE SEPARATIONS AND REORGANIZATIONS.—Subsection (h) of section 312 (relating to allocation in certain corporate separations) is amended to read as follows:

"(h) ALLOCATION IN CERTAIN CORPORATE SEPARATIONS AND REORGANIZATIONS.—

"(1) SECTION 355.—In the case of a distribution or exchange to which section 355 (or so much of section 356 as relates to section 355) applies, proper allocation with respect to the earnings and profits of the distributing corporation and the controlled corporation (or corporations) shall be made under regulations prescribed by the Secretary.

"(2) SECTION 368 (a)(1)(C) OR (D).—In the case of a reorganization described in subparagraph (C) or (D) of section 368(a)(1), proper allocation with respect to the earnings and profits of the acquired corporation shall, under regulations prescribed by the Secretary, be made between the acquiring corporation and the acquired corporation (or any corporation which had control of the acquired corporation before the reorganization)."

(c) EFFECTIVE DATE.—The amendment made by this section shall apply to transactions pursuant to plans adopted after the date of the enactment of this Act.

SEC. 64. DEFINITION OF CONTROL FOR PURPOSES OF NONDIVISIVE REORGANIZATIONS UNDER SECTION 368(a)(1)(D).

(a) IN GENERAL.—Subsection (c) of section 368 (defining control) is amended to read as follows:

"(c) CONTROL DEFINED.—

"(1) IN GENERAL.—For purposes of part I (other than section 304), part II, this part, and part V, the term 'control' means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

"(2) SPECIAL RULE FOR DETERMINING WHETHER CERTAIN TRANSACTIONS ARE DESCRIBED IN SUBSECTION (a)(1)(D).—In the case of any transaction with respect to which the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met, for purposes of determining whether such transaction is described in subparagraph (D) of subsection (a)(1), the term 'control' has the meaning given to such term by section 304(c)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to transactions pursuant to plans adopted after the date of the enactment of this Act.

SEC. 65. COLLAPSIBLE CORPORATIONS.

(a) DEFINITION.—Subparagraph (A) of section 341(b)(1) (relating to collapsible corporations) is amended by striking out "a substantial part" and inserting in lieu thereof "⅔".

(b) LIMITATIONS.—Subsection (d) of section 341 (relating to limitations on application of section) is amended by adding at the end thereof the following sentence: "In determining whether property is described in subsection (b)(1) for purposes of applying paragraph (2), all property described in section 1221(1) shall, to the extent provided in regulations prescribed by the Secretary, be treated as one item of property."

35-426 O — 84 - 7

(c) CONFORMING AMENDMENT.—Paragraph (2) of section 341(d) is amended by striking out "so manufactured, constructed, produced, or purchased" and inserting in lieu thereof "described in subsection (b)(1)".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to sales, exchanges, and distributions made after the date of the enactment of this Act.

SEC. 66. PHASE-OUT OF GRADUATED RATES FOR LARGE CORPORATIONS.

(a) IN GENERAL.—Subsection (b) of section 11 (relating to amount of tax imposed on corporations) is amended by adding at the end thereof the following new flush sentence: "In the case of a corporation with taxable income in excess of $1,000,000 for any taxable year, the amount of tax determined under the preceding sentence for such taxable year shall be increased by the lesser of (A) 5 percent of such excess, or (B) $20,250."

(b) CONFORMING AMENDMENT.—Section 1561(a) (relating to limitations on certain multiple tax benefits in the case of certain control corporations) is amended by adding at the end thereof the following new sentence: "Notwithstanding paragraph (1), in applying the last sentence of section 11(b) to such component members, the taxable income of all such component members shall be taken into account and any increase in tax under such last sentence shall be divided among such component members in the same manner as amounts under paragraph (1)."

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 1983.

(2) AMENDMENTS NOT TREATED AS CHANGED IN RATE OF TAX.—The amendments made by this subsection shall not be treated as a change in a rate of tax for purposes of section 21 of the Internal Revenue Code of 1954.

SEC. 67. RESTRICTIONS ON GOLDEN PARACHUTE PAYMENTS.

(a) DENIAL OF DEDUCTION.—Part IX of subchapter B of chapter 1 (relating to items not deductible) is amended by adding after section 280F the following new section:

"SEC. 280G. GOLDEN PARACHUTE PAYMENTS.

"(a) GENERAL RULE.—No deduction shall be allowed under this chapter for any excess parachute payment.

"(b) EXCESS PARACHUTE PAYMENT.—For purposes of this section—

"(1) IN GENERAL.—The term 'excess parachute payment' means an amount equal to the excess of any parachute payment over the portion of the base amount allocated to such payment.

"(2) PARACHUTE PAYMENT DEFINED.—

"(A) IN GENERAL.—The term 'parachute payment' means any payment in the nature of compensation to (or for the benefit of) a disqualified individual if—

"(i) such payment is contingent on a change—

"(I) in the ownership or effective control of the corporation, or

"(II) in the ownership of a substantial portion of the assets of the corporation, and

"(ii) the aggregate present value of the payments in the nature of compensation to (or for the benefit of) such individual which are contingent on such change equals or exceeds an amount equal to 3 times the base amount.

"(B) AGREEMENTS.—The term 'parachute payment' shall also include any payment in the nature of compensation to (or for the benefit of) a disqualified individual if such payment is pursuant to an agreement which violates any securities laws or regulations.

"(C) TREATMENT OF CERTAIN AGREEMENTS ENTERED INTO WITHIN 1 YEAR BEFORE CHANGE OF OWNERSHIP.—For purposes of subparagraph (A)(i), any payment pursuant to—

"(i) an agreement entered into within 1 year before the change described in subparagraph (A)(i), or

"(ii) an amendment made within such 1-year period of a previous agreement,

shall be presumed to be contingent on such change unless the contrary is established by clear and convincing evidence.

"(3) BASE AMOUNT.—

"(A) IN GENERAL.—The term 'base amount' means the individual's annualized includible compensation for the base period.

"(B) ALLOCATION.—The portion of the base amount allocated to any parachute payment shall be an amount which bears the same ratio to the base amount as—

"(i) the present value of such payment, bears to

"(ii) the aggregate present value of all such payments.

"(4) EXCESS PARACHUTE PAYMENTS REDUCED TO EXTENT TAXPAYER ESTABLISHES REASONABLE COMPENSATION.—In the case of any parachute payment described in paragraph (2)(A), the amount of any excess parachute payment shall be reduced by the portion of such payment which the taxpayer establishes by clear and convincing evidence is reasonable compensation for personal services actually rendered. For purposes of the preceding sentence, reasonable compensation shall be first offset against the base amount.

"(c) DISQUALIFIED INDIVIDUALS.—For purposes of this section, the term 'disqualified individual' means any individual who is—

"(1) an employee, independent contractor, or other person specified in regulations by the Secretary who performs personal services for any corportion, and

"(2) is an officer, shareholder, or highly-compensated individual.

For purposes of this section, a personal service corporation (or similar entity) shall be treated as an individual.

"(d) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) ANNUALIZED INCLUDIBLE COMPENSATION FOR BASE PERIOD.—The term 'annualized includible compensation for the base period' means the average annual compensation which—

"(A) was payable by the corporation with respect to which the change in ownership or control described in paragraph (2)(A) of subsection (b) occurs, and

"(B) was includible in the gross income of the disqualified individual for taxable years in the base period.

"(2) BASE PERIOD.—The term 'base period' means the period consisting of the most recent 5 taxable years ending before the date on which the change in ownership or control described in paragraph (2)(A) of subsection (b) occurs (or such portion of such period during which the disqualified individual was an employee of the corporation).

"(3) PROPERTY TRANSFERS.—Any transfer of property—

"(A) shall be treated as a payment, and

"(B) shall be taken into account as its fair market value.

"(4) PRESENT VALUE.—Present value shall be determined in accordance with section 1274(b)(2).

"(e) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section (including regulations for the application of this section in the case of related corporations and in the case of personal service corporations)."

(b) EXCISE TAX ON AMOUNTS RECEIVED.—

(1) IN GENERAL.—Subtitle D (relating to miscellaneous excise taxes) is amended by adding at the end thereof the following new chapter:

"CHAPTER 46—GOLDEN PARACHUTE PAYMENTS

"SEC. 4999. GOLDEN PARACHUTE PAYMENTS.

"(a) IMPOSITION OF TAX.—There is hereby imposed on any person who receives an excess parachute payment a tax equal to 20 percent of the amount of such payment.

"(b) EXCESS PARACHUTE PAYMENT DEFINED.—For purposes of this section, the term 'excess parachute payment' has the meaning given to such term by section 280G(b).

"(c) ADMINISTRATIVE PROVISIONS.—

"(1) WITHHOLDING.—In the case of any excess parachute payment which is wages (within the meaning of section 3401) the amount deducted and withheld under section 3402 shall be increased by the amount of the tax imposed by this section on such payment.

"(2) OTHER ADMINISTRATIVE PROVISIONS.—For purposes of subtitle F, any tax imposed by this section shall be treated as a tax imposed by subtitle A."

(2) DENIAL OF DEDUCTION.—Paragraph (6) of section 275(a) (relating to denial of deduction for certain taxes) is amended by striking out "and 44" and inserting in lieu thereof "44, and 46".

(c) FICA TAXES.—Subparagraph (A) of section 3121(v)(2) (relating to treatment of certain nonqualified deferred compensation plans) is amended by adding at the end thereof the following new sentence:

"The preceding sentence shall not apply to any excess parachute payment (as defined in section 280G(b))."

(d) CLERICAL AMENDMENTS.—

(1) The table of sections for part IX of subchapter B of chapter 1 is amended by adding after the item relating to section 280F the following new item:

"Sec. 280G. Golden parachute payments."

(2) The table of chapters for subtitle D is amended by adding at the end thereof the following new item:

"CHAPTER 46. Golden parachute payments."

(e) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to payments under agreements entered into or renewed after June 14, 1984, in taxable years ending after such date.

(2) SPECIAL RULE FOR CONTRACT AMENDMENTS.—In the case of any contract entered into before June 15, 1984, any amendment to such contract after June 14, 1984, which amends such contract in any significant relevant aspect shall be treated as a new contract.

SEC. 68. INCREASE IN REDUCTION IN CERTAIN CORPORATE PREFERENCE ITEMS FROM 15 PERCENT TO 20 PERCENT.

(a) IN GENERAL.—Each subsection (other than subsection (a)(2)) of section 291 (relating to special rules for corporate preference items) is amended by striking out "15 percent" each place it appears and inserting in lieu thereof "20 percent".

(b) DEFERRED FSC INCOME.—Paragraph (4) of section 291(a) (relating to certain deferred DISC income) is amended to read as follows:

"(4) CERTAIN DEFERRED FSC INCOME.—If a corporation is a shareholder of the FSC, in the case of taxable years beginning after December 31, 1984, section 923(a) shall be applied with respect to such corporation by substituting—

"(A) '32 percent' for '34 percent' in paragraph (2), and

"(B) '16/23' for '17/23' in paragraph (3).".

(c) MINIMUM TAX.—

(1) IN GENERAL.—Paragraph (1) of section 57(b) is amended to read as follows:

"(1) IN GENERAL.—

"(A) POLLUTION CONTROL FACILITIES; BAD DEBT RESERVES.—In the case of any item of tax preference of a corporation described in paragraph (4) or (7) of section (a), only $59\frac{5}{6}$ percent of the amount of such item of tax preference (determined without regard to this subsection) shall be taken into account as an item of tax preference.

"(B) IRON ORE AND COAL.—In the case of any item of tax preference of a corporation described in paragraph (8) of subsection (a) (but only to the extent such item is allocable to a deduction for depletion for iron ore and coal (including legnite)),

only 71.6 percent of the amount of such item of tax preference (determined without regard to this subsection) shall be taken into account as an item of tax preference.".

(2) CERTAIN CAPITAL GAINS.—Paragraph (2) of section 57(h) (relating to capital gains) is amended by striking out "71.6 percent" and inserting in lieu thereof "$59\frac{5}{6}$ percent".

(d) Deferred DISC Income.—Section 995(b)(1)(F)(i) (relating to deemed distributions) is amended by striking out "one/half" and inserting in lieu thereof "one-seventeenth".

(e) Effective Dates.—

(1) In general.—Except as provided in this subsection, the amendments made by this section shall apply to taxable years beginning after December 31, 1984.

(2) 1250 gain.—The amendments made by this section to section 291(a)(1) of the Internal Revenue Code of 1954 shall apply to sales or other dispositions after December 31, 1984, in taxable years ending after such date.

(3) Pollution control facilities.—The amendments made by this section to section 291(a)(5) of such Code shall apply to property placed in service after December 31, 1984, in taxable years ending after such date.

(4) Drilling and mining costs.—The amendments made by this section to section 291(b) of such Code shall apply to expenditures after December 31, 1984, in taxable years ending after such date.

Subtitle E—Partnership Provisions

SEC. 71. PARTNERSHIP ALLOCATIONS WITH RESPECT TO CONTRIBUTED PROPERTY.

(a) General Rule.—Subsection (c) of section 704 (relating to contributed property) is amended to read as follows:

"(c) Contributed Property.—Under regulations prescribed by the Secretary, income, gain, loss, and deduction with respect to property contributed to the partnership by a partner shall be shared among partners so as to take account of the variation between the basis of the property to the partnership and its fair market value at the time of contribution. Under regulations prescribed by the Secretary, rules similar to the rules of the preceding sentence shall apply to contributions by a partner (using the cash receipts and disbursements method of accounting) of accounts payable and other accrued but unpaid items."

(b) Conforming Amendments.—The fourth sentence of section 613A(c)(7)(D) and the third sentence of section 743(b) are each amended by striking out "an agreement described in section 704(c)(2) (relating to effect of partnership agreement on contributed property), such share shall be determined by taking such agreement into account" and inserting in lieu thereof "property contributed to the partnership by a partner, section 704(c) (relating to contributed property) shall apply in determining such share".

(c) Effective Date.—The amendments made by this section shall apply with respect to property contributed to the partnership after March 31, 1984, in taxable years ending after such date.

SEC. 72. DETERMINATION OF DISTRIBUTIVE SHARES WHEN PARTNER'S INTEREST CHANGES.

(a) General Rule.—Section 706 (relating to taxable years of partner and partnership) is amended by adding at the end thereof the following new subsection:

"(d) *DETERMINATION OF DISTRIBUTIVE SHARE WHEN PARTNER'S INTEREST CHANGES.*—

"(1) *IN GENERAL.—Except as provided in paragraphs (2) and (3), if during any taxable year of the partnership there is a change in any partner's interest in the partnership, each partner's distributive share of any item of income, gain, loss, deduction, or credit of the partnership for such taxable year shall be determined by the use of any method prescribed by the Secretary by regulations which takes into account the varying interests of the partners in the partnership during such taxable year.*

"(2) *CERTAIN CASH BASIS ITEMS PRORATED OVER PERIOD TO WHICH ATTRIBUTABLE.*—

"(A) *IN GENERAL.—If during any taxable year of the partnership there is a change in any partner's interest in the partnership, then (except to the extent provided in regulations) each partner's distributive share of any allocable cash basis item shall be determined—*

"(i) *by assigning the appropriate portion of each such item to each day in the period to which it is attributable, and*

"(ii) *by allocating the portion assigned to any such day among the partners in proportion to their interests in the partnership at the close of such day.*

"(B) *ALLOCABLE CASH BASIS ITEM.—For purposes of this paragraph, the term 'allocable cash basis item' means any of the following items which are described in paragraph (1) and with respect to which the partnership uses the cash receipts and disbursements method of accounting:*

"(i) *Interest.*

"(ii) *Taxes.*

"(iii) *Payments for services or for the use of property.*

"(iv) *Any other item of a kind specified in regulations prescribed by the Secretary as being an item with respect to which the application of this paragraph is appropriate to avoid significant misstatements of the income of the partners.*

"(C) *ITEMS ATTRIBUTABLE TO PERIODS NOT WITHIN TAXABLE YEAR.—If any portion of any allocable cash basis item is attributable to—*

"(i) *any period before the beginning of the taxable year, such portion shall be assigned under subparagraph (A)(i) to the first day of such taxable year and allocated among persons who are partners in the partnership during the period to which such portion is attributable in accordance with their varying interests in the partnership during such period, or*

"(ii) *periods after the close of the taxable year, such item shall be assigned under subparagraph (A)(i) to the last day of the taxable year.*

"(D) *TREATMENT OF ITEMS ALLOCATED TO PERSONS WHO ARE NO LONGER PARTNERS.—Any deduction allocated to a person under clause (i) of subparagraph (C) who is not a partner in the partnership on the first day referred to in* *such clause shall be capitalized by the partnership and treated in the manner provided for in section 755.*

"(3) ITEMS ATTRIBUTABLE TO INTEREST IN LOWER TIER PARTNERSHIP PRORATED OVER ENTIRE TAXABLE YEAR.—If—

"(A) during any taxable year of the partnership there is a change in any partner's interest in the partnership (hereinafter in this paragraph referred to as the 'upper tier partnership'), and

"(B) such partnership is a partner in another partnership (hereinafter in this paragraph referred to as the 'lower tier partnership'),

then (except to the extent provided in regulations) each partner's distributive share of any item of the upper tier partnership attributable to the lower tier partnership shall be determined by assigning the appropriate portion (determined by applying principles similar to the principles of subparagraphs (C) and (D) of paragraph (2)) of each such item to the appropriate days during which the upper tier partnership is a partner in the lower tier partnership and by allocating the portion assigned to any such day among the partners in proportion to their interests in the upper tier partnership at the close of such day.

"(4) TAXABLE YEAR DETERMINED WITHOUT REGARD TO SUBSECTION (c)(2)(A).—For purposes of this subsection, the taxable year of a partnership shall be determined without regard to subsection (c)(2)(A)."

(b) CONFORMING AMENDMENTS.—Paragraph (2) of section 706(c) is amended—

(1) by striking out the last sentence of subparagraph (A), and

(2) by striking out ", but such partner's distributive share of items described in section 702(a) shall be determined by taking into account his varying interests in the partnership during the taxable year" in subparagraph (B).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply—

(1) in the case of items described in section 706(d)(2) of the Internal Revenue Code of 1954 (as added by subsection (a)), to amounts attributable to periods after March 31, 1984, and

(2) in the case of items described in section 706(d)(3) of such Code (as added by subsection (a)), to amounts paid or accrued by the other partnership after March 31, 1984.

SEC. 73. PAYMENTS TO PARTNERS FOR PROPERTY OR CERTAIN SERVICES.

(a) GENERAL RULE.—Subsection (a) of section 707 (relating to transactions between partner and partnership) is amended to read as follows:

"(a) PARTNER NOT ACTING IN CAPACITY AS PARTNER.—

"(1) IN GENERAL.—If a partner engages in a transaction with a partnership other than in his capacity as a member of such partnership, the transaction shall, except as otherwise provided in this section, be considered as occurring between the partnership and one who is not a partner.

"(2) TREATMENT OF PAYMENTS TO PARTNERS FOR PROPERTY OR SERVICES.—Under regulations prescribed by the Secretary—

"(A) Treatment of certain services and transfers of property.—If —

"(i) a partner performs services for a partnership or transfers property to a partnership,

"(ii) there is a related direct or indirect allocation and distribution to such partner, and

"(iii) the performance of such services (or such transfer) and the allocation and distribution, when viewed together, are properly characterized as a transaction occurring between the partnership and a partner acting other than in his capacity as a member of the partnership,

such allocation and distribution shall be treated as a transaction described in paragraph (1).

"(B) Treatment of certain property transfers.—If—

"(i) there is a direct or indirect transfer of money or other property by a partner to a partnership,

"(ii) there is a related direct or indirect transfer of money or other property by the partnership to such partner (or another partner), and

"(iii) the transfers described in clauses (i) and (ii), when viewed together, are properly characterized as a sale of property,

such transfers shall be treated either as a transaction described in paragraph (1) or as a transaction between 2 or more partners acting other than in their capacity as members of the partnership."

(b) Effective Date.—

(1) In general.—The amendment made by subsection (a) shall apply—

(A) in the case of arrangements described in section 707(a)(2)(A) of the Internal Revenue Code of 1954 (as amended by subsection (a)), to services performed or property transferred after February 29, 1984, and

(B) in the case of transfers described in section 707(a)(2)(B) of such Code (as so amended), to property transferred after March 31, 1984.

(2) Binding contract exception.—The amendment made by subsection (a) shall not apply to a transfer of property described in section 707(a)(2)(B)(i) if such transfer is pursuant to a binding contract in effect on March 31, 1984, and at all times thereafter before the transfer.

(3) Exception for certain transfers.—The amendment made by subsection (a) shall not apply to a transfer of property described in section 707(a)(2)(B)(i) that is made before December 31, 1984, if—

(A) such transfer was proposed in a written private offering memorandum circulated before February 28, 1984;

(B) the out-of-pocket costs incurred with respect to such offering exceeded $250,000 as of February 28, 1984;

(C) the encumbrances placed on such property in anticipation of such transfer all constitute obligations for which neither the partnership nor any partner is liable; and

(D) the transferor of such property is the sole general partner of the partnership.

SEC. 74. CONTRIBUTIONS TO A PARTNERSHIP OF UNREALIZED RECEIVABLES, INVENTORY ITEMS, OR CAPITAL LOSS PROPERTY.

(a) GENERAL RULE.—Subpart A of part II of subchapter K of chapter 1 (relating to contributions to a partnership) is amended by adding at the end thereof the following new section:

"SEC. 724. CHARACTER OF GAIN OR LOSS ON CONTRIBUTED UNREALIZED RECEIVABLES, INVENTORY ITEMS, AND CAPITAL LOSS PROPERTY.

"(a) CONTRIBUTIONS OF UNREALIZED RECEIVABLES.—In the case of any property which—

"(1) was contributed to the partnership by a partner, and

"(2) was an unrealized receivable in the hands of such partner immediately before such contribution,

any gain or loss recognized by the partnership on the disposition of such property shall be treated as ordinary income or ordinary loss, as the case may be.

"(b) CONTRIBUTIONS OF INVENTORY ITEMS.—In the case of any property which—

"(1) was contributed to the partnership by a partner, and

"(2) was an inventory item in the hands of such partner immediately before such contribution,

any gain or loss recognized by the partnership on the disposition of such property during the 5-year period beginning on the date of such contribution shall be treated as ordinary income or ordinary loss, as the case may be.

"(c) CONTRIBUTIONS OF CAPITAL LOSS PROPERTY.—In the case of any property which—

"(1) was contributed by a partner to the partnership, and

"(2) was a capital asset in the hands of such partner immediately before such contribution,

any loss recognized by the partnership on the disposition of such property during the 5-year period beginning on the date of such contribution shall be treated as a loss from the sale of a capital asset to the extent that, immediately before such contribution, the adjusted basis of such property in the hands of the partner exceeded the fair market value of such property.

"(d) DEFINITIONS.—For purposes of this section—

"(1) UNREALIZED RECEIVABLE.—The term 'unrealized receivable' has the meaning given such term by section 751(c) (determined by treating any reference to the partnership as referring to the partner).

"(2) INVENTORY ITEM.—The term 'inventory item' has the meaning given such term by section 751(d)(2) (determined by treating any reference to the partnership as referring to the partner and by applying section 1231 without regard to any holding period therein provided).

"(3) SUBSTITUTED BASIS PROPERTY.—

"(A) IN GENERAL.—If any property described in subsection (a), (b), or (c) is disposed of in a nonrecognition transaction, the tax treatment which applies to such property under such subsection shall also apply to any substituted basis

property resulting from such transaction. A similar rule shall also apply in the case of a series of non-recognition transactions.

"(B) EXCEPTION FOR STOCK IN C CORPORATION.—Subparagaph (A) shall not apply to any stock in a C corporation received in an exchange described in section 351."

(b) AMENDMENT OF SECTION 735.—Section 735 (relating to character of gain or loss on disposition of distributed property) is amended by adding at the end thereof the following new subsection:

"(c) SPECIAL RULES.—

"(1) WAIVER OF HOLDING PERIODS CONTAINED IN SECTION 1231.—For purposes of this section, section 751(d)(2) (defining inventory item) shall be applied without regard to any holding period in section 1231(b).

"(2) SUBSTITUTED BASIS PROPERTY.—

"(A) IN GENERAL.—If any property described in subsection (a) is disposed of in a nonrecognition transaction, the tax treatment which applies to such property under such subsection shall also apply to any substituted basis property resulting from such transaction. A similar rule shall also apply in the case of a series of nonrecognition transactions.

"(B) EXCEPTION FOR STOCK IN C CORPORATION.—Subparagraph (A) shall not apply to any stock in a C corporation received in an exchange described in section 351."

(c) CLERICAL AMENDMENT.—The table of sections for subpart A of part II of subchapter K of chapter 1 is amended by adding at the end thereof the following new item:

(d) EFFECTIVE DATES.—

(1) SUBSECTION (a).—The amendment made by subsection (a) shall apply to property contributed to a partnership after March 31, 1984, in taxable years ending after such date.

(2) SUBSECTION (b).—The amendment made by subsection (b) shall apply to property distributed after March 31, 1984, in taxable years ending after such date.

SEC. 75. TRANSFERS OF PARTNERSHIP AND TRUST INTERESTS BY CORPORATIONS.

(a) GENERAL RULE.—Subchapter C of chapter 1 (relating to corporate distributions and adjustments) is amended by adding at the end thereof the following new part:

"PART VII—MISCELLANEOUS CORPORATE PROVISIONS

"SEC. 386. TRANSFERS OF PARTNERSHIP AND TRUST INTERESTS BY CORPORATIONS.

"(a) CORPORATE DISTRIBUTIONS.—For purposes of determining the amount (and character) of gain recognized by a corporation on any distribution of an interest in a partnership, the distribution shall be treated in the same manner as if it included a property distribution consisting of the corporation's proportionate share of the recognition property of such partnership.

"(b) SALES OR EXCHANGE TO WHICH SECTION 337 APPLIES.—For purposes of determining the amount (and character) of gain recognized on a sale or exchange described in section 337, any sale or exchange by a corporation of an interest in a partnership shall be treated as a sale or exchange of the corporation's proportionate share of the recognition property of such partnership.

"(c) RECOGNITION PROPERTY.—For purposes of this section, the term 'recognition property' means any property with respect to which gain would be recognized to the corporation if such property—

"(1) were distributed by the corporation in a distribution described in section 311 or 336, or

"(2) were sold in a sale described in section 337,

whichever is appropriate. In determining whether property of a partnership is recognition property, such partnership shall be treated as owning its proportionate share of the property of any other partnership in which it is a partner.

"(d) EXTENSION TO TRUSTS.—Under regulations, rules similar to the rules of this section shall also apply in the case of the distribution or sale or exchange by a corporation of an interest in a trust."

(b) DISTRIBUTIONS TREATED AS EXCHANGES FOR PURPOSES OF SUBCHAPTER K.—Section 761 (relating to definitions) is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) DISTRIBUTIONS TREATED AS EXCHANGES.—For purposes of—

"(1) section 708 (relating to continuation of partnership),

"(2) section 743 (relating to optional adjustment to basis of partnership property), and

"(3) any other provision of this subchapter specified in regulations prescribed by the Secretary,

any distribution (not otherwise treated as an exchange) shall be treated as an exchange."

(c) CLARIFICATION OF FAIR MARKET VALUE IN THE CASE OF NONRECOURSE INDEBTEDNESS.—Section 7701 (relating to definitions), as amended by this Act, is amended by redesignating subsection (g) as subsection (h) and by inserting after subsection (f) the following new subsection:

"(g) CLARIFICATION OF FAIR MARKET VALUE IN THE CASE OF NONRECOURSE INDEBTEDNESS.—For purposes of subtitle A, in determining the amount of gain or loss (or deemed gain or loss) with respect to any property, the fair market value of such property shall be treated as being not less than the amount of any nonrecourse indebtedness to which such property is subject."

(d) CLERICAL AMENDMENT.—The table of parts for subchapter C of chapter 1 is amended by adding at the end thereof the following new item:

"Part VII. Miscellaneous corporate provisions."

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions, sales, and exchanges made after March 31, 1984, in taxable years ending after such date.

SEC. 76. APPLICATION OF SECTION 751 IN THE CASE OF TIERED PARTNERSHIPS.

(a) GENERAL RULE.—Section 751 (relating to unrealized receivables and inventory items) is amended by adding at the end thereof the following new subsection:

"(f) SPECIAL RULES IN THE CASE OF TIERED PARTNERSHIPS, ETC.—In determining whether property of a partnership is—

"(1) an unrealized receivable, or

"(2) an inventory item,

such partnership shall be treated as owning its proportionate share of the property of any other partnership in which it is a partner. Under regulations, rules similar to the rules of the preceding sentence shall also apply in the case of interests in trusts."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to distributions, sales, and exchanges made after March 31, 1984, in taxable years ending after such date.

SEC. 77. SECTION 1031 NOT APPLICABLE TO PARTNERSHIP INTERESTS; LIMITATION ON THE PERIOD DURING WHICH LIKE KIND EXCHANGES MAY BE MADE.

(a) IN GENERAL.—Subsection (a) of section 1031 (relating to nonrecognition of gain or loss from exchanges solely in kind) is amended to read as follows:

"(a) NONRECOGNITION OF GAIN OR LOSS FROM EXCHANGES SOLELY IN KIND.—

"(1) IN GENERAL.—No gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.

"(2) EXCEPTION.—This subsection shall not apply to any exchange of—

"(A) stock in trade or other property held primarily for sale,

"(B) stocks, bonds, or notes,

"(C) other securities or evidences of indebtedness or interest,

"(D) interests in a partnership,

"(E) certificates of trust or beneficial interests, or

"(F) choses in action.

"(3) REQUIREMENT THAT PROPERTY BE IDENTIFIED AND THAT EXCHANGE BE COMPLETED NOT MORE THAN 180 DAYS AFTER TRANSFER OF EXCHANGED PROPERTY.—For purposes of this subsection, any property received by the taxpayer shall be treated as property which is not like-kind property if—

"(A) such property is not identified as property to be received in the exchange before the day which is 45 days after the date on which the taxpayer transfers the property relinquished in the exchange, or

"(B) such property is received after the earlier of—

"(i) the day which is 180 days after the date on which the taxpayer transfers the property relinquished in the exchange, or

"(ii) the due date (determined with regard to extension) for the transferor's return of the tax imposed by this chapter for the taxable year in which the transfer of the relinquished property occurs."

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendment made by subsection (a) shall apply to

transfers made after the date of the enactment of this Act in taxable years ending after such date.

(2) BINDING CONTRACT EXCEPTION FOR TRANSFER OF PARTNERSHIP INTERESTS.—Paragraph (2)(D) of section 1031(a) of the Internal Revenue Code of 1954 (as amended by subsection (a)) shall not apply in the case of any exchange pursuant to a binding contract in effect on March 1, 1984, and at all times thereafter before the exchange.

(3) REQUIREMENT THAT PROPERTY BE IDENTIFIED WITHIN 45 DAYS AND THAT EXCHANGE BE COMPLETED WITHIN 180 DAYS.—Paragraph (3) of section 1031(a) of the Internal Revenue Code of 1954 (as amended by subsection (a)) shall apply—

(A) to transfers after the date of the enactment of this Act, and

(B) to transfers on or before such date of enactment if the property to be received in the exchange is not received before January 1, 1987.

In the case of any transfer on or before the date of the enactment of this Act which the taxpayer treated as part of a like-kind exchange, the period for assessing any deficiency of tax attributable to the amendment made by subsection (a) shall not expire before January 1, 1988.

(4) SPECIAL RULE WHERE PROPERTY IDENTIFIED IN BINDING CONTRACT.—If the property to be received in the exchange is identified in a binding contract in effect on June 13, 1984, and at all times thereafter before the transfer, paragraph (3) shall be applied—

(A) by substituting "January 1, 1989" for "January 1, 1987", and

(B) by substituting "January 1, 1990" for "January 1, 1988".

(5) SPECIAL RULE FOR LIKE KIND EXCHANGE OF PARTNERSHIP INTERESTS.—Paragraph (2)(D) of section 1031(a) of the Internal Revenue Code of 1954 (as amended by subsection (a)) shall not apply to any exchange of an interest as general partner pursuant to a plan of reorganization of ownership interest under a contract which took effect on March 29, 1984, but only if all the exchanges contemplated by the reorganization plan are completed on, or before December 31, 1984.

SEC. 78. ELIMINATION OF BASIS STRIPS UNDER SECTION 734(b).

(a) GENERAL RULE.—Subsection (b) of section 734 is amended by adding at the end thereof the following new sentence: "Paragraph (1)(B) shall not apply to any distributed property which is an interest in another partnership with respect to which the election provided in section 754 is not in effect."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to distributions after March 1, 1984, in taxable years ending after such date.

SEC. 79. OVERRULING OF RAPHAN CASE.

(a) GENERAL RULE.—Section 752 of the Internal Revenue Code of 1954 (and the regulations prescribed thereunder) shall be applied without regard to the result reached in the case of Raphan vs the United States, 3 Cl. Ct. 457 (1983).

(b) Regulations.—In amending the regulations prescribed under section 752 of such Code to reflect subsection (a), the Secretary of the Treasury or his delegate shall prescribe regulations relating to liabilities including the treatment of guarantees, assumptions, indemnity agreements, and similar arrangements.

Subtitle F—Trust Provisions

SEC. 81. TREATMENT OF PROPERTY DISTRIBUTED IN KIND.

(a) General Rule.—Section 643 (relating to definitions applicable to subchapters A, B, C, and D) is amended by adding at the end thereof the following new subsection:

"(d) Treatment of Property Distributed in Kind.—

"(1) Basis of beneficiary.—The basis of any property received by a beneficiary in a distribution from an estate or trust shall be—

"(A) the adjusted basis of such property in the hands of the estate or trust immediately before the distribution, adjusted for

"(B) any gain or loss recognized to the estate or trust on the distribution.

"(2) Amount of distribution.—In the case of any distribution of property (other than cash), the amount taken into account under sections 661(a)(2) and 662(a)(2) shall be the lesser of—

"(A) the basis of such property in the hands of the beneficiary (as determined under paragraph (1)), or

"(B) the fair market value of such property.

"(3) Election to recognize gain.—

"(A) In general.—In the case of any distribution of property (other than cash) to which an election under this paragraph applies—

"(i) paragraph (2) shall not apply,

"(ii) gain or loss shall be recognized by the estate or trust in the same manner as if such property had been sold to the distributee at its fair market value, and

"(iii) the amount taken into account under sections 661(a)(2) and 662(a)(2) shall be the fair market value of such property.

"(B) Election.—Any election under this paragraph shall be made by the estate or trust on its return for the taxable year for which the distribution was made.

Any such election, once made, may be revoked only with the consent of the Secretary.

"(4) Exception for distributions described in section 663 (a).—This subsection shall not apply to any distribution described in section 663(a)."

(b) Effective Date.—

(1) In general.—The amendment made by subsection (a) shall apply to distributions after June 1, 1984, in taxable years ending after such date.

(2) Time for making election.—In the case of any distribution before the date of the enactment of this Act—

(A) the time for making an election under section 643(d)(3) of the Internal Revenue Code of 1954 (as added by this section) shall not expire before January 1, 1985, and

(B) the requirement that such election be made on the return of the estate or trust shall not apply.

SEC. 82. TREATMENT OF MULTIPLE TRUSTS.

(a) GENERAL RULE.—Section 643 (relating to definitions applicable to subparts A, B, C, and D) is amended by adding at the end thereof the following new subsection:

"(e) TREATMENT OF MULTIPLE TRUSTS.—For purposes of this subchapter, under regulations prescribed by the Secretary, 2 or more trusts shall be treated as 1 trust if—

"(1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and

"(2) a principal purpose of such trusts is the avoidance of the tax imposed by this chapter.

For purposes of the preceding sentence, a husband and wife shall be treated as 1 person."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after March 1, 1984.

Subtitle G—Accounting Changes

SEC. 91. CERTAIN AMOUNTS NOT TREATED AS INCURRED BEFORE ECONOMIC PERFORMANCE.

(a) IN GENERAL.—Section 461 (relating to general rule for taxable year of deduction) is amended by adding at the end thereof the following new subsections:

"(h) CERTAIN LIABILITIES NOT INCURRED BEFORE ECONOMIC PERFORMANCE.—

"(1) IN GENERAL.—For purposes of this title, in determining whether an amount has been incurred with respect to any item during any taxable year, the all events test shall not be treated as met any earlier than when economic performance with respect to such item occurs.

"(2) TIME WHEN ECONOMIC PERFORMANCE OCCURS.—Except as provided in regulations prescribed by the Secretary, the time when economic performance occurs shall be determined under the following principles:

"(A) SERVICES AND PROPERTY PROVIDED TO THE TAXPAYER.—If the liability of the taxpayer arises out of—

"(i) the providing of services to the taxpayer by another person, economic performance occurs as such person provides such services,

"(ii) the providing of property to the taxpayer by another person, economic performance occurs as the person provides such property, or

"(iii) the use of property by the taxpayer, economic performance occurs as the taxpayer uses such property.

"(B) SERVICES AND PROPERTY PROVIDED BY THE TAXPAYER.—If the liability of the taxpayer requires the taxpayer to

provide property or services, economic performance occurs as the taxpayer provides such property or services.

"(C) WORKERS COMPENSATION AND TORT LIABILITIES OF THE TAXPAYER.—If the liability of the taxpayer requires a payment to another person and—

"(i) arises under any workers compensation act, or

"(ii) arises out of any tort,

economic performance occurs as the payments to such person are made. Subparagraphs (A) and (B) shall not apply to any liability described in the preceding sentence.

"(D) OTHER ITEMS.—In the case of any other liability of the taxpayer, economic performance occurs at the time determined under regulations prescribed by the Secretary.

"(3) EXCEPTION FOR CERTAIN RECURRING ITEMS.—

"(A) IN GENERAL.—Notwithstanding paragraph (1) an item shall be treated as incurred during any taxable year if—

"(i) the all events test with respect to such item is met during such taxable year (determined without regard to paragraph (1)),

"(ii) economic performance with respect to such item occurs within the shorter of—

"(I) a reasonable period after the close of such taxable year, or

"(II) 8½ months after the close of such taxable year,

"(iii) such item is recurring in nature and the taxpayer consistently treats items of such kind as incurred in the taxable year in which the requirements of clause (i) are met, and

"(iv) either—

"(I) such item is not a material item, or

"(II) the accrual of such item in the taxable year in which the requirements of clause (i) are met results in a more proper match against income than accruing such item in the taxable year in which economic performance occurs.

"(B) FINANCIAL STATEMENTS CONSIDERED UNDER SUBPARAGRAPH (A)(iv).—In making a determination under subparagraph (A)(iv), the treatment of such item on financial statements shall be taken into account.

"(C) PARAGRAPH NOT TO APPLY TO WORKERS COMPENSATION AND TORT LIABILITIES.—This paragraph shall not apply to any item described in subparagraph (C) of paragraph (2).

"(4) ALL EVENTS TEST.—For purposes of this subsection, the all events test is met with respect to any item if all events have occurred which determine the fact of liability and the amount of such liability can be determined with reasonable accuracy.

"(5) SUBSECTION NOT TO APPLY TO CERTAIN CASES TO WHICH OTHER PROVISIONS OF THIS TITLE SPECIFICALLY APPLY.—This subsection shall not apply to any item to which any of the following provisions apply:

35-426 O - 84 - 8

"(A) Subsection (c) or (f) of section 166 (relating to reserves for bad debts).

"(B) Section 463 (relating to vacation pay).

"(C) Section 466 (relating to discount coupons).

"(D) Any other provisions of this title which specifically provides for a deduction for a reserve for estimated expenses.

"(i) TAX SHELTERS MAY NOT DEDUCT ITEMS EARLIER THAN WHEN ECONOMIC PERFORMANCE OCCURS.—

"(1) IN GENERAL.—In the case of a tax shelter computing taxable income under the cash receipts and disbursements method of accounting, such tax shelter shall not be allowed a deduction under this chapter with respect to any item any earlier than the time when such item would be treated as incurred under subsection (h) (determined without regard to paragraph (3) thereof).

"(2) EXCEPTION (TO EXTENT OF CASH BASIS) WHEN ECONOMIC PERFORMANCE OCCURS WITHIN 90 DAYS AFTER THE CLOSE OF THE TAXABLE YEAR.—

"(A) IN GENERAL.—Paragraph (1) shall not apply to any item if economic performance with respect to such item occurs within 90 days after the close of the taxable year.

"(B) DEDUCTION LIMITED TO CASH BASIS.—

"(i) TAX SHELTER PARTNERSHIPS.—In the case of a tax shelter which is a partnership, in applying section 704(d) to a deduction or loss for any taxable year attributable to an item which is deductible by reason of subparagraph (A), the term 'cash basis' shall be substituted for the term 'adjusted basis'.

"(ii) OTHER TAX SHELTERS.—Under regulations prescribed by the Secretary, in the case of a tax shelter other than a partnership, the aggregate amount of the deductions allowable by reason of subparagraph (A) for any taxable year shall be limited in a manner similar to the limitation under clause (i).

"(C) CASH BASIS DEFINED.—For purposes of subparagraph (B), a partner's cash basis in a partnership shall be equal to the adjusted basis of such partner's interest in the partnership, determined without regard to—

"(i) any liability of the partnership, and

"(ii) any amount borrowed by the partner with respect to such partnership which—

"(I) was arranged by the partnership or by any person who participated in the organization, sale, or management of the partnership (or any person related to such person within the meaning of section 168(e)(4)), or

"(II) was secured by any assets of the partnership.

"(D) SPECIAL CASH BASIS RULE FOR SPUDDING OF OIL OR GAS WELLS.—Solely for purposes of applying subparagraph (A), economic performance with respect to the act of drilling of an oil or gas well shall be treated as occurring when the drilling of the well is commenced.

"(3) TAX SHELTER DEFINED.—For purposes of this subsection, the term 'tax shelter' means—

"(A) any enterprise (other than a C corporation) if at any time interests in such enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having the authority to regulate the offering of securities for sale,

"(B) any syndicate (within the meaning of section 1256(e)(3)(B)), and

"(C) any tax shelter (within the meaning of section 6661(b)(2)(C)(ii)).

"(4) SPECIAL RULES FOR FARMING.—In the case of the trade or business of farming (as defined in section 464(e))—

"(A) section 464 shall be applied to any tax shelter described in paragraph (3)(C),

"(B) section 464 shall be applied before this subsection, and

"(C) in determining whether an entity is a tax shelter, the definition of farming syndicate in section 464(c) shall be substituted for subparagraphs (A) and (B) of paragraph (3).

"(5) ECONOMIC PERFORMANCE.—For purposes of this subsection, the term 'economic performance' has the meaning given such term by subsection (h)."

(b) SPECIAL RULES FOR MINING AND SOLID WASTE RECLAMATION AND CLOSING COSTS.—

(1) IN GENERAL.—Subpart C of part II of subchapter E of chapter 1 (relating to taxable year for which deduction taken), as amended by section 92, is amended by adding at the end thereof the following new section:

"SEC. 468. SPECIAL RULES FOR MINING AND SOLID WASTE RECLAMATION AND CLOSING COSTS.

"(a) ESTABLISHMENT OF RESERVES FOR RECLAMATION AND CLOSING COSTS.—

"(1) ALLOWANCE OF DEDUCTION.—If a taxpayer elects the application of this subsection with respect to any mining or solid waste disposal property, the amount of any deduction for qualified reclamation or closing costs for any taxable year to which such election applies shall be equal to the current reclamation or closing costs allocable to—

"(A) in the case of qualified reclamation costs, the portion of the reserve property which was disturbed during such taxable year, and

"(B) in the case of qualified closing costs, the production from the reserve property during such taxable year.

"(2) OPENING BALANCE AND ADJUSTMENTS TO RESERVE.—

"(A) OPENING BALANCE.—The opening balance of any reserve for its first taxable year shall be zero.

"(B) INCREASE FOR INTEREST.—

"(i) IN GENERAL.—A reserve shall be increased each taxable year by an amount equal to the amount of interest which would be earned during such taxable year

on the opening balance of such reserve for such taxable year if such interest were computed—

"(I) at the Federal short-term rate or rates (determined under section 1274) in effect, and

"(II) by compounding semiannually.

"(ii) PHASE-IN OF INTEREST RATE.—In the case of taxable years ending before 1987, the rate determined under clause (i)(I) shall be equal to the following percentage of such rate (determined without regard to this clause):

"In the case of taxable years ending in:	*The percentage is:*
1984 or 1985	*70*
1986	*85.*

"(C) RESERVE TO BE CHARGED FOR AMOUNTS PAID.— Any amount paid by the taxpayer during any taxable year for qualified reclamation or closing costs allocable to portions of the reserve property for which the election under paragraph (1) was in effect shall be charged to the appropriate reserve as of the close of the taxable year.

"(3) ALLOWANCE OF DEDUCTION FOR EXCESS AMOUNTS PAID.— There shall be allowed as a deduction for any taxable year the excess of—

"(A) the amounts described in paragraph (2)(C) paid during such taxable year, over

"(B) the closing balance of the reserve for such taxable year (determined without regard to paragraph (2)(C)).

"(4) LIMITATION ON BALANCE AS OF THE CLOSE OF ANY TAXABLE YEAR.—

"(A) RECLAMATION RESERVES.—In the case of any reserve for qualified reclamation costs, there shall be included in gross income for any taxable year an amount equal to the excess of—

"(i) the closing balance of the reserve for such taxable year, over

"(ii) the current reclamation costs of the taxpayer for all portions of the reserve property disturbed during any taxable year to which the election under paragraph (1) applies.

"(B) CLOSING COSTS RESERVES.—In the case of any reserve for qualified closing costs, there shall be included in gross income for any taxable year an amount equal to the excess of—

"(i) the closing balance of the reserve for such taxable year, over

"(ii) the current closing cost of the taxpayer with respect to the reserve property, determined as if all production with respect to the reserve property for any taxable year to which the election under paragraph (1) applies had occurred in such taxable year.

"(c) ORDER OF APPLICATION.—This paragraph shall be applied after all adjustments to the reserve have been made for the taxable year.

"(5) INCOME INCLUSIONS ON COMPLETION OR DISPOSITION.— Proper inclusion in income shall be made upon—

"(A) the revocation of an election under paragraph (1), or

"(B) completion of the closing, or disposition of any portion, of a reserve property.

"(b) ALLOCATION FOR PROPERTY WHERE ELECTION NOT IN EFFECT FOR ALL TAXABLE YEARS.—If the election under subsection (a)(1) is not in effect for 1 or more taxable years in which the reserved property is disturbed (or production occurs), items with respect to the reserve property shall be allocated to the reserve in such manner as the Secretary may prescribe by regulations.

"(c) REVOCATION OF ELECTION; SEPARATE RESERVES.—

"(1) REVOCATION OF ELECTION.—

"(A) IN GENERAL.—The taxpayer may revoke an election under subsection (a)(1) with respect to any property. Such revocation, once made, shall be irrevocable.

"(B) TIME AND MANNER OF REVOCATION.—Any revocation under subparagraph (A) shall be made at such time and in such manner as the Secretary may prescribe.

"(2) SEPARATE RESERVES REQUIRED.—If a taxpayer makes an election under subsection (a)(1), the taxpayer shall establish with respect to the property for which the election was made—

"(A) a separate reserve for qualified reclamation costs, and

"(B) a separate reserve for qualified closing costs.

"(d) DEFINITIONS AND SPECIAL RULES RELATING TO RECLAMATION AND CLOSING COSTS.—For purposes of this section—

"(1) CURRENT RECLAMATION AND CLOSING COSTS.—

"(A) CURRENT RECLAMATION COSTS.—The term 'current reclamation costs' means the amount which the taxpayer would be required to pay for qualified reclamation costs if the reclamation activities were performed currently.

"(B) CURRENT CLOSING COSTS.—

"(i) IN GENERAL.—The term 'current closing costs' means the amount which the taxpayer would be required to pay for qualified closing costs if the closing activities were performed currently.

"(ii) COSTS COMPUTED ON UNIT-OF-PRODUCTION OR CAPACITY METHOD.—Estimated closing costs shall—

"(I) in the case of the closing of any mine site, be computed on the unit-of-production method of accounting, and

"(II) in the case of the closing of any solid waste disposal site, be computed on the unit-of-capacity method.

"(2) QUALIFIED RECLAMATION OR CLOSING COSTS.—The term 'qualified reclamation or closing costs' means any of the following expenses:

"(A) MINING RECLAMATION AND CLOSING COSTS.—Any expenses incurred for any land reclamation or closing activity which is conducted in accordance with a reclamation plan (including an amendment or modification thereof)—

"(i) which—

"(I) is submitted pursuant to the provisions of section 511 or 528 of the Surface Mining Control *and Reclamation Act of 1977 (as in effect on January 1, 1984), and*

"(II) is part of a surface mining and reclamation permit granted under the provisions of title V of such Act (as so in effect), or

"(ii) which is submitted pursuant to any other Federal or State law which imposes surface mining reclamation and permit requirements substantially similar to the requirements imposed by title V of such Act (as so in effect).

"(B) SOLID WASTE DISPOSAL AND CLOSING COSTS.—

"(i) IN GENERAL.—Any expenses incurred for any land reclamation or closing activity in connection with any solid waste disposal site which is conducted in accordance with any permit issued pursuant to—

"(I) any provision of the Solid Waste Disposal Act (as in effect on January 1, 1984) requiring such activity, or

"(II) any other Federal, State, or local law which imposes requirements substantially similar to the requirements imposed by the Solid Waste Disposal Act (as so in effect).

"(ii) EXCEPTION FOR CERTAIN HAZARDOUS WASTE SITES.—Clause (i) shall not apply to that portion of any property which is disturbed after the property is listed in the national contingency plan established under section 105 of the Comprehensive Environmental, Compensation, and Liability Act of 1980.

"(3) PROPERTY.—The term 'property' has the meaning given such term by section 614.

"(4) RESERVE PROPERTY.—The term 'reserve property' means any property with respect to which a reserve is established under subsection (a)(1)."

(2) CONFORMING AMENDMENT.—The table of sections for subpart C of part II of subchapter E of Chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 468. Special rules for mining and solid waste reclamation and closing costs."

(c) SPECIAL RULE FOR LIABILITIES IN CONNECTION WITH THE DECOMMISSIONING OF A NUCLEAR POWERPLANT.—

(1) IN GENERAL.—Subpart C of part II of subchapter E of chapter 1 (relating to taxable year for which deduction taken), as amended by subsection (b), is amended by adding at the end thereof the following new section:

"SEC. 468A. SPECIAL RULES FOR NUCLEAR DECOMMISSIONING COSTS.

"(a) IN GENERAL.—If the taxpayer elects the application of this subsection, there shall be allowed as a deduction for any taxable year the amount of payments made by the taxpayer to a Nuclear Decommissioning Reserve Fund (hereinafter referred to as the 'Fund') during such taxable year.

"(b) LIMITATION ON AMOUNTS PAID INTO FUND.—The amount which a taxpayer may pay into the Fund for any taxable year shall not exceed the lesser of—

"(1) the amount of nuclear decommissioning costs allocable to the Fund which is included in the taxpayer's cost of service for ratemaking purposes for such taxable year, or

"(2) the ruling amount applicable to such taxable year.

"(c) INCOME AND DEDUCTIONS OF THE TAXPAYER.—

"(1) INCLUSION OF AMOUNTS DISTRIBUTED.—There shall be includible in the gross income of the taxpayer for any taxable year—

"(A) any amount distributed from the Fund during such taxable year, other than any amount distributed to pay costs described in subsection (e)(2)(B), and

"(B) except to the extent provided in regulations, amounts properly includible in gross income in the case of any deemed distribution under subsection (e)(6), any termination under subsection (e)(7), or the disposition of any interest in the nuclear powerplant.

"(2) DEDUCTION WHEN ECONOMIC PERFORMANCE OCCURS.—In addition to any deduction under subsection (a), there shall be allowable as a deduction for any taxable year the amount of the nuclear decommissioning costs with respect to which economic performance (within the meaning of section 461(h)(2)) occurs during such taxable year.

"(d) RULING AMOUNT.—For purposes of this subsection—

"(1) REQUEST REQUIRED.—No deduction shall be allowed for any payment to the Fund unless the taxpayer requests, and receives, from the Secretary a schedule of ruling amounts.

"(2) RULING AMOUNT.—The term 'ruling amount' means, with respect to any taxable year, the amount which the Secretary determines under paragraph (1) to be necessary to—

"(A) fund that portion of the nuclear decommissioning costs of the taxpayer with respect to the nuclear powerplant which bears the same ratio to the total nuclear decommissioning costs with respect to such nuclear powerplant as the period for which the Fund is in effect bears to the estimated useful life of such nuclear powerplant, and

"(B) prevent any excessive funding of such costs or the funding of such costs at a rate more rapid than level funding, taking into account such discount rates as the Secretary deems appropriate.

"(3) REVIEW OF AMOUNT.—The Secretary shall at least once during the useful life of the nuclear powerplant (or, more frequently, upon the request of the taxpayer) review, and revise if necessary, the schedule of ruling amounts determined under paragraph (1).

"(e) NUCLEAR DECOMMISSIONING TRUST FUND.—

"(1) IN GENERAL.—Each taxpayer who elects the application of this subsection shall establish a Nuclear Decommissioning Trust Fund with respect to each nuclear powerplant to which such election applies.

"(2) TAXATION OF FUND.—There is imposed on the gross income of the Fund for any taxable year a tax at a rate equal to the maximum rate in effect under section 11(b), except that—

"(A) there shall not be included in the gross income of the Fund any payment to the Fund with respect to which a deduction is allowable under subsection (a), and

"(B) there shall be allowed as a deduction any amount paid by the Fund described in paragraph (4)(B) (other than to the taxpayer).

"(3) CONTRIBUTIONS TO FUND.—The Fund shall not accept any payments (or other amounts) other than payments with respect to which a deduction is allowable under subsection (a).

"(4) USE OF FUND.—The Fund shall be used exclusively for—

"(A) satisfying, in whole or in part, any liability of any person contributing to the Fund for the decommissioning of a nuclear powerplant (or unit thereof), and

"(B) to pay administrative costs (including taxes) and other incidental expenses of the Fund (including legal, accounting, actuarial, and trustee expenses) in connection with the operation of the Fund.

"(5) PROHIBITIONS AGAINST SELF-DEALING.—Under regulations prescribed by the Secretary, for purposes of section 4951 (and so much of this title as relates to such section), the Fund shall be treated in the same manner as a trust described in section 501(c)(21).

"(6) DISQUALIFICATION OF FUND.—In any case in which the Fund violates any provision of this subsection or section 4951, the Secretary may disqualify such Fund from the application of this subsection. In any case to which this subparagraph applies, the Fund shall be treated as having distributed all of its funds on the date such determination takes effect.

"(7) TERMINATION UPON COMPLETION.—Upon substantial completion of the nuclear decommissioning of the nuclear powerplant with respect to which a Fund relates, the taxpayer shall terminate such Fund.

"(f) NUCLEAR POWERPLANT.—The term 'nuclear powerplant' includes any unit thereof."

(2) CONFORMING AMENDMENT.—The table of sections for subpart C of part II of subchapter E of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 468A. Special rules for nuclear decommissioning costs."

(d) 10-YEAR NET OPERATING LOSS CARRYBACK PERIOD FOR DEFERRED STATUTORY OR TORT LIABILITY DEDUCTIONS.—

(1) IN GENERAL.—Paragraph (1) of section 172(b) (relating to years to which loss may be carried) is amended by adding at the end thereof the following new subparagraph:

"(K) SPECIAL RULE FOR DEFERRED STATUTORY OR TORT LIABILITY LOSSES.—In the case of a taxpayer which has a deferred statutory or tort liability loss (as defined in subsection (k)) for any taxable year beginning after December 31, 1983, the deferred statutory or tort liability loss shall be a net operating loss carryback to each of the 10 taxable years preceding the taxable year of such loss."

(2) DEFERRED STATUTORY OR TORT LIABILITY LOSSES.—Section 172 is amended by redesignating subsection (k) as subsection (l) and by inserting after subsection (j) the following new subsection:

"(k) DEFINITIONS AND SPECIAL RULES RELATING TO DEFERRED STATUTORY OR TORT LIABILITY LOSSES.—For purposes of this section—

"(1) DEFERRED STATUTORY OR TORT LIABILITY LOSS.—The term 'deferred statutory or tort liability loss' means, for any taxable year, the lesser of—

"(A) the net operating loss for such taxable year, reduced by any portion thereof attributable to—

"(i) a foreign expropriation loss, or

"(ii) a product liability loss, or

"(B) the sum of the amounts allowable as a deduction under this chapter (other than any deduction described in subsection (j)(1)(B)) which—

"(i) is taken into account in computing the net operating loss for such taxable year, and

"(ii) is for an amount incurred with respect to a liability which arises under a Federal or State law or out of any tort of the taxpayer and—

"(I) in the case of a liability arising out of a Federal or State law, the act (or failure to act) giving rise to such liability occurs at least 3 years before the beginning of such taxable year, or

"(II) in the case of a liability arising out of a tort, such liability arises out of a series of actions (or failures to act) over an extended period of time a substantial portion of which occurs at least 3 years before the beginning of such taxable year.

A liability shall not be taken into account under the preceding sentence unless the taxpayer used an accrual method of accounting throughout the period or periods during which the acts or failures to act giving rise to such liability occurred.

"(2) SPECIAL RULE FOR NUCLEAR POWERPLANTS.—Except as provided in regulations prescribed by the Secretary, that portion of a deferred statutory or tort liability loss which is attributable to amounts incurred in the decommissioning of a nuclear powerplant (or any unit thereof) may, for purposes of subsection (b)(1)(K), be carried back to each of the taxable years during the period—

"(A) beginning with the taxable year in which such plant (or unit thereof) was placed in service, and

"(B) ending with the taxable year preceding the loss year.

"(3) COORDINATION WITH SUBSECTION (b)(2).—In applying paragraph (2) of subsection (b), a deferred statutory or tort liability loss shall be treated in a manner similar to the manner in which a foreign expropriation loss is treated.

"(4) NO CARRYBACK TO TAXABLE YEARS BEGINNING BEFORE JANUARY 1, 1984.—No deferred statutory or tort liability loss may be carried back to a taxable year beginning before January 1, 1984, unless such loss may be carried back to such year without regard to subsection (b)(1)(K)."

(3) CONFORMING AMENDMENTS.—

(A) Clause (i) of section 172(b)(1)(A) is amended by striking out "and (J)" and inserting in lieu thereof "(J), and (K)".

(B) Subsections (h) and (j) of section 172 are each amended by striking out "subsection (b)" in the matter preceding paragraph (1) and inserting in lieu thereof "this section".

(e) CONFORMING AMENDMENT.—Paragraph (4) of section 461(f) (relating to contested liabilities) is amended by inserting "determined after application of subsection (h)" after "taxable year)".

(f) INCLUSION IN INCOME OF NUCLEAR DECOMMISSIONING COSTS INCLUDED IN THE TAXPAYER'S RATE BASE.—

(1) IN GENERAL.—Part II of subchapter B of chapter 1 (relating to items specifically included in gross income) is amended by adding at the end thereof the following new section:

"SEC. 88. CERTAIN AMOUNTS WITH RESPECT TO NUCLEAR DECOMMISSIONING COSTS.

"In the case of any taxpayer who is required to include the amount of any nuclear decommissioning costs in the taxpayer's cost of service of ratemaking purposes, there shall be includible in the gross income of such taxpayer the amount so included for any taxable year."

(2) CONFORMING AMENDMENT.—The table of sections for part II of subchapter B of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 88. Certain amounts with respect to nuclear decommissioning costs."

(g) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in this subsection and subsections (h) and (i), the amendments made by this section shall apply to amounts—

(A) incurred after the date of the enactment of this Act (determined without regard to such amendments), or

(B) which—

(i) are incurred before the date of the enactment of this Act (determined without regard to such amendments), and

(ii) are incurred after the date of the enactment of this Act (determined with regard to such amendments).

(2) ELECTION TREATED AS CHANGE IN METHOD OF ACCOUNTING.—For purposes of section 481 of the Internal Revenue Code of 1954, if paragraph (1)(B) applies to any amount, the application of the amendments made by this section shall be treated as a change in method of accounting—

(A) initiated by the taxpayer, and

(B) made with the consent of the Secretary of the Treasury.

(3) SECTION 461(h) TO APPLY IN CERTAIN CASES.—Notwithstanding paragraph (1), section 461(h) of the Internal Revenue Code of 1954 (as added by this section) shall be treated as being in effect to the extent necessary to carry out any amendments made by this section which take effect before section 461(h).

(h) EXCEPTION FOR CERTAIN EXISTING ACTIVITIES AND CONTRACTS.—If—

(1) EXISTING ACCOUNTING PRACTICES.—If, on March 1, 1984, any taxpayer was regularly computing his deduction for mining reclamation activities under a current cost method of account-

ing (as determined by the Secretary of the Treasury or his delegate), the liability for reclamation activities—

(A) for land disturbed before the date of the enactment of this Act, or

(B) to which paragraph (2) applies,

shall be treated as having been incurred when the land was disturbed.

(2) FIXED PRICE SUPPLY CONTRACT.—

(A) IN GENERAL.—In the case of any fixed price supply contract entered into before March 1, 1984, the amendments made by subsection (b) shall not apply to any minerals extracted from such property which are sold pursuant to such contract.

(B) NO EXTENSION OR RENEGOTIATION.—Subparagraph (A) shall not apply—

(i) to any extension of any contract beyond the period such contract was in effect on March 1, 1984, or

(ii) to any renegotiation of, or other change in, the terms and conditions of such contract in effect on March 1, 1984.

(i) TRANSITIONAL RULE FOR ACCRUED VACATION PAY.—

(1) IN GENERAL.—In the case of any taxpayer—

(A) with respect to whom a deduction was allowable (other than under section 463 of the Internal Revenue Code of 1954) for vested accrued vacation pay for the last taxable year ending before the date of the enactment of this Act, and

(B) who elects the application of section 463 of such Code for the first taxable year ending after the date of the enactment of this Act,

then, for purposes of section 463(b) of such Code, the opening balance of the taxpayer with respect to any vested accrued vacation pay shall be determined under section 463(b)(1) of such Code.

(2) VESTED ACCRUED VACATION PAY.—For purposes of this subsection, the term "vested accrued vacation pay" means any amount allowable under section 162(a) of such Code with respect to vacation pay of employees of the taxpayer (determined without regard to section 463 of such Code).

SEC. 92. TREATMENT OF CERTAIN DEFERRED PAYMENTS FOR USE OF PROPERTY OR SERVICES.

(a) GENERAL RULE.—Subpart C of part II of subchapter E of chapter 1 (relating to taxable year for which deduction is taken) is amended by adding at the end thereof the following new section:

"SEC. 467. CERTAIN PAYMENTS FOR THE USE OF PROPERTY OR SERVICES.

"(a) ACCRUAL METHOD ON PRESENT VALUE BASIS.—In the case of the lessor or lessee under any section 467 rental agreement, there shall be taken into account for purposes of this title for any taxable year the sum of—

"(1) the amount of the rent which accrues during such taxable year as determined under subsection (b), and

"(2) interest for the year on the amounts which were taken into account under this subsection for prior taxable years and which are unpaid.

"(b) ACCRUAL OF RENTAL PAYMENTS.—

"(1) ALLOCATION FOLLOWS AGREEMENT.—Except as provided in paragraph (2), the determination of the amount of the rent under any section 467 rental agreement which accrues during any taxable year shall be made—

"(A) by allocating rents in accordance with the agreement, and

"(B) by taking into account any rent to be paid after the close of the period in an amount determined under regulations which shall be based on present value concepts.

"(2) CONSTANT RENTAL ACCRUAL IN CASE OF CERTAIN TAX AVOIDANCE TRANSACTIONS, ETC.—In the case of any section 467 rental agreement to which this paragraph applies, the portion of the rent which accrues during any taxable year shall be that portion of the constant rental amount with respect to such agreement which is allocable to such taxable year.

"(3) AGREEMENTS TO WHICH PARAGRAPH (2) APPLIES.—Paragraph (2) applies to any rental payment agreement if—

"(A) such agreement is a disqualified leaseback or long-term agreement, or

"(B) such agreement does not provide for the allocation referred to in paragraph (1)(A).

"(4) DISQUALIFIED LEASEBACK OR LONG-TERM AGREEMENT.—For purposes of this subsection, the term 'disqualified leaseback or long-term agreement' means any section 467 rental agreement if—

"(A) such agreement is part of a leaseback transaction or such agreement is for a term in excess of 75 percent of the statutory recover period for the property, and

"(B) a principal purpose for providing increasing rents under the agreement is the avoidance of tax imposed by this subtitle.

"(5) EXCEPTIONS TO DISQUALIFICATION IN CERTAIN CASES.—The Secretary shall prescribe regulations setting forth circumstances under which agreements will not be treated as disqualified leaseback or long-term agreements, including circumstances relating to—

"(A) changes in amounts paid determined by reference to price indices,

"(B) rents based on a fixed percentage of lessee receipts or similar amounts,

"(C) reasonable rent holidays, or

"(D) changes in amounts paid to unrelated 3rd parties.

"(c) RECAPTURE OF PRIOR UNDERSTATED INCLUSIONS UNDER LEASEBACK OR LONG-TERM AGREEMENTS.—

"(1) IN GENERAL.—If—

"(A) the lessor under any section 467 rental agreement disposes of any property subject to such agreement during the term of such agreement, and

"(B) such agreement is a leaseback or long-term agreement to which paragraph (2) of subsection (b) did not apply,

the recapture amount shall be treated as ordinary income. Such gain shall be recognized notwithstanding any other provision of this subtitle.

"(2) RECAPTURE AMOUNT. —For purposes of paragraph (1), the term 'recapture amount' means the lesser of—

"(A) the prior understated inclusions, or

"(B) the excess of the amount realized (or in the case of a disposition other than a sale, exchange, or involuntary conversion, the fair market value of the property) over the adjusted basis of such property.

The amount determined under subparagraph (B) shall be reduced by the amount of any gain treated as ordinary income on the disposition under any other provision of this subtitle.

"(3) PRIOR UNDERSTATED INCLUSIONS.—For purposes of this subsection, the term 'prior understated inclusion' means the excess (if any) of—

"(A) the amount which would have been taken into account by the lessor under subsection (a) for periods before the disposition if subsection (b)(2) had applied to the agreement, over

"(B) the amount taken into account under subsection (a) by the lessor for periods before the disposition.

"(4) LEASEBACK OR LONG-TERM AGREEMENT.—For purposes of this subsection, the term 'leaseback or long-term agreement' means any agreement described in subsection (b)(3)(A).

"(5) SPECIAL RULES.—Under regulations prescribed by the Secretary—

"(A) exceptions similar to the exceptions applicable under section 1245 or 1250 (whichever is appropriate) shall apply for purposes of this subsection,

"(B) any transferee in a disposition excepted by reason of subparagraph (A) who has a transferred basis in the property shall be treated in the same manner as the transferor, and

"(C) for purposes of sections 163(d), 170(e), 341(e)(12), 453B(d)(2), and 751(c), amounts treated as ordinary income under this section shall be treated in the same manner as amounts treated as ordinary income under section 1245 or 1250.

"(d) SECTION 467 RENTAL AGREEMENTS.—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, the term 'section 467 rental agreements' means any rental agreement for the use of tangible property under which—

"(A) there is at least one amount allocable to the use of property during a calendar year which is to be paid after the close of the calendar year following the calendar year in which such use occurs, or

"(B) there are increases in the amount to be paid as rent under the agreement.

"(2) SECTION NOT TO APPLY TO AGREEMENTS INVOLVING PAYMENTS OF $250,000 OR LESS.—This section shall not apply to any amount to be paid for the use of property if the sum of the following amounts does not exceed $250,000—

"(A) the aggregate amount of payments received as consideration for such use of property, and

"(B) the aggregate value of any other consideration to be received for such use of property.

For purposes of the preceding sentence, rules similar to the rules of clauses (ii) and (iii) of section 1274(c)(2)(C) shall apply.

"(e) DEFINITIONS.—For purposes of this section—

"(1) CONSTANT RENTAL AMOUNT.—The term 'constant rental amount' means, with respect to any section 467 rental agreement, the amount which, if paid as of the close of each lease period under the agreement, would result in an aggregate present value equal to the present value of the aggregate payments required under the agreement.

"(2) LEASEBACK TRANSACTION.—A transaction is a leaseback transaction if it involves a leaseback to any person who had an interest in such property at any time within 2 years before such leaseback (or to a related person).

"(3) STATUTORY RECOVERY PERIOD.—

"(A) IN GENERAL.—

"In the case of property which is:	*The statutory recovery period is:*
3-year property	*3 years*
5-year property	*5 years*
10-year property	*10 years*
15-year public utility property	*15 years*
18-year real property	*18 years.*

"(B) SPECIAL RULE FOR PROPERTY WHICH IS NOT RECOVERY PROPERTY.—In the case of any property which is not recovery property, subparagraph (A) shall be applied as if such property were recovery property.

"(4) DISCOUNT AND INTEREST RATE.—For purposes of computing present value and interest under subsection (a)(2), the rate used shall be equal to 110 percent of the applicable Federal rate determined under section 1274(d) (compounded semiannually) which is in effect at the time the agreement is entered into with respect to debt instruments having a maturity equal to the term of the agreement.

"(5) RELATED PERSON.—The term 'related person' has the meaning given to such term by section 168(d)(4)(D).

"(6) CERTAIN OPTIONS OF LESSEE TO RENEW NOT TAKEN INTO ACCOUNT.—Except as provided in regulations prescribed by the Secretary, there shall not be taken into account in computing the term of any agreement for purposes of this section any extension which is solely at the option of the lessee.

"(f) COMPARABLE RULES WHERE AGREEMENT FOR DECREASING PAYMENTS.—Under regulations prescribed by the Secretary, rules comparable to the rules of this section shall also apply in the case of any agreement where the amount paid under the agreement for the use of property decreases during the term of the agreement.

"(g) COMPARABLE RULES FOR SERVICES.—Under regulations prescribed by the Secretary, rules comparable to the rules of subsection (a)(2) shall also apply in the case of payments for services which meet requirements comparable to the requirements of subsection (d).

"(h) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this section,

including regulations providing for the application of this section in the case of contingent payments."

(b) CLERICAL AMENDMENT.—The table of sections for subpart C of part II of subchapter E of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 467. Certain payments for use of property or services."

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply with respect to agreements entered into after June 8, 1984.

(2) EXCEPTIONS.—The amendments made by this section shall not apply—

(A) to any agreement entered into pursuant to a written agreement which was binding on June 8, 1984, and at all times thereafter,

(B) subject to the provisions of paragraph (3), to any agreement to lease property if—

10 (i) there was in effect a firm plan, evidenced by a
25 board of directors' resolution, memorandum of agree-
45 ment, or letter of intent on March 15, 1984, to enter
70 into such an agreement, and
100.

(ii) construction of the property was commenced (but such property was not placed in service) on or before March 15, 1984, and

(C) to any agreement to lease property if—

(i) the lessee of such property adopted a firm plan to lease the property, evidenced by a resolution of the Finance Committee of the Board of Directors of such lessee, on February 10, 1984,

(ii) the sum of the present values of the rents payable by the lessee under the lease at the inception thereof equals at least $91,223,034, assuming—

(I) the annual discount rate is 12.6 percent,

(II) the initial payment of rent occurs 12 months after the commencement of the lease, and

(III) subsequent payments of rents occur on the anniversary date of the initial payment, and

(iii) during—

(I) the first 5 years of the lease, at least 9 percent of the rents payable by the lessee under the agreement are paid, and

(II) the second 5 years of the lease, at least 16.25 percent of the rents payable by the lessee under the agreement are paid.

Paragraph (3)(B)(ii)(II) shall apply for purposes of clauses (ii) and (iii) of subparagraph (C), except that each separate agreement shall be treated as relating to all property placed in service before the property to which the agreement relates. If the lessor under the agreement described in subparagraph (C) leases the property from another person, this exception shall also apply to any agreement between the lessor and such *person which is integrally related to, and contains essentially the same terms as, such agreement.*

(3) SCHEDULE OF DEEMED RENTAL PAYMENTS.—

(A) IN GENERAL.—In any case to which paragraph (2)(B) applies, for purposes of the Internal Revenue Code of 1954, the lessor shall be treated as having received or accrued (and the lessee shall be treated as having paid or incurred) rents equal to the greater of—

(i) the amount of rents actually paid under the agreement during the taxable year, or

(ii) the amount of rents determined in accordance with the schedule under subparagraph (B) for such taxable year.

(B) SCHEDULE.—

(i) IN GENERAL.—The schedule under this subparagraph is as follows:

Portion of lease term:	*Cumulative percentage of total rent deemed paid:*
1st 1/5	*10*
2nd 1/5	*25*
3rd 1/5	*45*
4th 1/5	*70*
Last 1/5	*100.*

(ii) OPERATING RULES.—For purposes of this schedule—

(I) the rent allocable to each taxable year within any portion of a lease term described in such schedule shall be a level pro rata amount properly allocable to such taxable year, and

(II) any agreement relating to property which is to be placed in service in 2 or more stages shall be treated as 2 or more separate agreements.

(C) PARAGRAPH NOT TO APPLY.—This paragraph shall not apply to any agreement if the sum of the present values of all payments under the agreement is greater than the sum of the present value of all the payments deemed to be paid or received under the schedule under subparagraph (B). For purposes of computing any present value under this subparagraph, the annual discount rate shall be equal to 12 percent, compounded semiannually

SEC. 93. AMORTIZATION OF CONSTRUCTION PERIOD INTEREST AND TAXES FOR RESIDENTIAL REAL PROPERTY HELD BY CORPORATIONS.

(a) IN GENERAL.—Subsection (d) of section 189 (relating to amortization of real property construction period interest and taxes) is amended—

(1) by striking out paragraph (2), and

(2) by redesignating paragraph (3) as paragraph (2).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1984, with respect to construction beginning after March 15, 1984.

SEC. 94. CAPITALIZATION OF START-UP EXPENDITURES.

(a) IN GENERAL.—Section 195 (relating to start-up expenditures) is amended to read as follows:

"SEC. 195. START-UP EXPENDITURES.

"(a) CAPITALIZATION OF EXPENDITURES.—Except as otherwise provided in this section, no deduction shall be allowed for start-up expenditures.

"(b) ELECTION TO AMORTIZE.—

"(1) IN GENERAL.—Start-up expenditures may, at the election of the taxpayer, be treated as deferred expenses. Such deferred expenses shall be allowed as a deduction prorated equally over such period of not less than 60 months as may be selected by the taxpayer (beginning with the month in which the active trade or business begins).

"(2) DISPOSITIONS BEFORE CLOSE OF AMORTIZATION PERIOD.—In any case in which a trade or business is completely disposed of by the taxpayer before the end of the period to which paragraph (1) applies, any deferred expenses which were not allowed as a deduction by reason of this section may be deducted to the extent allowable under section 165.

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

"(1) START-UP EXPENDITURES.—The term 'start-up expenditure' means any amount—

"(A) paid or incurred in connection with—

"(i) investigating the creation or acquisition of an active trade or business, or

"(ii) creating an active trade or business, or

"(iii) any activity engaged in for profit and for the production of income before the day on which the active trade or business begins, in anticipation of such activity becoming an active trade or business, and

"(B) which, if paid or incurred in connection with the operation of an existing active trade or business (in the same field as the trade or business referred to in subparagraph (A)), would be allowable as a deduction for the taxable year in which paid or incurred.

The term 'start-up expenditure' does not include any amount with respect to which a deduction is allowable under section 163(a), 164, or 174.

"(2) BEGINNING OF TRADE OR BUSINESS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the determination of when an active trade or business begins shall be made in accordance with such regulations as the Secretary may prescribe.

"(B) ACQUIRED TRADE OR BUSINESS.—An acquired active trade or business shall be treated as beginning when the taxpayer acquires it.

"(d) ELECTION.—

"(1) TIME FOR MAKING ELECTION.—An election under subsection (b) shall be made not later than the time prescribed by law for filing the return for the taxable year in which the trade or business begins (including extensions thereof).

"(2) SCOPE OF ELECTION.—The period selected under subsection (b) shall be adhered to in computing taxable income for the taxable year for which the election is made and all subsequent taxable years."

35-426 O 84 - 9

(b) CONFORMING AMENDMENT.—*The table of sections for part VI of subchapter B of chapter 1 is amended by striking out the item relating to section 195 and inserting in lieu thereof the following:*

"Sec. 195. Start-up expenditures."

(c) EFFECTIVE DATE.—*The amendments made by this section shall apply to taxable years beginning after June 30, 1984.*

SEC. 95. LIFO CONFORMITY RULES APPLIED ON CONTROLLED GROUP BASIS.

(a) GENERAL RULE.—*Section 472 (relating to last-in, first-out inventories) is amended by adding at the end thereof the following new subsection:*

"(g) CONFORMITY RULES APPLIED ON CONTROLLED GROUP BASIS.——

"(1) IN GENERAL.—*Except as otherwise provided in regulations, all members of the same group of financially related corporations shall be treated as 1 taxpayer for purposes of subsections (c) and (e)(2).*

"(2) GROUP OF FINANCIALLY RELATED CORPORATIONS.—*For purposes of paragraph (1), the term 'group of financially related corporations' means——*

"(A) any affiliated group as defined in section 1504 determined by substituting '50 percent' for '80 percent' each place it appears in section 1504(a) and without regard to section 1504(b), and

"(B) any other group of corporations which consolidate or combine for purposes of financial statements."

(b) EFFECTIVE DATE.—*The amendment made by subsection (a) shall apply to taxable years beginning after the date of the enactment of this Act.*

Subtitle H—Provisions Relating to Tax Straddles

SEC. 101. REPEAL OF EXCEPTION FROM STRADDLE RULES FOR STOCK OPTIONS AND CERTAIN STOCK.

(a) REPEAL OF EXCEPTION FOR STOCK OPTIONS.—

(1) IN GENERAL.—*Paragraph (2) of section 1092(d) (defining position) is amended to read as follows:*

"(2) POSITION.—*The term 'position' means an interest (including a futures or forward contract or option) in personal property."*

(2) SECTIONS 1092 AND 263(g) NOT TO APPLY TO STRADDLES CONSISTING OF QUALIFIED COVERED CALL OPTIONS AND THE OPTIONED STOCK.—*Subsection (c) of section 1092 (defining straddle) is amended by adding at the end thereof the following new paragraph:*

"(4) EXCEPTION FOR CERTAIN STRADDLES CONSISTING OF QUALIFIED COVERED CALL OPTIONS AND THE OPTIONED STOCK.—

"(A) IN GENERAL.—*If—*

"(i) all the offsetting positions making up any straddle consist of 1 or more qualified covered call options and the stock to be purchased from the taxpayer under such options, and

"(ii) such straddle is not part of a larger straddle, such straddle shall not be treated as a straddle for purposes of this section and section 263(g).

"(B) QUALIFIED COVERED CALL OPTION DEFINED.—For purposes of subparagraph (A), the term 'qualified covered call option' means any option granted by the taxpayer to purchase stock held by the taxpayer (or stock acquired by the taxpayer in connection with the granting of the option) but only if—

"(i) such option is traded on a national securities exchange which is registered with the Securities and Exchange Commission or other market which the Secretary determines has rules adequate to carry out the purposes of this paragraph,

"(ii) such option is granted more than 30 days before the day on which the option expires,

"(iii) such option is not a deep-in-the-money option,

"(iv) such option is not granted by an options dealer (within the meaning of section 1256(g)(8)) in connection with his activity of dealing in options, and

"(v) gain or loss with respect to such option is not ordinary income or loss.

"(C) DEEP-IN-THE-MONEY OPTION.—For purposes of subparagraph (B), the term 'deep-in-the-money option' means an option having a strike price lower than the lowest qualified bench mark.

"(D) LOWEST QUALIFIED BENCH MARK.—

"(i) IN GENERAL.—Except as otherwise provided in this subparagraph, for purposes of subparagraph (C), the term 'lowest qualified bench mark' means the highest available strike price which is less than the applicable stock price.

"(ii) SPECIAL RULE WHERE OPTION IS FOR PERIOD MORE THAN 90 DAYS AND STRIKE PRICE EXCEEDS $50.—In the case of an option—

"(I) which is granted more than 90 days before the date on which such option expires, and

"(II) with respect to which the strike price is more than $50,

the lowest qualified bench mark is the second highest available strike price which is less than the applicable stock price.

"(iii) 85 PERCENT RULE WHERE APPLICABLE STOCK PRICE $25 OR LESS.—If—

"(I) the applicable stock price is $25 or less, and

"(II) but for this clause, the lowest qualified bench mark would be less than 85 percent of the applicable stock price,

the lowest qualified bench mark shall be treated as equal to 85 percent of the applicable stock price.

"(iv) LIMITATION WHERE APPLICABLE STOCK PRICE $150 OR LESS.—If—

"(I) the applicable stock price is $150 or less, and

"(II) but for this clause, the lowest qualified bench mark would be less than the applicable stock price reduced by $10,

the lowest qualified bench mark shall be treated as equal to the applicable stock price reduced by $10.

"(E) SPECIAL YEAR-END RULE.—Subparagraph (A) shall not apply to any straddle for purposes of section 1092(a) if—

"(i) the qualified covered call options referred to in such subparagraph are closed during any taxable year,

"(ii) gain on disposition of the stock to be purchased from the taxpayer under such options is includible in gross income for a later taxable year, and

"(iii) such stock was not held by the taxpayer for 30 days or more after the closing of such options.

For purposes of the preceding sentence, the rules of paragraphs (3) (other than subparagraph (B) thereof) and (4) of section 246(c) shall apply in determining the period for which the taxpayer holds the stock.

"(F) STRIKE PRICE.—For purposes of this paragraph, the term 'strike price' means the price at which the option is exercisable.

"(G) APPLICABLE STOCK PRICE.—For purposes of subparagraph (D), the term 'applicable stock price' means, with respect to any stock for which an option has been granted—

"(i) the closing price of such stock on the most recent day on which such stock was traded before the date on which such option was granted, or

"(ii) the opening price of such stock on the day on which such option was granted, but only if such price is greater than 110 percent of the price determined under clause (i).

"(H) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph. Such regulations may include modifications to the provisions of this paragraph which are appropriate to take account of changes in the practices of option exchanges or to prevent the use of options for tax avoidance purposes."

(b) REPEAL OF EXCEPTION FOR STOCK.—

(1) IN GENERAL.—Paragraph (1) of section 1092(d) (defining personal property) is amended by striking out "(other than stock)".

(2) EXCEPTION WHERE STRADDLE CONSISTS OF HOLDING STOCK.—Subsection (d) of section 1092 is amended by redesignating paragraphs (3), (4), and (5) as paragraphs (4), (5), and (6), respectively, and by inserting after paragraph (2) the following new paragraph:

"(3) SPECIAL RULES FOR STOCK.—For purposes of paragraph (1)—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'personal property' does not include stock.

"(B) EXCEPTIONS.—The term 'personal property' includes—

"(i) any stock which is part of a straddle at least 1 of the offsetting positions of which is—

"(I) an option with respect to such stock or substantially identical stock or securities, or

"(II) under regulations, a position with respect to substantially similar or related property (other than stock), and

"(ii) any stock of a corporation formed or availed of to take positions in personal property which offset positions taken by any shareholder.

"(C) SPECIAL RULES.—

"(i) For purposes of subparagraph (B), subsection (c) and paragraph (4) shall be applied as if stock described in clause (i) or (ii) of subparagraph (B) were personal property.

"(ii) For purposes of determining whether subsection (e) applies to any transaction with respect to stock described in clause (ii) of subparagraph (B), all includible corporations of an affiliated group (within the meaning of section 1504(a)) shall be treated as 1 taxpayer."

(c) TREATMENT OF GAIN OR LOSS AND SUSPENSION OF HOLDING PERIOD WHERE TAXPAYER GRANTOR OF OPTION TO BUY STOCK.—Section 1092 is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection:

"(f) TREATMENT OF GAIN OR LOSS AND SUSPENSION OF HOLDING PERIOD WHERE TAXPAYER GRANTOR OF QUALIFIED COVERED CALL OPTION.—If a taxpayer holds any stock and grants a qualified covered call option to purchase such stock with a strike price less than the applicable stock price—

"(1) TREATMENT OF LOSS.—Any loss with respect to such option shall be treated as long-term capital loss if, at the time such loss is realized, gain on the sale or exchange of such stock would be treated as long-term capital gain.

"(2) SUSPENSION OF HOLDING PERIOD.—The holding period of such stock shall not include any period during which the taxpayer is the grantor of such option."

(d) TREATMENT OF IDENTIFIED STRADDLES INVOLVING SECTION 1256 CONTRACTS.—Paragraph (4) of subsection (d) of section 1092 is amended to read as follows:

"(4) SPECIAL RULE FOR SECTION 1256 CONTRACTS.—

"(A) GENERAL RULE.—In the case of a straddle at least 1 (but not all) of the positions of which are section 1256 contracts, the provisions of this section shall apply to any section 1256 contract and any other position making up such straddle.

"(B) SPECIAL RULE FOR IDENTIFIED STRADDLES.—For purposes of subsection (a)(2) (relating to identified straddles), subparagraph (A) and section 1256 (a)(4) shall not apply to a straddle all of the offsetting positions of which consist of section 1256 contracts."

(e) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to posi-

tions established after December 31, 1983, in taxable years ending after such date.

(2) SPECIAL RULE FOR OFFSETTING POSITION STOCK.—In the case of any stock of a corporation formed or availed of to take positions in personal property which offset positions taken by any shareholder, the amendments made by this section shall apply to positions established on or after May 23, 1983, in taxable years ending on or after such date.

(3) SUBSECTION (c).—The amendment made by subsection (c) shall apply to positions established after June 30, 1984, in taxable years ending after such date.

(4) SUBSECTION (d).—The amendment made by subsection (d) shall apply to positions established after the date of the enactment of this Act in taxable years ending after such date.

SEC. 102. SECTION 1256 EXTENDED TO CERTAIN OPTIONS.

(a) GENERAL RULE.—

(1) Section 1256 (relating to regulated futures contracts marked to market) is amended—

(A) by striking out "regulated futures contract" each place in appears and inserting in lieu thereof "section 1256 contract", and

(B) by striking out "regulated futures contracts" each place in appears and inserting in lieu thereof "section 1256 contracts".

(2) Subsection (b) of section 1256 is amended to read as follows:

"(b) SECTION 1256 CONTRACT DEFINED.—For purposes of this section, the term 'section 1256 contract' means—

"(1) any regulated futures contract,

"(2) any foreign currency contract,

"(3) any nonequity option, and

"(4) any dealer equity option."

(3) Subsection (g) of section 1256 is amended to read as follows:

"(g) DEFINITIONS.—For purposes of this section—

"(1) REGULATED FUTURES CONTRACTS DEFINED.—The term 'regulated futures contract' means a contract—

"(A) with respect to which the amount required to be deposited and the amount which may be withdrawn depends on a system of marking to market, and

"(B) which is traded on or subject to the rules of a qualified board or exchange.

"(2) FOREIGN CURRENCY CONTRACT DEFINED.—

"(A) FOREIGN CURRENCY CONTRACT.—The term 'foreign currency contract' means a contract—

"(i) which requires delivery of, or the settlement of which depends on the value of, a foreign currency which is a currency in which positions are also traded through regulated futures contracts,

"(ii) which is traded in the interbank market, and

"(iii) which is entered into at arm's length at a price determined by reference to the price in the interbank market.

"(B) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of subparagraph (A), including regulations excluding from the application of subparagraph (A) any contract (or type of contract) if its application thereto would be inconsistent with such purposes.

"(3) NONEQUITY OPTION.—The term 'nonequity option' means any listed option which is not an equity option.

"(4) DEALER EQUITY OPTION.—The term 'dealer equity option' means, with respect to an options dealer, any listed option which—

"(A) is an equity option,

"(B) is purchased or granted by such options dealer in the normal course of his activity of dealing in options, and

"(C) is listed on the national securities exchange on which such options dealer is registered.

"(5) LISTED OPTION.—The term 'listed option' means any option (other than a right to acquire stock from the issuer) which is traded on (or subject to the rules of) a qualified board or exchange.

"(6) EQUITY OPTION.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'equity option' means any option—

"(i) to buy or sell stock, or

"(ii) the value of which is determined directly or indirectly by reference to any stock (or group of stocks) or stock index.

"(B) EXCEPTION FOR CERTAIN OPTIONS REGULATED BY COMMODITIES FUTURES TRADING COMMISSION.—The term 'equity option' does not include any option with respect to any group of stocks or stock index if—

"(i) there is in effect a designation by the Commodities Futures Trading Commission of a contract market for a contract based on such group of stocks or index, or

"(ii) the Secretary determines that such option meets the requirements of law for such a designation.

"(7) QUALIFIED BOARD OR EXCHANGE.—The term 'qualified board or exchange' means—

"(A) a national securities exchange which is registered with the Securities and Exchange Commission,

"(B) a domestic board of trade designated as a contract market by the Commodity Futures Trading Commission, or

"(C) any other exchange, board of trade, or other market which the Secretary determines has rules adequate to carry out the purposes of this section.

"(8) OPTIONS DEALER.—

"(A) IN GENERAL.—The term 'options dealer' means any person registered with an appropriate national securities exchange as a market maker or specialist in listed options.

"(B) PERSONS TRADING IN OTHER MARKETS.—In any case in which the Secretary makes a determination under subparagraph (C) of paragraph (7), the term 'options dealer' also includes any person whom the Secretary determines

performs functions similar to the persons described in subparagraph (A). Such determinations shall be made to the extent appropriate to carry out the purposes of this section.

(b) CAPITAL GAIN TREATMENT FOR TRADERS IN SECTION 1256 CONTRACTS.—Subsection (f) of section 1256 (relating to special rules) is amended by adding at the end thereof the following new paragraphs:

"(4) CAPITAL GAIN TREATMENT FOR TRADERS IN SECTION 1256 CONTRACTS.—

"(A) IN GENERAL.—For purposes of this title, gain or loss from trading of section 1256 contracts shall be treated as gain or loss from the sale or exchange of a capital asset.

"(B) EXCEPTION FOR CERTAIN HEDGING TRANSACTIONS.—Subparagraph (A) shall not apply to any section 1256 contract to the extent such contract is held for purposes of hedging property if any loss with respect to such property in the hands of the taxpayer would be ordinary loss.

"(C) TREATMENT OF UNDERLYING PROPERTY.—For purposes of determining whether gain or loss with respect to any property is ordinary income or loss, the fact that the taxpayer is actively engaged in dealing in or trading section 1256 contracts related to such property shall not be taken into account.

"(5) SPECIAL RULE FOR DEALER EQUITY OPTIONS OF LIMITED PARTNERS OR LIMITED ENTREPRENEURS.—In the case of any gain or loss with respect to dealer equity options which are allocable to limited partners or limited entrepreneurs (within the meaning of subsection (e)(3))—

"(A) paragraph (3) of subsection (a) shall not apply to any such gain or loss, and

"(B) all such gains or losses shall be treated as short-term capital gains or losses, as the case may be."

(c) APPLICATION OF SELF-EMPLOYMENT INCOME TAX TO OPTIONS AND COMMODITIES DEALERS.—

(1) AMENDMENT TO THE INTERNAL REVENUE CODE OF 1954.—Section 1402 (relating to definitions for tax on self-employment income) is amended by adding at the end thereof the following new subsection:

"(i) SPECIAL RULES FOR OPTIONS AND COMMODITIES DEALERS.—

"(1) IN GENERAL.—In determining the net earnings from self-employment of any options dealer or commodities dealer—

"(A) notwithstanding subsection (a)(3)(A), there shall not be excluded any gain or loss (in the normal course of the taxpayer's activity of dealing in or trading section 1256 contracts) from section 1256 contracts or property related to such contracts, and

"(B) the deduction provided by section 1202 shall not apply.

"(2) DEFINITIONS.—For purposes of this subsection—

"(A) OPTIONS DEALER.—The term 'options dealer' has the meaning given such term by section 1256(g)(8).

"(B) COMMODITIES DEALER.—The term 'commodities dealer' means a person who is actively engaged in trading section 1256 contracts and is registered with a domestic

board of trade which is designated as a contract market by the Commodities Futures Trading Commission.

"(C) SECTION 1256 CONTRACTS.—The term 'section 1256 contract' has the meaning given to such term by section 1256(b)."

(2) AMENDMENT TO THE SOCIAL SECURITY ACT.—Section 211 of the Social Security Act is amended by adding at the end thereof the following new subsection:

"(h)(1) In determining the net earnings from self-employment of any options dealer or commodities dealer—

"(A) notwithstanding subsection (a)(3)(A), there shall not be excluded any gain or loss (in the normal course of the taxpayer's activity of dealing in or trading section 1256 contracts) from section 1256 contracts or property related to such contracts, and

"(B) the deduction provided by section 1202 of the Internal Revenue Code of 1954 shall not apply.

"(2) For purposes of this subsection—

"(A) The term 'options dealer' has the meaning given such term by section 1256(g)(8) of such Code.

"(B) The term 'commodities dealer' means a person who is actively engaged in trading section 1256 contracts and is registered with a domestic board of trade which is designated as a contract market by the Commodities Futures Trading Commission.

"(C) The term 'section 1256 contracts' has the meaning given to such term by section 1256(b) of such Code."

(d) TREATMENT UNDER SUBCHAPTER S OF OPTIONS AND COMMODITIES DEALERS.—

(1) TAX IMPOSED ON CERTAIN CAPITAL GAINS NOT TO APPLY.—Subsection (c) of section 1374 (relating to tax imposed on certain capital gains) is amended by adding at the end thereof the following new paragraph:

"(4) TREATMENT OF CERTAIN GAINS OF OPTIONS AND COMMODITIES DEALERS.—

"(A) EXCLUSION OF CERTAIN CAPITAL GAINS.—For purposes of this section, the net capital gain of any options dealer or commodities dealer shall be determined by not taking into account any gain or loss (in the normal course of the taxpayer's activity of dealing in or trading section 1256 contracts) from any section 1256 contract or property related to such a contract.

"(B) DEFINITIONS.—For purposes of this paragraph—

"(i) OPTIONS DEALER.—The term 'options dealer' has the meaning given to such term by section 1256(g)(8).

"(ii) COMMODITIES DEALER.—The term 'commodities dealer' means a person who is actively engaged in trading section 1256 contracts and is registered with a domestic board of trade which is designated as a contract market by the Commodities Futures Trading Commission.

"(iii) SECTION 1256 CONTRACTS.—The term 'section 1256 contracts' has the meaning given to such term by section 1256(b)."

(2) CERTAIN GAINS NOT TREATED AS PASSIVE INVESTMENT INCOME.—Subparagraph (D) of section 1362(d)(3) (defining passive investment income) is amended by adding at the end thereof the following new clause:

"(v) SPECIAL RULE FOR OPTIONS AND COMMODITIES DEALERS.—In the case of any options or commodities dealer, passive investment income shall be determined by not taking into account any gain or loss described in section 1374(c)(4)(A)."

(3) SUBCHAPTER S ELECTION.—Notwithstanding section 1362(b), an election under section 1362(a) made by a commodities dealer or an options dealer within 75 days following the date of the enactment of this Act will be treated as made for the taxable year which includes such data of enactment.

(e) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Subsection (c) of section 1256 (relating to terminations, etc.) is amended—

(A) by striking out "by taking or making delivery," in paragraph (1) and inserting in lieu thereof "by taking or making delivery, by exercise or being exercised, by assignment or being assigned, by lapse,",

(B) by striking out "takes delivery under" in paragraph (2) and inserting in lieu thereof "takes delivery under or exercises", and

(C) by striking out "TAKES DELIVERY ON" in the heading of paragraph (2) and inserting in lieu thereof "TAKES DELIVERY ON OR EXERCISES".

(2) Paragraph (5) of section 1092(d) is amended to read as follows:

"(5) SECTION 1256 CONTRACT.—The term 'section 1256 contract' has the meaning given such term by section 1256(b)."

(3) Subsection (c) of section 1212 (relating to carryback of losses from regulated futures contracts to offset prior gains from such contracts) is amended—

(A) by striking out "net commodity futures loss" each place it appears (including in any headings) and inserting in lieu thereof "net section 1256 contracts loss",

(B) by striking out "regulated futures contracts" each place it appears (including in any headings) and inserting in lieu thereof "section 1256 contracts",

(C) by striking out "regulated futures contract" each place it appears in paragraph (7)(A) (including the heading) and inserting in lieu thereof "section 1256 contract", and

(D) by striking out "net commodity futures gain" each place it appears (including in any headings) and inserting in lieu thereof "net section 1256 contract gain".

(4) Paragraph (2) of section 1234A (relating to gains or losses from certain terminations) is amended by striking out "a regulated futures contract" and inserting in lieu thereof "a section 1256 contract".

*(5) The section heading for section 1256 is amended by striking out "**REGULATED FUTURES CONTRACTS**" and inserting in lieu thereof "**SECTION 1256 CONTRACTS**".*

(6) The table of sections for part IV of subchapter P of chapter 1 is amended by striking out "Regulated futures contracts" in the item relating to section 1256 and inserting in lieu thereof "Section 1256 contracts".

(7) Paragraph (2) of section 263(g) (defining interest and carrying charges) is amended to read as follows:

"(2) INTEREST AND CARRYING CHARGES DEFINED.—For purposes of paragraph (1), the term 'interest and carrying charges' means the excess of—

"(A) the sum of—

"(i) interest on indebtedness incurred or continued to purchase or carry the personal property, and

"(ii) all other amounts (including charges to insure, store, or transport the personal property) paid or incurred to carry the personal property, over

"(B) the sum of—

"(i) the amount of interest (including original issue discount) includible in gross income for the taxable year with respect to the property described in subparagraph (A),

"(ii) any amount treated as ordinary income under section 1271(a)(3)(A), 1278, or 1281(a) with respect to such property for the taxable year, and

"(iii) the excess of any dividends includible in gross income with respect to such property for the taxable year over the amount of any deduction allowable with respect to such dividends under section 243, 244, or 245.

For purposes of subparagraph (A), the term 'interest' includes any amount paid or incurred in connection with personal property used in a short sale."

(8) Subsection (g) of section 263 (relating to certain interest and carrying charges in the case of straddles) is amended by adding at the end thereof the following new paragraph:

"(4) APPLICATION WITH OTHER PROVISIONS.—

"(A) SUBSECTION (c).—In the case of any short sale, this subsection shall be applied after subsection (h).

"(B) SECTION 1277 OR 1282.—In the case of any obligation to which section 1277 or 1282 applies, this subsection shall be applied after section 1277 or 1282."

(9) Section 1234A (relating to gains or losses from certain terminations) is amended by adding at the end thereof the following new sentence: "The preceding sentence shall not apply to the retirement of any debt instrument (whether or not through a trust or other participation arrangement)."

(f) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection or subsection (g), the amendments made by this section shall apply to positions established after the date of the enactment of this Act, in taxable years ending after such date.

(2) SPECIAL RULE FOR OPTIONS ON REGULATED FUTURES CONTRACTS.—In the case of any option with respect to a regulated futures contract (within the meaning of section 1256 of the Internal Revenue Code of 1954), the amendments made by this

section shall apply to positions established after October 31, 1983, in taxable years ending after such date.

(3) SPECIAL RULE FOR SELF-EMPLOYMENT TAX.—Except as provided in subsection (g)(2), the amendments made by subsection (c) shall apply to taxable years beginning after the date of the enactment of this Act.

(4) GAINS OR LOSSES FROM CERTAIN TERMINATIONS.—The amendment made by subsection (d)(9) shall apply as if included in the amendment made by section 505(a) of the Economic Recovery Tax Act of 1981, as amended by section 105(e) of the Technical Corrections Act of 1982.

(g) ELECTIONS WITH RESPECT TO PROPERTY HELD ON OR BEFORE THE DATE OF THE ENACTMENT OF THIS ACT.—At the election of the taxpayer—

(1) the amendments made by this section shall apply to all section 1256 contracts held by the taxpayer on the date of the enactment of this Act, effective for periods after such date in taxable years ending after such date, or

(2) in lieu of an election under paragraph (1), the amendments made by this section shall apply to all section 1256 contracts held by the taxpayer at any time during the taxable year of the taxpayer which includes the date of the enactment of this Act.

(h) ELECTIONS FOR INSTALLMENT PAYMENT OF TAX ATTRIBUTABLE TO STOCK OPTIONS.—

(1) IN GENERAL.—If the taxpayer makes an election under subsection (g)(2) and under this subsection—

(A) the taxpayer may pay part or all the tax for the taxable year referred to in subsection (g)(2) in 2 or more (but not exceeding 5) equal installments, and

(B) the maximum amount of tax which may be paid in installments under this subsection shall be the excess of—

(i) the tax for such taxable year determined by taking into account subsection (g)(2), over

(ii) the tax for such taxable year determined by taking into account subsection (g)(2) and by treating—

(I) all section 1256 contracts which are stock options, and

(II) any stock which was a part of a straddle including any such stock options,

as having been acquired for a purchase price equal to their fair market value on the last business day of the preceding taxable year. Stock options and stock shall be taken into account under subparagraph (B)(ii) only if such options or stock were held on the last day of the preceding taxable year and only if income on such options or stock would have been ordinary income if such options or stock were sold at a gain on such last day.

(2) DATE FOR PAYMENT OF INSTALLMENT.—

(A) If an election is made under this subsection, the first installment under paragraph (1) shall be paid on or before the due date for filing the return for the taxable year described in paragraph (1), and each succeeding installment

shall be paid on or before the date which is 1 year after the date prescribed for payment of the preceding installment.

(B) If a bankruptcy case or insolvency proceeding involving the taxpayer is commenced before the final installment is paid, the total amount of any unpaid installments shall be treated as due and payable on the day preceding the day on which such case or proceeding is commenced.

(3) INTEREST IMPOSED.—For purposes of section 6601 of the Internal Revenue Code of 1954, the time for payment of any tax with respect to which an election is made under this subsection shall be determined without regard to this subsection.

(4) FORM OF ELECTION.—An election under this subsection shall be made not later than the time for filing the return for the taxable year described in paragraph (1) and shall be made in the manner and form required by regulations prescribed by Secretary of the Treasury or his delegate. The election shall set forth—

(A) the amount determined under paragraph (1)(B) and the number of installments elected by the taxpayer,

(B) the property described in paragraph (1)(B)(ii), and the date on which such property was acquired,

(C) the fair market value of the property described in paragraph (1)(B)(ii) on the last business day of the taxable year preceding the taxable year described in paragraph (1), and

(D) such other information for purposes of carrying out the provisions of this subsection as may be required by such regulations.

(5) DELAY OF IDENTIFICATION REQUIREMENT.—Section 1256(e)(2)(C) of the Internal Revenue Code of 1954 shall not apply to any stock option or stock acquired on or before the 60th day after the date of the enactment of this Act.

(i) DEFINITIONS.—For purposes of subsections (g) and (h)—

(1) SECTION 1256 CONTRACT.—The term "section 1256 contract" has the meaning given to such term by section 1256(b) of the Internal Revenue Code of 1954 (as amended by this section).

(2) STOCK OPTION.—The term "stock option" means any option to buy or sell stock.

SEC. 103. REGULATIONS UNDER SECTION 1092(b).

(a) GENERAL RULE.—Subsection (b) of section 1092 (relating to character of gain or loss; wash sales) is amended to read as follows:

"(b) REGULATIONS.—

"(1) IN GENERAL.—The Secretary shall prescribe such regulations with respect to gain or loss on positions which are a part of a straddle as may be appropriate to carry out the purposes of this section and section 263(g). To the extent consistent with such purposes, such regulations shall include rules applying the principles of subsections (a) and (d) of section 1091 and of subsections (b) and (d) of section 1233.

"(2) REGULATIONS RELATING TO MIXED STRADDLES.—

"(A) ELECTIVE PROVISIONS IN LIEU OF SECTION 1233(d) PRINCIPLES.—The regulations prescribed under paragraph (1) shall provide that—

"(i) the taxpayer may offset gains and losses from positions which are part of mixed straddles—

"(I) by straddle-by-straddle identification, or

"(II) by the establishment (with respect to any class of activities) of a mixed straddle account for which gains and losses would be recognized (and offset) on a periodic basis,

"(ii) such offsetting will occur before the application of section 1256, and section 1256(a)(3) will only apply to net gain or net loss attributable to section 1256 contracts, and

"(iii) the principles of section 1233(d) shall not apply with respect to any straddle identified under clause (i)(I) or part of an account established under clause (i)(II).

"(B) LIMITATION ON NET GAIN OR NET LOSS FROM MIXED STRADDLE ACCOUNT.—In the case of any mixed straddle account referred to in subparagraph (A)(i)(II)—

"(i) NOT MORE THAN 50 PERCENT OF NET GAIN MAY BE TREATED AS LONG-TERM CAPITAL GAIN.—In no event shall more than 50 percent of the net gain from such account for any taxable year be treated as long-term capital gain.

"(ii) NOT MORE THAN 40 PERCENT OF NET LOSS MAY BE TREATED AS SHORT-TERM CAPITAL LOSS.—In no event shall more than 40 percent of the net loss from such account for any taxable year be treated as short-term capital loss.

"(C) AUTHORITY TO TREAT CERTAIN POSITIONS AS MIXED STRADDLES.—The regulations prescribed under paragraph (1) may treat as a mixed straddle positions not described in section 1256(d)(4)."

(b) REQUIREMENT THAT REGULATIONS BE ISSUED WITHIN 6 MONTHS AFTER THE DATE OF ENACTMENT.—The Secretary of the Treasury or his delegate shall prescribe initial regulations under section 1092(b) of the Internal Revenue Code of 1954 (including regulations relating to mixed straddles) not later than the date 6 months after the date of the enactment of this Act.

(c) EFFECTIVE DATE OF REGULATIONS WITH RESPECT TO MIXED STRADDLES.—The regulations described in subsection (b) with respect to the application of section 1233 of the Internal Revenue Code of 1954 to mixed straddles shall not apply to mixed straddles all of the positions of which were established before January 1, 1984.

SEC. 104. LIMITATION ON LOSSES FROM HEDGING TRANSACTIONS.

(a) GENERAL RULE.—Subsection (e) of section 1256 (relating to mark to market not to apply to hedging transactions) is amended by adding at the end thereof the following new paragraph:

"(5) LIMITATION ON LOSSES FROM HEDGING TRANSACTIONS.—

"(A) IN GENERAL.—

"(i) LIMITATION.—Any hedging loss for a taxable year which is allocable to any limited partner or limited entrepreneur (within the meaning of paragraph (3)) shall be allowed only to the extent of the taxable

income of such limited partner or entrepreneur for such taxable year attributable to the trade or business in which the hedging transactions were entered into. For purposes of the preceding sentence, taxable income shall be determined by not taking into account items attributable to hedging transactions.

"(ii) CARRYOVER OF DISALLOWED LOSS.—Any hedging loss disallowed under clause (i) shall be treated as a deduction attributable to a hedging transaction allowable in the first succeeding taxable year.

"(B) EXCEPTION WHERE ECONOMIC LOSS.—Subparagraph (A)(i) shall not apply to any hedging loss to the extent that such loss exceeds the aggregate unrecognized gains from hedging transactions as of the close of the taxable year attributable to the trade or business in which the hedging transactions were entered into.

"(C) EXCEPTION FOR CERTAIN HEDGING TRANSACTIONS.—In the case of any hedging transaction relating to property other than stock or securities, this paragraph shall apply only in the case of a taxpayer described in section 465(a)(1).

"(D) HEDGING LOSS.—The term 'hedging loss' means the excess of—

"(i) the deductions allowable under this chapter for the taxable year attributable to hedging transactions (determined without regard to subparagraph (A)(i)), over

"(ii) income received or accrued by the taxpayer during such taxable year from such transactions.

"(E) UNRECOGNIZED GAIN.—The term 'unrecognized gain' has the meaning given to such term by section 1092(a)(3)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1984.

SEC. 105. CLARIFICATION THAT SECTION 1234 APPLIES TO OPTIONS ON REGULATED FUTURES CONTRACTS AND CASH SETTLEMENT OPTIONS.

(a) GENERAL RULE.—Section 1234 (relating to options to buy or sell) is amended by adding at the end thereof the following new subsection:

"(c) TREATMENT OF OPTIONS ON SECTION 1256 CONTRACTS AND CASH SETTLEMENT OPTIONS.—

"(1) SECTION 1256 CONTRACTS.—Gain or loss shall be recognized on the exercise of an option on a section 1256 contract (within the meaning of section 1256(b)).

"(2) TREATMENT OF CASH SETTLEMENT OPTIONS.—

"(A) IN GENERAL.—For purposes of subsections (a) and (b), a cash settlement option shall be treated as an option to buy or sell property.

"(B) CASH SETTLEMENT OPTION.—For purposes of subparagraph (A), the term 'cash settlement option' means any option which on exercise settles in (or could be settled in) cash or property other than the underlying property."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to options purchased or granted after October 31, 1983, in taxable years ending after such date.

SEC. 106. WASH SALE RULES TO APPLY TO LOSSES ON CERTAIN SHORT SALES.

(a) IN GENERAL.—Section 1091 (relating to losses from wash sales of stock or securities) is amended by adding at the end thereof the following new subsection:

"(e) CERTAIN SHORT SALES OF STOCK OR SECURITIES.—Rules similar to the rules of subsection (a) shall apply to any loss realized on the closing of a short sale of stock or securities if, within a period beginning 30 days before the date of such closing and ending 30 days after such date—

"(1) substantially identical stock or securities were sold, or

"(2) another short sale of substantially identical stock or securities was entered into."

(b) LOSSES FROM WASH SALES ONLY IN CASE OF BUSINESS LOSSES.—Section 1091(a) (relating to disallowance of loss deduction for wash sales) is amended by striking out all that follows "then" and inserting in lieu thereof "no deduction shall be allowed under section 165 unless the taxpayer is a dealer in stock or securities and the loss is sustained in a transaction made in the ordinary course of such business."

(c) EFFECTIVE DATE.—

(1) SUBSECTION (a).—The amendment made by subsection (a) shall apply to short sales of stock or securities after the date of the enactment of this Act in taxable years ending after such date.

(2) SUBSECTION (b).—The amendment made by subsection (b) shall apply to sales after December 31, 1984, in taxable years ending after such date.

SEC. 107. TIME FOR IDENTIFICATION BY TAXPAYER OF CERTAIN TRANSACTIONS.

(a) IDENTIFIED STRADDLES.—Clause (i) of section 1092(a)(2)(B) (defining identified straddles) is amended to read as follows:

"(i) which is clearly identified on the taxpayer's records as an identified straddle before the earlier of—

"(I) the close of the day on which the straddle is acquired, or

"(II) such time as the Secretary may prescribe by regulations."

(b) DEALERS IN SECURITIES.—

(1) Paragraph (1) of section 1236(a) (relating to capital gain of dealers in securities) is amended to read as follows:

"(1) the security was, before the close of the day on which it was acquired (or such earlier time as the Secretary may prescribe by regulations), clearly identified in the dealer's records as a security held for investment; and".

(2) Paragraph (2) of section 1236(a) is amended by inserting "(or such earlier time)" after "such day".

(c) MIXED STRADDLES.—Subparagraph (B) of section 1256(d)(4) (defining mixed straddles) is amended by inserting "(or such earlier time as the Secretary may prescribe by regulations)" after "acquired".

(d) HEDGING TRANSACTIONS.—Subparagraph (C) of section 1256(e)(2) (defining hedging transactions) is amended by inserting

"(or such earlier time as the Secretary may prescribe by regulations)" after "entered into".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to positions entered into after the date of the enactment of this Act, in taxable years ending after such date.

SEC. 108. TREATMENT OF CERTAIN LOSSES ON STRADDLES ENTERED INTO BEFORE EFFECTIVE DATE OF ECONOMIC RECOVERY TAX ACT OF 1981.

(a) GENERAL RULE.—For purposes of the Internal Revenue Code of 1954, in the case of any disposition of 1 or more positions—

(1) which were entered into before 1982 and form part of a straddle, and

(2) to which the amendments made by title V of such Act do not apply,

any loss from such disposition shall be allowed for the taxable year of the disposition if such position is part of a transaction entered into for profit.

(b) PRESUMPTION THAT TRANSACTION ENTERED INTO FOR PROFIT.—For purposes of subsection (a), any position held by a commodities dealer or any person regularly engaged in investing in regulated futures contracts shall be rebuttably presumed to be part of a transaction entered into for profit.

(c) NET LOSS ALLOWED WHETHER OR NOT TRANSACTION ENTERED INTO FOR PROFIT.—If any loss with respect to a position described in paragraphs (1) and (2) of subsection (a) is not allowable as a deduction (after applying subsections (a) and (b)), such loss shall be allowed in determining the gain or loss from dispositions of other positions in the straddle to the extent required to accurately reflect the taxpayer's net gain or loss from all positions in such straddle.

(d) OTHER RULES.—Except as otherwise provided in subsections (a) and (c) and in sections 1233 and 1234 of such Code, the determination of whether there is recognized gain or loss with respect to a position, and the amount and timing of such gain or loss, and the treatment of such gain or loss as long-term or short-term shall be made without regard to whether such position constitutes part of a straddle.

(e) STRADDLE.—For purposes of this section, the term "straddle" has the meaning given to such term by section 1092(c) of the Internal Revenue Code of 1954 as in effect on the day after the date of the enactment of the Economic Recovery Tax Act of 1981, and shall include a straddle all the positions of which are regulated futures contracts.

(f) COMMODITIES DEALER.—For purposes of this section, the term "commodities dealer" has the meaning given to such term by section 1402(i)(2)(B) of the Internal Revenue Code of 1954 (as added by this subtitle).

(g) REGULATED FUTURES CONTRACTS.—For purposes of this section, the term "regulated futures contracts" has the meaning given to such term by section 1256(b) of the Internal Revenue Code of 1954 (as in effect before the date of enactment of this Act).

(h) SYNDICATES.—Subsection (b) shall not apply to any syndicate (as defined in section 1256(e)(3)(B) of the Internal Revenue Code of 1954).

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Subtitle I—Depreciation

SEC. 111. RECOVERY PERIOD FOR CERTAIN REAL PROPERTY EXTENDED TO 18 YEARS.

(a) IN GENERAL.—Paragraph (2) of section 168(b) (relating to 15-year real property) is amended—

(1) by striking out "15-year real property" each place it appears in the text and heading thereof and inserting in lieu thereof "18-year real property",

(2) by striking out "15-year recovery period" in subparagraph (A)(i) and inserting in lieu thereof "18-year recovery period", and

(3) by striking out "(200 percent declining balance method in the case of low-income housing)".

(b) LOW-INCOME HOUSING.—

(1) DETERMINATION OF RECOVERY PERCENTAGE.—Subsection (b) of section 168 (relating to the amount of deduction) is amended by adding at the end thereof the following new paragraph:

"(4) LOW-INCOME HOUSING.—

"(A) IN GENERAL.—In the case of low-income housing, the applicable percentage shall be determined in accordance with the table prescribed in paragraph (2), except that in prescribing such table, the Secretary shall—

"(i) assign to the property a 15-year recovery period, and

"(ii) assign percentages generally determined in accordance with use of the 200 percent declining balance method, switching to the method described in section 167(b)(1) at a time to maximize the deduction allowable under subsection (a).

"(B) SPECIAL RULE FOR YEAR OF DISPOSITION.—In the case of a disposition of low-income housing, the deduction allowable under subsection (a) for the taxable year in which the disposition occurs shall reflect only the months during such year the property was placed in service."

(2) LOW-INCOME HOUSING DEFINED.—Paragraph (2) of section 168(c) (defining recovery property) is amended by redesignating subparagraph (F) as subparagraph (G) and by inserting after subparagraph (E) the following new subparagraph:

"(F) LOW-INCOME HOUSING.—The term 'low-income housing' means property described in clause (i), (ii), (iii), or (iv) of section 1250(a)(1)(B)."

(3) CONFORMING AMENDMENTS.—

(A) Subparagraph (A) of section 168(b)(2) is amended by striking out the last sentence thereof.

(B) Subparagraph (D) of section 168(c)(2) is amended to read as follows:

"(D) 18-YEAR REAL PROPERTY.—The term '18-year real property' means section 1250 class property which—

"(i) does not have a present class life of 12.5 years or less, and

"(ii) is not low-income housing."

(c) Transitional Rule for Components.—Subparagraph (B) of section 168(f)(1) is amended to read as follows:

"(B) Transitional rules.—

"(i) Building placed in service before 1981.—In the case of any building placed in service by the taxpayer before January 1, 1981, for purposes of applying subparagraph (A) to components of such buildings placed in service after December 31, 1980, and before March 16, 1984, the deduction allowable under subsection (a) with respect to such components shall be computed in the same manner as the deduction allowable with respect to the first such component placed in service after December 31, 1980.

"(ii) Buildings placed in service before March 16, 1984.—In the case of any building placed in service by the taxpayer before March 16, 1984, for purposes of applying subparagraph (A) to components of such buildings placed in service after March 15, 1984, the deduction allowable under subsection (a) with respect to such components shall be computed in the same manner as the deduction allowable with respect to the first such component placed in service after March 15, 1984.

"(iii) First component treated as separate building.—For purposes of clause (i) or (ii), the method of computing the deduction allowable with respect to the first component described in such clause shall be determined as if it were a separate building."

(d) Use of Mid-Month Convention.—The second last sentence of subparagraph (A), and subparagraph (B), of section 168(b)(2) (relating to 15-year real property) are each amended by inserting "(using a mid-month convention)" after "months".

(e) Conforming Amendments.—

(1) Subsections (b)(3)(B)(iii), (f)(2)(B), (f)(2)(C)(ii)(II), (f)(2)(E), and (f)(5) of section 168 are each amended by striking out "15-year real property" each place it appears and inserting in lieu thereof "18-year real property or low-income housing".

(2) Clause (ii) of section 168(b)(3)(B) is amended by striking out "15-year real property" and inserting in lieu thereof "18-year real property or low-income housing,".

(3) Subparagraph (B) of section 168(d)(2) is amended by striking out "15-year real property" and inserting in lieu thereof "18-year real property or low-income housing".

(4) Clause (i) of section 168(f)(2)(C) (relating to recovery period for property used outside United States) is amended by striking out the item relating to 15-year real property in the table and inserting in lieu thereof the following new item:

"18-year real property or low-income housing .... 35 or 45 years.".

(5) Sections 57(a)(12)(A) and 312(k)(3)(A) and subparagraphs (A), (B), and (C) of section 1245(A)(5) are each amended by striking out "15-year real property" each place it appears in the text and headings and inserting in lieu thereof "18-year real property and low-income housing".

(6) Subparagraph (B) of section 57(a)(12) (relating to items of tax preference) is amended to read as follows:

"(B) 18-YEAR REAL PROPERTY AND LOW-INCOME HOUSING.—With respect to each recovery property which is 18-year real property or low-income housing, the amount (if any) by which the deduction allowed under section 168(a) for the taxable year exceeds the deduction which would have been allowable for a taxable year had the property been depreciated using the straight-line method (without regard to salvage value) over a recovery period of—

"(i) 18 years in the case of 18-year real property, and

"(ii) 15 years in the case of low-income housing property."

(7) Subparagraph (E) of section 57(a)(12) is amended by striking out " '15-year real property'," and inserting in lieu thereof " '18-year real property', 'low-income housing',".

(8) Paragraph (2) of section 48(g) (relating to qualified rehabilitation expenditure) is amended—

(A) by striking out "property" each place it appears in subparagraph (A)(i) and inserting in lieu thereof "real property",

(B) by striking out "15" in subparagraph (A)(i) and inserting in lieu thereof "18 (15 years in the case of low-income housing),

(C) by striking out "15 years" in subparagraph (B)(v) and inserting in lieu thereof "18 years (15 years in the case of low-income housing)", and

(D) by adding at the end thereof the following new subparagraph:

"(D) LOW-INCOME HOUSING.—For purposes of subparagraph (B), the term 'low-income housing' has the meaning given such term by section 168(c)(2)(F)."

(9) Subparagraph (A) of section 168(b)(3) (relating to election of different recovery percentage) is amended—

(A) by striking out "under paragraphs (1) and (2)" and inserting in lieu thereof "under paragraph (1), (2), or (4)", and

(B) by striking out the item in the table relating to 15-year real property and inserting in lieu thereof the following new item:

"18-year real property and low-income housing .... 18, 35, or 45."

(10) Section 1245(a)(5)(D) is amended to read as follows:

"(D) low-income housing (within the meaning of section 168(c)(2)(F))."

(g) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply with respect to property placed in service by the taxpayer after March 15, 1984.

(2) EXCEPTION.—The amendments made by this section shall not apply to property placed in service by the taxpayer before January 1, 1987, if—

(A) the taxpayer or a qualified person entered into a binding contract to purchase or construct such property before March 16, 1984, or

(B) construction of such property was commenced by or for the taxpayer or a qualified person before March 16, 1984.

For purposes of this paragraph the term "qualified person" means any person who transfers his rights in such a contract or such property to the taxpayer, but only if such property is not placed in service by such person before such rights are transferred to the taxpayer.

(3) SPECIAL RULES FOR APPLICATION OF PARAGRAPH (2).—

(A) CERTAIN INVENTORY.—In the case of any property which—

(i) is held by a person as property described in section 1221(1), and

(ii) is disposed of by such person before January 1, 1985,

such person shall not, for purposes of paragraph (2), be treated as having placed such property in service before such property is disposed of merely because such person rented such property or held such property for rental. No deduction for depreciation or amortization shall be allowed to such person with respect to such property,

(B) CERTAIN PROPERTY FINANCED BY BONDS.—In the case of any property with respect to which—

(i) bonds were issued to finance such property before 1984, and

(ii) an architectural contract was entered into before March 1984,

paragraph (2) shall be applied by substituting "May 2" for "March 16".

(4) SPECIAL RULE FOR COMPONENTS.—For purposes of applying section 168 (f)(1)(B) of the Internal Revenue Code of 1954 (as amended by this section) to components placed in service after December 31, 1986, property to which paragraph (2) applies shall be treated as placed in service by the taxpayer before March 16, 1984.

SEC. 112. RECAPTURE IN CASE OF INSTALLMENT SALES.

(a) GENERAL RULE.—Subsection (i) of section 453 (relating to installment method) is amended to read as follows:

"(i) RECOGNITION OF RECAPTURE INCOME IN YEAR OF DISPOSITION.—

"(1) IN GENERAL.—In the case of any installment sale of property to which subsection (a) applies—

"(A) notwithstanding subsection (a), any recapture income shall be recognized in the year of the disposition and

"(B) any gain in excess of the recapture income shall be taken into account under the installment method.

"(2) RECAPTURE INCOME.—For purposes of paragraph (1), the term 'recapture income' means, with respect to any installment sale, the aggregate amount which would be treated as ordinary income under section 1245 or 1250 for the taxable year of the disposition if all payments to be received were received in the taxable year of disposition."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply with respect to dispositions made after June 6, 1984.

(2) EXCEPTION.—The amendments made by this Act shall not apply with respect to any disposition conducted pursuant to a contract which was binding on March 22, 1984, and at all times thereafter.

SEC. 113. PROVISIONS RELATING TO SOUND RECORDINGS AND FILMS.

(a) SOUND RECORDINGS.—

(1) IN GENERAL.—Section 48 (defining section 38 property) is amended by redesignating subsection (r) as subsection (s) and by inserting after subsection (q) the following new subsection:

"(r) SPECIAL RULES RELATING TO SOUND RECORDINGS.—

"(1) IN GENERAL.—For purposes of this title, in the case of any sound recording, the original use of which commences with the taxpayer, the taxpayer may elect to treat such recording as recovery property which is 3-year property to the extent that the taxpayer has an ownership interest in such recording.

"(2) FAILURE TO MAKE ELECTION.—If a taxpayer does not make an election under paragraph (1) with respect to any sound recording—

"(A) no credit shall be allowed under section 38 with respect to such recording, and

"(B) such recording shall not be treated as recovery property.

"(3) PREDOMINANT USE TEST AND AT RISK RULES NOT TO APPLY; QUALIFIED INVESTMENT.—In the case of any sound recording—

"(A) sections 46(c)(8), 46(c)(9), and 48(a)(2) shall not apply, and

"(B) in determining the qualified investment under section 46(c)(1), there shall be used (in lieu of the basis of the property) an amount equal to the production costs which are allocable to the United States (as determined under rules similar to the rules of section 48(k)(5)(D)).

"(4) OWNERSHIP INTEREST.—For purposes of determining the credit allowable under section 38, the ownership interest of any person in a sound recording shall be determined on the basis of his proportionate share of any loss which may be incurred with respect to the production costs of such sound recording.

"(5) SOUND RECORDING.—For purposes of this subsection, the term 'sound recording' means any sound recording described in section 280(c)(2).

"(6) PRODUCTION COSTS—

"(A) IN GENERAL.—For purposes of this subsection, the term 'production costs' includes—

"(i) a reasonable allocation of general overhead costs,

"(ii) compensation for services performed by song writers, artists, production personnel, directors, producers, and similar personnel,

"(iii) costs of 'first' distribution of records or tapes, and

"(iv) the cost of the material being recorded.

"(B) CERTAIN COSTS NOT TAKEN INTO ACCOUNT.—Except as provided in subparagraph (C), the term 'production costs' shall not include—

"(i) 'residuals' payable under contracts with labor organizations, or

"(ii) participations or royalties payable as compensation to song writers, artists, production personnel, directors, producers, and similar personnel, or

"(iii) any other contingent amounts.

"(C) CERTAIN CONTINGENT AMOUNTS TAKEN INTO ACCOUNT.—In the case of any amount which is described in subparagraph (B) and which is incurred in the taxable year in which the sound recording is placed in service or the next taxable year—

"(i) subparagraph (B) shall not apply, and

"(ii) for purposes of sections 38 and 168, the taxpayer shall be treated as having placed in service in each such taxable year 3-year recovery property with a basis equal to the amount so incurred in such taxable year.

"(7) ELECTION MADE SEPARATELY.—An election under paragraph (1) shall be made separately with respect to each sound recording and must be made by all persons having an ownership interest in such recording.

"(8) UNITED STATES.—For purposes of this subsection, the term 'United States' includes the possessions of the United States."

(2) CONFORMING AMENDMENTS.—Section 168(f) (relating to special rules), as amended by this Act, is amended by adding at the end thereof the following new paragraph:

"(14) SPECIAL RULES FOR SOUND RECORDINGS.—In the case of a sound recording (within the meaning of section 48(r)), the unadjusted basis of such property shall be equal to the production costs (within the meaning of section 48(r)(6))."

(b) FILMS AND OTHER PROPERTY.—

(1) FILM AND VIDEO TAPES NOT TREATED AS RECOVERY PROPERTY.—Section 168(e) (relating to property excluded from application of this section) is amended by adding at the end thereof the following new paragraph:

"(5) FILMS AND VIDEO TAPES NOT RECOVERY PROPERTY.—The term 'recovery property' shall not include any motion picture film or video tape."

(2) APPLICATION OF RECOVERY PROPERTY EXCEPTIONS.—

(A) Section 168(e) is amended by striking out "section" and inserting in lieu thereof "title" in the matter preceding paragraph (1).

(B) Subparagraph (A) of section 46(c)(7) is amended by inserting "recovery" before "property" the first place it appears.

(3) FILMS NOT SUBJECT TO INVESTMENT CREDIT AT-RISK RULES.—Paragraph (4) of section 48(k) is amended—

(A) by inserting ", section 46(c)(8), or section 46(c)(9)" after "section 48(a)(2)" in subparagraph (A),

(B) by inserting "or at-risk rules" after "test" in the heading thereof, and

(C) by striking out "issued" and inserting in lieu thereof "used".

(4) BASIS ADJUSTMENT FOR FILMS.—Section 48(q) (relating to basis adjustment) is amended by adding at the end thereof the following new paragraph:

"(6) SPECIAL RULE FOR QUALIFIED FILMS.—If a credit is allowed under section 38 with respect to any qualified film (within the meaning of subsection (k)(1)(B)) then, in lieu of any reduction under paragraph (1)—

"(A) to the extent that the credit is determined with respect to any amount described in clause (v) or (vi) of subsection (k)(5)(B), any deduction allowable under this chapter with respect to such amount shall be reduced by 50 percent of the amount of the credit so determined, and

"(B) the basis of the taxpayer's ownership interest (within the meaning of subsection (k)(1)(C)) shall be reduced by the excess of—

"(i) 50 percent of the amount of the credit determined under subsection (k), over

"(ii) the amount of the reduction under subparagraph (A)."

(c) EFFECTIVE DATES.—

(1) SOUND RECORDINGS.—The amendments made by subsection (a) shall apply to property placed in service after March 15, 1984, in taxable years ending after such date.

(2) FILMS AND OTHER PROPERTY.—

(A) The amendment made by paragraph (1) shall apply to any films placed in service before, on, or after the date of the enactment of this Act, except that such amendment shall not apply to—

(i) any qualified film placed in service by the taxpayer before March 15, 1984, if the taxpayer treated such film as recovery property for purposes of section 168 of the Internal Revenue Code of 1954 on a return of tax under chapter 1 of such Code filed before March 16, 1984, or

(ii) any qualified film placed in service by the taxpayer before January 1, 1985, if—

(I) 20 percent or more of the production costs of such film were incurred before March 16, 1984, and

(II) the taxpayer treats such film as recovery property for purposes of section 168 of such Code.

No credit shall be allowable under section 38 of such Code with respect to any qualified film described in clause (ii), except to the extent provided in section 48(k) of such Code.

(B) The amendments made by paragraphs (2) and (3) shall apply as if included in the amendments made by sections 201(a), 211(a)(1), and 211(f)(1) of the Economic Recovery Tax Act of 1981.

(C) The amendment made by paragraph (4) of subsection (b) shall take effect as if included in the amendments made by section 205(a)(1) of the Tax Equity and Fiscal Responsibility Act of 1982.

SEC. 114. DEFINITION OF SECTION 38 PROPERTY IN SALE-LEASEBACK TRANSACTIONS.

(a) IN GENERAL.—Subsection (b) of section 48 (defining new section 38 property) is amended to read as follows:

"(b) NEW SECTION 38 PROPERTY.—For purposes of this subpart—

"(1) IN GENERAL.—The term 'new section 38 property' means section 38 property the original use of which commences with the taxpayer.

"(2) SPECIAL RULE FOR SALE-LEASEBACKS.—For purposes of paragraph (1), in the case of any section 38 property which—

"(A) is originally placed in service by a person, and

"(B) is sold and leased back by such person, or is leased to such person, within 3 months of the date such property was originally placed in service,

such property shall be treated as originally placed in service not earlier than the date on which such property is used under the lease.

"(3) SPECIAL RULE FOR ENERGY PROPERTY.—The principles of paragraph (2) shall be applicable in determining whether the original use of property commences with the taxpayer for purposes of section 48(l)(2)(B)(ii)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to property originally placed in service after April 11, 1984 (determined without regard to such amendment).

Subtitle J—Foreign Provisions

PART I—CHANGES IN SOURCE AND CHARACTER RULES

SEC. 121. CERTAIN AMOUNTS TREATED AS DERIVED FROM UNITED STATES SOURCES FOR PURPOSES OF LIMITATION ON FOREIGN TAX CREDIT.

(a) GENERAL RULE.—Section 904 (relating to limitation on foreign tax credit) is amended by redesignating subsections (g) and (h) as subsections (h) and (i), respectively, and by inserting after subsection (f) the following new subsection:

"(g) SOURCE RULES IN CASE OF UNITED STATES-OWNED FOREIGN CORPORATIONS.—

"(1) IN GENERAL.—The following amounts which are derived from a United States-owned foreign corporation and which would be treated as derived from sources outside the United States without regard to this subsection shall, for purposes of this section, be treated as derived from sources within the United States to the extent provided in this subsection:

"(A) Any amount included in gross income under—

"(i) section 951(a) (relating to amounts included in gross income of United States shareholders), or

"(ii) section 551 (relating to foreign personal holding company income taxed to United States shareholders).

"(B) Interest.

"(C) Dividends.

"(2) SUBPART F AND FOREIGN PERSONAL HOLDING COMPANY INCLUSIONS.—Any amount described in subparagraph (A) of paragraph (1) shall be treated as derived from sources within the United States to the extent such amount is attributable to income of the United States-owned foreign corporation from sources within the United States.

"(3) CERTAIN INTEREST ALLOCABLE TO UNITED STATES SOURCE INCOME.—Any interest which—

"(A) is paid or accrued by a United States-owned foreign corporation during any taxable year,

"(B) is paid or accrued to a United States shareholder (as defined in section 951(b)) or a related person (within the meaning of section 267(b)) to such a shareholder, and

"(C) is properly allocable (under regulations prescribed by the Secretary) to income of such foreign corporation for the taxable year from sources within the United States,

shall be treated as derived from sources within the United States.

"(4) DIVIDENDS.—

"(A) IN GENERAL.—The United States source ratio of any dividend paid or accrued by a United States-owned foreign corporation shall be treated as derived from sources within the United States.

"(B) UNITED STATES SOURCE RATIO.—For purposes of subparagraph (A), the term 'United States source ratio' means, with respect to any dividend paid out of the earnings and profits for any taxable year, a fraction—

"(i) the numerator of which is the portion of the earnings and profits for such taxable year from sources within the United States, and

"(ii) the denominator of which is the total amount of earnings and profits for such taxable year.

"(5) EXCEPTION WHERE UNITED STATES-OWNED FOREIGN CORPORATION HAS SMALL AMOUNT OF UNITED STATES SOURCE INCOME.—Paragraph (3) shall not apply to interest paid or accrued during any taxable year (and paragraph (4) shall not apply to any dividends paid out of the earnings and profits for such taxable year) if—

"(A) the United States-owned foreign corporation has earnings and profits for such taxable year, and

"(B) less than 10 percent of such earnings and profits is attributable to sources within the United States.

For purposes of the preceding sentence, earnings and profits shall be determined without any reduction for interest described in paragraph (3) (determined without regard to subparagraph (C) thereof).

"(6) UNITED STATES-OWNED FOREIGN CORPORATION.—For purposes of this subsection, the term 'United States-owned foreign corporation' means any foreign corporation if 50 percent or more of—

"(A) the total combined voting power of all classes of stock of such corporation entitled to vote, or

"(B) the total value of the stock of such corporation,

is held directly (or indirectly through applying paragraphs (2) and (3) of section 958(a) and paragraph (4) of section 318(a)) by United States persons (as defined in section 7701(a)(30)).

"(7) DIVIDEND.—For purposes of this subsection, the term 'dividend' includes any gain treated as ordinary income under section 1246 or as a dividend under section 1248.

"(8) COORDINATION WITH SUBSECTION (f).—This subsection shall be applied before subsection (f).

"(9) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate for purposes of this subsection, including—

"(A) regulations for the application of this subsection in the case of interest or dividend payments through 1 or more entities, and

"(B) regulations providing that this subsection shall apply to interest paid or accrued to any person (whether or not a United States shareholder)."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendment made by subsection (a) shall take effect on the date of the enactment of this Act. In the case of the taxable year of any United States-owned foreign corporation in which occurs the date of the enactment of this Act—

(A) only income received or accrued by such foreign corporation after such date of enactment shall be taken into account under section 904(g) of the Internal Revenue Code of 1954 (as added by subsection (a)); except that

(B) paragraph (5) of such section 904(g) (relating to exception where small amount of United States source income) shall be applied by taking into account all income received or accrued by such foreign corporation during such taxable year.

(2) SPECIAL RULE FOR APPLICABLE CFC.—

(A) IN GENERAL.—In the case of qualified interest received or accrued by an applicable CFC before January 1, 1992—

(i) such interest shall not be taken into account under section 904(g) of the Internal Revenue Code of 1954 (as added by subsection (a)), except that

(ii) such interest shall be taken into account for purposes of applying paragraph (5) of such section 904(g) (relating to exception where small amount of United States source income).

(B) QUALIFIED INTEREST.—For purposes of subparagraph (A), the term "qualified interest" means—

(i) the aggregate amount of interest received or accrued during any taxable year by an applicable CFC on United States affiliate obligations held by such applicable CFC, multiplied by,

(ii) a fraction (not in excess of 1)—

(I) the numerator of which is the sum of the aggregate principal amount of United States affiliate obligations held by the applicable CFC on March 31, 1984, but not in excess of the applicable limit, and

(II) the denominator of which is the average daily principal amount of United States affiliate obligations held by such applicable CFC during the taxable year.

Proper adjustments shall be made to the numerator described in clause (ii) (I) for original issue discount accruing after March 31, 1984, on CFC obligations and United States affiliate obligations.

(C) ADJUSTMENT FOR RETIREMENT OF CFC OBLIGATIONS.—The amount described in subparagraph (B)(ii)(I) for any taxable year shall be reduced by the sum of—

(i) the excess of (I) the aggregate principal amount of CFC obligations which are outstanding on March 31, 1984, but only with respect to obligations issued before March 8, 1984, or issued after March 7, 1984, by the applicable CFC pursuant to a binding commitment in effect on March 7, 1984, over (II) the average daily outstanding principal amount during the taxable year of the CFC obligations described in subclause (I), and

(ii) the portion of the equity of such applicable CFC allocable to the excess described in clause (i) (determined on the basis of the debt-equity ratio of such applicable CFC on March 31, 1984).

(D) APPLICABLE CFC.—For purposes of this paragraph, the term "applicable CFC" means any controlled foreign corporation (within the meaning of section 957)—

(i) which was in existence on March 31, 1984, and

(ii) the principal purpose of which on such date consisted of the issuing of CFC obligations and the holding of short-term obligations and lending the proceeds of such obligations to affiliates.

(E) AFFILIATES; UNITED STATES AFFILIATES.—For purposes of this paragraph—

(i) AFFILIATE.—The term "affiliate" means any person who is a related person (within the meaning of section 482 of the Internal Revenue Code of 1954) to the applicable CFC.

(ii) UNITED STATES AFFILIATE.—The term "United States affiliate" means any United States person which is an affiliate of the applicable CFC.

(F) UNITED STATES AFFILIATE OBLIGATIONS.—For purposes of this paragraph, the term "United States affiliate obligations" means any obligation of (and payable by) a United States affiliate.

(G) CFC OBLIGATION.—For purposes of this paragraph, the term "CFC obligation" means any obligation of (and issued by) a CFC if—

(i) the requirements of clause (i) of section 163(f)(2)(B) of the Internal Revenue Code of 1954 are met with respect to such obligation, and

(ii) in the case of an obligation issued after December 31, 1982, the requirements of clause (ii) of such section 163(f)(2)(B) are met with respect to such obligation.

(H) TREATMENT OF OBLIGATIONS WITH ORIGINAL ISSUE DISCOUNT.—For purposes of this paragraph, in the case of any obligation with original issue discount, the principal amount of such obligation as of any day shall be treated as equal to the revised issue price as of such day (as defined in section 1278(a)(4) of the Internal Revenue Code of 1954).

(I) APPLICABLE LIMIT.—For purposes of subparagraph (B)(ii)(I), the term "applicable limit" means the sum of—

(i) the equity of the applicable CFC on March 31, 1984, and

(ii) the aggregate principal amount of CFC obligations outstanding on March 31, 1984, which were issued by an applicable CFC—

(I) before March 8, 1984, or

(II) after March 7, 1984, pursuant to a binding commitment in effect on March 7, 1984.

(3) EXCEPTION FOR CERTAIN TERM OBLIGATIONS.—The amendments made by subsection (a) shall not apply to interest on any term obligations held by a foreign corporation on March 7, 1984. The preceding sentence shall not apply to any United States affiliate obligation (as defined in paragraph (2)(F)) held by an applicable CFC (as defined in paragraph (2)D)).

(4) DEFINITIONS.—Any term used in this subsection which is also used in section 904(g) of the Internal Revenue Code of 1954 (as added by subsection (a)) shall have the meaning given such term by such section 904(g).

(5) SEPARATE APPLICATION OF SECTION 904 IN CASE OF INCOME COVERED BY TRANSITIONAL RULES.—Subsections (a), (b), and (c) of section 904 of the Internal Revenue Code of 1954 shall be applied separately to any amount not treated as income derived from sources within the United States but which (but for the provisions of paragraphs (2) or (3) of this subsection) would be so treated under the amendments made by subsection (a). Any such separate application shall be made before any separate application required under section 904(d) of such Code.

(6) APPLICATION OF PARAGRAPH (5) DELAYED IN CERTAIN CASES.—In the case of a foreign corporation—

(A) which is a subsidary of a domestic corporation which has been engaged in manufacturing for more than 50 years, and

(B) which issued obligations on—

(i) September 24, 1979, denominated in French francs,

(ii) September 10, 1981, denominated in Swiss francs,

(iii) July 14, 1982, denominated in Swiss francs, and

(iv) December 1, 1982, denominated in United States dollars,

with a total principal amount of less than 200,000,000 United States dollars.

then paragraph (5) shall not apply to income received or accrued on such obligations before January 1, 1986.

SEC. 122. CERTAIN AMOUNTS TREATED AS INTEREST FOR PURPOSES OF THE LIMITATION ON THE FOREIGN TAX CREDIT.

(a) GENERAL RULE.—Subsection (d) of section 904 (relating to limitation on foreign tax credit) is amended by adding at the end thereof the following new paragraph:

"(3) CERTAIN AMOUNTS ATTRIBUTABLE TO UNITED STATES-OWNED FOREIGN CORPORATIONS, ETC., TREATED AS INTEREST.—

"(A) IN GENERAL.—For purposes of this subsection, dividends and interest—

"(i) paid or accrued by a designated payor corporation, and

"(ii) attributable to any taxable year of such corporation,

shall be treated as interest income described in paragraph (2) to the extent that the aggregate amount of such dividends and interest does not exceed the separate limitation interest of the designated payor corporation for such taxable year.

"(B) SEPARATE LIMITATION INTEREST.—For purposes of this subsection, the term 'separate limitation interest' means, with respect to any taxable year—

"(i) the aggregate amount of the interest income described in paragraph (2) (including amounts treated as so described by reason of this paragraph) which is received or accrued by the designated payor corporation during the taxable year, reduced by

"(ii) the deductions properly allocable (under regulations prescribed by the Secretary) to such income.

"(C) EXCEPTION WHERE DESIGNATED CORPORATION HAS SMALL AMOUNT OF SEPARATE LIMITATION INTEREST.—Subparagraph (A) shall not apply to any amount attributable to the taxable year of a designated payor corporation, if—

"(i) such corporation has earnings and profits for such taxable year, and

"(ii) less than 10 percent of such earnings and profits is attributable to separate limitation interest.

"(D) TREATMENT OF CERTAIN INTEREST.—For purposes of this paragraph, the amount of the separate limitation interest and the earnings and profits of any designated payor corporation shall be determined without any reduction for interest paid or accrued to a United States shareholder (as defined in section 951(b)) or a related person (within the meaning of section 267(b)) to such a shareholder.

"(E) DESIGNATED PAYOR CORPORATION.—For purposes of this paragraph, the term 'designated payor corporation' means—

"(i) any United States-owned foreign corporation (within the meaning of subsection (g)(6)),

"(ii) any other foreign corporation in which the taxpayer is a United States shareholder (as defined in section 951(b)) at any time during the taxable year of such foreign corporation, and

"(iii) any regulated investment company.

"(F) DETERMINATION OF YEAR TO WHICH AMOUNT IS ATTRIBUTABLE.—For purposes of determining whether an amount is attributable to a taxable year of a designated payor corporation—

"(i) any amount includible in gross income under section 551 or 951 in respect of such taxable year,

"(ii) any interest paid or accrued by such corporation during such taxable year, and

"(iii) any dividend paid out of the earnings and profits of such corporation for such taxable year,

shall be treated as attributable to such taxable year.

"(G) ORDERING RULES.—Subparagraph (A) shall be applied to amounts described therein in the order in which such amounts are described in subparagraph (F).

"(H) DIVIDEND.—For purposes of this paragraph, the term 'dividend' includes—

"(i) any amount includible in gross income under section 551 or 951, and

"(ii) any gain treated as ordinary income under section 1246 or as a dividend under section 1248.

"(I) DISTRIBUTIONS THROUGH OTHER ENTITIES.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this paragraph in the case of distributions or payments through 1 or more entities.

"(J) INTEREST FROM MEMBERS OF SAME AFFILIATED GROUP.—For purposes of this paragraph, interest received or accrued by the designated payor corporation from another member of the same affiliated group (determined under section 1504 without regard to subsection (b)(3) thereof) shall not be treated as separate limitation interest, under such interest is attributable directly or indirectly to separate limitation interest of such other member."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

(2) SPECIAL RULES FOR INTEREST INCOME.—

(A) IN GENERAL.—Interest income received or accrued by a designated payor corporation shall be taken into account for purposes of the amendment made by subsection (a) only in taxable years beginning after the date of the enactment of this Act.

(B) EXCEPTION FOR INVESTMENT AFTER JUNE 22, 1984.—Notwithstanding subparagraph (A), the amendment made by subsection (a) shall apply to interest income received or accrued by a designated payor after the date of enactment of this Act if it is attributable to investment in the designated payor after June 22, 1984.

(3) TERM OBLIGATIONS OF DESIGNATED PAYOR CORPORATIONS WHICH ARE NOT APPLICABLE CFC.—In the case of any designated payor corporation which is not an applicable CFC (as defined in section 131(b)(2)(D)), any interest received or accrued by such corporation on a term obligation held by such corporation on March 7, 1984, shall not be taken into account.

SEC. 123. TREATMENT OF RELATED PERSON FACTORING INCOME.

(a) GENERAL RULE.—Section 864 (relating to source definitions) is amended by adding at the end thereof the following new subsection:

"(d) TREATMENT OF RELATED PERSON FACTORING INCOME.—

"(1) IN GENERAL.—For purposes of the provisions set forth in paragraph (2), if any person acquires (directly or indirectly) a trade or service receivable from a related person, any income of such person from the trade or service receivable so acquired shall be treated as if it were interest on a loan to the obligor under the receivable.

"(2) PROVISIONS TO WHICH PARAGRAPH (1) APPLIES.—The provisions set forth in this paragraph are as follows:

"(A) Part III of subchapter G of this chapter (relating to foreign personal holding companies).

"(B) Section 904 (relating to limitation on foreign tax credit).

"(C) Subpart F of part III of this subchapter (relating to controlled foreign corporations).

"(3) TRADE OR SERVICE RECEIVABLE.—For purposes of this subsection, the term 'trade or service receivable' means any account receivable or evidence of indebtedness arising out of—

"(A) the disposition by a related person of property described in section 1221(1), or

"(B) the performance of services by a related person.

"(4) RELATED PERSON.—For purposes of this subsection, the term 'related person' means—

"(A) any person who is a related person (within the meaning of section 267(b)), and

"(B) any United States shareholder (as defined in section 951(b)) and any person who is a related person (within the meaning of section 267(b)) to such a shareholder.

"(5) CERTAIN PROVISIONS NOT TO APPLY.—

"(A) CERTAIN EXCEPTIONS.—The following provisions shall not apply to any amount treated as interest under paragraph (1) or (6):

"(i) Subparagraphs (A), (B), (C), and (D) of section 904(d)(2) (relating to interest income to which separate limitation applies).

"(ii) Subparagraph (A) of section 954(b)(3) (relating to exception where foreign base company income is less than 10 percent).

"(iii) Subparagraph (B) of section 954(c)(3) (relating to certain income derived in active conduct of trade or business).

"(iv) Subparagraphs (A) and (B) of section 954(c)(4) (relating to exception for certain income received from related persons).

"(B) SPECIAL RULES FOR POSSESSIONS.—

"(i) PUERTO RICO AND POSSESSIONS TAX CREDIT.—Any amount treated as interest under paragraph (1) shall not be treated as income described in subparagraph (A) or (B) of section 936(a)(1) unless such amount is from sources within a possession of the United States (determined after the application of paragraph (1)).

"(ii) VIRGIN ISLANDS CORPORATIONS.—Subsection (b) of section 934 shall not apply to any amount treated as interest under paragraph (1) unless such amount is from sources within the Virgin Islands (determined after the application of paragraph (1)).

"(6) SPECIAL RULE FOR CERTAIN INCOME FROM LOANS OF A CONTROLLED FOREIGN CORPORATION.—Any income of a controlled foreign corporation (within the meaning of section 957(a)) from a loan to a person other than a related person for the purpose of financing—

"(A) the purchase of property described in section 1221(1) of such related person, or

"(B) the payment for the performance of services by such related person,

shall be treated as interest described in paragraph (1).

"(7) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to prevent the avoidance of the provisions of this subsection or section 956(b)(3)."

(b) TREATMENT AS UNITED STATES PROPERTY.—Subsection (b) of section 956 (defining United States property) is amended by adding at the end thereof the following new paragraph:

"(3) CERTAIN TRADE OR SERVICE RECEIVABLES ACQUIRED FROM RELATED UNITED STATES PERSONS.—

"(A) IN GENERAL.—Notwithstanding paragraph (2), the term 'United States property' includes any trade or service receivable if—

"(i) such trade or service receivable is acquired (directly or indirectly) from a related person who is a United States person, and

"(ii) the obligor under such receivable is a United States person.

"(B) DEFINITIONS.—For purposes of this paragraph, the term 'trade or service receivable' and 'related person' have the respective meanings given to such terms by section 864(d)."

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to accounts receivable and evidences of indebtedness transferred after March 1, 1984, in taxable years ending after such date.

(2) TRANSITIONAL RULE.—The amendments made by this section shall not apply to accounts receivable and evidences of indebtedness acquired after March 1, 1984, and before March 1, 1984, by a Belgian corporation in existence on March 1, 1984, in any taxable year ending after such date, but only to the extent that the investment in United States property of such corpora-

tion for all such taxable years is not reduced by reason of this paragraph by more than the lesser of—

(A) $15,000,000 or

(B) the amount of the Belgian corporation's investment on or before March 1, 1984, in stock of a foreign corporation formed to issue bonds outside the United States to the public.

SEC. 124. TREATMENT OF CERTAIN TRANSPORTATION INCOME.

(a) GENERAL RULE.—Section 863 (relating to items not specified in section 861 or 862) is amended by adding at the end thereof the following new subsection:

"(c) SOURCE RULE FOR CERTAIN TRANSPORTATION INCOME.—

"(1) TRANSPORTATION BEGINNING AND ENDING IN THE UNITED STATES.—All transportation income attributable to transportation which begins and ends in the United States shall be treated as derived from sources within the United States.

"(2) TRANSPORTATION BETWEEN UNITED STATES AND ANY POSSESSION.—

"(A) IN GENERAL.—50 percent of all transportation income attributable to transportation which—

"(i) begins in the United States and ends in a possession of the United States, or

"(ii) begins in a possession of the United States and ends in the United States,

shall be treated as derived from sources within the United States.

"(B) SPECIAL RULE FOR CERTAIN LESSORS OF AIRCRAFT.—If—

"(i) the taxpayer owns an aircraft which is section 38 property and leases such aircraft to a United States person (other than a member of the same controlled group of corporations (as defined in section 1563) as the taxpayer), and

"(ii) such United States person is a regularly scheduled air carrier,

subparagraph (A) shall be applied by substituting '100 percent' for '50 percent'.

"(3) TRANSPORTATION INCOME.—For purposes of this subsection, the term 'transportation income' means any income derived from, or in connection with—

"(A) the use (or hiring or leasing for use) of a vessel or aircraft, or

"(B) the performance of services directly related to the use of a vessel or aircraft.

For purposes of the preceding sentence, the term 'vessel or aircraft' includes any container used in connection with a vessel or aircraft."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to transportation beginning after the date of the enactment of this Act in taxable years ending after such date.

SEC. 125. TREATMENT OF CERTAIN DISTRIBUTIONS RECEIVED BY UNITED STATES-OWNED FOREIGN CORPORATIONS.

(a) GENERAL RULE.—Section 535 (defining accumulated taxable income) is amended by adding at the end thereof the following new subsection:

"(d) INCOME DISTRIBUTED TO UNITED STATES-OWNED FOREIGN CORPORATION RETAINS UNITED STATES CONNECTION.—

"(1) IN GENERAL.—For purposes of this part, if 10 percent or more of the earnings and profits of any foreign corporation for any taxable year—

"(A) is derived from sources within the United States, or

"(B) is effectively connected with the conduct of a trade or business within the United States,

any distribution out of such earnings and profits (and any interest payment) received (directly or through 1 or more other entities) by a United States-owned foreign corporation shall be treated as derived by such corporation from sources within the United States.

"(2) UNITED STATES-OWNED FOREIGN CORPORATION.—The term 'United States-owned foreign corporation' has the meaning given to such term by section 904(g)(6)."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendment made by subsection (a) shall apply to distributions and interest payments received by a United States-owned foreign corporation (within the meaning of section 535(d) of the Internal Revenue Code of 1954) on or after May 23, 1983, in taxable years ending on or after such date.

(2) CORPORATIONS IN EXISTENCE ON MAY 23, 1983.—In the case of a United States-owned foreign corporation (as so defined) in existence on May 23, 1983, the amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1984.

SEC. 126. ALLOCATION UNDER SECTION 861 OF RESEARCH AND EXPERIMENTAL EXPENDITURES.

(a) IN GENERAL.—For purposes of section 861(b), section 862(b), and section 863(b) of the Internal Revenue Code of 1954, all amounts allowable as a deduction for qualified research and experimental expenditures shall be allocated to income from sources within the United States and deducted from such income in determining the amount of taxable income from sources within the United States.

(b) QUALIFIED RESEARCH AND EXPERIMENTAL EXPENDITURES.—For purposes of this section—

(1) IN GENERAL.—The term "qualified research and experimental expenditures" means amounts—

(A) which are research and experimental expenditures within the meaning of section 174 of such Code, and

(B) which are attributable to activities conducted in the United States.

(2) TREATMENT OF DEPRECIATION, ETC.—Rules similar to the rules of subsection (c) of section 174 of such Code shall apply.

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—This section shall apply to taxable years beginning after August 13, 1983, and on or before August 1, 1985.

(2) SPECIAL RULE.—If the taxpayer's 3rd taxable year beginning after August 13, 1981, is not described in paragraph (1), this section shall apply also to such 3rd taxable year.

PART II—WITHHOLDING PROVISIONS

SEC. 127. REPEAL OF THE 30 PERCENT TAX ON INTEREST RECEIVED BY FOREIGNERS ON CERTAIN PORTFOLIO INVESTMENTS.

(a) REPEAL OF TAX ON NONRESIDENT INDIVIDUALS.—

(1) IN GENERAL.—Section 871 (relating to 30 percent tax on income not connected with United States business), as amended by this Act, is amended by redesignating subsection (i) as subsection (j) and by adding at the end thereof the following new subsection:

"(i) REPEAL OF TAX ON INTEREST OF NONRESIDENT ALIEN INDIVIDUALS RECEIVED FROM CERTAIN PORTFOLIO DEBT INVESTMENTS.—

"(1) IN GENERAL.—In the case of any portfolio interest received by a nonresident individual from sources within the United States, no tax shall be imposed under paragraph (1)(A) or (1)(C) of subsection (a).

"(2) PORTFOLIO INTEREST.—For purposes of this subsection, the term 'portfolio interest' means any interest (including original issue discount) which is described in any of the following subparagraphs:

"(A) CERTAIN OBLIGATIONS WHICH ARE NOT REGISTERED.—Interest which is paid on any obligation which—

"(i) is not in registered form, and

"(ii) is described insection 163(f)(2)(B).

"(B) CERTAIN REGISTERED OBLIGATIONS.—Interest which is paid on an obligation—

"(i) which is in registered form, and

"(ii) with respect to which the United States person who is, or would otherwise be, required to deduct and withhold tax from such interest under section 1441(a) has received a statement (which meets the requirements of paragraph (4)) that the beneficial owner of the obligation is not a United States person.

"(3) PORTFOLIO INTEREST NOT TO INCLUDE INTEREST RECEIVED BY 10-PERCENT SHAREHOLDERS.— For purposes of this subsection—

"(A) IN GENERAL.—The term 'portfolio interest' shall not include any interest described in subparagraph (A) or (B) of paragraph (2) which is received by a 10-percent shareholder.

"(B) 10-PERCENT SHAREHOLDER.—The term '10-percent shareholder' means—

"(i) in the case of an obligation issued by a corporation, any person who owns 10 percent or more of the total combined voting power of all classes of stock of such corporation entitled to vote, or

"(ii) in the case of an obligation issued by a partnership, any person who owns 10 percent or more of the capital or profits interest in such partnership.

"(C) ATTRIBUTION RULES.—For purposes of determining ownership of stock under subparagraph (B)(i) the rules of section 318(a) shall apply, except that—

"(i) Section 318(a)(2)(C) shall be applied without regard to the 50-percent limitation therein, and

"(ii) any stock which a person is treated as owning after application of section 318(a)(4) shall not, for purposes of applying paragraphs (2) and (3) of section 318(a), be treated as actually owned by such person.

Under regulations prescribed by the Secretary, rules similar to the rules of the preceding sentence shall be applied in determining the ownership of the capital or profits interest in a partnership for purposes of subparagraph (B)(ii).

"(4) CERTAIN STATEMENTS.—A statement with respect to any obligation meets the requirements of this paragraph if such statement is made by—

"(A) the beneficial owner of such obligation, or

"(B) a securities clearing organization, a bank, or other financial institution that holds customers' securities in the ordinary course of its trade or business.

The preceding sentence shall not apply to any statement with respect to payment of interest on any obligation by any person if, at least one month before such payment, the Secretary has published a determination that any statement from such person (or any class including such person) does not meet the requirements of this paragraph.

"(5) SECRETARY MAY PROVIDE SUBSECTION NOT TO APPLY IN CASES OF INADEQUATE INFORMATION EXCHANGE.—

"(A) IN GENERAL.—If the Secretary determines that the exchange of information between the United States and a foreign country is inadequate to prevent evasion of the United States income tax by United States persons, the Secretary may provide in writing (and publish a statement) that the provisions of this subsection shall not apply to payments of interest to any person within such foreign country (or payments addressed to, or for the account of, persons within such foreign country) during the period—

"(i) beginning on the date specified by the Secretary, and

"(ii) ending on the date that the Secretary determines that the exchange of information between the United States and the foreign country is adequate to prevent the evasion of United States income tax by United States persons.

"(B) Exception for certain obligations.—Subparagraph (A) shall not apply to the payment of interest on any obligation which is issued on or before the date of the publication of the Secretary's determination under such subparagraph.

"(6) Registered form.—For purposes of this subsection, the term 'registered form' has the same meaning given such term by section 163(f).".

(2) Conforming amendment.—Paragraph (1) of section 871(a) (relating to tax on income other than capital gains) is amended by striking out "There" and inserting in lieu thereof "Except as provided in subsection (i), there".

(b) Foreign Corporations.—

(1) In general.—Section 881 (relating to tax on income of foreign corporations not connected with United States business), as amended by this Act, is amended by redesignating subsection (c) as subsection (d) and by adding after subsection (b) the following new subsection:

"(c) Repeal of Tax on Interest of Foreign Corporations Received From Certain Portfolio Debt Investments.—

"(1) In general.—In the case of any portfolio interest received by a foreign corporation from sources within the United States, no tax shall be imposed under paragraph (1) of subsection (a).

"(2) Portfolio interest.—For purposes of this subsection, the term 'portfolio interest' means any interest (including original issue discount) which is described in any of the following subparagraphs:

"(A) Certain obligations which are not registered.—Interest which is paid on any obligation which is described in section 871(i)(2)(A).

"(B) Certain registered obligations.—Interest which is paid on an obligation—

"(i) which is in registered form, and

"(ii) with respect to which the person who is, or would otherwise be, required to deduct and withhold tax from such interest under section 1442(a) has received a statement which meets the requirements of section 871(i)(4) that the beneficial owner of the obligation is not a United States person.

"(3) Portfolio interest shall not include interest received by certain persons.—For purposes of this subsection, the term 'portfolio interest' shall not include any portfolio interest which—

"(A) except in the case of interest paid on an obligation of the United States, is received by a bank on an extension of credit made pursuant to a loan agreement entered into in the ordinary course of its trade or business, or

"(B) is received by a 10-percent shareholder (within the meaning of section 871(i)(3)(B)).

"(4) Special rules for controlled foreign corporations.—

"(A) IN GENERAL.—In the case of any portfolio interest received by a controlled foreign corporation, the following provisions shall not apply:

"(i) Subparagraph (A) of section 954(b)(3) (relating to exception where foreign base company income is less than 10 percent).

"(ii) Paragraph (4) of section 954(b) (relating to corporations not found or availed of to avoid tax).

"(iii) Subparagraph (B) of section 954(c)(3) (relating to certain income derived in active conduct of trade or business).

"(iv) Subparagraph (C) of section 954(c)(3) (relating to certain income derived by an insurance company).

"(v). Subparagraphs (A) and (B) of section 954(c)(4) (relating to exception for certain income received from related persons).

"(B) INTEREST RECEIVED FROM RELATED PERSONS.—This subsection shall not apply to any portfolio interest received by a controlled foreign corporation from a related person (within the meaning of section 864(d)(4)).

"(C) CONTROLLED FOREIGN CORPORATION.—The term 'controlled foreign corporation' has the meaning given such term by section 957(a).

"(5) SECRETARY MAY CEASE APPLICATION OF THIS SUBSECTION.—Under rules similar to the rules of section 871(i)(5), the Secretary may provide that this subsection shall not apply to payments of interest described in section 871(i)(5).

"(6) REGISTERED FORM.—For purposes of this subsection, the term "registered form' has the meaning given such term by section 163(f)."

(2) CONFORMING AMENDMENT.—Subsection (a) of section 881 (relating to imposition of tax) is amended by striking out "There" and inserting in lieu thereof "Except as provided in subsection (c), there".

(c) AMENDMENT OF SECTION 864(c)(2).—Paragraph (2) of section 864(c) (relating to effectively connected income, etc.) is amended by striking out "section 871(a)(1) or section 881(a)" and inserting in lieu thereof "section 871(a)(1), section 871(i) section 881(a), or section 881(c)".

(d) AMENDMENT OF SECTION 2105.—Subsection (b) of section 2105 (relating to property without the United States) is amended to read as follows:

"(b) BANK DEPOSITS AND CERTAIN OTHER DEBT OBLIGATIONS.—For purposes of this subchapter—

"(1) amounts described in section 861(c), if any interest thereon would be treated by reason of section 861(a)(1)(A) as income from sources without the United States were such interest received by the decedent at the time of his death,

"(2) deposits with a foreign branch of a domestic corporation or domestic partnership, if such branch is engaged in the commercial banking business, and

"(3) debt obligations, if, without regard to whether a statement meeting the requirements of section 871(i)(4) has been received, any interest thereon would be eligible for the exemption

from tax under section 871(i)(1) were such interest received by the decedent at the time of his death,

shall not be deemed property within the United States.".

(e) WITHHOLDING.—

(1) NONRESIDENT ALIENS.—Subsection (c) of section 1441 (relating to withholding of tax on nonresident aliens) is amended by adding at the end thereof the following new paragraph:

"(9) INTEREST INCOME FROM CERTAIN PORTFOLIO DEBT INVESTMENTS.—In the case of portfolio interest (within the meaning of 871(i)(2)), no tax shall be required to be deducted and withheld from such interest unless the person required to deduct and withhold tax from such interest knows, or has reason to know, that such interest is not portfolio interest by reason of section 871(i)(3).".

(2) FOREIGN CORPORATIONS.—The last sentence of section 1442(a) is amended—

(A) by striking out "and" after "section 881(a)(4),", and

(B) by inserting ", and the references in section 1441(c)(9) to section 871(l)(1) and 871(i)(3) shall be treated as referring to sections 881(c)(1) and 881(c)(3)".

(f) REGISTERED OBLIGATIONS.—Subparagraph (C)(i) of section 163(f)(2) (relating to authority to include other obligations) is amended to read as follows:

"(i) in the case of—

"(I) subparagraph (A), such obligation is of a type which the Secretary has determined by regulations to be used frequently in avoiding Federal taxes, or

"(II) subparagraph (B), such obligation is of a type specified by the Secretary in regulations and".

(g) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to interest received after the date of the enactment of this Act with respect to obligations issued after such date, in taxable years ending after such date.

(2) SUBSECTION (d).—The amendment made by subsection (d) shall apply to obligations issued after the date of the enactment of this Act with respect to the estates of decedents dying after such date.

(3) SPECIAL RULE FOR CERTAIN UNITED STATES AFFILIATE OBLIGATIONS.—

(A) IN GENERAL.—For purposes of the Internal Revenue Code of 1954, payments of interest on a United States affiliate obligation to an applicable CFC in existence on or before June 22, 1984, shall be treated as payments to a resident of the country in which the applicable CFC is incorporated.

(B) EXCEPTION.—Subparagraph (A) shall not apply to any applicable CFC which did not meet requirements which are based on the principles set forth in Revenue Rulings 69-501, 69-377, 70-645, and 73-110.

(C) DEFINITIONS.—

(i) The term "applicable CFC" has the meaning given such term by section 131(b)(2)(D) of this Act, except that

such section shall be applied by substituting "the date of interest payment" for "March 31, 1984," in clause (i) thereof.

(ii) The term "United States affiliate obligation" means an obligation described in section 131(b)(2)(F) of this Act which was issued before June 22, 1984.

SEC. 128. TREATMENT OF UNITED STATES SOURCE ORIGINAL ISSUE DISCOUNT IN CASE OF FOREIGN PERSONS.

(a) NONRESIDENT ALIEN INDIVIDUALS.—

"(1) IN GENERAL.—Subparagraph (C) of section 871(a)(1) (relating to income not connected with United States business) is amended to read as follows:

"(C) in the case of—

"(i) a sale or exchange of an original issue discount obligation, the amount of any gain not in excess of the original issue discount accruing while such obligation was held by the nonresident alien individual (to the extent such discount was not theretofore taken into account under clause (ii)), and

"(ii) the payment of interest on an original issue discount obligation, an amount equal to the original issue discount accrued on such obligation since the last payment of interest thereon (except that such original issue discount shall be taken into account under this clause only to the extent that the tax thereon does not exceed the interest payment less the tax imposed by subparagraph (A) thereon), and".

(2) DEFINITIONS AND SPECIAL RULES.—Section 871 is amended by redesignating subsection (g) as subsection (h) and by inserting after subsection (f) the following new subsection:

"(g) SPECIAL RULES FOR ORIGINAL ISSUE DISCOUNT.—For purposes of this section and section 881—

"(1) ORIGINAL ISSUE DISCOUNT OBLIGATION.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'original issue discount obligation' means any bond or other evidence of indebtedness having original issue discount (within the meaning of section 1273).

"(B) EXCEPTIONS.—The term 'original issue discount obligation' shall not include—

"(i) CERTAIN SHORT-TERM OBLIGATIONS.—Any obligation payable 183 days or less from the date of original issue (without regard to the period held by the taxpayer).

"(ii) TAX-EXEMPT OBLIGATIONS.—Any obligation the interest on which is exempt from tax under section 103 or under any other provision of law without regard to the identity of the holder.

"(2) DETERMINATION OF PORTION OF ORIGINAL ISSUE DISCOUNT ACCRUING DURING ANY PERIOD.—The determination of the amount of the original issue discount which accrues during any period shall be made under the rules of section 1272 (or the corresponding provisions of prior law) without regard to any exception for short-term obligations.

"(3) SOURCE OF ORIGINAL ISSUE DISCOUNT.—Except to the extent provided in regulations prescribed by the Secretary, the determination of whether any amount described in subsection (a)(1)(C) is from sources within the United States shall be made at the time of the payment (or sale or exchange) as if such payment (or sale or exchange) involved the payment of interest.

"(4) STRIPPED BONDS.—The provisions of section 1286 (relating to the treatment of stripped bonds and stripped coupons as obligations with original issue discount) shall apply for purposes of this section."

(b) FOREIGN CORPORATIONS.—

(1) IN GENERAL.—Paragraph (3) of section 881(a) (relating to tax on income of foreign corporations not connected with United States business) is amended to read as follows:

"(3) in the case of—

"(A) a sale or exchange of an original issue discount obligation, the amount of any gain not in excess of the original issue discount accruing while such obligation was held by the foreign corporation (to the extent such discount was not therefore taken into account under subparagraph (B)), and

"(B) the payment of interest on an original issue discount obligation, an amount equal to the original issue discount accrued on such obligation since the last payment of interest thereon (except that such original issue discount shall be taken into account under this subparagraph only to the extent that the tax thereon does not exceed the interest payment less the tax imposed by paragraph (1) thereon), and".

(2) CROSS REFERENCE.—Subsection (c) of section 881 (relating to doubling of tax) is amended to read as follows:

"(c) CROSS REFERENCE.—

"For doubling of tax on corporations of certain foreign countries, see section 891.

"For special rules for original issue discount, see section 871(g)."

(c) DEDUCTION FOR ORIGINAL ISSUE DISCOUNT HELD BY RELATED FOREIGN PERSON.—Subsection (e) of section 163 (relating to original issue discount), as amended by this Act, is amended by redesignating paragraph (3) as paragraph (4), and by inserting after paragraph (2) the following new paragraph:

"(3) SPECIAL RULE FOR ORIGINAL ISSUE DISCOUNT ON OBLIGATION HELD BY RELATED FOREIGN PERSON.—

"(A) IN GENERAL.—If any debt instrument having original issue discount is held by a related foreign person, any portion of such original issue discount shall not be allowable as a deduction to the issuer until paid.

"(B) RELATED FOREIGN PERSON.—For purposes of subparagraph (A), the term 'related foreign person' means any person—

"(i) who is not a United States person, and

"(ii) who is related (within the meaning of section 267(b)) to the issuer."

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to payments made

on or after the 60th day after the date of the enactment of this Act with respect to obligations issued after March 31, 1972.

(2) SUBSECTION (c).—The amendment made by subsection (c) shall apply to obligations issued after June 9, 1984.

SEC. 129. WITHHOLDING OF TAX ON DISPOSITIONS OF UNITED STATES REAL PROPERTY INTERESTS.

(a) WITHHOLDING OF TAX.—

(1) IN GENERAL.—Subchapter A of chapter 3 (relating to withholding of tax on nonresident aliens and foreign corporations) is amended by adding at the end thereof the following new section:

"SEC. 1445. WITHHOLDING OF TAX ON DISPOSITIONS OF UNITED STATES REAL PROPERTY INTERESTS.

"(a) GENERAL RULE.—Except as otherwise provided in this section, in the case of any disposition of a United States real property interest (as defined in section 897(c)) by a foreign person, the transferee shall be required to deduct and withhold a tax equal to 10 percent of the amount realized on the disposition.

"(b) EXEMPTIONS.—

"(1) IN GENERAL.—No person shall be required to deduct and withhold any amount under subsection (a) with respect to a disposition if paragraph (2), (3), (4), (5), or (6) applies to the transaction.

"(2) TRANSFEROR FURNISHES NONFOREIGN AFFIDAVIT.—Except as provided in paragraph (7), this paragraph applies to the disposition if the transferor furnishes to the transferee an affidavit by the transferor stating, under penalty or perjury, the transferor's United States taxpayer identification number and that the transferor is not a foreign person.

"(3) NONPUBLICLY TRADED DOMESTIC CORPORATION FURNISHES AFFIDAVIT THAT IT IS NOT A UNITED STATES REAL PROPERTY HOLDING CORPORATION.—Except as provided in paragraph (7), this paragraph applies in the case of a disposition of any interest in any domestic corporation, if the domestic corporation furnishes to the transferee an affidavit by the domestic corporation stating, under penalty or perjury, that the domestic corporation is not and has not been a United States real property holding corporation (as defined in section 897(c)(2)) during the applicable period specified in section 897(c)(1)(A)(ii).

"(4) TRANSFEREE RECEIVES QUALIFYING STATEMENT.—

"(A) IN GENERAL.—This paragraph applies to the disposition if the transferee receives a qualifying statement at such time, in such manner, and subject to such terms and conditions as the Secretary may by regulations prescribe.

"(B) QUALIFYING STATEMENT.—For purposes of subparagraph (A), the term 'qualifying statement' means a statement by the Secretary that—

"(i) the transferor either—

"(I) has reached agreement with the Secretary (or such agreement has been reached by the transferee) for the payment of any tax imposed by section 871(b)(1) or 882(a)(1) on any gain recognized by the

transferor on the disposition of the United States real property interest, or

"(II) is exempt from any tax imposed by section 871(b)(1) or 882(a)(1) on any gain recognized by the transferor on the disposition of the United States real property interest, and

"(ii) the transferor or transferee has satisfied any transferor's unsatisfied withholding liability or has provided adequate security to cover such liability.

"(5) RESIDENCE WHERE AMOUNT REALIZED DOES NOT EXCEED $300,000.—This paragraph applies to the disposition if—

"(A) the property is acquired by the transferee for use by him as a residence, and

"(B) the amount realized for the property does not exceed $300,000.

"(6) STOCK REGULARLY TRADED ON ESTABLISHED SECURITIES MARKET.—This paragraph applies if the disposition is of a share of a class of stock that is regularly traded on an established securities market.

"(7) SPECIAL RULES FOR PARAGRAPHS (2) AND (3).—Paragraph (2) or (3) (as the case may be) shall not apply to any disposition—

"(A) if—

"(i) the transferee has actual knowledge that the affidavit referred to in such paragraph is false, or

"(ii) the transferee receives a notice (as described in subsection (d)) from a transferor's agent or a transferee's agent that such affidavit is false, or

"(B) if the Secretary by regulations requires the transferee to furnish a copy of such affidavit to the Secretary and the transferee fails to furnish a copy of such affidavit to the Secretary at such time and in such manner as required by such regulations.

"(c) LIMITATIONS ON AMOUNT REQUIRED TO BE WITHHELD.—

"(1) CANNOT EXCEED TRANSFEROR'S MAXIMUM TAX LIABILITY.—

"(A) IN GENERAL.—The amount required to be withheld under this section with respect to any disposition shall not exceed the amount (if any) determined under subparagraph (B) as the transferor's maximum tax liability.

"(B) REQUEST.—At the request of the transferor or transferee, the Secretary shall determine, with respect to any disposition, the transferor's maximum tax liability.

"(C) REFUND OF EXCESS AMOUNTS WITHHELD.—Subject to such terms and conditions as the Secretary may by regulations prescribe, a transferor may seek and obtain a refund of any amounts withheld under this section in excess of the transferor's maximum tax liability.

"(2) AUTHORITY OF SECRETARY TO PRESCRIBE REDUCED AMOUNT.—At the request of the transferor or transferee, the Secretary may prescribe a reduced amount to be withheld under this section if the Secretary determines that to substitute such reduced amount will not jeopardize the collection of the tax imposed by section 871(b)(1) or 882(a)(1).

"(3) PROCEDURAL RULES.—

"(A) REGULATIONS.—Requests for—

"(i) qualifying statements under subsection (b)(4),

"(ii) determinations of transferor's maximum tax liability under paragraph (1), and

"(iii) reductions under paragraph (2) in the amount required to be withheld,

shall be made at the time and manner, and shall include such information, as the Secretary shall prescribe by regulations.

"(B) REQUESTS TO BE HANDLED WITHIN 90 DAYS.—The Secretary shall take action with respect to any request described in subparagraph (A) within 90 days after the Secretary receives the request.

"(d) LIABILITY OF TRANSFEROR'S AGENTS OR TRANSFEREE'S AGENTS.—

"(1) NOTICE OF FALSE AFFIDAVIT; FOREIGN CORPORATIONS.—If—

"(A) the transferor furnishes the transferee an affidavit described in paragraph (2)(A) of subsection (b) or a domestic corporation furnishes the transferee an affidavit described in paragraph (3) of subsection (b), and

"(B) any transferor's agent or transferee's agent has actual knowledge that such affidavit is false or the transferor is a foreign corporation,

such agent shall so notify the transferee at such time and in such manner as the Secretary shall require by regulations.

"(2) FAILURE TO FURNISH NOTICE.—

"(A) IN GENERAL.—If any transferor's agent or transferee's agent is required by paragraph (1) to furnish notice, but fails to furnish such notice at such time or times and in such manner as may be required by regulations, such agent shall have the same duty to deduct and withhold that the transferee would have had if such agent had complied with paragraph (1).

"(B) LIABILITY LIMITED TO AMOUNT OF COMPENSATION.—An agent's liability under subparagraph (A) shall be limited to the amount of compensation the agent derives from the transaction.

"(3) TRANSFEROR'S AGENT.—For purposes of this subsection, the term 'transferor's agent' means any person who represents the transferor—

"(A) in any negotiation with the transferee or any transferee's agent related to the transaction, or

"(B) in settling the transaction.

"(4) TRANSFEREE'S AGENT.—For purposes of this subsection, the term 'transferee's agent' means any person who represents the transferee—

"(A) in any negotiation with the transferor or any transferor's agent related to the transaction, or

"(B) in settling the transaction.

"(5) SETTLEMENT OFFICER NOT TREATED AS TRANSFEROR'S AGENT.—For purposes of this subsection, a person shall not be treated as a transferor's agent or transferee's agent with respect

to any transaction merely because such person performs 1 or more of the following acts:

"(A) The receipt and the disbursement of any portion of the consideration for the transaction.

"(B) The recording of any document in connection with the transaction.

"(e) SPECIAL RULES RELATING TO DISTRIBUTIONS, ETC., BY CORPORATIONS, PARTNERSHIPS, TRUSTS, OR ESTATES.—

"(1) CERTAIN DOMESTIC PARTNERSHIPS, TRUSTS, AND ESTATES.—A domestic partnership, the trustee of a domestic trust, or the executor of a domestic estate shall be required to deduct and withhold under subsection (a) a tax equal to 10 percent of any amount of which such partnership, trustee, or executor has custody which is—

"(A) attributable to the disposition of a United States real property interest (as defined in section 897(c), other than a disposition described in paragraph (4) or (5)), and

"(B) either—

"(i) includible in the distributive share of a partner of the partnership who is a foreign person,

"(ii) includible in the income of a beneficiary of the trust or estate who is a foreign person, or

"(iii) includible in the income of a foreign person under the provisions of section 671.

"(2) CERTAIN DISTRIBUTIONS BY FOREIGN CORPORATIONS.—In the case of any distribution by a foreign corporation on which gain is recognized under subsection (d) or (e) of section 897, the foreign corporation shall deduct and withhold under subsection (a) a tax equal to 28 percent of the amount of gain recognized on such distribution under such subsection.

"(3) DISTRIBUTIONS BY CERTAIN DOMESTIC CORPORATIONS TO FOREIGN SHAREHOLDERS.—If a domestic corporation which is or has been a United States real property holding corporation (as defined in section 897(c)(2)) during the applicable period specified in section 897(c)(1)(A)(ii) distributes property to a foreign person in a transaction to which section 302 or part II of subchapter C applies, such corporation shall deduct and withhold under subsection (a) a tax equal to 10 percent of the amount realized by the foreign shareholder.

"(4) TAXABLE DISTRIBUTIONS BY DOMESTIC OR FOREIGN PARTNERSHIPS, TRUSTS, OR ESTATES.—A domestic or foreign partnership, the trustee of a domestic or foreign trust, or the executor of a domestic or foreign estate shall be required to deduct and withhold under subsection (a) a tax equal to 10 percent of the fair market value (as of the time of the taxable distribution) of any United States real property interest distributed to a partner of the partnership or a beneficiary of the trust or estate, as the case may be, who is a foreign person in a transaction which would constitute a taxable distribution under the regulations promulgated by the Secretary pursuant to section 897(g).

"(5) RULES RELATING TO DISPOSITIONS OF INTEREST IN PARTNERSHIPS, TRUSTS, OR ESTATES.—To the extent provided in regulations, the transferee of a partnership interest or of a beneficial interest in a trust or estate shall be required to deduct and

withhold under subsection (a) a tax equal to 10 percent of the amount realized on the disposition.

"(6) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including regulations providing for exceptions from provisions of this subsection.

"(f) DEFINITIONS.—For purposes of this section—

"(1) TRANSFEROR.—The term 'transferor' means the person disposing of the United States real property interest.

"(2) TRANSFEREE.—The term 'transferee' means the person acquiring the United States real property interest.

"(3) FOREIGN PERSON.—The term 'foreign person' means any person other than a United States person.

"(4) TRANSFEROR'S MAXIMUM TAX LIABILITY.—The term 'transferor's maximum tax liability' means, with respect to the disposition of any interest, the sum of—

"(A) the maximum amount which the Secretary determines could be imposed as tax under section 871(b)(1) or 882(a)(1) by reason of the disposition, plus

"(B) the amount the Secretary determines to be the transferor's unsatisfied withholding liability with respect to such interest.

"(5) TRANSFEROR'S UNSATISFIED WITHHOLDING LIABILITY.—The term 'transferor's unsatisfied withholding liability' means the withholding obligation imposed by this section on the transferor's acquisition of the United States real property interest or on the acquisition of a predecessor interest, to the extent such obligation has not been satisfied."

(2) CLERICAL AMENDMENT.—The table of sections for subchapter A of chapter 3 is amended by adding at the end thereof the following new item:

"Sec. 1445. Withholding of tax on dispositions of United States real property interests."

(b) REPORTING REQUIREMENTS LIMITED TO FOREIGN PERSONS HOLDING DIRECT INVESTMENTS IN UNITED STATES REAL PROPERTY.—

(1) IN GENERAL.—Section 6039C (relating to returns with respect to United States real property interests) is amended to read as follows:

"SEC. 6039C. RETURNS WITH RESPECT TO FOREIGN PERSONS HOLDING DIRECT INVESTMENTS IN UNITED STATES REAL PROPERTY INTERESTS.

"(a) GENERAL RULE.—To the extent provided in regulations, any foreign person holding direct investments in United States real property interests for the calendar year shall make a return setting forth—

"(1) the name and address of such person,

"(2) a description of all United States real property interests held by such person at any time during the calendar year, and

"(3) such other information as the Secretary may by regulations prescribe.

"(b) DEFINITION OF FOREIGN PERSONS HOLDING DIRECT INVESTMENTS IN UNITED STATES REAL PROPERTY INTERESTS.—For purposes of this section, a foreign person shall be treated as holding direct

investments in United States real property interests during any calendar year if--

"(1) such person did not engage in a trade or business in the United States at any time during such calendar year, and

"(2) the fair market value of the United States real property interests held directly by such person at any time during such year equals or exceeds $50,000.

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

"(1) UNITED STATES REAL PROPERTY INTEREST.—The term 'United States real property interest' has the meaning given to such term by section 897(c).

"(2) FOREIGN PERSON.—The term 'foreign person' means any person who is not a United States person.

"(3) ATTRIBUTION OF OWNERSHIP.—For purposes of subsection (b)(2)—

"(A) INTERESTS HELD BY PARTNERSHIPS, ETC.—United States real property interests held by a partnership, trust, or estate shall be treated as owned proportionately by its partners or beneficiaries.

"(B) INTERESTS HELD BY FAMILY MEMBERS.—United States real property interests held by the spouse or any minor child of an individual shall be treated as owned by such individual.

"(4) TIME AND MANNER OF FILING RETURN.—All returns required to be made under this section shall be made at such time and in such manner as the Secretary shall by regulations prescribe.

"(d) SPECIAL RULE FOR UNITED STATES INTEREST AND VIRGIN ISLANDS INTEREST.—A nonresident alien individual or foreign corporation subject to tax under section 897(a) shall pay any tax and file any return required by this title—

"(1) to the United States, in the case of any interest in real property located in the United States and an interest (other than an interest solely as a creditor) in a domestic corporation (with respect to the United States) described in section 897(c)(1)(A)(ii), and

"(2) to the Virgin Islands, in the case of any interest in real property located in the Virgin Islands and an interest (other than an interest solely as a creditor) in a domestic corporation (with respect to the Virgin Islands) described in section 897(c)(1)(A)(ii)."

(2) CLERICAL AMENDMENT.—The table of sections for subpart A of part III of subchapter A of chapter 61 is amended by striking out the item relating to section 6039C and inserting in lieu thereof the following:

"Sec. 6039C. Returns with respect to foreign persons holding direct investments in United States real property interests."

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by subsection (a) shall apply to any disposition on or after January 1, 1985.

(2) REPORTING REQUIREMENTS.—The amendments made by subsection (b) shall apply to calendar year 1980 and subsequent calendar years.

SEC. 130. TREATMENT OF PAYMENTS TO GUAM AND VIRGIN ISLANDS CORPORATIONS.

(a) GENERAL RULE.—Subsection (b) of section 881 (relating to exception for Guam corporations) is amended to read as follows:

"(b) EXCEPTION FOR CERTAIN GUAM AND VIRGIN ISLANDS CORPORATIONS.—

"(1) IN GENERAL.—For purposes of this section, a corporation created or organized in Guam or the Virgin Islands or under the law of Guam or the Virgin Islands shall not be treated as a foreign corporation for any taxable year if—

"(A) at all times during such taxable year less than 25 percent in value of the stock of such corporation is owned (directly or indirectly) by foreign persons, and

"(B) at least 20 percent of the gross income of such corporation is shown to the satisfaction of the Secretary to have been derived from sources within Guam or the Virgin Islands (as the case may be) for the 3-year period ending with the close of the preceding taxable year of such corporation (or for such part of such period as the corporation has been in existence).

"(2) PARAGRAPH (1) NOT TO APPLY TO TAX IMPOSED IN GUAM.—For purposes of applying this subsection with respect to income tax liability incurred to Guam—

"(A) Paragraph (1) shall not apply, and

"(B) for purposes of this section, the term 'foreign corporation' does not include a corporation created or organized in Guam or under the law of Guam.

"(3) DEFINITIONS.—

"(A) FOREIGN PERSON.—For purposes of paragraph (1), the term 'foreign person' means any person other than—

"(i) a United States person, or

"(ii) a person who would be a United States person if references to the United States in section 7701 included references to a possession of the United States.

"(B) INDIRECT OWNERSHIP RULES.—For purposes of paragraph (1), the rules of section 318(a)(2) shall apply except that '5 percent' shall be substituted for '50 percent' in subparagraph (C) thereof.

"(4) CROSS REFERENCE.—

"For tax imposed in the Virgin Islands, see sections 934 and 934A."

(b) WITHHOLDING OF TAX.—Subsection (c) of section 1442 (relating to exception for Guam corporations) is amended to read as follows:

"(c) EXCEPTION FOR CERTAIN GUAM AND VIRGIN ISLANDS CORPORATIONS.—

"(1) IN GENERAL.—For purposes of this section, the term 'foreign corporation' does not include a corporation created or organized in Guam or the Virgin Islands or under the law of Guam or the Virgin Islands if the requirements of subparagraphs (A) and (B) of section 881(b)(1) are met with respect to such corporation.

"(2) PARAGRAPH (1) NOT TO APPLY TO TAX IMPOSED IN GUAM.—For purposes of applying this subsection with respect to income tax liability incurred to Guam—

"(A) paragraph (1) shall not apply, and

"(B) for purposes of this section, the term 'foreign corporation' does not include a corporation created or organized in Guam or under the law of Guam.

"(3) CROSS REFERENCE.—

"For tax imposed in the Virgin Islands, see sections 934 and 934A."

(c) TECHNICAL AMENDMENT.—Subparagraph (B) of section 7651(5) is amended by inserting "(other than section 881(b)(1))" after "For purposes of this title".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to payments made after March 1, 1984, in taxable years ending after such date.

PART III—TAXATION OF CERTAIN TRANSFERS OF PROPERTY OUTSIDE THE UNITED STATES

SEC. 131. TAXATION OF CERTAIN TRANSFERS OF PROPERTY OUTSIDE THE UNITED STATES.

(a) IN GENERAL.—Subsection (a) of section 367 (relating to transfers of property from the United States) is amended to read as follows:

"(a) TRANSFERS OF PROPERTY FROM THE UNITED STATES.—

"(1) GENERAL RULE.—If, in connection with any exchange described in section 332, 351, 354, 355, 356, or 361, a United States person transfers property to a foreign corporation, such foreign corporation shall not, for purposes of determining the extent to which gain shall be recognized on such transfer, be considered to be a corporation.

"(2) EXCEPTION FOR CERTAIN STOCK OR SECURITIES.—Except to the extent provided in regulations, paragraph (1) shall not apply to the transfer of stock or securities of a foreign corporation which is a party to the exchange or a party to the reorganization.

"(3) EXCEPTION FOR TRANSFERS OF CERTAIN PROPERTY USED IN THE ACTIVE CONDUCT OF A TRADE OR BUSINESS.—

"(A) IN GENERAL.—Except as provided in regulations prescribed by the Secretary, paragraph (1) shall not apply to any property transferred to a foreign corporation for use by such foreign corporation in the active conduct of a trade or business outside of the United States.

"(B) PARAGRAPH NOT TO APPLY TO CERTAIN PROPERTY.—Except as provided in regulations prescribed by the Secretary, subparagraph (A) shall not apply to any—

"(i) property described in paragraph (1) or (3) of section 1221 (relating to inventory and copyrights, etc.),

"(ii) installment obligation, accounts receivable, or similar property,

"(iii) foreign currency or other property denominated in foreign currency,

"(iv) intangible property (within the meaning of section 936(h)(3)(B)), or

"(v) property with respect to which the transferor is a lessor at the time of the transfer, except that this clause shall not apply if the transferee was the lessee.

"(C) TRANSFER OF FOREIGN BRANCH WITH PREVIOUSLY DEDUCTED LOSSES.—Except as provided in regulations prescribed by the Secretary, subparagraph (A) shall not apply to gain realized on the transfer of the assets of a foreign branch of a United States person to a foreign corporation in an exchange described in paragraph (1) to the extent that—

"(i) the sum of losses—

"(I) which were incurred by the foreign branch before the transfer, and

"(II) with respect to which a deduction was allowed to the taxpayer, exceeds

"(ii) the sum of—

"(I) any taxable income of such branch for a taxable year after the taxable year in which the loss was incurred and through the close of the taxable year of the transfer, and

"(II) the amount which is recognized under section 904(f)(3) on account of the transfer.

Any gain recognized by reason of the preceding sentence shall be treated for purposes of this chapter as income from sources outside the United States having the same character as such losses had.

"(4) SPECIAL RULE FOR TRANSFER OF PARTNERSHIP INTERESTS.—Except as provided in regulations prescribed by the Secretary, a transfer by a United States person of an interest in a partnership to a foreign corporation in an exchange described in paragraph (1) shall, for purposes of this subsection, be treated as a transfer to such corporation of such person's pro rata share of the assets of the partnership.

"(5) SECRETARY MAY EXEMPT CERTAIN TRANSACTIONS FROM APPLICATION OF THIS SUBSECTION.—Paragraph (1) shall not apply to the transfer of any property which the Secretary, in order to carry out the purposes of this subsection, designates by regulation."

(b) SPECIAL RULES FOR TRANSFERS OF INTANGIBLES.—Subsection (d) of section 367 (relating to special rule for transfer of intangibles by possession corporations) is amended to read as follows:

"(d) SPECIAL RULES RELATING TO TRANSFERS OF INTANGIBLES.—

"(1) IN GENERAL.—Except as provided in regulations prescribed by the Secretary, if a United States person transfers any intangible property (within the meaning of section 936(h)(3)(B)) to a foreign corporation in an exchange described in section 351 or 361—

"(A) subsection (a) shall not apply to the transfer of such property, and

"(B) the provisions of this subsection shall apply to such transfer.

"(2) TRANSFER OF INTANGIBLES TREATED AS TRANSFER PURSUANT TO SALE OF CONTINGENT PAYMENTS.—

"(A) IN GENERAL.—If paragraph (1) applies to any transfer, the United States person transferring such property shall be treated as—

"(i) having sold such property in exchange for payments which are contingent upon the productivity, use, or disposition of such property, and

"(ii) receiving amounts which reasonably reflect the amounts which would have been received—

"(I) annually in the form of such payments over the useful life of such property, or

"(II) in the case of a disposition following such transfer (whether direct or indirect), at the time of the disposition.

"(B) EFFECT ON EARNINGS AND PROFITS.—For purposes of this chapter, the earnings and profits of a foreign corporation to which the intangible property was transferred shall be reduced by the amount required to be included in the income of the transferor of the intangible property under subparagraph (A)(ii).

"(C) AMOUNTS RECEIVED TREATED AS UNITED STATES SOURCE ORDINARY INCOME.—For purposes of this chapter, any amount included in gross income by reason of this subsection shall be treated as ordinary income from sources within the United States."

(c) TREATMENT OF LIQUIDATIONS UNDER SECTION 336.—Section 367 is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) TREATMENT OF LIQUIDATIONS UNDER SECTION 336.—In the case of any distribution described in section 336 by a domestic corporation which is made to a person who is not a United States person, to the extent provided in regulations, gain shall be recognized under principles similar to the principles of this section."

(d) SECRETARY MUST BE NOTIFIED OF TRANSACTIONS DESCRIBED IN SECTION 367.—

(1) NOTIFICATION REQUIREMENT.—Subpart A of part III of subchapter A of chapter 61 is amended by adding after section 6038A the following new section:

"SEC. 6038B. NOTICE OF CERTAIN TRANSFERS TO FOREIGN PERSONS.

"(a) IN GENERAL.—Each United States person who—

"(1) transfers property to a foreign corporation in an exchange described in section 332, 351, 354, 355, 356, or 361, or

"(2) makes a distribution described in section 336 to a person who is not a United States person,

shall furnish to the Secretary, at such time and in such manner as the Secretary shall by regulations prescribe, such information with respect to such exchange or distribution as the Secretary may require in such regulations.

"(b) PENALTY FOR FAILURE TO FURNISH INFORMATION.—

"(1) IN GENERAL.—If any United States person fails to furnish the information described in subsection (a) at the time and in the manner required by regulations, such person shall pay a penalty equal to 25 percent of the amount of the gain realized on the exchange.

"(2) REASONABLE CAUSE EXCEPTION.—Paragraph (1) shall not apply to any failure if the United States person shows such failure is due to reasonable cause and not to willful neglect."

(2) EXTENSION OF PERIOD FOR ASSESSMENT AND COLLECTION WHERE SECRETARY NOT NOTIFIED.—Subsection (c) of section 6603 (relating to exceptions to limitations on assessment and collection) is amended by adding at the end thereof the following new paragraph:

"(8) FAILURE TO NOTIFY SECRETARY UNDER SECTION 6038B.—In the case of any tax imposed on any exchange by reason of subsection (a) or (d) of section 367, the time for assessment of such tax shall not expire before the date which is 3 years after the date on which the Secretary is notified of such exchange under section 6038B(a)."

(3) CONFORMING AMENDMENT.—The table of sections for subpart A of part III of subchapter A of chapter 61 is amended by adding after the item relating to section 6038A the following new item:

"Sec. 6038B. Notice of certain transfers to foreign persons."

(e) REPEAL OF DECLARATORY JUDGMENT PROVISIONS INVOLVING TRANSFERS OF PROPERTY FROM THE UNITED STATES.—

(1) IN GENERAL.—Section 7477 is hereby repealed.

(2) CONFORMING AMENDMENTS.—

(A) Section 7482(b)(1) (relating to venue for review of Tax Court decisions) is amended by striking out subparagraph (D) and by redesignating subparagraphs (E) and (F) as subparagraphs (D) and (E), respectively.

(B) The table of sections for part IV of subchapter C of chapter 76 is amended by striking out the item relating to section 7477.

(f) TRANSFERS TO AVOID INCOME TAX.—

(1) IN GENERAL.—Section 1492 (relating to nontaxable transfers) is amended—

(A) by striking out paragraphs (2) and (3) and by inserting in lieu thereof—

"(2) To a transfer—

"(A) described in section 367, or

"(B) not described in section 367 but with respect to which the taxpayer elects (before the transfer) the application of principles similar to the principles of section 367, or", and

(B) by redesignating paragraph (4) as paragraph (3).

(2) CONFORMING AMENDMENT.—Subsection (b) of section 1494 (relating to abatement or refund) is amended to read as follows:

"(b) ABATEMENT OR REFUND.—Under regulations prescribed by the Secretary, the tax may be abated, remitted, or refunded if the taxpayer, after the transfer, elects the application of principles similar to the principles of section 367."

(g) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to transfers or exchanges after December 31, 1984, in taxable years ending after such date.

(2) SPECIAL RULE FOR CERTAIN TRANFERS OF INTANGIBLES.—

(A) IN GENERAL.—If, after June 6, 1984, and before January 1, 1985, a United States person transfers any intangible property (within the meaning of section 936(h)(3)(B) of the

Internal Revenue Code of 1954) to a foreign corporation or in a transfer described in section 1491, such transfer shall be treated for purposes of sections 367(a), 1492(2), and 1494(b) of such Code as pursuant to a plan having as one of its principal purposes the avoidance of Federal income tax.

(B) WAIVER.—Subject to such terms and conditions as the Secretary of the Treasury or his delegate may prescribe, the Secretary may waive the application of subparagraph (A) with respect to any transfer.

(3) RULING REQUEST BEFORE MARCH 1, 1984.—The amendments made by this section (and the provisions of paragraph (2) of this subsection) shall not apply to any transfer or exchange of property described in a request filed before March 1, 1984, under section 367(a), 1492(2), or 1494(b) of the Internal Revenue Code of 1954 (as in effect before such amendments).

PART IV—MISCELLANEOUS FOREIGN CORPORATE PROVISIONS

SEC. 132. AMENDMENTS RELATED TO FOREIGN PERSONAL HOLDING COMPANIES.

(a) ATTRIBUTION FROM FAMILY MEMBERS AND PARTNERSHIPS.—Section 554 (relating to stock ownership) is amended by adding at the end thereof the following new subsection:

"(c) SPECIAL RULES FOR APPLICATION OF SUBSECTION (a)(2).—For purposes of the stock ownership requirement provided in section 552(a)(2)—

"(1) stock owned by a nonresident alien individual (other than a foreign trust or foreign estate) shall not be considered by reason of so much of subsection (a)(2) as relates to attribution through family membership as owned by a citizen or by a resident alien individual who is not the spouse of the nonresident individual and who does not otherwise own stock in such corporation (determined after the application of subsection (a), other than attribution through family membership), and

"(2) stock of a corporation owned by any foreign person shall not be considered by reason of so much of subsection (a)(2) as relates to attribution through partners as owned by a citizen or resident of the United States who does not otherwise own stock in such corporation (determined after application of subsection (a) and paragraph (1), other than attribution through partners)."

(b) INCLUSION IN INCOME OF UNITED STATES PERSONS HOLDING INTEREST THROUGH FOREIGN ENTITY.—Section 551 (relating to foreign personal holding company income taxed to United States shareholders) is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection:

"(f) STOCK HELD THROUGH FOREIGN ENTITY.—For purposes of this section, stock of a foreign personal holding company owned (directly or through the application of this subsection) by—

"(1) a partnership, estate, or trust which is not a United States shareholder, or

"(2) a foreign corporation which is not a foreign personal holding company,

shall be considered as being owned proportionately by its partners, beneficiaries, or shareholders. In any case to which the preceding sentence applies, the Secretary may by regulations provide for such adjustments in the application of this part as may be necessary to carry out the purposes of the preceding sentence."

(c) COORDINATION OF SUBPART F WITH FOREIGN PERSONAL HOLDING COMPANY PROVISIONS.—

(1) IN GENERAL.—Subsection (d) of section 951 (relating to coordination with foreign personal holding company provisions) is amended to read as follows:

"(d) COORDINATION WITH FOREIGN PERSONAL HOLDING COMPANY PROVISIONS.—If, but for this subsection, an amount would be included in the gross income of a United States shareholder for any taxable year both under subsection (a)(1)(A)(i) and under section 551(b) (relating to foreign personal holding company income included in gross income of United States shareholder), such amount shall be included in the gross income of such shareholder only under subsection (a)(1)(A)."

(2) CERTAIN DIVIDENDS AND INTEREST NOT TAKEN INTO ACCOUNT FOR PERSONAL HOLDING COMPANY DETERMINATION.—Section 552 (defining foreign personal holding company) is amended by adding at the end thereof the following new subsection:

"(c) CERTAIN DIVIDENDS AND INTEREST NOT TAKEN INTO ACCOUNT.—For purposes of subsection (a)(1) and section 553(a)(1), gross income and foreign personal holding company income shall not include any dividends and interest which—

"(1) are described in subparagraph (A) of section 954(c)(4), and

"(2) are received from a related person which is not a foreign personal holding company (determined without regard to this subsection)."

(d) EFFECTIVE DATES.—

(1) SUBSECTIONS (a) AND (b).—

(A) IN GENERAL.—Except as provided in subparagraph (B), the amendments made by subsections (a) and (b) shall apply to taxable years of foreign corporations beginning after December 31, 1983.

(B) 1-YEAR EXTENSION FOR CERTAIN TRUSTS CREATED BEFORE JUNE 30, 1953.—

(i) IN GENERAL.—The amendment made by subsection (b) shall apply to taxable years of a foreign corporation beginning after December 31, 1984, with respect to stock of such corporation which is held (directly or indirectly, within the meaning of section 554 of the Internal Revenue Code of 1954) by a trust created before June 30, 1953, if—

(I) none of the beneficiaries of such trust was a citizen or resident of the United States at the time of its creation or within 5 years thereafter, and

(II) such trust does not, after July 1, 1983, acquire (directly or indirectly) stock of any foreign personal holding company other than a company described in clause (ii).

(ii) DESCRIPTION OF COMPANY.—A company is described in this clause if—

(I) substantially all of the assets of such company are stock or assets previously held by such trust, or

(II) such company ceases to be a foreign personal holding company before January 1, 1985.

(2) SUBSECTION (c).—

(A) The amendment made by paragraph (1) of subsection (c) shall apply to taxable years of United States shareholders beginning after the date of the enactment of this Act.

(B) The amendment made by paragraph (2) of subsection (c) shall apply to taxable years of foreign corporations beginning after March 15, 1984.

SEC. 133. AMENDMENTS RELATED TO SECTION 1248.

(a) SECTION 1248 TO APPLY TO CERTAIN INDIRECT TRANSFERS OF STOCK IN A FOREIGN CORPORATION.—Section 1248 (relating to gain from certain sales or exchanges of stock in foreign corporations) is amended by adding at the end thereof the following new subsection:

"(i) TREATMENT OF CERTAIN INDIRECT TRANSFERS.—

"(1) IN GENERAL.—If any shareholder of a 10-percent corporate shareholder of a foreign corporation exchanges stock of the 10-percent corporate shareholder for stock of the foreign corporation, for purposes of this section, the stock of the foreign corporation received in such exchange shall be treated as if it had been—

"(A) issued to the 10-percent corporate shareholder, and

"(B) then distributed by the 10-percent corporate shareholder to such shareholder in redemption of his stock.

"(2) 10-PERCENT CORPORATE SHAREHOLDER DEFINED.—For purposes of this subsection, the term '10-percent corporate shareholder' means any domestic corporation which, as of the day before the exchange referred to in paragraph (1), satisfies the stock ownership requirements of subsection (a)(2) with respect to the foreign corporation."

(b) ELIMINATION OF DOUBLE TAXATION OF EARNINGS AND PROFITS OF CERTAIN FOREIGN CORPORATIONS.—

(1) Section 959 (relating to exclusion from gross income of previously taxed earnings and profits) is amended by adding at the end thereof the following new subsection:

"(e) COORDINATION WITH AMOUNTS PREVIOUSLY TAXED UNDER SECTION 1248.—For purposes of this section and section 960(b), any amount included in the gross income of any person as a dividend by reason of subsection (a) or (f) of section 1248 shall be treated as an amount included in the gross income of such person under section 951(a)(1)(A)."

(2) Section 1248 is amended by adding at the end thereof the following new subsection:

"(j) CROSS REFERENCE.—

"For provision excluding amounts previously taxed under this section from gross income when subsequently distributed, see section 959(e)."

(c) CLARIFICATION OF SECTION 1248(c)(2)(D).—Subparagraph (D) of section 1248(c)(2) (relating to earnings and profits of subsidiaries of foreign corporations) is amended by striking out "section 958(a)(2)" and inserting in lieu thereof "section 958(a)".

(d) EFFECTIVE DATES.—

(1) Subsection (a).—The amendment made by subsection (a) shall apply to exchanges after the date of the enactment of this Act in taxable years ending after such date.

(2) Subsections (b) and (c).—Except as provided in paragraph (3), the amendments made by subsections (b) and (c) shall apply with respect to transactions to which subsection (a) or (f) of section 1248 of the Internal Revenue Code of 1954 applies occurring after the date of the enactment of this Act.

(3) Election of earlier date for certain transactions.—

(A) In general.—If the appropriate election is made under subparagraph (B), the amendments made by subsection (b) shall apply with respect to transactions to which subsection (a) or (f) of section 1248 of such Code applies occurring after October 9, 1975.

(B) Election.—

(i) Subparagraph (A) shall apply with respect to transactions to which subsection (a) of section 1248 of such Code applies if the foreign corporation described in such subsection (or its successor in interest) so elects.

(ii) Subparagraph (A) shall apply with respect to transactions to which subsection (f) of section 1248 of such Code applies if the domestic corporation described in section 1248(f)(1) of such Code (or its successor) so elects.

(iii) Any election under clause (i) or (ii) shall be made not later than 180 days after the date of the enactment of this Act and shall be made in such manner as the Secretary of the Treasury or his delegate shall prescribe.

SEC. 134. DEFINITION OF FOREIGN INVESTMENT COMPANY.

(a) General Rule.—Paragraph (2) of section 1246(b) (defining foreign investment company) is amended to read as follows:

"(2) engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in—

"(A) securities (as defined in section 2(a)(36) of the Investment Company Act of 1940, as amended),

"(B) commodities, or

"(C) any interest (including a futures or forward contract or option) in property described in subparagraph (A) or (B),

at a time when 50 percent or more of the total combined voting power of all classes of stock entitled to vote, or the total value of all classes of stock, was held directly (or indirectly through applying paragraphs (2) and (3) of section 958(a) and paragraph (4) of section 318(a)) by United States persons (as defined in section 7701(a)(30))."

(b) Effective Dates.—

(1) In general.—Except as provided in paragraph (2), the amendment made by subsection (a) shall apply to sales and exchanges (and distributions) on or after September 29, 1983, in taxable years ending on or after such date.

(2) Stock held on September 29, 1983.—In the case of a sale or exchange (or distribution) not later than the date which is 1 year after the date of the enactment of this Act, the amendment

made by subsection (a) shall not apply with respect to stock held by the taxpayer continuously from September 29, 1983, to the date of such sale or exchange (or distribution).

SEC. 135. APPLICATION OF COLLAPSIBLE CORPORATION RULES TO FOREIGN CORPORATIONS.

(a) IN GENERAL.—Subsection (f) of section 341 (relating to collapsible corporations) is amended by adding at the end thereof the following new paragraph:

"(8) SPECIAL RULE FOR FOREIGN CORPORATIONS.—Except to the extent provided in regulations prescribed by the Secretary—

"(A) any consent given by a foreign corporation under paragraph (1) shall not be effective, and

"(B) paragraph (3) shall not apply if the transferee is a foreign corporation."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

SEC. 136. STAPLED STOCK; STAPLED ENTITIES.

(a) GENERAL RULE.—Part IX of subchapter B of chapter 1 is amended by inserting after section 269A the following new section:

"SEC. 269B. STAPLED ENTITIES.

"(a) GENERAL RULE.—Except as otherwise provided by regulations, for purposes of this title—

"(1) if a domestic corporation and a foreign corporation are stapled entities, the foreign corporation shall be treated as a domestic corporation.

"(2) in applying section 1563, stock in a second corporation which constitutes a stapled interest with respect to stock of a first corporation shall be treated as owned by such first corporation, and

"(3) in applying subchapter M for purposes of determining whether any stapled entity is a regulated investment company or a real estate investment trust, all entities which are stapled entities with respect to each other shall be treated as 1 entity.

"(b) SECRETARY TO PRESCRIBE REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to prevent avoidance or evasion of Federal income tax through the use of stapled entities. Such regulations may include (but shall not be limited to) regulations providing the extent to which 1 of such entities shall be treated as owning the other entity (to the extent of the stapled interest).

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

"(1) ENTITY.—The term 'entity' means any corporation, partnership, trust, association, estate, or other form of carrying on a business or activity.

"(2) STAPLED ENTITIES.—The term 'stapled entities' means any group of 2 or more entities if more than 50 percent in value of the beneficial ownership in each of such entities consists of stapled interests.

"(3) STAPLED INTERESTS.—Two or more interests are stapled interests if, by reason of form of ownership, restrictions on transfer, or other terms or conditions, in connection with the transfer of 1 of such interests the other such interests are also transferred or required to be transferred.

"(d) SPECIAL RULE FOR TREATIES.—Nothing in section 894 or 7852(d) or in any other provision of law shall be construed as permitting an exemption, by reason of any treaty obligation of the United States heretofore or hereafter entered into, from the provisions of this section."

(b) CLERICAL AMENDMENT.—The table of sections for part IX of subchapter B of chapter 1 is amended by inserting after the item relating to section 269A the following new item:

"Sec. 269B. Stapled entities."

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall take effect on the date of the enactment of this Act.

(2) INTERESTS STAPLED AS OF JUNE 30, 1983.—Except as otherwise provided in this subsection, in the case of any interests which on June 30, 1983, were stapled interests (as defined in section 269B(c)(3) of the Internal Revenue Code of 1954 (as added by this section)), the amendments made by this section shall take effect on January 1, 1985 (January 1, 1987, in the case of stapled interests in a foreign corporation).

(3) CERTAIN STAPLED ENTITIES WHICH INCLUDE REAL ESTATE INVESTMENT TRUST.—Paragraph (3) of section 269B(a) of such Code shall not apply in determining the application of the provisions of part II of subchapter M of chapter 1 of such Code to any real estate investment trust which is part of a group of stapled entities if—

(A) all members of such group were stapled entities as of June 30, 1983, and

(B) as of June 30, 1983, such group included one or more real estate investment trusts.

(4) CERTAIN STAPLED ENTITIES WHICH INCLUDE PUERTO RICAN CORPORATIONS.—

(A) Paragraph (1) of section 269B(a) of such Code shall not apply to a domestic corporation and a qualified Puerto Rican corporation which, on June 30, 1983, were stapled entities.

(B) For purposes of subparagraph (A), the term "qualified Puerto Rican corporation" means any corporation organized in Puerto Rico—

(i) which is described in section 957(c) of such Code or would be so described if any dividends it received from any other corporation described in such section 957(c) were treated as gross income of the type described in such section 957(c), and

(ii) does not, at any time during the taxable year, own (within the meaning of section 958 of such Code but before applying paragraph (2) of section 269B(a) of such Code) any stock of any corporation which is not described in such section 957(c).

(5) TREATY RULE NOT TO APPLY TO STAPLED ENTITIES ENTITLED TO TREATY BENEFITS AS OF JUNE 30, 1983.—In the case of any entity which was a stapled entity as of June 30, 1983, subsection (d) of section 269B of such Code shall not apply to any

treaty benefit to which such entity was entitled as of June 30, 1983.

(6) ELECTIONS TO TREAT STAPLED FOREIGN ENTITIES AS SUBSIDIARIES.—

(A) IN GENERAL.—In the case of any foreign corporation and domestic corporation which as of June 30, 1983, were stapled entities, such domestic corporation may elect (in lieu of applying paragraph (1) of section 269B(a) of such Code) to be treated as owning all interests in the foreign corporation which constitute stapled interests with respect to stock of the domestic corporation.

(B) ELECTION.—Any election under subparagraph (A) shall be made not later than 180 days after the date of the enactment of this Act and shall be made in such manner as the Secretary of the Treasury or his delegate shall prescribe.

(C) ELECTION IRREVOCABLE.—Any election under subparagraph (A), once made, may be revoked only with the consent of the Secretary of the Treasury or his delegate.

(7) OTHER STAPLED ENTITIES WHICH INCLUDE REAL ESTATE INVESTMENT TRUST.—

(A) IN GENERAL.—Paragraph (3) of section 269B(a) of such Code shall not apply in determining the application of the provisions of part II of subchapter M of chapter 1 of such Code to any qualified real estate investment trust which is a part of a group of stapled entities—

(i) which was created pursuant to a written board of directors resolution adopted before April 15, 1984, and

(ii) all members of such group were stapled entities as of June 16, 1985.

(B) QUALIFIED REAL ESTATE INVESTMENT TRUST.—The term "qualified real estate investment trust" means any real estate trust—

(i) at least 75 percent of the gross income of which is derived from interest on obligations secured by mortgages on real property (as defined in section 856 of such Code),

(ii) with respect to which the interest on the obligations described in clause (i) made or acquired by such trust (other than to persons who are independent contractors, as defined in section 856(d)(3) of such Code) is at an arm's length rate or a rate not more than 1 percentage point greater than the associated borrowing cost of the trust, and

(iii) with respect to which any real property held by the trust is not used in the trade or business of any other member of the group of stapled entities.

SEC. 137. SERVICES RELATING TO INSURANCE POLICIES ARE TREATED AS PERFORMED IN COUNTRY OF RISK.

(a) IN GENERAL.—Subsection (e) of section 954 (defining foreign base company services income) is amended by adding at the end thereof the following new sentence: "For purposes of paragraph (2), any services performed with respect to any policy of insurance or re-

insurance with respect to which the primary insured is a related person (within the meaning of section 864(d)(4)) shall be treated as having been performed in the country within which the insured hazards, risks, losses, or liabilities occur, and except as provided in regulations prescribed by the Secretary, rules similar to the rules of section 953(b) shall be applied in determining the income from such services."

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to taxable years of controlled foreign corporations beginning after the date of the enactment of this Act.

PART V—TREATMENT OF ALIEN INDIVIDUALS

SEC. 138. DEFINITION OF RESIDENT ALIEN AND NONRESIDENT ALIEN.

(a) GENERAL RULE.—Section 7701 (relating to definitions) is amended by redesignating subsections (b), (c), and (d) as subsections (c), (d), and (e), respectively, and by inserting after subsection (a) the following new subsection:

"(b) DEFINITION OF RESIDENT ALIEN AND NONRESIDENT ALIEN.—

"(1) IN GENERAL.—For purposes of this title (other than subtitle B)—

"(A) RESIDENT ALIEN.—An alien individual shall be treated as a resident of the United States with respect to any calendar year if (and only if) such individual meets the requirements of clause (i) or (ii):

"(i) LAWFULLY ADMITTED FOR PERMANENT RESIDENCE.—Such individual is a lawful permanent resident of the United States at any time during such calendar year.

"(ii) SUBSTANTIAL PRESENCE TEST.—Such individual meets the substantial presence test of paragraph (3).

"(B) NONRESIDENT ALIEN.—An individual is a nonresident alien if such individual is neither a citizen of the United States nor a resident of the United States (within the meaning of subparagraph (A)).

"(2) SPECIAL RULES FOR FIRST AND LAST YEAR OF RESIDENCY.—

"(A) FIRST YEAR OF RESIDENCY.—

"(i) IN GENERAL.—If an alien individual is a resident of the United States under paragraph (1)(A) with respect to any calendar year, but was not a resident of the United States at any time during the preceding calendar year, such alien individual shall be treated as a resident of the United States only for the portion of such calendar year which begins on the residency starting date.

"(ii) RESIDENCY STARTING DATE FOR INDIVIDUALS LAWFULLY ADMITTED FOR PERMANENT RESIDENCE.—In the case of an individual who is a lawfully permanent resident of the United States at any time during the calendar year, but does not meet the substantial presence test of paragraph (3), the residency starting date shall be the first day in such calendar year on which

he was present in the United States while a lawful permanent resident of the United States.

"(iii) RESIDENCY STARTING DATE FOR INDIVIDUALS MEETING SUBSTANTIAL PRESENCE TEST.—In the case of an individual who meets the substantial presence test of paragraph (3) with respect to any calendar year, the residency starting date shall be the first day during such calendar year on which the individual is present in the United States.

"(B) LAST YEAR OF RESIDENCY.—An alien individual shall not be treated as a resident of the United States during a portion of any calendar year if—

"(i) such portion is after the last day in such calendar year on which the individual was present in the United States (or, in the case of an individual described in paragraph (1)(A)(i), the last day on which he was so described),

"(ii) during such portion the individual has a closer connection to a foreign country than to the United States, and

"(iii) the individual is not a resident of the United States at any time during the next calendar year.

"(C) CERTAIN NOMINAL PRESENCE DISREGARDED.—

"(i) IN GENERAL.—For purposes of subparagraphs (A)(iii) and (B), an individual shall not be treated as present in the United States during any period for which the individual establishes that he has a closer connection to a foreign country than to the United States.

"(ii) NOT MORE THAN 10 DAYS DISREGARDED.—Clause (i) shall not apply to more than 10 days on which the individual is present in the United States.

"(3) SUBSTANTIAL PRESENCE TEST.—

"(A) IN GENERAL.—Except as otherwise provided in this paragraph, an individual meets the substantial presence test of this paragraph with respect to any calendar year (hereinafter in this subsection referred to as the 'current year') if—

"(i) such individual was present in the United States on at least 31 days during the calendar year, and

"(ii) the sum of the number of days on which such individual was present in the United States during the current year and the 2 preceding calendar years (when multiplied by the applicable multiplier determined under the following table) equals or exceeds 183 days:

"In the case of days in:	*The applicable multiplier is:*
Current year	*1*
1st preceding year	$\frac{1}{3}$
2nd preceding year	$\frac{1}{6}$

"(B) EXCEPTION WHERE INDIVIDUAL IS PRESENT IN THE UNITED STATES DURING LESS THAN ONE-HALF OF CURRENT YEAR AND CLOSER CONNECTION TO FOREIGN COUNTRY IS ESTABLISHED.—An individual shall not be treated as meeting

the substantial presence test of this paragraph with respect to any current year if—

"(i) such individual is present in the United States on fewer than 183 days during the current year, and

"(ii) it is established that for the current year such individual has a tax home (as defined in section 911(d)(3) without regard to the second sentence thereof) in a foreign country and has a closer connection to such foreign country than to the United States.

"(C) SUBPARAGRAPH (B) NOT TO APPLY IN CERTAIN CASES.—Subparagraph (B) shall not apply to any individual with respect to any current year if at any time during such year—

"(i) such individual had an application for adjustment of status pending, or

"(ii) such individual took other steps to apply for status as a lawful permanent resident of the United States.

"(D) EXCEPTION FOR EXEMPT INDIVIDUALS OR FOR CERTAIN MEDICAL CONDITIONS.—An individual shall not be treated as being present in the United States on any day if—

"(i) such individual is an exempt individual for such day, or

"(ii) such individual was unable to leave the United States on such day because of a medical condition which arose while such individual was present in the United States.

"(4) EXEMPT INDIVIDUAL DEFINED.—For purposes of this subsection—

"(A) IN GENERAL.—An individual is an exempt individual for any day if, for such day, such individual is—

"(i) a foreign government-related individual,

"(ii) a teacher or trainee, or

"(iii) a student.

"(B) FOREIGN GOVERNMENT-RELATED INDIVIDUAL.—The term 'foreign government-related individual' means any individual temporarily present in the United States by reason of—

"(i) diplomatic status, or a visa which the Secretary (after consultation with the Secretary of State) determines represents full-time diplomatic or consular status for purposes of this subsection,

"(ii) being a full-time employee of an international organization, or

"(iii) being a member of the immediate family of an individual described in clause (i) or (ii).

"(C) TEACHER OR TRAINEE.—The term 'teacher or trainee' means any individual—

"(i) who is temporarily present in the United States under subparagraph (J) of section 101(15) of the Immigration and Nationality Act (other than as a student), and

"(ii) who substantially complies with the requirements for being so present.

"(D) STUDENT.—The term 'student' means any individual—

"(i) who is temporarily present in the United States—

"(I) under subparagraph (F) of section 101(15) of the Immigration and Nationality Act, or

"(II) as a student under subparagraph (J) of such section 101(15), and

"(ii) who substantially complies with the requirements for being so present.

"(E) SPECIAL RULES FOR TEACHERS, TRAINEES, AND STUDENTS.—

"(i) LIMITATION ON TEACHERS AND TRAINEES.—An individual shall not be treated as an exempt individual by reason of clause (ii) of subparagraph (A) for the current year if, for any 2 calendar years during the preceeding 6 calendar years, such person was an exempt person under clause (ii) or (iii) of subparagraph (A).

"(ii) LIMITATION ON STUDENTS.—For any calendar year after the 5th calendar year for which an individual was an exempt individual under clause (ii) or (iii) of subparagraph (A), such individual shall not be treated as an exempt individual by reason of clause (iii) of subparagraph (A), unless such individual establishes to the satisfaction of the Secretary that such individual does not intend to permanently reside in the United States and that such individual meets the requirements of subparagraph (D)(ii).

"(5) LAWFUL PERMANENT RESIDENT.—For purposes of this subsection, an individual is a lawful permanent resident of the United States at any time if—

"(A) such individual has the status of having been lawfully accorded the privilege of residing permanently in the United States as an immigrant in accordance with the immigration laws, and

"(B) such status has not been revoked (and has not been administratively or judicially determined to have been abandoned).

"(6) PRESENCE IN THE UNITED STATES.—For purposes of this subsection—

"(A) IN GENERAL.—Except as provided in subparagraph (B) or (C), an individual shall be treated as present in the United States on any day if such individual is physically present in the United States at any time during such day.

"(B) COMMUTERS FROM CANADA OR MEXICO.—If an individual regularly commutes to employment (or self-employment) in the United States from a place of residence in Canada or Mexico, such individual shall not be treated as present in the United States on any day during which he so commutes.

"(C) TRANSIT BETWEEN 2 FOREIGN POINTS.—If an individual, who is in transit between 2 points outside the United

States, is physically present in the United States for less than 24 hours, such individual shall not be treated as present in the United States on any day during such transit.

"(7) ANNUAL STATEMENTS.—The Secretary may prescribe regulations under which an individual who (but for subparagraph (B) or (D) of paragraph (3)) would meet the substantial presence test of paragraph (3) is required to submit an annual statement setting forth the basis on which such individual claims the benefits of subparagraph (B) or (D) of paragraph (3), as the case may be.

"(8) TAXABLE YEAR.—

"(A) IN GENERAL.—For purposes of this title, an alien individual who has not established a taxable year for any prior period shall be treated as having a taxable year which is the calendar year.

"(B) FISCAL YEAR TAXPAYER.—If—

"(i) an individual is treated under paragraph (1) as a resident of the United States for any calendar year, and

"(ii) after the application of subparagraph (A), such individual has a taxable year other than a calendar year,

he shall be treated as a resident of the United States with respect to any portion of a taxable year which is within such calendar year.

"(9) COORDINATION WITH SECTION 877.—If—

"(A) an alien individual was treated as a resident of the United States during any period which includes at least 3 consecutive calendar years (hereinafter referred to as the 'initial residency period'), and

"(B) such individual ceases to be treated as a resident of the United States but subsequently becomes a resident of the United States before the close of the 3rd calendar year beginning after the close of the initial residency period,

such individual shall be taxable for the period after the close of the initial residency period and before the day on which he subsequently became a resident of the United States in the manner provided in section 877(b). The preceding sentence shall apply only if the tax imposed pursuant to section 877(b) exceeds the tax which, without regard to this paragraph, is imposed pursuant to section 871.

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

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1984.

(2) TRANSITIONAL RULE FOR APPLYING SUBSTANTIAL PRESENCE TEST.—

(A) If an alien individual was not a resident of the United States as of the close of calendar year 1984, the determination of whether such individual meets the substantial presence test of section 7701(b)(3) of the Internal Reve-

nue Code of 1954 (as added by this section) shall be made by only taking into account presence after 1984.

(B) If an alien individual was a resident of the United States as of the close of calendar year 1984, but was not a resident of the United States as of the close of calendar year 1983, the determination of whether such individual meets such substantial presence test shall be made by only taking into account presence in the United States after 1983.

(3) TRANSITIONAL RULE FOR APPLYING LAWFUL RESIDENCE TEST.—In the case of any individual who—

(A) was a lawful permanent resident of the United States (within the meaning of section 7701(b)(5) of the Internal Revenue Code of 1954, as added by this section) throughout calendar year 1984, or

(B) was present in the United States at any time during 1984 while such individual was a lawful permanent resident of the United States (within the meaning of such section 7701(b)(5)),

for purposes of section 7701(b)(2)(A) of such Code (as so added), such individual shall be treated as a resident of the United States during 1984.

SEC. 139. TREATMENT OF COMMUNITY INCOME.

(a) GENERAL RULE.—Subsection (a) of section 879 (relating to tax treatment of certain community income in the case of a resident or citizen of the United States who is married to a nonresident alien individual) is amended by striking out so much of such subsection as precedes paragraph (1) thereof and inserting in lieu thereof the following:

"(a) GENERAL RULE.—In the case of a married couple 1 or both of whom are nonresident alien individuals and who have community income for the taxable year, such community shall be treated as follows:".

(b) CLERICAL AMENDMENTS.—

(1) The heading of section 879 is amended to read as follows:

"SEC. 879. TAX TREATMENT OF CERTAIN COMMUNITY INCOME IN THE CASE OF NONRESIDENT ALIEN INDIVIDUALS."

(2) The table of sections for subpart A of part II of subchapter N of chapter 1 is amended by striking out the item relating to section 879 and inserting in lieu thereof the following:

"Sec. 879. Tax treatment of certain community income in the case of nonresident alien individuals."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1984.

Subtitle K—Reporting, Penalty, and Other Provisions

PART I—PROVISIONS RELATING TO TAX SHELTERS

SEC. 141. REGISTRATION OF TAX SHELTERS.

(a) IN GENERAL.—Subchapter B of chapter 61 (relating to miscellaneous provisions involving information and returns) is amended

by redesignating section 6111 as section 6112 and by inserting after section 6110 the following new section:

"SEC. 6111. REGISTRATION OF TAX SHELTERS.

"(a) REGISTRATION.—

"(1) IN GENERAL.—Any tax shelter organizer shall register the tax shelter with the Secretary (in such form and in such manner as the Secretary may prescribe) not later than the day on which the first offering for sale of interests in such tax shelter occurs.

"(2) INFORMATION INCLUDED IN REGISTRATION.—Any registration under paragraph (1) shall include—

"(A) information identifying and describing the tax shelter,

"(B) information describing the tax benefits of the tax shelter represented (or to be represented) to investors, and

"(C) such other information as the Secretary may prescribe.

"(b) FURNISHING OF TAX SHELTER IDENTIFICATION NUMBER; INCLUSION ON RETURN.—

"(1) SELLERS, ETC.—Any person who sells (or otherwise transfers) an interest in a tax shelter shall (at such times and in such manner as the Secretary shall prescribe) furnish to each investor who purchases (or otherwise acquires) an interest in such tax shelter from such person the identification number assigned by the Secretary to such tax shelter.

"(2) INCLUSION OF NUMBER ON RETURN.—Any person claiming any deduction, credit, or other tax benefit by reason of a tax shelter shall include (in such manner as the Secretary may prescribe) on the return of tax on which such deduction, credit, or other benefit is claimed the identification number assigned by the Secretary to such tax shelter.

"(c) TAX SHELTER.—For purposes of this section—

"(1) IN GENERAL.—The term 'tax shelter' means any investment—

"(A) with respect to which any person could reasonably infer from the representations made, or to be made, in connection with the offering for sale of interests in the investment that the tax shelter ratio for any investor as of the close of any of the first 5 years ending after the date on which such investment is offered for sale may be greater than 2 to 1, and

"(B) which is—

"(i) required to be registered under a Federal or State law regulating securities,

"(ii) sold pursuant to an exemption from registration requiring the filing of a notice with a Federal or State agency regulating the offering or sale of securities, or

"(iii) a substantial investment.

"(2) TAX SHELTER RATIO DEFINED.—For purposes of this subsection, the term 'tax shelter ratio' means, with respect to any year, the ratio which—

"(A) the aggregate amount of the deductions and 200 percent of the credits which are represented to be potentially

allowable to any investor under subtitle A for all periods up to (and including) the close of such year, bears to

"(B) the investment base as of the close of such year.

"(3) INVESTMENT BASE.—

"(A) IN GENERAL.—Except as provided in this paragraph, the term 'investment base' means, with respect to any year, the amount of money and the adjusted basis of other property (reduced by any liability to which such other property is subject) contributed by the investor as of the close of such year.

"(B) CERTAIN BORROWED AMOUNTS EXCLUDED.—For purposes of subparagraph (A), there shall not be taken into account any amount borrowed from any person—

"(i) who participated in the organization, sale, or management of the investment, or

"(ii) who is a related person (as defined in section 168(e)(4)) to any person described in clause (i),

unless such amount is unconditionally required to be repaid by the investor before the close of the year for which the determination is being made.

"(C) CERTAIN OTHER AMOUNTS INCLUDED OR EXCLUDED.—

"(i) AMOUNTS HELD IN CASH EQUIVALENTS, ETC.—No amount shall be taken into account under subparagraph (A) which is to be held in cash equivalent or marketable securities.

"(ii) AMOUNTS INCLUDED OR EXCLUDED BY SECRETARY.—The Secretary may by regulation—

"(I) exclude from the investment base any amount described in subparagraph (A), or

"(II) include in the investment base any amount not described in subparagraph (A),

if the Secretary determines that such exclusion or inclusion is necessary to carry out the purposes of this section.

"(4) SUBSTANTIAL INVESTMENT.—An investment is a substantial investment if—

"(A) the aggregate amount which may be offered for sale exceeds $250,000, and

"(B) there are expected to be 5 or more investors.

"(d) OTHER DEFINITIONS.—For purposes of this section—

"(1) TAX SHELTER ORGANIZER.—The term 'tax shelter organizer' means—

"(A) the person principally responsible for organizing the tax shelter,

"(B) if the requirements of subsection (a) are not met by a person described in subpargraph (A) at the time prescribed therefor, any other person who participated in the organization of the tax shelter, and

"(C) if the requirements of subsection (a) are not met by a person described in subparagraph (A) or (B) at the time prescribed therefor, any person participating in the sale or management of the investment at a time when the tax shelter was not registered under subsection (a).

"(2) YEAR.—The term 'year' means—

"(A) the taxable year of the tax shelter, or

"(B) if the tax shelter has no taxable year, the calendar year.

"(e) REGULATIONS.—The Secretary may prescribe regulations which provide—

"(1) rules for the aggregation of similar investments offered by the same person or persons for purposes of applying subsection (c)(4),

"(2) that only 1 person shall be required to meet the requirements of subsection (a) in cases in which 2 or more persons would otherwise be required to meet such requirements,

"(3) exemptions from the requirements of this section, and

"(4) such rules as may be necessary or appropriate to carry out the purposes of this section in the case of foreign tax shelters."

(b) PENALTIES.—Subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end thereof the following new section:

"SEC. 6707. FAILURE TO FURNISH INFORMATION REGARDING TAX SHELTERS.

"(a) FAILURE TO REGISTER TAX SHELTER.—

"(1) IMPOSITION OF PENALTY.—If a person who is required to register a tax shelter under section 6111(a)—

"(A) fails to register such tax shelter on or before the date described in section 6111(a)(1), or

"(B) files false or incomplete information with the Secretary with respect to such registration,

such person shall pay a penalty with respect to such registration in the amount determined under paragraph (2). No penalty shall be imposed under the preceding sentence with respect to any failure which is due to reasonable cause.

"(2) AMOUNT OF PENALTY.—The penalty imposed under paragraph (1) with respect to any tax shelter shall be an amount equal to the greater of—

"(A) $500, or

"(B) the lesser of (i) 1 percent of the aggregate amount invested in such tax shelter, or (ii) $10,000.

The $10,000 limitation in subparagraph (B) shall not apply where there is an intentional disregard of the requirements of section 6111(a).

"(b) FAILURE TO FURNISH TAX SHELTER IDENTIFICATION NUMBER.—

"(1) SELLERS, ETC.—Any person who fails to furnish the identification number of a tax shelter which such person is required to furnish under section 6111(b)(1) shall pay a penalty of $100 for each such failure.

"(2) FAILURE TO INCLUDE NUMBER ON RETURN.—Any person who fails to include an identification number on a return on which such number is required to be included under section 6111(b)(2) shall pay a penalty of $50 for each such failure, unless such failure is due to reasonable cause."

(c) CONFORMING AMENDMENTS.—

(1) The table of sections for subchapter B of chapter 61 is amended by striking out the item relating to section 6111 and inserting in lieu thereof the following new items:

"Sec. 6111. Registration of tax shelters.
"Sec. 6112. Cross references."

(2) The table of sections for subchapter B of chapter 68 is amended by adding at the end thereof the following new item:

"Sec. 6707. Failure to furnish information regarding tax shelters."

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to any tax shelter (within the meaning of section 6111 of the Internal Revenue Code of 1954, as added by this section) any interest in which is first sold to any investor after August 31, 1984.

(2) SUBSTANTIAL INVESTMENT TEST.—For purposes of determining whether any investment is a tax shelter by reason of section 6111(c)(1)(B)(iii) of such Code (as added by this section), only offers for sale after August 31, 1984, shall be taken into account.

(3) FURNISHING OF SHELTER IDENTIFICATION NUMBER FOR INTERESTS SOLD BEFORE SEPTEMBER 1, 1984.—With respect to interests sold before September 1, 1984, any liability to act under paragraph (1) of section 6111(b) of such Code (as added by this section) which would (but for this sentence) arise before such date shall be deemed to arise on December 31, 1984.

SEC. 142. ORGANIZERS AND SELLERS OF POTENTIALLY ABUSIVE TAX SHELTERS MUST KEEP LISTS OF INVESTORS.

(a) IN GENERAL.—Subchapter B of chapter 61 (relating to miscellaneous provisions involving information and returns) is amended by redesignating section 6112 as section 6113 and by inserting after section 6111 the following new section:

"SEC. 6112. ORGANIZERS AND SELLERS OF POTENTIALLY ABUSIVE TAX SHELTERS MUST KEEP LISTS OF INVESTORS.

"(a) IN GENERAL.—Any person who—

"(1) organizes any potentially abusive tax shelter, or

"(2) sells any interest in such a shelter,

shall maintain (in such manner as the Secretary may by regulations prescribe) a list identifying each person who was sold an interest in such shelter and containing such other information as the Secretary may be regulations require.

"(b) POTENTIALLY ABUSIVE TAX SHELTER.—For purposes of this section, the term 'potentially abusive tax shelter' means—

"(1) any tax shelter (as defined in section 6111) with respect to which registration is required under section 6111, and

"(2) any entity, investment plan or arrangement, or other plan or arrangement which is of a type which the Secretary determines by regulations as having a potential for tax avoidance or evasion.

"(c) SPECIAL RULES.—

"(1) AVAILABILITY FOR INSPECTION; RETENTION OF INFORMATION ON LIST.—Any person who is required to maintain a list under subsection (a)—

"(A) shall make such list available to the Secretary for inspection upon request by the Secretary, and

"(B) except as otherwise provided under regulations prescribed by the Secretary, shall retain any information which is required to be included on such list for 7 years.

"(2) LISTS WHICH WOULD BE REQUIRED TO BE MAINTAINED BY 2 OR MORE PERSONS.—The Secretary shall prescribe regulations which provide that, in cases in which 2 or more persons are required under subsection (a) to maintain the same list (or portion thereof), only 1 person shall be required to maintain such list (or portion)."

(b) PENALTY FOR FAILURE TO MAINTAIN LIST.—Subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end thereof the following new section:

"SEC. 6708. FAILURE TO MAINTAIN LISTS OF INVESTORS IN POTENTIALLY ABUSIVE TAX SHELTERS.

"(a) IN GENERAL.—Any person who fails to meet any requirement imposed by section 6112 shall pay a penalty of $50 for each person with respect to whom there is such a failure, unless it is shown that such failure is due to reasonable cause and not due to willful neglect. The maximum penalty imposed under this subsection for any calendar year shall not exceed $50,000.

"(b) PENALTY IN ADDITION TO OTHER PENALTIES.—The penalty imposed by this section shall be in addition to any other penalty provided by law."

(c) CONFORMING AMENDMENTS.—

(1) The table of sections for subchapter B of chapter 61 is amended by striking out the item relating to section 6112 and inserting in lieu thereof the following new items:

"Sec. 6112. Organizers and sellers of potentially abusive tax shelters must keep lists of investors.

"Sec. 6113. Cross reference."

(2) The table of sections for subchapter B of chapter 68 is amended by adding at the end thereof the following new item:

"Sec. 6708. Failure to maintain lists of investors in potentially abusive tax shelters."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to any interest which is first sold to any investor after August 31, 1984.

SEC. 143. INCREASE IN PENALTY FOR PROMOTING ABUSIVE TAX SHELTERS; INJUNCTION AGAINST AIDING OR ABETTING UNDERSTATEMENT OF TAX LIABILITY.

(a) INCREASE IN PROMOTER PENALTY.—Subsection (a) of section 6700 (relating to promotion of abusive tax shelters) is amended by striking out "10 percent" and inserting in lieu thereof "20 percent".

(b) INJUNCTION AGAINST AIDING OR ABETTING UNDERSTATEMENTS OF TAX LIABILITY.—

(1) Subsections (a) and (b) of section 7408 (relating to action to enjoin promoters of abusive tax shelters, etc.) are each amended by inserting "or section 6701 (relating to penalties for aiding and abetting understatement of tax liability)" after "etc.)".

(2) Subsection (a) of section 7408 is amended by inserting "or section 6701" before the period at the end of the second sentence.

(3) Subsection (b) of section 7408 is amended by inserting before the period "or section 6701".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the day after the date of the enactment of this Act.

SEC. 144. INCREASED RATE OF INTEREST ON SUBSTANTIAL UNDERPAYMENTS ATTRIBUTABLE TO CERTAIN TAX MOTIVATED TRANSACTIONS.

(a) GENERAL RULE.—Section 6621 (relating to determination of rate of interest) is amended by adding at the end thereof the following new subsection:

"(d) INTEREST ON SUBSTANTIAL UNDERPAYMENTS ATTRIBUTABLE TO TAX MOTIVATED TRANSACTIONS.—

"(1) IN GENERAL.—In the case of interest payable under section 6601 with respect to any substantial underpayment attributable to tax motivated transactions, the annual rate of interest established under this section shall be 120 percent of the adjusted rate established under subsection (b).

"(2) SUBSTANTIAL UNDERPAYMENT ATTRIBUTABLE TO TAX MOTIVATED TRANSACTIONS.—For purposes of this subsection, the term 'substantial underpayment attributable to tax motivated transactions' means any underpayment of taxes imposed by subtitle A for any taxable year which is attributable to 1 or more tax motivated transactions if the amount of the underpayment for such year so attributable exceeds $1,000.

"(3) TAX MOTIVATED TRANSACTIONS.—

"(A) IN GENERAL.—For purposes of this subsection, the term 'tax motivated transaction' means—

"(i) any valuation overstatement (within the meaning of section 6659(c)),

"(ii) any loss disallowed by reason of section 465(a) and any credit disallowed under section 46(c)(8),

"(iii) any straddle (as defined in section 1092(c) without regard to subsections (d) and (e) of section 1092), and

"(iv) any use of an accounting method specified in regulations prescribed by the Secretary as a use which may result in a substantial distortion of income for any period.

"(B) REGULATORY AUTHORITY.—The Secretary may by regulations specify other types of transactions which will be treated as tax motivated for purposes of this subsection and may by regulations provide that specified transactions being treated as tax motivated will no longer be so treated. In prescribing regulations under the preceding sentence, the Secretary shall take into account—

"(i) the ratio of tax benefits to cash invested,

"(ii) the methods of promoting the use of this type of transaction, and

"(iii) other relevant considerations.

"(C) EFFECTIVE DATE FOR REGULATIONS.—Any regulations prescribed under subparagraph (A)(iv) or (B) shall apply only to interest accruing after a date (specified in such regulations) which is after the date on which such regulations are prescribed.

"(4) JURISDICTION OF TAX COURT.—In the case of any proceeding in the Tax Court for a redetermination of a deficiency, the

Tax Court shall also have jurisdiction to determine the portion (if any) of such deficiency which is a substantial underpayment attributable to tax motivated transactions."

(b) CROSS REFERENCE.—Section 6214 (relating to determinations by Tax Court) is amended by adding at the end thereof the following new subsection:

"(e) CROSS REFERENCE.—

"For provision giving Tax Court jurisdiction to determine whether any portion of deficiency is a substantial underpayment attributable to tax motivated transactions, see section 6621(d)(4)."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to interest accruing after December 31, 1984.

PART II—INFORMATION REPORTING PROVISIONS

SEC. 145. RETURNS RELATING TO MORTGAGE INTEREST RECEIVED IN TRADE OR BUSINESS FROM INDIVIDUALS.

(a) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61 (relating to information concerning transactions with other persons) is amended by adding at the end thereof the following new section:

"SEC. 6050H. RETURNS RELATING TO MORTGAGE INTEREST RECEIVED IN TRADE OR BUSINESS FROM INDIVIDUALS.

"(a) MORTGAGE INTEREST OF $600 OR MORE.—Any person—

"(1) who is engaged in a trade or business, and

"(2) who, in the course of such trade or business, receives from any individual interest aggregating $600 or more for any calendar year on any mortgage,

shall make the return described in subsection (b) with respect to each individual from whom such interest was received at such time as the Secretary may by regulations prescribe.

"(b) FORM AND MANNER OR RETURNS.—A return is described in this subsection if such return—

"(1) is in such form as the Secretary may prescribe,

"(2) contains—

"(A) the name and address of the individual from whom the interest described in subsection (a)(2) was received,

"(B) the amount of such interest received for the calendar year, and

"(C) such other information as the Secretary may prescribe.

"(c) APPLICATION TO GOVERNMENTAL UNITS.—For purposes of subsection (a)—

"(1) TREATED AS PERSONS.—The term 'person' includes any governmental unit (and any agency or instrumentality thereof).

"(2) SPECIAL RULES.—In the case of a governmental unit or any agency or instrumentality thereof—

"(A) subsection (a) shall be applied without regard to the trade or business requirement contained therein, and

"(B) any return required under subsection (a) shall be made by the officer or employee appropriately designated for the purpose of making such return.

"(d) STATEMENTS TO BE FURNISHED TO INDIVIDUALS WITH RESPECT TO WHOM INFORMATION IS FURNISHED.—Every person making

a return under subsection (a) shall furnish to each individual whose name is set forth in such return a written statement showing—

"(1) the name and address of the person making such return, and

"(2) the aggregate amount of interest described in subsection (a)(2) received by the person making such return from the individual to whom the statement is furnished.

The written statement required under the preceding sentence shall be furnished on or before January 31 of the year following the calendar year for which the return under subsection (a) was made.

"(e) MORTGAGE DEFINED.—For purposes of this section, except as provided in regulations prescribed by the Secretary, the term 'mortgage' means any obligation secured by real property.

"(f) RETURNS WHICH WOULD BE REQUIRED TO BE MADE BY 2 OR MORE PERSONS.—Except to the extent provided in regulations prescribed by the Secretary, in the case of interest received by any person on behalf of another person, only the person first receiving such interest shall be required to make the return under subsection (a)."

(b) PENALTIES—

(1) Subparagraph (B) of section 6652(a)(1) (relating to failure to file certain information returns, etc.) is amended—

(A) by striking out "or" at the end of clause (iii),

(B) by inserting "or" at the end of clause (iv), and

(C) by inserting after clause (iv) the following new clause:

"(v) section 6050H(a) (relating to mortgage interest received in trade or business from individuals),".

(2) Clause (iii) of section 6652(a)(3)(A) (relating to penalty in case of intentional disregard) is amended by inserting "or section 6050H" after "section 6041A(b)".

(3) Paragraph (1) of section 6678(a) (relating to failure to furnish certain statements) is amended—

(A) by striking out "or 6052(b)" and inserting in lieu thereof "6052(b), or 6050H(d)", and

(B) by striking out "or 6052(a)" and inserting in lieu thereof "6052(a), or 6050H(a)".

(c) CONFORMING AMENDMENT.—The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by adding at the end thereof the following new item:

"Sec. 6050H. Returns relating to mortgage interest received in trade or business from individuals."

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to amounts received after December 31, 1984.

(2) SPECIAL RULE FOR OBLIGATIONS IN EXISTENCE ON DECEMBER 31, 1984.—In the case of any obligation in existence on December 31, 1984, no penalty shall be imposed under section 6652 of the Internal Revenue Code of 1954 by reason of the amendments made by this section on any failure to supply a taxpayer identification number with respect to amounts received before January 1, 1986.

SEC. 146. RETURNS RELATING TO CASH RECEIVED IN TRADE OR BUSINESS.

(a) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61 (relating to information concerning transactions with other persons) is amended by adding at the end thereof the following new section:

"SEC. 6050I. RETURNS RELATING TO CASH RECEIVED IN TRADE OR BUSINESS.

"(a) CASH RECEIPTS OF MORE THAN $10,000.—Any person—

"(1) who is engaged in a trade or business, and

"(2) who, in the course of such trade or business, receives more than $10,000 in cash in 1 transaction (or 2 or more related transactions),

shall make the return described in subsection (b) with respect to such transaction (or related transactions) at such time as the Secretary may by regulations prescribe.

"(b) FORM AND MANNER OF RETURNS.—A return is described in this subsection if such return—

"(1) is in such form as the Secretary may prescribe,

"(2) contains—

"(A) the name, address, and TIN of the person from whom the cash was received,

"(B) the amount of cash received,

"(C) the date and nature of the transaction, and

"(D) such other information as the Secretary may prescribe.

"(c) EXCEPTIONS.—

"(1) CASH RECEIVED BY FINANCIAL INSTITUTIONS.—Subsection (a) shall not apply to—

"(A) cash received in a transaction reported under title 31, United States Code, if the Secretary determines that reporting under this section would duplicate the reporting to the Treasury under title 31, or

"(B) cash received by any financial institution (as defined in subparagraphs (A), (B), (C), (D), (E), (F), (G), (J), (K), (R), and (S) of section 5312(a)(2) of title 31, United States Code).

"(2) TRANSACTIONS OCCURRING OUTSIDE THE UNITED STATES.—Except to the extent provided in regulations prescribed by the Secretary, subsection (a) shall not apply to any transaction if the entire transaction occurs outside the United States.

"(d) CASH INCLUDES FOREIGN CURRENCY.—For purposes of this section, the term 'cash' includes foreign currency.

"(e) STATEMENTS TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS FURNISHED.—Every person making a return under subsection (a) shall furnish to each person whose name is set forth in such return a written statement showing—

"(1) the name and address of the person making such return, and

"(2) the aggregate amount of cash described in subsection (a) received by the person making such return.

The written statement required under the preceding sentence shall be furnished to the person on or before January 31 of the year following the calendar year for which the return under subsection (a) was made."

(b) PENALTIES—

(1) Subparagraph (B) of section 6652(a)(1) (relating to failure to file certain information returns, etc.) is amended—

(A) by striking out "or" at the end of clause (iv),

(B) by inserting "or" at the end of clause (v), and

(C) by inserting after clause (v) the following new clause:

"(vi) section 6050I(a) (relating to cash received in trade or business),".

(2) Clause (iii) of section 6652(a)(3)(A) (relating to penalty in case of intentional disregard) is amended by striking out "or section 6050H" and inserting in lieu thereof ", 6050H or 6050I".

(3) Paragraph (1) of section 6678(a) (relating to failure to furnish certain statements) is amended—

(A) by striking out "or 6050H(d)" and inserting in lieu thereof "6050H(d), or 6050I(e)", and

(B) by striking out "or 6050H(a)" and inserting in lieu thereof "6050H(a), or 6050I(a)".

(c) CONFORMING AMENDMENT.—The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by adding at the end thereof the following new item:

"Sec. 6050I. Returns relating to cash received in trade or business."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts received after December 31, 1984.

SEC. 147. PROVISIONS RELATING TO INDIVIDUAL RETIREMENT ACCOUNTS.

(a) CLARIFICATION THAT REGULATIONS MAY REQUIRE REPORTS TO IDENTIFY YEARS TO WHICH CONTRIBUTIONS RELATE.—Subsection (i) of section 408 (relating to individual retirement accounts) is amended by inserting "(and the years to which they relate)" after "contributions".

(b) INCREASE IN PENALTY FOR FAILURE TO FILE REPORTS.—Subsection (a) of section 6693 (relating to failure to provide reports on individual retirement accounts and annuities) is amended by striking out "$10" and inserting in lieu thereof "$50".

(c) CONTRIBUTIONS REQUIRED TO BE MADE ON OR BEFORE UNEXTENDED RETURN FILING DATE.—Subparagraph (A) of section 219(f)(3) (relating to time when contributions deemed made) is amended by striking out "including" and inserting in lieu thereof "not including".

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to contributions made after December 31, 1984.

(2) SUBSECTION (b).—The amendment made by subsection (b) shall apply to failures occurring after the date of the enactment of this Act.

SEC. 148. RETURNS RELATING TO FORECLOSURES AND ABANDONMENTS OF SECURITY.

(a) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61 (relating to information concerning transactions with other persons) is amended by adding at the end thereof the following new section:

"SEC. 6050J. RETURNS RELATING TO FORECLOSURES AND ABANDONMENTS OF SECURITY.

(a) IN GENERAL.—Any person who, in connection with a trade or business conducted by such person, lends money secured by property and who—

"(1) in full or partial satisfaction of any indebtedness, acquires an interest in any property which is security for such indebtedness, or

"(2) has reason to know that the property in which such person has a security interest has been abandoned,

shall make a return described in subsection (c) with respect to each of such acquisitions or abandonments, at such time as the Secretary may by regulations prescribe.

"(b) EXCEPTION.—Subsection (a) shall not apply to any loan to an individual secured by an interest in tangible personal property which is not held for investment and which is not used in a trade or business.

"(c) FORM AND MANNER OF RETURN.—The return required under subsection (a) with respect to any acquisition or abandonment of property—

"(1) shall be in such form as the Secretary may prescribe,

"(2) shall contain—

"(A) the name and address of each person who is a borrower with respect to the indebtedness which is secured,

"(B) a general description of the nature of such property and such indebtedness,

"(C) in the case of a return required under subsection (a)(1)—

"(i) the amount of such indebtedness at the time of such acquisition, and

"(ii) the amount of indebtedness satisfied in such acquisition,

"(D) in the case of a return required under subsection (a)(2), the amount of such indebtedness at the time of such abandonment, and

"(E) such other information as the Secretary may prescribe.

"(d) APPLICATIONS TO GOVERNMENTAL UNITS.—For purposes of this section—

"(1) TREATED AS PERSONS.—The term 'person' includes any governmental unit (and any agency or instrumentality thereof).

"(2) SPECIAL RULES.—In the case of a governmental unit or any agency or instrumentality thereof—

"(A) subsection (a) shall be applied without regard to the trade or business requirement contained therein, and

"(B) any return under this section shall be made by the officer or employee appropriately designated for the purpose of making such return.

"(e) STATEMENTS TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED TO BE FURNISHED.—Every person required to make a return under subsection (a) shall furnish to each person whose name is required to be set forth in such return a written statement showing the name and address of the person required to make such return. The written statement required under the pre-

ceding sentence shall be furnished to the person on or before January 31 of the year following the calendar year for which the return under subsection (a) was made.

"(f) TREATMENT OF OTHER DISPOSITIONS.—To the extent provided by regulations prescribed by the Secretary, any transfer of the property which secures the indebtedness to a person other than the lender shall be treated as an abandonment of such property."

(b) PENALTIES.—

(1) Subparagraph (B) of section 6652(a)(1) (relating to failure to file certain information returns, etc.) is amended—

(A) by striking out "or" at the end of clause (v),

(B) by adding "or" at the end of clause (vi), and

(C) by inserting after clause (vi) the following new clause:

"(vii) section 6050J(a) (relating to foreclosures and abandonments of security),".

(2) Clause (iii) of section 6652(a)(3)(A) (relating to penalty in case of intentional disregard) is amended by striking out "or 6050I" and inserting in lieu thereof ", 6050I, or 6050J".

(3) Paragraph (1) of section 6678(a) (relating to failure to furnish certain statements) is amended—

(A) by striking out "or 6050I(e)" and inserting in lieu thereof "6050I(e), or 6050J(e)", and

(B) by striking out "or 6050I(a)" and inserting in lieu thereof "6050I(a), or 6050J(a)".

(c) CONFORMING AMENDMENT.—The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by adding at the end thereof the following new item:

"Sec. 605J. Returns relating to foreclosures and abandonments of security."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to acquisitions of property and abandonments of property after December 31, 1984.

SEC. 149. RETURNS RELATING TO EXCHANGES OF PARTNERSHIP INTERESTS WHERE UNREALIZED RECEIVABLES, ETC., INVOLVED.

(a) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61 (relating to information and returns) is amended by adding at the end thereof the following new section.

"SEC. 6050K. RETURNS RELATING TO EXCHANGES OF CERTAIN PARTNERSHIP INTERESTS.

"(a) IN GENERAL.—Except as provided in regulations prescribed by the Secretary, if there is an exchange described in section 751(a) of any interest in a partnership during any calendar year, such partnership shall make a return for such calendar year stating—

"(1) the name and address of the transferee and transferor in such exchange, and

"(2) such other information as the Secretary may by regulations prescribe.

Such return shall be made at such time and in such manner as the Secretary may require by regulations.

"(b) STATEMENT TO BE FURNISHED TO TRANSFEROR AND TRANSFEREE.—Every partnership making a return under subsection (a) shall furnish to each person whose name is set forth in such return a written statement showing—

"(1) the name and address of the partnership making the return, and

"(2) the information shown on the return with respect to such person.

The statement required under the preceding sentence shall be furnished to the person on or before January 31 following the calendar year for which the return under subsection (a) was made.

"(c) REQUIREMENT THAT TRANSFEROR NOTIFY PARTNERSHIP.—

"(1) IN GENERAL.—In the case of any exchange described in subsection (a), the transferor of the partnership interest shall promptly notify the partnership of such exchange.

"(2) PARTNERSHIP NOT REQUIRED TO MAKE RETURN UNTIL NOTICE.—A partnership shall not be required to make a return under this subsection with respect to any exchange until the partnership is notified of such exchange."

(b) PENALTIES.—

(1) Subparagraph (B) of section 6652(a)(1) (relating to failure to file certain information returns, etc.) is amended by striking out "or" at the end of clause (vi), by adding "or" at the end of clause (vii), and by inserting after clause (vii) the following new clause:

"(viii) section 6050K (relating to exchanges of certain partnership interests),".

(2) Paragraph (1) of section 6678(a) (relating to failure to furnish certain statements) is amended—

(A) by striking out "or 6050J(e)" and inserting in lieu thereof "6050J(e), or 6050K(b)", and

(B) by striking out "or 6050J(a)" and inserting in lieu thereof "6050J(a), or 6050K(a)".

(3) Section 6678 (relating to failure to furnish certain statements) is amended by adding at the end thereof the following new subsection:

"(c) FAILURE TO NOTIFY PARTNERSHIP OF EXCHANGE OF PARTNERSHIP INTEREST.—In the case of any person who fails to furnish the notice required by section 6050K(c)(1) on the date prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, such person shall pay a penalty of $50 for each such failure."

(c) CONFORMING AMENDMENT.—The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by adding at the end thereof the following new item:

"Sec. 6050K. Returns relating to exchanges of certain partnership interests."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to exchanges after December 31, 1984.

SEC. 150. STATEMENTS REQUIRED IN CASE OF CERTAIN SUBSTITUTE PAYMENTS.

(a) IN GENERAL.—Section 6045 (relating to returns of brokers) is amended by adding at the end thereof the following new subsection:

"(d) STATEMENTS REQUIRED IN CASE OF CERTAIN SUBSTITUTE PAYMENTS.—If any broker—

"(1) transfers securities of a customer for use in a short sale or similar transaction, and

"(2) receives (on behalf of the customer) a payment in lieu of—

"(A) a dividend,

"(B) tax-exempt interest, or

"(C) such other items as the Secretary may prescribe by regulations,

during the period such short sale or similar transaction is open, the broker shall furnish such customer a written statement (at such time and in the manner as the Secretary shall prescribe by regulations) identifying such payment as being in lieu of the dividend, tax-exempt interest, or such other item. The Secretary may prescribe regulations which require the broker to make a return which includes the information contained in such written statement."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to payments received after December 31, 1984.

SEC. 151. REPORTING OF STATE AND LOCAL REFUNDS NOT REQUIRED WITH RESPECT TO NON-ITEMIZERS.

(a) IN GENERAL.—Subsection (b) of section 6050E (relating to State and local income tax refunds) is amended by adding at the end thereof the following: "No statement shall be required under this subsection with respect to any individual if it is determined (in the manner provided by regulations) that such individual did not claim itemized deductions under chapter 1 for the taxable year giving rise to the refund, credit, or offset."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to payments of refunds, and credits and offsets made, after December 31, 1982.

SEC. 152. FURNISHING OF TIN UNDER BACKUP WITHHOLDING.

(a) IN GENERAL.—Section 3406(e)(1) (relating to backup withholding) is amended by inserting at the end thereof the following new sentence: "The Secretary may require that a TIN required to be furnished under subsection (a)(1)(A) be provided under penalties of perjury only with respect to interest, dividends, patronage dividends, and amounts subject to broker reporting."

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on the date of the enactment of this Act.

PART III—OTHER COMPLIANCE PROVISIONS

SEC. 155. SUBSTANTIATION OF CHARITABLE CONTRIBUTIONS; MODIFICATIONS OF INCORRECT VALUATION PENALTY.

(a) SUBSTANTIATION OF CONTRIBUTIONS OF PROPERTY.—

(1) IN GENERAL.—Not later than December 31, 1984, the Secretary shall prescribe regulations under section 170(a)(1) of the Internal Revenue Code of 1954, which require any individual, closely held corporation, or personal service corporation claiming a deduction under section 170 of such Code for a contribution described in paragraph (2)—

(A) to obtain a qualified appraisal for the property contributed,

(B) to attach an appraisal summary to the return on which such deduction is first claimed for such contribution, and

(C) to include on such return such additional information (including the cost basis and acquisition date of the contributed property) as the Secretary may prescribe in such regulations.

Such regulations shall require the taxpayer to retain any qualified appraisal.

(2) CONTRIBUTIONS TO WHICH PARAGRAPH (1) APPLIES.—For purposes of paragraph (1), a contribution is described in this paragraph—

"(A) if such contribution is of property (other than publicly traded securities), and

"(B) if the claimed value of such property (plus the claimed value of all similar items of property donated to 1 or more donees) exceeds $5,000.

In the case of any property which is nonpublicly traded stock, subparagraph (B) shall be applied by substituting "$10,000" for "$5,000".

"(3) APPRAISAL SUMMARY.—For purposes of this subsection, the appraisal summary shall be in such form and include such information as the Secretary prescribes by regulations. Such summary shall be signed by the qualified appraiser preparing the qualified appraisal and shall contain the TIN of such appraiser. Such summary shall be acknowledged by the donee of the property appraised in such manner as the Secretary prescribes in such regulations.

"(4) QUALIFIED APPRAISAL.—The term "qualified appraisal" means an appraisal prepared by a qualified appraiser which includes—

"(A) a description of the property appraised,

"(B) the fair market value of such property on the date of contribution and the specific basis for the valuation,

"(C) a statement that such appraisal was prepared for income tax purposes,

"(D) the qualifications of the qualified appraiser,

"(E) the signature and TIN of such appraiser, and

"(F) such additional information as the Secretary prescribes in such regulations.

"(5) QUALIFIED APPRAISER.—

"(A) IN GENERAL.—For purposes of this subsection, the term "qualified appraiser" means an appraiser qualified to make appraisals of the type of property donated, who is not—

"(i) the taxpayer,

"(ii) a party to the transaction in which the taxpayer acquired the property,

"(iii) the donee,

"(iv) any person employed by any of the foregoing persons or related to any of the foregoing persons under section 267(b) of the Internal Revenue Code of 1954, or

"(v) to the extent provided in such regulations, any person whose relationship to the taxpayer would cause

35-426 O 84 - 14

a reasonable person to question the independence of such appraiser.

"(B) APPRAISAL FEES.—For purpose of this subsection, an appraisal shall not be treated as a qualified appraisal if all or part of the fee paid for such appraisal is based on a percentage of the appraised value of the property. The preceding sentence shall not apply to fees based on a sliding scale that are paid to a generally recognized association regulating appraisers.

(6) OTHER DEFINITIONS.—For purposes of this subsection—

(A) CLOSELY HELD CORPORATION.—The term "closely held corporation" means any corporation (other than an S corporation) with respect to which the stock ownership requirement of paragraph (2) of section 542(a) of such Code is met.

(B) PERSONAL SERVICE CORPORATION.—The term "personal service corporation" means any corporation (other than an S corporation) which is a service organization (within the meaning of section 414(m)(3) of such Code).

(C) PUBLICLY TRADED SECURITIES.—The term "publicly traded securities" means securities for which (as of the date of the contribution) market quotations are readily available on an established securities market.

(D) NONPUBLICLY TRADED STOCK.—The term "nonpublicly traded stock" means any stock of a corporation which is not a publicly traded security.

(E) THE SECRETARY.—The term "Secretary" means the Secretary of the Treasury or his delegate.

(b) INFORMATION REPORT REQUIRED ON DISPOSITION BY DONEE.—

(1) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61 (relating to information and returns) is amended by adding at the end thereof the following new section:

"SEC. 6050L. RETURNS RELATING TO CERTAIN DISPOSITIONS OF DONATED PROPERTY.

"(a) GENERAL RULE.—If the donee of any charitable deduction property sells, exchanges, or otherwise disposes of such property within 2 years after its receipt, the donee shall make a return (in accordance with forms and regulations prescribed by the Secretary) showing—

"(1) the name, address, and TIN of the donor,

"(2) a description of the property,

"(3) the date of the contribution,

"(4) the amount received on the disposition, and

"(5) the date of such disposition.

"(b) CHARITABLE DEDUCTION PROPERTY.—For purposes of this section, the term 'charitable deduction property' means any property (other than publicly traded securities) contributed in a contribution for which a deduction was claimed under section 170 if the claimed value of such property (plus the claimed value of all similar items of property donated by the donor to 1 or more donees) exceeds $5,000.

"(c) STATEMENT TO BE FURNISHED TO DONORS.—Every person making a return under subsection (a) shall furnish a copy of such return to the donor at such time and in such manner as the Secretary may by regulations prescribe.

"(d) DEFINITION OF PUBLICLY TRADED SECURITIES.—The term 'publicly traded securities' means securities for which (as of the date of the contribution) market quotations are readily available on an established securities market."

(2) PENALTIES.—

(A) Subparagraph (B) of section 6652(a)(1) (relating to failure to file certain information returns, etc.) is amended—

(i) by striking out "or" at the end of clause (vii),

(ii) By adding "or" at the end of clause (viii), and

(iii) by inserting after clause (viii) the following new clause:

"(ix) section 6050L (relating to returns relating to certain dispositions of donated property),"

(B) Paragraph (1) of section 6678(a) (relating to failure to furnish certain statements) is amended—

(i) by striking out "or 6050K(b)" and inserting in lieu thereof "6050K(b), or 6050L(c)", and

(ii) by striking out "or 6050K(a)" and inserting in lieu thereof "6050K(a), or 6050L(a)".

(3) Clerical amendment.—The table of sections of subpart B of part III of subchapter A of chapter 61 is amended by adding at the end thereof the following new item:

"Sec. 6050L. Returns relating to certain dispositions of donated property."

(c) MODIFICATIONS OF INCORRECT VALUATION PENALTY.—

(1) MODIFICATIONS OF SECTION 6659.—

(A) ELIMINATION OF REQUIREMENT THAT PROPERTY BE ACQUIRED WITHIN THE LAST 5 YEARS.—Subsection (c) of section 6659 is amended to read as follows:

"(c) VALUATION OVERSTATEMENT DEFINED.—For purposes of this section, there is a valuation overstatement if the value of any property, or the adjusted basis of any property, claimed on any return is 150 percent or more of the amount determined to be the correct amount of such valuation or adjusted basis (as the case may be)."

(B) SPECIAL RULES FOR OVERSTATEMENT OF CHARITABLE DEDUCTION.—Section 6659 is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection:

"(f) SPECIAL RULES FOR OVERSTATEMENT OF CHARITABLE DEDUCTION.—

"(1) AMOUNT OF APPLICABLE PERCENTAGE.—In the case of any underpayment attributable to a valuation overstatement with respect to charitable deduction property, the applicable percentage for purposes of subsection (a) shall be 30 percent.

"(2) LIMITATION ON AUTHORITY TO WAIVE.—In the case of any underpayment attributable to a valuation overstatement with respect to charitable deduction property, the Secretary may not waive any portion of the addition to tax provided by this section unless the Secretary determines that—

"(A) the claimed value of the property was based on a qualified appraisal made by a qualified appraiser, and

"(B) in addition to obtaining such appraisal, the taxpayer made a good faith investigation of the value of the contributed property.

"(3) DEFINITIONS.—For purposes of this subsection—

"(A) CHARITABLE DEDUCTION PROPERTY.—The term 'charitable deduction property' means any property contributed by the taxpayer in a contribution for which a deduction was claimed under section 170. For purposes of paragraph (2), such term shall not include any securities for which (as of the date of the contribution) market quotations are readily available on an established securities market.

"(B) QUALIFIED APPRAISER.—The term 'qualified appraiser' means any appraiser meeting the requirements of the regulations prescribed under section 170(a)(1).

"(C) QUALIFIED APPRAISAL.—The term 'qualified appraisal' means any appraisal meeting the requirements of the regulations prescribed under section 170(a)(1)."

(2) EXTENSION OF INCORRECT VALUATION PENALTY TO ESTATE AND GIFT TAX.—

(A) Subchapter A of chapter 68 (relating to additions to the tax and additional amounts) is amended by inserting after section 6659 the following new section:

"SEC. 6660. ADDITION TO TAX IN THE CASE OF VALUATION UNDERSTATEMENT FOR PURPOSES OF THE ESTATE OR GIFT TAXES.

"(a) ADDITION TO THE TAX.—In the case of any underpayment of a tax imposed by subtitle B (relating to estate and gift taxes) which is attributable to a valuation understatement, there shall be added to the tax an amount equal to the applicable percentage of the underpayment so attributed.

"(b) APPLICABLE PERCENTAGE.—For purposes of subsection (a), the applicable percentage shall be determined under the following table:

"If the valuation claimed is the following percent of the correct valuation—	*The applicable percentage is:*
50 percent or more but not more than 66⅔ percent	*10*
40 percent or more but less than 50 percent	*20*
Less than 40 percent	*30.*

"(c) VALUATION UNDERSTATEMENT DEFINED.—For purposes of this section, there is a valuation understatement if the value of any property claimed on any return is 66⅔ percent or less of the amount determined to be the correct amount of such valuation.

"(d) UNDERPAYMENT MUST BE AT LEAST $1,000.—This section shall not apply if the underpayment is less than $1,000 for any taxable period (or, in the case of the tax imposed by chapter 11, with respect to the estate of the decedent).

"(e) AUTHORITY TO WAIVE.—The Secretary may waive all or any part of the addition to the tax provided by this section on a showing by the taxpayer that there was a reasonable basis for the valuation claimed on the return and that such claim was made in good faith."

(B) CLERICAL AMENDMENT.—The table of sections for subchapter A of chapter 68 is amended by inserting after the item relating to section 6659 the following new item:

"Sec. 6660. Addition to tax in the case of valuation understatement for purposes of estate or gift taxes."

(d) EFFECTIVE DATES.—

(1) SUBSECTIONS (a) AND (b).—The amendments made by subsections (a) and (b) shall apply to contributions made after December 31, 1984, in taxable years ending after such date.

(2) SUBSECTION (c).—The amendments made by subsection (c) shall apply to returns filed after December 31, 1984.

SEC. 156. AUTHORIZATION TO DISREGARD APPRAISALS OF PERSONS PENALIZED FOR AIDING IN UNDERSTATEMENTS OF TAX LIABILITY.

(a) IN GENERAL.—Section 330 of title 31, United States Code, is amended by adding at the end thereof the following new subsection:

"(c) After notice and opportunity for a hearing to any appraiser with respect to whom a penalty has been assessed under section 6701(a) of the Internal Revenue Code of 1954, the Secretary may—

"(1) provide that appraisals by such appraiser shall not have any probative effect in any administrative proceeding before the Department of the Treasury or the Internal Revenue Service, and

"(2) bar such appraiser from presenting evidence or testimony in any such proceeding."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to penalties assessed after the date of the enactment of this Act.

SEC. 157. LIMITATION ON MAILING OF DEPOSITS OF TAXES.

(a) IN GENERAL.—Subsection (e) of section 7502 (relating to mailing of deposits) is amended by adding at the end thereof the following new paragraph:

"(3) NO APPLICATION TO CERTAIN DEPOSITS.—Paragraph (1) shall not apply with respect to any deposit of $20,000 or more by any person who is required to deposit the tax more than once a month."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to deposits required to be made after July 31, 1984.

SEC. 158. INTEREST ON CERTAIN ADDITIONS TO TAX.

(a) IN GENERAL.—Paragraph (2) of section 6601(e) (relating to interest on penalties and additions to tax) is amended to read as follows:

"(2) INTEREST ON PENALTIES, ADDITIONAL AMOUNTS, OR ADDITIONS TO THE TAX.—

"(A) IN GENERAL.—Interest shall be imposed under subsection (a) in respect of any assessable penalty, additional amount, or addition to the tax (other than an addition to tax imposed under section 6651(a)(1), 6659, 6660, or 6661) only if such assessable penalty, additional amount, or addition to the tax is not paid within 10 days from the date of notice and demand therefor, and in such case interest shall be imposed only for the period from the date of the notice and demand to the date of payment.

"(B) INTEREST ON CERTAIN ADDITIONS TO TAX.—Interest shall be imposed under this section with respect to any addition to tax imposed by section 6651(a)(1), 6659, 6660, or 6661 for the period which—

"(i) begins on the date on which the return of the tax with respect to which such addition to tax is imposed is required to be filed (including any extensions), and

"(ii) ends on the date of payment of such addition to tax."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to interest accrued after the date of the enactment of this Act, except with respect to additions to tax for which notice and demand is made before such date.

SEC. 159. PENALTY FOR FRAUDULENT WITHHOLDING EXEMPTION CERTIFICATE OR FAILURE TO SUPPLY INFORMATION.

(a) IN GENERAL.—Section 7205 (relating to penalty for fraudulent withholding exemption certificate) is amended—

"(1) by striking out "in lieu of" each place it appears and inserting in lieu thereof "in addition to", and

"(2) by striking out "(except the penalty provided by section 6682)" each place it appears.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to actions and failures to act occurring after the date of the enactment of this Act.

SEC. 160. APPLICATION OF PENALTY FOR FRIVOLOUS PROCEEDINGS TO PENDING TAX COURT PROCEEDINGS.

Paragraph (2) of section 292(e) of the Tax Equity and Fiscal Responsibility Act of 1982 is amended to read as follows:

"(2) PENALTY.—The amendments made by subsections (b) and (d)(2) shall apply to any action or proceeding in the United States Tax Court which—

"(A) is commenced after December 31, 1982, or

"(B) is pending in the United States Tax Court on the day which is 120 days after the date of the enactment of the Tax Reform Act of 1984."

SEC. 161. FAILURE TO REQUEST CHANGE OF METHOD OF ACCOUNTING.

(a) IN GENERAL.—Section 446 (relating to general rule for methods of accounting) is amended by adding at the end thereof the following new subsection:

"(f) FAILURE TO REQUEST CHANGE OF METHOD OF ACCOUNTING.—If the taxpayer does not file with the Secretary a request to change the method of accounting, the absence of the consent of the Secretary to a change in the method of accounting shall not be taken into account—

"(1) to prevent the imposition of any penalty, or the addition of any amount to tax, under this title, or

"(2) to diminish the amount of such penalty or addition to tax."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 162. CLARIFICATION OF CHANGE OF VENUE FOR CERTAIN TAX OFFENSES.

Section 3237(b) of title 18 of the United States Code is amended to read as follows:

"(b) Notwithstanding subsection (a), where an offense is described in section 7203 of the Internal Revenue Code of 1954, or where venue for prosecution of an offense described in section 7201 or 7206 (1), (2), or (5) of such Code (whether or not the offense is also described in another provision of law) is based solely on a mailing to the Internal Revenue Service, and prosecution is begun in a judicial district other than the judicial district in which the defendant re-

sides, he may upon motion filed in the district in which the prosecution is begun, elect to be tried in the district in which he was residing at the time the alleged offense was committed: Provided, That the motion is filed within twenty days after arraignment of the defendant upon indictment or information."

SEC. 163. EXTENSION OF STATUTE OF LIMITATIONS WITH RESPECT TO CERTAIN EXPENDITURES RELATING TO CONTRIBUTIONS IN AID OF CONSTRUCTION.

(a) IN GENERAL.—Section 118 (relating to contributions to the capital of a corporation) is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) STATUTE OF LIMITATIONS.—If the taxpayer for any taxable year treats an amount as a contribution to the capital of the taxpayer described in subsection (b), then—

"(1) the statutory period for the assessment of any deficiency attributable to any part of such amount shall not expire before the expiration of 3 years from the date the Secretary is notified by the taxpayer (in such manner as the Secretary may prescribe) of—

"(A) the amount of the expenditure referred to in subparagraph (A) of subsection (b)(2),

"(B) the taxpayer's intention not to make the expenditures referred to in such subparagraph, or

"(C) a failure to make such expenditure within the period described in subparagraph (B) of subsection (b)(2); and

"(2) such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment."

(b) TECHNICAL AMENDMENTS.—

(1) Section 6603 is amended by striking out subsections (l) and (o) and by redesignating subsection (m), (n), and (p) as subsections (k), (l), and (m), respectively, and by inserting after subsection (m) (as so redesignated) the following new subsection:

"(n) CROSS REFERENCES.—

"(1) For period of limitations for assessment and collection in the case of a joint income return filed after separate returns have been filed, see section 6013(b) (3) and (4).

"(2) For extension of period in the case of partnership items (as defined in section 6231(a)(3)), see section 6229.

"(3) For extension of period in the case of certain contributions in aid of construction, see section 118(c)."

(2) Subsection (f) of section 6613 is amended by striking out "section 6603(n)(1)" and inserting in lieu thereof "section 6603(l)(1)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to expenditures with respect to which the second taxable year described in section 118(b)(2)(B) of the Internal Revenue Code of 1954 ends after December 31, 1984.

Subtitle L—Miscellaneous Provisions

SEC. 171. INCLUSION OF TAX BENEFIT ITEMS IN INCOME.

(a) IN GENERAL.—Section 111 (relating to recovery of bad debts, prior taxes, and delinquency amounts) is amended to read as follows:

"SEC. 111. RECOVERY OF TAX BENEFIT ITEMS.

"(a) DEDUCTIONS.—Gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce income subject to tax.

"(b) CREDITS.—

"(1) IN GENERAL.—If—

"(A) a credit was allowable with respect to any amount for any prior taxable year, and

"(B) during the taxable year there is a downward price adjustment or similar adjustment,

the tax imposed by this chapter for the taxable year shall be increased by the amount of the credit attributable to the adjustment.

"(2) EXCEPTION WHERE CREDIT DID NOT REDUCE TAX.—Paragraph (1) shall not apply to the extent that the credit allowable for the recovered amount did not reduce the amount of tax imposed by this chapter.

"(3) EXCEPTION FOR INVESTMENT TAX CREDIT AND FOREIGN TAX CREDIT.—This subsection shall not apply with respect to the credit determined under section 46 and the foreign tax credit.

"(c) TREATMENT OF CARRYOVERS.—For purposes of this section, an increase in a carryover which has not expired before the beginning of the taxable year in which the recovery takes place shall be treated as reducing income subject to tax or reducing tax imposed by this chapter, as the case may be.

"(d) SPECIAL RULES FOR ACCUMULATED EARNINGS TAX AND FOR PERSONAL HOLDING COMPANY TAX.—In applying subsection (a) for the purpose of determining the accumulated earnings tax under section 531 or the tax under section 541 (relating to personal holding companies)—

"(1) any excluded amount under subsection (a) allowed for the purposes of this subtitle (other than section 531 or section 541) shall be allowed whether or not such amount resulted in a reduction of the tax under section 531 or the tax under section 541 for the prior taxable year; and

"(2) where any excluded amount under subsection (a) was not allowable as a deduction for the prior taxable year for purposes of this subtitle other than of section 531 or section 541 but was allowable for the same taxable year under section 531 or section 541, then such excluded amount shall be allowable if it did not result in a reduction of the tax under section 531 or the tax under section 541."

(b) CLERICAL AMENDMENT.—The table of sections for part III of subchapter B of chapter 1 (relating to items specifically excluded

from gross income) is amended by striking out the item relating to section 111 and inserting in lieu thereof:

"Sec. 111. Recovery of tax benefit items."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts recovered after December 31, 1983, in taxable years ending after such date.

SEC. 172. LOANS WITH BELOW-MARKET INTEREST RATES.

(a) GENERAL RULE.—Subchapter C of chapter 80 (relating to provisions affecting more than 1 subtitle) is amended by adding at the end thereof the following new section:

"SEC. 7872. TREATMENT OF LOANS WITH BELOW-MARKET INTEREST RATES.

"(a) TREATMENT OF GIFT LOANS AND DEMAND LOANS.—

"(1) IN GENERAL.—For purposes of this title, in the case of any below-market loan to which this section applies and which is a gift loan or a demand loan, the foregone interest shall be treated as—

"(A) transferred from the lender to the borrower, and

"(B) retransferred by the borrower to the lender as interest.

"(2) TIME WHEN TRANSFERS MADE.—Except as otherwise provided in regulations prescribed by the Secretary, any foregone interest attributable to periods during any calendar year shall be treated as transferred (and retransferred) under paragraph (1) on the last day of such calendar year.

"(b) TREATMENT OF OTHER BELOW-MARKET LOANS.—

"(1) IN GENERAL.—For purposes of this title, in the case of any below-market loan to which this section applies and to which subsection (a)(1) does not apply, the lender shall be treated as having transferred on the date the loan was made (or, if later, on the first day on which this section applies to such loan), and the borrower shall be treated as having received on such date, cash in an amount equal to the excess of—

"(A) the amount loaned, over

"(B) the present value of all payments which are required to be made under the terms of the loan.

"(2) OBLIGATION TREATED AS HAVING ORIGINAL ISSUE DISCOUNT.—For purposes of this title—

"(A) IN GENERAL.—Any below-market loan to which paragraph (1) applies shall be treated as having original issue discount in an amount equal to the excess described in paragraph (1).

"(B) AMOUNT IN ADDITION TO OTHER ORIGINAL ISSUE DISCOUNT.—Any original issue discount which a loan is treated as having by reason of subparagraph (A) shall be in addition to any other original issue discount on such loan (determined without regard to subparagraph (A)).

"(c) BELOW-MARKET LOANS TO WHICH SECTION APPLIES.—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, this section shall apply to—

"(A) GIFTS.—Any below-market loan which is a gift loan.

"(B) COMPENSATION-RELATED LOANS.—Any below-market loan directly or indirectly between—

"(i) an employer and an employee, or

"(ii) an independent contractor and a person for whom such independent contractor provides services.

"(C) CORPORATION-SHAREHOLDER LOANS.—Any below-market loan directly or indirectly between a corporation and any shareholder of such corporation.

"(D) TAX AVOIDANCE LOANS.—Any below-market loan 1 of the principal purposes of the interest arrangements of which is the avoidance of any Federal tax.

"(E) OTHER BELOW-MARKET LOANS.—To the extent provided in regulations, any below-market loan which is not described in subparagraph (A), (B), or (C) if the interest arrangements of such loan have a significant effect on any Federal tax liability of the lender or the borrower.

"(2) $10,000 DE MINIMIS EXCEPTION FOR GIFT LOANS BETWEEN INDIVIDUALS.—

"(A) IN GENERAL.—In the case of any gift loan directly between individuals, this section shall not apply to any day on which the aggregate outstanding amount of loans between such individuals does not exceed $10,000.

"(B) DE MINIMIS EXCEPTION NOT TO APPLY TO LOANS ATTRIBUTABLE TO ACQUISITION OF INCOME-PRODUCING ASSETS.—Subparagraph (A) shall not apply to any gift loan directly attributable to the purchase or carrying of income-producing assets.

"(C) CROSS REFERENCE.—

"For limitation on amount treated as interest where loans do not exceed $100,000, see subsection (d)(1).

"(3) $10,000 DE MINIMIS EXCEPTION FOR COMPENSATION-RELATED AND CORPORATE-SHAREHOLDER LOANS.—

"(A) IN GENERAL.—In the case of any loan described in subparagraph (B) or (C) of paragraph (1), this section shall not apply to any day on which the aggregate outstanding amount of loans between the borrower and lender does not exceed $10,000.

"(B) EXCEPTION NOT TO APPLY WHERE 1 OF PRINCIPAL PURPOSES IS TAX AVOIDANCE.—Subparagraph (A) shall not apply to any loan the interest arrangements of which have as 1 of their principal purposes the avoidance of any Federal tax.

"(d) SPECIAL RULES FOR GIFT LOANS.—

"(1) LIMITATION ON INTEREST ACCRUAL FOR PURPOSES OF INCOME TAXES WHERE LOANS DO NOT EXCEED $100,000.—

"(A) IN GENERAL.—For purposes of subtitle A, in the case of a gift loan directly between individuals, the amount treated as retransferred by the borrower to the lender as of the close of any year shall not exceed the borrower's net investment income for such year.

"(B) LIMITATION NOT TO APPLY WHERE 1 OF PRINCIPAL PURPOSES IS TAX AVOIDANCE.—Subparagraph (A) shall not apply to any loan the interest arrangements of which have as 1 of their principal purposes the avoidance of any Federal tax.

"(C) SPECIAL RULE WHERE MORE THAN 1 GIFT LOAN OUTSTANDING.—For purposes of subparagraph (A), in any case in which a borrower has outstanding more than 1 gift loan, the net investment income of such borrower shall be allocated among such loans in proportion to the respective amounts which would be treated as retransferred by the borrower without regard to this paragraph.

"(D) LIMITATION NOT TO APPLY WHERE AGGREGATE AMOUNT OF LOANS EXCEED $100,000.—This paragraph shall not apply to any loan made by a lender to a borrower for any day on which the aggregate outstanding amount of loans between the borrower and lender exceeds $100,000.

"(E) NET INVESTMENT INCOME.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'net investment income' has the meaning given such term by section 163(d)(3).

"(ii) DE MINIMIS RULE.—If the net investment income of any borrower for any year does not exceed $1,000, the net investment income of such borrower for such year shall be treated as zero.

"(iii) ADDITIONAL AMOUNTS TREATED AS INTEREST.—In determining the net investment income of a person for any year, any amount which would be included in the gross income of such person for such year by reason of section 1272 if such section applied to all deferred payment obligations shall be treated as interest received by such person for such year.

"(iv) DEFERRED PAYMENT OBLIGATIONS.—The term 'deferred payment obligation' includes any market discount bond, short-term obligation, United States savings bond, annuity, or similar obligation.

"(2) SPECIAL RULE FOR GIFT TAX.—In the case of any gift loan which is a term loan, subsection (b)(1) (and not subsection (a)) shall apply for purposes of chapter 12.

"(e) DEFINITIONS OF BELOW-MARKET LOAN AND FOREGONE INTEREST.—For purposes of this section—

"(1) BELOW-MARKET LOAN.—The term 'below-market loan' means any loan if—

"(A) in the case of a demand loan, interest is payable on the loan at a rate less than the applicable Federal rate, or

"(B) in the case of a term loan, the amount loaned exceeds the present value of all payments due under the loan.

"(2) FOREGONE INTEREST.—The term 'foregone interest' means, with respect to any period during which the loan is outstanding, the excess of—

"(A) the amount of interest which would have been payable on the loan for the period if interest accrued on the loan at the applicable Federal rate and were payable annually on the day referred to in subsection (a)(2), over

"(B) any interest payable on the loan properly allocable to such period.

"(f) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) PRESENT VALUE.—The present value of any payment shall be determined in the manner provided by regulations prescribed by the Secretary—

"(A) as of the date of the loan, and

"(B) by using a discount rate equal to the applicable Federal rate.

"(2) APPLICABLE FEDERAL RATE.—

"(A) TERM LOANS.—In the case of any term loan, the applicable Federal rate shall be the applicable Federal rate in effect under section 1274(d) (as of the day on which the loan was made), compounded semiannually.

"(B) DEMAND LOANS.—In the case of a demand loan, the applicable Federal rate shall be the Federal short-term rate in effect under section 1274(d) for the period for which the amount of foregone interest is being determined.

"(3) GIFT LOAN.—The term 'gift loan' means any below-market loan where the foregoing of interest is in the nature of a gift.

"(4) AMOUNT LOANED.—The term 'amount loaned' means the amount received by the borrower.

"(5) DEMAND LOAN.—The term 'demand loan' means any loan which is payable in full at any time on the demand of the lender. Such term also includes (for purposes other than determining the applicable Federal rate under paragraph (2)) any loan which is not transferrable and the benefits of the interest arrangements of which is conditioned on the future performance of substantial services by an individual.

"(6) TERM LOAN.—The term 'term loan' means any loan which is not a demand loan.

"(7) HUSBAND AND WIFE TREATED AS 1 PERSON.—A husband and wife shall be treated as 1 person.

"(8) LOANS TO WHICH SECTION 483 OR 1274 APPLIES.—This section shall not apply to any loan to which section 483 or 1274 applies.

"(9) NO WITHHOLDING.—No amount shall be withheld under chapter 24 with respect to any amount treated as transferred or retransferred under subsection (a).

"(10) SPECIAL RULE FOR TERM LOANS.—If this section applies to any term loan on any day, this section shall continue to apply to such loan notwithstanding paragraphs (2) and (3) of subsection (c). In the case of a gift loan, the preceding sentence shall only apply for purposes of chapter 12.

"(g) REGULATIONS.—

"(1) IN GENERAL.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including—

"(A) regulations providing that where, by reason of varying rates of interest, conditional interest payments, waivers of interest, disposition of the lender's or borrower's interest in the loan, or other circumstances, the provisions of this section do not carry out the purposes of this section, adjustments to the provisions of this section will be made to the extent necessary to carry out the purposes of this section,

"(B) regulations for the purpose of assuring that the positions of the borrower and lender are consistent as to the application (or nonapplication) of this section, and

"(C) regulations exempting from the application of this section any class of transactions the interest arrangements of which have no significant effect on any Federal tax liability of the lender or the borrower.

"(2) ESTATE TAX COORDINATION.—Under regulations prescribed by the Secretary, any loan which is made with donative intent and which is a term loan shall be taken into account for purposes of chapter 11 in a manner consistent with the provisions of subsection (b)."

(b) CLERICAL AMENDMENT.—The table of sections for subchapter C of chapter 80 is amended by adding at the end thereof the following new item:

"Sec. 7872. Treatment of loans with below-market interest rates."

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to—

(A) term loans made after June 6, 1984, and

(B) demand loans outstanding after June 6, 1984.

(2) EXCEPTION FOR DEMAND LOANS OUTSTANDING ON JUNE 6, 1984, AND REPAID WITHIN 60 DAYS AFTER DATE OF ENACTMENT.—The amendments made by this section shall not apply to any demand loan which—

(A) was outstanding on June 6, 1984, and

(B) was repaid before the date 60 days after the date of the enactment of this Act.

(3) EXCEPTION FOR CERTAIN EXISTING LOANS TO CONTINUING CARE FACILITIES.—Nothing in this subsection shall be construed to apply the amendments made by this section to any loan made before June 6, 1984, to a continuing care facility by a resident of such facility which is contingent on continued residence at such facility.

(4) APPLICABLE FEDERAL RATE FOR PERIODS BEFORE JANUARY 1, 1985.—For periods before January 1, 1985, the applicable Federal rate under paragraph (2) of section 7872(f) of the Internal Revenue Code of 1954, as added by this section, shall be 10 percent, compounded semiannually.

(5) TREATMENT OF RENEGOTIATIONS, ETC.—For purposes of this subsection, any loan renegotiated, extended, or revised after June 6, 1984, shall be treated as a loan made after such date.

(6) DEFINITION OF TERM AND DEMAND LOANS.—For purposes of this subsection, the terms 'demand loan' and 'term loan' have the respective meanings given such terms by paragraphs (5) and (6) of section 7872(f) of the Internal Revenue Code of 1954, as added by this section, but the second sentence of such paragraph (5) shall not apply.

SEC. 173. ELIGIBILITY FOR INCOME AVERAGING.

(a) BASE PERIOD SHORTENED TO 3 YEARS.—Paragraph (2) of section 1302(c) (relating to definition of averagable income; related definitions) is amended by striking out "4 taxable years" and inserting in lieu thereof "3 taxable years".

(b) INCREASE IN PERCENTAGE OF AVERAGE BASE INCOME TAKEN INTO ACCOUNT.—Section 1301 (relating to limitation on tax) is amended by striking out "120 percent" and inserting in lieu thereof "140 percent".

(c) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Section 1301 (relating to limitation on tax) is amended—

(A) by striking out "5 times" and inserting in lieu thereof "4 times", and

(B) by striking out "20 percent" and inserting in lieu thereof "25 percent".

(2) Paragraph (1) of section 1302(a) (defining averagable income) is amended by striking out "120 percent" and inserting in lieu thereof "140 percent".

(3) Paragraph (1) of section 1302(b) (defining average base period income) is amended by striking out "one-fourth" and inserting in lieu thereof "1/3".

(4) Paragraph (3) of section 1302(c) is amended by striking out "4 taxable years" and inserting in lieu thereof "3 taxable years".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to computation years beginning after December 31, 1983, and to base period years applicable to such computation years.

SEC. 174. AMENDMENTS TO SECTION 267.

(a) ALLOWANCE OF DEDUCTION WHERE EXPENSES AND INTEREST ARE PAID TO RELATED CASH-BASIS TAXPAYERS AFTER 2½-MONTH PERIOD.—

(1) IN GENERAL.—Subsection (a) of section 267 (relating to losses, expenses, and interest with respect to transactions between related taxpayers) is amended to read as follows:

"(a) IN GENERAL.—

"(1) DEDUCTION FOR LOSSES DISALLOWED.—No deduction shall be allowed in respect of any loss from the sale or exchange of property (other than a loss in case of a distribution in corporate liquidation), directly or indirectly, between persons specified in any of the paragraphs of subsection (b).

"(2) MATCHING OF DEDUCTION AND PAYEE INCOME ITEM IN THE CASE OF EXPENSES AND INTEREST.—If—

"(A) by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not (unless paid) includible in the gross income of such person, and

"(B) at the close of the taxable year of the taxpayer for which (but for this paragraph) the amount would be deductible under this chapter, both the taxpayer and the person to whom the payment is to be made are persons specified in any of the paragraphs of subsection (b),

then any deduction allowable under this chapter in respect of such amount shall be allowable as of the day as of which such amount is includible in the gross income of the person to whom the payment is made (or, if later, as of the day on which it would be so allowable but for this paragraph)."

(2) CONFORMING AMENDMENT.—Subsection (e) of section 267 (relating to rule where last day of 2½-month period falls on Sunday, etc.) is hereby repealed.

(b) EXTENSION OF SECTION 267 TO CERTAIN RELATED ENTRIES.—

(1) PASS-THRU ENTITIES.—Section 267 is amended by striking out subsection (f) and inserting in lieu thereof the following:

"(e) SPECIAL RULES FOR PASS-THRU ENTITIES.—

"(1) IN GENERAL.—In the case of any amount paid or incurred by, to, or on behalf of, a pass-thru entity, for purposes of applying subsection (a)(2)—

"(A) such entity,

"(B) in the case of—

"(i) a partnership, any person who owns (directly or indirectly) any capital interest or profits interest of such partnership, or

"(ii) an S corporation, any person who owns (directly or indirectly) any of the stock of such corporation,

"(C) any person who owns (directly or indirectly) any capital interest or profits interest of a partnership in which such entity owns (directly or indirectly) any capital interest or profits interest, and

"(D) any person related (within the meaning of subsection (b) of this section or section 707(b)(1)) to a person described in subparagraph (B) or (C),

shall be treated as persons specified in a paragraph of subsection (b). Subparagraph (C) shall apply to a transaction only if such transaction is related either to the operations of the partnership described in such subparagraph or to an interest in such partnership.

"(2) PASS-THRU ENTITY.—For purposes of this section, the term 'pass-thru entity' means—

"(A) a partnership, and

"(B) an S corporation.

"(3) CONSTRUCTIVE OWNERSHIP IN THE CASE OF PARTNERSHIPS.—For purposes of determining ownership of a capital interest or profits interest of a partnership, the principles of subsection (c) shall apply, except that—

"(A) paragraph (3) of subsection (c) shall not apply, and

"(B) interests owned (directly or indirectly) by or for a C corporation shall be considered as owned by or for any shareholder only if such shareholder owns (directly or indirectly) 5 percent or more in value of the stock of such corporation.

"(4) SUBSECTION (a)(2) NOT TO APPLY TO CERTAIN GUARANTEED PAYMENTS OF PARTNERSHIPS.—In the case of any amount paid or incurred by a partnership, subsection (a)(2) shall not apply to the extent that section 707(c) applies to such amount.

"(5) EXCEPTION FOR CERTAIN EXPENSES AND INTEREST OF PARTNERSHIPS OWNING LOW-INCOME HOUSING.—

"(A) IN GENERAL.—This subsection shall not apply with respect to qualified expenses and interest paid or incurred by a partnership owning low-income housing to—

"(i) any qualified 5-percent or less partner of such partnership, or

"(ii) any person related (within the meaning of subsection (b) of this section or section 707(b)(1)) to any qualified 5-percent or less partner of such partnership.

"(B) QUALIFIED 5-PERCENT OR LESS PARTNER.—For purposes of this paragraph, the term 'qualified 5-percent or less partner' means any partner who has (directly or indirectly) an interest of 5 percent or less in the aggregate capital and profits interests of the partnership but only if—

"(i) such partner owned the low-income housing at all times during the 2-year period ending on the date such housing was transferred to the partnership, or

"(ii) such partnership acquired the low-income housing pursuant to a purchase, assignment, or other transfer from the Department of Housing and Urban Development or any State or local housing authority.

For purposes of the preceding sentence, a partner shall be treated as holding any interest in the partnership which is held (directly or indirectly) by any person related (within the meaning of subsection (b) of this section or section 707(b)(1)) to such partner.

"(C) QUALIFIED EXPENSES AND INTEREST.—For purpose of this paragraph, the term 'qualified expenses and interest' means any expense or interest incurred by the partnership with respect to low-income housing held by the partnership but—

"(i) only if the amount of such expense or interest (as the case may be) is unconditionally required to be paid by the partnership not later than 10 years after the date such amount was incurred, and

"(ii) in the case of such interest, only if such interest is incurred at an annual rate not in excess of 12 percent.

"(D) LOW-INCOME HOUSING.—For purposes of this paragraph, the term 'low-income housing' means—

"(i) any interest in low-income housing (as defined in paragraph (5) of section 189(e)), and

"(ii) any interest in a partnership owning low-income housing (as so defined)."

(2) CERTAIN CONTROLLED GROUPS.—

(A) Paragraph (3) of section 267(b) is amended to read as follows:

"(3) Two corporations which are members of the same controlled group (as defined in subsection (f));".

(B) Section 267 is amended by adding at the end thereof the following new subsection:

"(f) CONTROLLED GROUP DEFINED; SPECIAL RULES APPLICABLE TO CONTROLLED GROUPS.—

"(1) CONTROLLED GROUP DEFINED.—For purposes of this section, the term 'controlled group' has the meaning given to such term by section 1563(a), except that—

"(A) 'more than 50 percent' shall be substituted for 'at least 80 percent' each place it appears in section 1563(a), and

"(B) the determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of section 1563.

"(2) DEFERRAL (RATHER THAN DENIAL) OF LOSS FROM SALE OR EXCHANGE BETWEEN MEMBERS.—In the case of any loss from the sale or exchange of property which is between members of the same controlled group and to which subsection (a)(1) applies (determined without regard to this paragraph but with regard to paragraph (3))—

"(A) subsections (a)(1) and (d) shall not apply to such loss, but

"(B) such loss shall be deferred until the property is transferred outside such controlled group and there would be recognition of loss under consolidated return principles or until such other time as may be prescribed in regulations.

"(3) LOSS DEFERRAL RULES NOT TO APPLY IN CERTAIN CASES.—

"(A) TRANSFER TO DISC.—For purposes of applying subsection (a)(1), the term 'controlled group' shall not include a DISC.

"(B) CERTAIN SALES OF INVENTORY.—Except to the extent provided in regulations prescribed by the Secretary, subsection (a)(1) shall not apply to the sale or exchange of property between members of the same controlled group if—

"(i) such property in the hands of the transferor is property described in section 1221(1),

"(ii) such sale or exchange is in the ordinary course of the transferor's trade or business,

"(iii) such property in the hands of the transferee is property described in section 1221(1), and

"(iv) the transferee or the transferor is a foreign corporation.

"(C) CERTAIN FOREIGN CURRENCY LOSSES.—To the extent provided in regulations, subsection (a)(1) shall not apply to any loss sustained by a member of a controlled group on the repayment of a loan made to another member of such group if such loan is payable in a foreign currency or is denominated in such a currency and such loss is attributable to a reduction in value of such foreign currency."

(3) CORPORATION AND PARTNERSHIP OWNED BY SAME PERSONS.—Paragraph (10) of section 267(b) is amended—

(A) by striking out "An S corporation" and inserting in lieu thereof "A corporation", and

(B) by striking out "the S corporation" and inserting in lieu thereof "the corporation".

(4) S CORPORATION AND C CORPORATION OWNED BY SAME PERSONS.—Paragraph (12) of section 267(b) is amending by striking out "the same individual" and inserting in lieu thereof "the same persons".

(5) TECHNICAL AMENDMENTS.—

(A) Paragraph (3) of section 170(a) is amended by striking out "section 267(b)" and inserting in lieu thereof "section 267(b) or 707(b)".

(B) Clause (iii) of section 514(c)(9)(B) is amended by striking out "section 267(b)" and inserting in lieu thereof "section 267(b) or 707(b)".

(C) Subsection (d) of section 1235 is amended—

(i) by striking out "section 267(b)" in the matter preceding paragraph (1) and inserting in lieu thereof "section 267(b) or persons described in section 707(b)",

(ii) by striking out "section 267 (b) and (c)" and inserting in lieu thereof "section 267 (b) and (c) and section 707(b)", and

(iii) by striking out "section 267(b)" in paragraph (1) and inserting in lieu thereof "section 267(b) or 707(b)".

(D) Subparagraph (F) of section 368(a)(2) is amended by striking out clause (viii).

(c) EFFECTIVE DATES.—

(1) SUBSECTIONS (a) AND (b)(1).—The amendments made by subsections (a) and (b)(1) shall apply to amounts allowable as deductions under chapter 1 of the Internal Revenue Code of 1954 for taxable years beginning after December 31, 1983. For purposes of the preceding sentence, the allowability of a deduction shall be determined without regard to any disallowance or postponement of deductions under section 267 of such Code.

(2) SUBSECTION (b) (OTHER THAN PARAGRAPH (1)).—

(A) IN GENERAL.—Except as provided in subparagraph (B), the amendments made by subsection (b) (other than paragraph (1) thereof) shall apply to transactions after December 31, 1983, in taxable years ending after such date.

(B) EXCEPTION FOR TRANSFERS TO FOREIGN CORPORATIONS ON OR BEFORE MARCH 1, 1984.—The amendments made by subsection (b)(2) shall not apply to property transferred to a foreign corporation on or before March 1, 1984.

(3) EXCEPTION FOR EXISTING INDEBTEDNESS, ETC.—

(A) IN GENERAL.—The amendments made by this section shall not apply to any amount paid or incurred—

(i) on indebtedness incurred on or before September 29, 1983, or

(ii) pursuant to a contract which was binding on September 29, 1983, and at all times thereafter before the amount is paid or incurred.

(B) TREATMENT OF RENEGOTIATIONS, EXTENSIONS, ETC.—If any indebtedness (or contract described in subparagraph (A)) is renegotiated, extended, renewed, or revised after September 29, 1983, subparagraph (A) shall not apply to any amount paid or incurred on such indebtedness (or pursuant to such contract) after the date of such renegotiation, extension, renewal, or revision.

SEC. 175. AMENDMENTS TO SECTION 1239.

(a) PATENT APPLICATIONS TREATED AS DEPRECIABLE PROPERTY.—Section 1239 (relating to gain from sale of depreciable property between certain related taxpayers) is amended by adding at the end thereof the following new subsection:

"(e) PATENT APPLICATIONS TREATED AS DEPRECIABLE PROPERTY.—For purposes of this section, a patent application shall be treated as

property which, in the hands of the transferee, is of a character which is subject to the allowance for depreciation provided in section 167."

(b) TAXPAYER AND CERTAIN TRUSTS TREATED AS RELATED PERSONS.—Subsection (b) of section 1239 is amended to read as follows:

"(b) RELATED PERSONS.—For purposes of subsection (a), the term 'related person' means—

"(1) a husband and wife,

"(2) a person and all entities which are 80-percent owned entities with respect to such person,

"(3) a taxpayer and any trust in which such taxpayer (or his spouse) is a beneficiary, unless such beneficiary's interest in the trust is a remote contingent interest (within the meaning of section 318(a)(3)(B)(i))."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to sales or exchanges after March 1, 1984, in taxable years ending after such date.

SEC. 176. RECAPTURE OF NET ORDINARY LOSSES UNDER SECTION 1231.

(a) GENERAL RULE.—Section 1231 (relating to property used in the trade or business and involuntary conversions) is amended by adding at the end thereof the following new subsection:

"(c) RECAPTURE OF NET ORDINARY LOSSES.—

"(1) IN GENERAL.—The net section 1231 gain for any taxable year shall be treated as ordinary income to the extent such gain does not exceed the non-recaptured net section 1231 losses.

"(2) NON-RECAPTURED NET SECTION 1231 LOSSES.—For purposes of this subsection, the term 'non-recaptured net section 1231 losses' means the excess of—

"(A) the aggregate amount of the net section 1231 losses for the 5 most recent preceding taxable years beginning after December 31, 1981, over

"(B) the portion of such losses taken into account under paragraph (1) for such preceding taxable years.

"(3) NET SECTION 1231 GAIN.—For purposes of this subsection, the term 'net section 1231 gain' means the excess of—

"(A) the section 1231 gains, over

"(B) the section 1231 losses.

"(4) NET SECTION 1231 LOSS.—For purposes of this subsection, the term 'net section 1231 loss' means the excess of—

"(A) the section 1231 losses, over

"(B) the section 1231 gains.

"(5) SPECIAL RULES.—For purposes of determining the amount of the net section 1231 gain or loss for any taxable year, the rules of paragraph (4) of subsection (a) shall apply."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to net section 1231 gains for taxable years beginning after December 31, 1984.

SEC. 177. REPEAL OF EXEMPTION FROM FEDERAL TAX OF THE FEDERAL HOME LOAN MORTGAGE CORPORATION.

(a) REPEAL OF EXEMPTION.—Subsection (d) of section 303 of the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1452(d)) is amended—

(1) by striking out "by the United States,",

(2) by striking out "possession thereof," and inserting in lieu thereof "possession of the United States", and

(3) by striking out the last sentence.

(b) TREATMENT OF DIVIDENDS PAID BY FEDERAL HOME LOAN BANK WHICH ARE ALLOCABLE TO DIVIDENDS FROM THE FEDERAL HOME LOAN MORTGAGE CORPORATION.—Subsection (a) of section 246 (relating to denial of dividends received deduction for dividends from certain corporations) is amended to read as follows:

"(a) DEDUCTION NOT ALLOWED FOR DIVIDENDS FROM CERTAIN CORPORATIONS.—

"(1) IN GENERAL.—The deductions allowed by sections 243, 244, and 245 shall not apply to any dividend from a corporation which, for the taxable year of the corporation in which the distribution is made, or for the next preceding taxable year of the corporation, is a corporation exempt from tax under section 501 (relating to certain charitable, etc., organizations) or section 521 (relating to farmers' cooperative associations).

"(2) SUBSECTION NOT TO APPLY TO CERTAIN DIVIDENDS OF FEDERAL HOME LOAN BANKS.—

"(A) DIVIDENDS OUT OF CURRENT EARNINGS AND PROFITS.—In the case of any dividend paid by any FHLB out of earnings and profits of the FHLB for the taxable year in which such dividend was paid, paragraph (1) shall not apply to that portion of such dividend which bears the same ratio to the total dividend as—

"(i) the dividends received by the FHLB from the FHLMC during such taxable year, bears to

"(ii) the total earnings and profits of the FHLB for such taxable year.

"(B) DIVIDENDS OUT OF ACCUMULATED EARNINGS AND PROFITS.—For purposes of subparagraph (A), in the case of any dividend which is paid out of any accumulated earnings and profits of any FHLB, paragraph (1) shall not apply to that portion of the dividend which bears the same ratio to the total dividend as—

"(i) the amount of dividends received by such FHLB from the FHLMC which are out of earnings and profits of the FHLMC—

"(I) for taxable years ending after December 31, 1984, and

"(II) which were not taken into account under subparagraph (A), bears to

"(ii) the total accumulated earnings and profits of the FHLB as of the time such dividend is paid.

For purposes of clause (ii), the accumulated earnings and profits of the FHLB as of January 1, 1985, shall be treated as equal to its retained earnings as of such date.

"(C) DEFINITIONS.—For purposes of this paragraph—

"(i) FHLB.—The term 'FHLB' means any Federal Home Loan Bank.

"(ii) FHLMC.—The term 'FHLMC' means the Federal Home Loan Mortgage Corporation.

"(iii) TAXABLE YEAR OF FHLB.—The taxable year of an FHLB shall, except as provided in regulations pre-

scribed by the Secretary, be treated as the calendar year."

(c) TREATMENT OF NET OPERATING LOSSES OF THE FEDERAL HOME LOAN MORTGAGE CORPORATION.—

(1) IN GENERAL.—Subparagraph (H) of section 172(b)(1) (relating to years to which net operating losses may be carried) is amended—

(A) by inserting ", or a net operating loss of the Federal Home Loan Mortgage Corporation for any taxable year beginning after December 31, 1984" after "1981",

(B) by striking out "the FNMA mortgage disposition loss (within the meaning of subsection (i))" in clause (i) and inserting in lieu thereof "the mortgage disposition loss (within the meaning of subsection (i))", and

(C) by striking out "FNMA mortgage disposition loss" in clause (ii) and inserting in lieu thereof "mortgage disposition loss".

(2) CONFORMING AMENDMENT.—Subsection (i) of section 172 is amended—

(A) by striking out "FNMA mortgage disposition loss" each place it appears in paragraphs (1) and (2) (including in headings) and inserting in lieu thereof "mortgage disposition loss", and

(B) by striking out "FNMA MORTGAGE DISPOSITION LOSS" in the subsection heading and inserting in lieu thereof "MORTGAGE DISPOSITION LOSS OF THE FEDERAL NATIONAL MORTGAGE ASSOCIATION OR THE FEDERAL HOME LOAN MORTGAGE CORPORATION".

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall take effect on January 1, 1985.

(2) ADJUSTED BASIS OF ASSETS.—

(A) IN GENERAL.—Except as otherwise provided in subparagraph (B), the adjusted basis of any asset of the Federal Home Loan Mortgage Corporation held on January 1, 1985, shall—

(i) for purposes of determining any loss, be equal to the lesser of the adjusted basis of such asset or the fair market value of such asset as of such date, and

(ii) for purposes of determining any gain, be equal to the higher of the adjusted basis of such asset or the fair market value of such asset as of such date.

(B) SPECIAL RULE FOR TANGIBLE DEPRECIABLE PROPERTY.—In the case of any tangible property which—

(i) is of a character subject to the allowance for depreciation provided by section 167 of the Internal Revenue Code of 1954, and

(ii) is held by the Federal Home Loan Mortgage Corporation on January 1, 1985,

the adjusted basis of such property shall be equal to the lesser of the basis of such property or the fair market value of such property as of such date.

(3) TREATMENT OF PARTICIPATION CERTIFICATES.—

(A) IN GENERAL.—Paragraph (2) shall not apply to any right to receive income with respect to any mortgage pool participation certificate or other similar interest in any mortgage (not including any mortgage).

(B) TREATMENT OF CERTAIN SALES AFTER MARCH 15, 1984, AND BEFORE JANUARY 1, 1985.—If any gain is realized on the sale or exchange of any right described in subparagraph (A) after March 15, 1984, and before January 1, 1985, the gain shall not be recognized when realized but shall be recognized on January 1, 1985.

(4) NO ACCUMULATED EARNINGS AND PROFITS ON JANUARY 1, 1985.—For purposes of the Internal Revenue Code of 1954, the accumulated profits of the Federal Home Loan Mortgage Corporation as of January 1, 1985, shall be treated as zero.

(5) ADJUSTED BASIS.—For purposes of this subsection, the adjusted basis of any asset shall be determined under part II of subchapter O of the Internal Revenue Code of 1954.

(6) NO CARRYBACKS FOR YEARS BEFORE 1985.—No net operating loss, capital loss, or excess credit of the Federal Home Loan Mortgage Corporation for any taxable year beginning after December 31, 1984, shall be allowed as a carryback to any taxable year beginning before January 1, 1985.

(7) NO DEDUCTION ALLOWED FOR INTEREST ON REPLACEMENT OBLIGATIONS.—

(A) IN GENERAL.—The Federal Home Loan Mortgage Corporation shall not be allowed any deduction for interest accruing after December 31, 1984, on any replacement obligation.

(B) REPLACEMENT OBLIGATION DEFINED.—For purposes of subparagraph (A), the term "replacement obligation" means any obligation to any person created after March 15, 1984, which the Secretary of the Treasury or his delegate determines replaces any equity or debt interest of a Federal Home Loan Bank or any other person in the Federal Home Loan Mortgage Corporation existing on such date. The preceding sentence shall not apply to any obligation with respect to which the Federal Home Loan Mortgage Corporation establishes that there is no tax avoidance effect.

SEC. 178. SPECIAL RULE RELATING TO SALES OR EXCHANGES OF CERTAIN ECONOMIC INTERESTS IN COAL BETWEEN RELATED PARTIES.

(a) IN GENERAL.—The last sentence of section 631(c) (relating to disposal of coal or domestic iron ore with a retained economic interest) is amended by inserting "or coal" after "iron ore" each place it appears.

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendment made by subsection (a) shall apply to dispositions after September 30, 1985.

(2) SPECIAL RULE FOR FIXED CONTRACTS.—

(A) IN GENERAL.—The amendment made by subsection (a) shall not apply to any disposition of an interest in coal by a person to a related person if such coal is subsequently sold before January 1, 1990, by either such person—

(i) to a person who is not a related person with respect to either such person, and

(ii) pursuant to a qualified fixed contract.

(B) ALLOCATION WHERE MORE THAN 1 CONTRACT.—If, for any taxable year, there is a disposition described in subparagraph (A) which is not specifically allocable to a qualified fixed contract or to a contract which is not a qualified fixed contract, such disposition shall be treated as first allocable to the qualified fixed contract.

(C) QUALIFIED FIXED CONTRACT DEFINED.—The term "qualified fixed contract" means any contract for the sale of coal which—

(i) was entered into before June 12, 1984,

(ii) is binding at all times thereafter, and

(iii) cannot be adjusted to reflect to any extent the increase in liabilities of the person disposing of the coal for tax under chapter 1 of the Internal Revenue Code of 1954 by reason of the amendment made by subsection (a).

(D) RELATED PERSON.—For purposes of this paragraph, the term "related person" means a person who bears a relationship to another person described in the last sentence of section 631(c).

SEC. 179. LIMITATION ON AMOUNT OF DEPRECIATION AND INVESTMENT TAX CREDIT FOR LUXURY AUTOMOBILES; LIMITATION WHERE CERTAIN PROPERTY USED FOR PERSONAL PURPOSES.

(a) IN GENERAL.—Part IX of subchapter B of chapter 1 (relating to items not deductible) is amended by adding after section 280E the following new section:

"SEC. 280F. LIMITATION ON INVESTMENT TAX CREDIT AND DEPRECIATION FOR LUXURY AUTOMOBILES; LIMITATION WHERE CERTAIN PROPERTY USED FOR PERSONAL PURPOSES.

"(a) LIMITATION ON AMOUNT OF INVESTMENT TAX CREDIT AND DEPRECIATION FOR LUXURY AUTOMOBILES.—

"(1) INVESTMENT TAX CREDIT.—The amount of the credit determined under section 46(a) for any passenger automobile shall not exceed $1,000.

"(2) DEPRECIATION.—

"(A) LIMITATION.—The amount of the recovery deduction for any taxable year for any passenger automobile shall not exceed—

"(i) $4,000 for the first taxable year in the recovery period, and

"(ii) $6,000 for each succeeding taxable year in the recovery period.

"(B) DISALLOWED DEDUCTIONS ALLOWED FOR YEARS AFTER RECOVERY PERIOD.—

"(i) IN GENERAL.—Except as provided in clause (ii), the unrecovered basis of any passenger automobile shall be treated as an expense for the 1st taxable year after the recovery period. Any excess of the unrecovered basis over the limitation of clause (ii) shall be treated as an expense in the succeeding taxable year.

"(ii) $6,000 LIMITATION.—The amount treated as an expense under clause (i) for any taxable year shall not exceed $6,000.

"(iii) PROPERTY MUST BE DEPRECIABLE.—No amount shall be allowable as a deduction by reason of this subparagraph with respect to any property for any taxable year unless a depreciation deduction would be allowable with respect to such property for such taxable year.

"(iv) AMOUNT TREATED AS RECOVERY DEDUCTION.—For purposes of this subtitle, any amount allowable as a deduction by reason of this subparagraph shall be treated as a recovery deduction allowable under section 168.

"(3) COORDINATION WITH REDUCTIONS IN AMOUNT ALLOWABLE BY REASON OF PERSONAL USE, ETC.—This subsection shall be applied before—

"(A) the application of subsection (b), and

"(B) the application of any other reduction in the amount of the credit determined under section 46(a) or any recovery deduction allowable under section 168 by reason of any use not qualifying the property for such credit or recovery deduction.

"(4) SPECIAL RULE WHERE ELECTION OF REDUCED CREDIT IN LIEU OF THE BASIS ADJUSTMENT.—In the case of any election under section 48(q)(4) with respect to any passenger automobile, the limitation of paragraph (1) applicable to such passenger automobile shall be ⅔ of the amount which would be so applicable but for this paragraph.

"(b) LIMITATION WHERE BUSINESS USE OF LISTED PROPERTY NOT GREATER THAN 50 PERCENT.—

"(1) INVESTMENT TAX CREDIT.—For purposes of this subtitle, any listed property shall not be treated as section 38 property for any taxable year unless such property is predominantly used in a qualified business use for such taxable year.

"(2) DEPRECIATION.—If any listed property is not predominantly used in a qualified business use for any taxable year, the deduction allowed under section 168 with respect to such property for such taxable year and any subsequent taxable year shall be determined under the straightline method over the earnings and profits life for such property.

"(3) RECAPTURE.—

"(A) WHERE BUSINESS USE PERCENTAGE DOES NOT EXCEED 50 PERCENT.—If—

"(i) property is predominantly used in a qualified business use in a taxable year in which it is placed in service, and

"(ii) such property is not predominantly used in a qualified business use for any subsequent taxable year,

then any excess depreciation shall be included in gross income for the taxable year referred to in clause (ii), and the recovery deduction for the taxable year referred to in clause (ii) and any subsequent taxable years shall be deter-

mined under the straightline method over the earnings and profits life.

"(B) EXCESS DEPRECIATION.—For purposes of subparagraph (A), the term 'excess depreciation' means the excess (if any) of—

"(i) the amount of the recovery deductions allowable with respect to the property for taxable years before the 1st taxable year in which the property was not predominantly used in a qualified business use, over

"(ii) the amount which would have been so allowable if the property had not been predominantly used in a qualified business use for the taxable year in which it was placed in service.

"(4) DEFINITIONS.—For purposes of this subsection—

"(A) PROPERTY PREDOMINANTLY USED IN QUALIFIED BUSINESS USE.—Property shall be treated as predominantly used in a qualified business use for any taxable year if the business use percentage for such taxable year exceeds 50 percent.

"(B) STRAIGHT-LINE METHOD OVER EARNINGS AND PROFITS LIFE.—The amount determined under the straightline method over the earnings and profits life with respect to any property shall be the amount which would be determined with respect to such property under the principles of section 312(k)(3). If the recovery period applicable to any property under section 168 is longer than the recovery period applicable to such property under section 312(k)(3), such longer recovery period shall be used for purposes of the preceding sentence.

"(c) TREATMENT OF LEASES.—

"(1) LESSOR'S CREDITS AND DEDUCTIONS NOT AFFECTED.—This section shall not apply to any listed property leased or held for leasing by any person regularly engaged in the business of leasing such property.

"(2) LESSEE'S DEDUCTIONS REDUCED.—For purposes of determining the amount allowable as a deduction under this chapter for rentals or other payments under a lease for a period of 30 days or more of listed property, only the allowable percentage of such payments shall be taken into account.

"(3) ALLOWABLE PERCENTAGE.—For purposes of paragraph (2), the allowable percentage shall be determined under tables prescribed by the Secretary. Such tables shall be prescribed so that the reduction in the deduction under paragraph (2) is substantially equivalent to the applicable restrictions contained in subsections (a) and (b).

"(4) LEASE TERM.—In determining the term of any lease for purposes of paragraph (2), the rules of section 168(j)(6)(B) shall apply.

"(5) LESSEE RECAPTURE.—Under regulations prescribed by the Secretary, rules similar to the rules of subsection (b)(3) shall apply to any lessee to which paragraph (2) applies.

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

"(1) COORDINATION WITH SECTION 179.—Any deduction allowable under section 179 with respect to any listed property shall

be subject to the limitations of subsections (a) and (b) in the same manner as if it were a recovery deduction allowable under section 168.

"(2) SUBSEQUENT DEPRECIATION DEDUCTIONS REDUCED FOR DEDUCTIONS ALLOCABLE TO PERSONAL USE.—Solely for purposes of determining the amount of the recovery deduction for subsequent taxable years, if less than 100 percent of the use of any listed property during any taxable year is not use described in section 168(c)(1) (defining recovery property), all of the use of such property during such taxable year shall be treated as use so described.

"(3) DEDUCTIONS OF EMPLOYEE.—

"(A) IN GENERAL.—Any employee use of listed property shall not be treated as use in a trade or business for purposes of determining the amount of any credit allowable under section 38 to the employee or the amount of any recovery deduction allowable to the employee unless such use is for the convenience of the employer and required as a condition of employment.

"(B) EMPLOYEE USE.—For purposes of subparagraph (A), the term 'employee use' means any use in connection with the performance of services as an employee.

"(4) LISTED PROPERTY.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'listed property' means—

"(i) any passenger automobile,

"(ii) any other property used as a means of transportation,

"(iii) any property of a type generally used for purposes of entertainment, recreation, or amusement,

"(iv) any computer or peripheral equipment (as defined in section 168(j)(5)(D)), and

"(v) any other property of a type specified by the Secretary by regulations.

"(B) EXCEPTION FOR CERTAIN COMPUTERS.—The term 'listed property' shall not include any computer or peripheral equipment (as so defined) used exclusively at a regular business establishment. For purposes of the preceding sentence, any portion of a dwelling unit shall be treated as a regular business establishment if (and only if) the requirements of section 280A(c)(1) are met with respect to such portion.

"(5) PASSENGER AUTOMOBILE.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'passenger automobile' means any 4-wheeled vehicle—

"(i) which is manufactured primarily for use on public streets, roads, and highways, and

"(ii) which is rated at 6,000 pounds gross vehicle weight or less.

"(B) EXCEPTION FOR CERTAIN VEHICLES.—The term 'passenger automobile' shall not include—

"(i) any ambulance, hearse, or combination ambulance-hearse used by the taxpayer directly in a trade or business,

"(ii) any vehicle used by the taxpayer directly in the trade or business of transporting persons or property for compensation or hire, and

"(iii) under regulations, any truck or van.

"(6) BUSINESS USE PERCENTAGE.—

"(A) IN GENERAL.—The term 'business use percentage' means the percentage of the use of any listed property during any taxable year which is a qualified business use.

"(B) QUALIFIED BUSINESS USE.—Except as provided in subparagraph (C), the term 'qualified business use' means any use in a trade or business of the taxpayer.

"(C) EXCEPTION FOR CERTAIN USE BY 5-PERCENT OWNERS AND RELATED PERSONS.—

"(i) IN GENERAL. The term 'qualified business use' shall not include—

"(I) LEASING PROPERTY TO ANY 5-PERCENT OWNER OR RELATED PERSON,

"(II) USE OF PROPERTY PROVIDED AS COMPENSATION FOR THE PERFORMANCE OF SERVICES BY A 5-PERCENT OWNER OR RELATED PERSON, OR

"(III) use of property provided as compensation for the performance of services by any person not described in subclause (II) unless an amount is included in the gross income of such person with respect to such use, and, where required, there was withholding under chapter 24.

"(ii) SPECIAL RULE FOR AIRCRAFT.—Clause (i) shall not apply with respect to any aircraft if at least 25 percent of the total use of the aircraft during the taxable year consists of qualified business use not described in clause (i).

"(D) DEFINITIONS.—For purposes of this paragraph—

"(i) 5-PERCENT OWNER.—The term '5-percent owner' means any person who is a 5-percent owner with respect to the taxpayer (as defined in section 416(i)(1)(B)(i)).

"(ii) RELATED PERSON.—The term 'related person' means any person related to the taxpayer (within the meaning of section 267(b)).

"(7) AUTOMOBILE PRICE INFLATION ADJUSTMENT.—

"(A) IN GENERAL.—In the case of any passenger automobile, subsection (a) shall be applied by increasing each dollar amount contained in such subsection by the automobile price inflation adjustment for the calendar year in which such automobile is placed in service. Any increase under the preceding sentence shall be rounded to the nearest multiple of $100 (or if the increase is a multiple of $50, such increase shall be increased to the next higher multiple of $100).

"(B) AUTOMOBILE PRICE INFLATION ADJUSTMENT.—For purposes of this paragraph—

"(i) IN GENERAL.—The automobile price inflation adjustment for any calendar year is the percentage (if any) by which—

"(I) the CPI automobile component for October of the preceding calendar year, exceeds

"(II) the CPI automobile component for October of 1983.

In the case of calendar year 1984, the automobile price inflation adjustment shall be zero.

"(ii) CPI AUTOMOBILE COMPONENT.—The term 'CPI automobile component' means the automobile component of the Consumer Price Index for All Urban Consumers published by the Department of Labor.

"(8) UNRECOVERED BASIS.—For purposes of subsection (a)(2), the term 'unrecovered basis' means the excess (if any) of—

"(A) the unadjusted basis (as defined in section 168(d)(1)(A)) of the passenger automobile, over

"(B) the amount of the recovery deductions which would have been allowable for taxable years in the recovery period determined after the application of subsection (a) and as if all use during the recovery period were use described in section 168(c)(1).

"(9) ALL TAXPAYERS HOLDING INTERESTS IN PASSENGER AUTOMOBILE TREATED AS 1 TAXPAYER.—All taxpayers holding interests in any passenger automobile shall be treated as 1 taxpayer for purposes of applying subsection (a) to such automobile, and the limitations of subsection (a) shall be allocated among such taxpayers in proportion to their interests in such automobile.

"(10) SPECIAL RULE FOR PROPERTY ACQUIRED IN NONRECOGNITION TRANSACTIONS.—For purposes of subsection (a)(2), notwithstanding any regulations prescribed under section 168(f)(7), any property acquired in a nonrecognition transaction shall be treated as a single property originally placed in service in the taxable year in which it was placed in service after being so acquired.

"(e) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations with respect to items properly included in, or excluded from, the adjusted basis of any listed property."

(b) COMPLIANCE PROVISIONS.—

(1) AMENDMENT OF SECTION 274(d).—Subsection (d) of section 274 (relating to substantiation requirements) is amended—

(A) by striking out "No deduction" and inserting in lieu thereof "No deduction or credit",

(B) by striking out "or" at the end of paragraph (2), by inserting "or" at the end of paragraph (3), and by inserting after paragraph (3) the following new paragraph:

"(4) with respect to any listed property (as defined in section 280F(d)(4)),",

(C) by striking out "adequate records or by sufficient evidence corroborating his own statement" and inserting in lieu thereof "adequate contemporaneous records", and

(D) by striking out "the facility" each place it appears following paragraph (4) (as added by subparagraph (B)) and inserting in lieu thereof "the facility or property".

(2) DUTIES OF RETURN PREPARERS.—Subsection (b) of section 6695 (relating to failure to sign return) is amended to read as follows:

"(b) FAILURE TO INFORM TAXPAYER OF CERTAIN RECORDKEEPING REQUIREMENTS OR TO SIGN RETURN.—Any person who is an income tax return preparer with respect to any return or claim for refund and who is required by regulations to sign such return or claim—

"(1) shall advise the taxpayer of the substantiation requirements of section 274(d) and obtain written confirmation from the taxpayer that such requirements were met with respect to any deduction or credit claimed on such return or claim for refund, and

"(2) shall sign such return or claim for refund.

Any person who fails to comply with the requirements of the preceding sentence with respect to any return or claim shall pay a penalty of $25 for such failure, unless it is shown that such failure is due to reasonable cause and not to willful neglect."

(3) UNDERPAYMENT ATTRIBUTABLE TO FAILURE TO MEET SUBSTANTIATION REQUIREMENTS TREATED AS DUE TO NEGLIGENCE.—Section 6653 (relating to failure to pay tax) is amended by adding at the end thereof the following new subsection:

"(h) SPECIAL RULE IN THE CASE OF UNDERPAYMENT ATTRIBUTABLE TO FAILURE TO MEET CERTAIN SUBSTANTIATION REQUIREMENTS.—

"(1) IN GENERAL.—Any portion of an underpayment attributable to a failure to comply with the requirements of section 274(d) shall be treated, for purposes of subsection (a), as due to negligence in the absence of clear and convincing evidence to the contrary.

"(2) PENALTY TO APPLY ONLY TO PORTION OF UNDERPAYMENT DUE TO FAILURE TO MEET SUBSTANTIATION REQUIREMENTS.—If any penalty is imposed under subsection (a) by reason of paragraph (1), the amount of the penalty imposed by paragraph (1) of subsection (a) shall be 5 percent of the portion of the underpayment which is attributable to the failure described in paragraph (1)."

(c) CLERICAL AMENDMENT.—The table of sections for part IX of subchapter B of chapter 1 is amended by adding after the item relating to section 280E the following new item:

"Sec. 280F. Limitation on investment tax credit and depreciation for luxury automobiles; limitation where certain property used for personal purposes."

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—

(A) Except as provided in subparagraph (B), the amendments made by subsections (a) and (c) shall apply to—

(i) property placed in service after June 18, 1984, in taxable years ending after such date, and

(ii) property leased after June 18, 1984, in taxable years ending after such date.

(B) The amendments made by subsections (a) and (c) shall not apply to any property—

(i) acquired by the taxpayer pursuant to a binding contract in effect on June 18, 1984, and at all times thereafter (or under construction on such date) but only if the property is placed in service before January 1, 1985 (January 1, 1987, in the case of 15-year real property), or

(ii) of which the taxpayer is the lessee but only if the lease is pursuant to a binding contract in effect on June 18, 1984, and at all times thereafter and only if the taxpayer first uses such property under the lease before January 1, 1985 (January 1, 1987, in the case of 15-year real property).

(2) COMPLIANCE PROVISIONS.—The amendments made by subsection (b) shall apply to taxable years beginning after December 31, 1984.

TITLE II—LIFE INSURANCE PROVISIONS

SEC. 201. TABLE OF SECTIONS FOR PART I OF SUBCHAPTER L.

Under the amendment to part I of subchapter L made by section 211(a), the subparts and sections of such part I will be as follows:

PART I—LIFE INSURANCE COMPANIES

SUBPART A—TAX IMPOSED

SUBPART B—LIFE INSURANCE GROSS INCOME

SUBPART C—LIFE INSURANCE DEDUCTIONS

SUBPART D—ACCOUNTING, ALLOCATION, AND FOREIGN PROVISIONS

SUBPART E—DEFINITIONS AND SPECIAL RULES

Subtitle A—Taxation of Life Insurance Companies

PART I—AMENDMENT OF SUBCHAPTER L

SEC. 211. AMENDMENT OF SUBCHAPTER L.

(a) GENERAL RULE.—Part I of subchapter L of chapter 1 is amended to read as follows:

"PART I—LIFE INSURANCE COMPANIES

"Subpart A—Tax Imposed

"SEC. 801. TAX IMPOSED.

"(a) TAX IMPOSED.—

"(1) IN GENERAL.—A tax is hereby imposed for each taxable year on the life insurance company taxable income of every life insurance company. Such tax shall consist of a tax computed as provided in section 11 as though the life insurance company taxable income were the taxable income referred to in section 11.

"(2) ALTERNATIVE TAX IN CASE OF CAPITAL GAINS.—

"(A) IN GENERAL.—If a life insurance company has a net capital gain for the taxable year, then (in lieu of the tax imposed by paragraph (1)), there is hereby imposed a tax (if such tax is less than the tax imposed by paragraph (1)).

"(B) AMOUNT OF TAX.—The amount of the tax imposed by this paragraph shall be the sum of—

"(i) a partial tax, computed as provided by paragraph (1), on the life insurance company taxable income reduced by the amount of the net capital gain, and

"(ii) an amount determined as provided in section 1201(a) on such net capital gain.

"(C) NET CAPITAL GAIN NOT TAKEN INTO ACCOUNT IN DETERMINING SPECIAL LIFE INSURANCE COMPANY DEDUCTION AND SMALL LIFE INSURANCE COMPANY DEDUCTION.—For purposes of subparagraph (B)(i), the amounts allowable as deductions under paragraphs (2) and (3) of section 804 shall be determined by reducing the tentative LICTI by the amount of the net capital gain (determined without regard to items attributable to noninsurance businesses).

"(b) LIFE INSURANCE COMPANY TAXABLE INCOME.—For purposes of this part, the term 'life insurance company taxable income' means—

"(1) life insurance gross income, reduced by

"(2) life insurance deductions.

"(c) *TAXATION OF DISTRIBUTIONS FROM PRE-1984 POLICYHOLDERS SURPLUS ACCOUNT.*—

"For provision taxing distributions to shareholders from pre-1984 policyholders surplus account, see section 815.

"Subpart B—Life Insurance Gross Income

"SEC. 803. LIFE INSURANCE GROSS INCOME.

"(a) IN GENERAL.—For purposes of this part, the term 'life insurance gross income' means the sum of the following amounts:

"(1) PREMIUMS.—

"(A) The gross amount of premiums and other consideration on insurance and annuity contracts, less

"(B) return premiums, and premiums and other consideration arising out of indemnity reinsurance.

"(2) DECREASES IN CERTAIN RESERVES.—Each net decrease in reserves which is required by section 807(a) to be taken into account under this paragraph.

"(3) OTHER AMOUNTS.—All amounts not includible under paragraph (1) or (2) which under this subtitle are includible in gross income.

"(b) SPECIAL RULES FOR PREMIUMS.—

"(1) CERTAIN ITEMS INCLUDED.—For purposes of subsection (a)(1)(A), the term 'gross amount of premiums and other consideration' includes—

"(A) advance premiums,

"(B) deposits,

"(C) fees,

"(D) assessments,

"(E) consideration in respect of assuming liabilities under contracts not issued by the taxpayer, and

"(F) the amount of policyholder dividends reimbursable to the taxpayer by a reinsurer in respect of reinsured policies,

on insurance and annuity contracts.

"(2) POLICYHOLDER DIVIDENDS EXCLUDED FROM RETURN PREMIUMS.—For purposes of subsection (a)(1)(B)—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'return premiums' does not include any policyholder dividends.

"(B) EXCEPTION FOR INDEMNITY REINSURANCE.—Subparagraph (A) shall not apply to amounts of premiums or other consideration returned to another life insurance company in respect of indemnity reinsurance.

"Subpart C—Life Insurance Deductions

"SEC. 804. LIFE INSURANCE DEDUCTIONS.

"For purposes of this part, the term 'life insurance deductions' means—

"(1) the general deductions provided in section 805,

"(2) the special life insurance company deduction determined under section 806(a), and

"(3) the small life insurance company deduction (if any) determined under section 806(b).

"SEC. 805. GENERAL DEDUCTIONS.

"(a) GENERAL RULE.—For purposes of this part, there shall be allowed the following deductions:

"(1) DEATH BENEFITS, ETC.—All claims and benefits accrued, and all losses incurred (whether or not ascertained), during the taxable year on insurance and annuity contracts.

"(2) INCREASES IN CERTAIN RESERVES.—The net increase in reserves which is required by section 807(b) to be taken into account under this paragraph.

"(3) POLICYHOLDER DIVIDENDS.—The deduction for policyholder dividends (determined under section 808(c)).

"(4) DIVIDENDS RECEIVED BY COMPANY.—

"(A) IN GENERAL.—The deductions provided by sections 243, 244, and 245 (as modified by subparagraph (B))—

"(i) for 100 percent dividends received, and

"(ii) for the life insurance company's share of the dividends (other than 100 percent dividends) received.

"(B) APPLICATION OF SECTION 246(b).—In applying section 246(b) (relating to limitation on aggregate amount of deductions for dividends received) for purposes of subparagraph (A), the limit on the aggregate amount of the deductions allowed by sections 243(a)(1), 244(a), and 245 shall be 85 percent of the life insurance company taxable income, computed without regard to—

"(i) the special life insurance company deduction and the small life insurance company deduction,

"(ii) the operations loss deduction provided by section 810,

"(iii) the deductions allowed by sections 243(a)(1), 244(a), and 245, and

"(iv) any capital loss carryback to the taxable year under section 1212(a)(1),

but such limit shall not apply for any taxable year for which there is a loss from operations.

"(C) 100 PERCENT DIVIDEND.—For purposes of subparagraph (A), the term '100 percent dividend' means any dividend if the percentage used for purposes of determining the deduction allowable under section 243 or 244 is 100 percent. Such term does not include any dividend to the extent it is a distribution out of tax-exempt interest or out of dividends which are not 100 percent dividends (determined with the application of this sentence).

"(D) Certain dividends received by foreign corporations.—Subparagraph (A)(i) (and not subparagraph (A)(ii)) shall apply to any dividend received by a foreign corporation from a domestic corporation which would be a 100 percent dividend if section 1504(b)(3) did not apply for purposes of applying section 243(b)(5).

"(5) Operations loss deduction.—The operations loss deduction (determined under section 810).

"(6) Assumption by another person of liabilities under insurance, etc., contracts.—The consideration (other than consideration arising out of indemnity reinsurance) in respect of the assumption by another person of liabilities under insurance and annuity contracts.

"(7) Reimbursable dividends.—The amount of policyholder dividends which—

"(A) are paid or accrued by another insurance company in respect of policies the taxpayer has reinsured, and

"(B) are reimbursable by the taxpayer under the terms of the reinsurance contract.

"(8) Other deductions.—Subject to the modifications provided by subsection (b), all other deductions allowed under this subtitle for purposes of computing taxable income.

Except as provided in paragraph (3), no amount shall be allowed as a deduction under this part in respect of policyholder dividends.

"(b) Modifications.—The modifications referred to in subsection (a)(8) are as follows:

"(1) Interest.—In applying section 163 (relating to deduction for interest), no deduction shall be allowed for interest in respect of items described in section 807(c).

"(2) Bad debts.—Section 166(c) (relating to reserve for bad debts) shall not apply.

"(3) Charitable, etc., contributions and gifts.—In applying section 170—

"(A) the limit on the total deductions under such section provided by section 170(b)(2) shall be 10 percent of the life insurance company taxable income computed without regard to—

"(i) the deduction provided by section 170,

"(ii) the deductions provided by paragraphs (3) and (4) of subsection (a),

"(iii) the special life insurance company deduction and the small life insurance company deduction,

"(iv) any operations loss carryback to the taxable year under section 810, and

"(v) any capital loss carryback to the taxable year under section 1212(a)(1), and

"(B) under regulations prescribed by the Secretary, a rule similar to the rule contained in section 170(d)(2)(B) (relating to special rule for net operating loss carryovers) shall be applied.

"(4) Amortizable bond premium.—

"(A) In general.—Section 171 shall not apply.

"(B) Cross reference.—

"For rules relating to amortizable bond premium, see section 811(b).

"(5) NET OPERATING LOSS DEDUCTION.—Except as provided by section 844, the deduction for net operating losses provided in section 172 shall not be allowed.

"(6) DIVIDENDS RECEIVED DEDUCTION.—Except as provided in subsection (a)(4), the deductions for dividends received provided by sections 243, 244, and 245 shall not be allowed.

"SEC. 806. SPECIAL DEDUCTIONS.

"(a) SPECIAL LIFE INSURANCE COMPANY DEDUCTION.—For purposes of section 804, the special life insurance company deduction for any taxable year is 20 percent of the excess of the tentative LICTI for such taxable year over the small life insurance company deduction (if any).

"(b) SMALL LIFE INSURANCE COMPANY DEDUCTION.—

"(1) IN GENERAL.—For purposes of section 804, the small life insurance company deduction for any taxable year is 60 percent of so much of the tentative LICTI for such taxable year as does not exceed $3,000,000.

"(2) PHASEOUT BETWEEN $3,000,000 AND $15,000,000.—The amount of the small life insurance company deduction determined under paragraph (1) for any taxable year shall be reduced (but not below zero) by 15 percent of so much of the tentative LICTI for such taxable year as exceeds $3,000,000.

"(3) SMALL LIFE INSURANCE COMPANY DEDUCTION NOT ALLOWABLE TO COMPANY WITH ASSETS OF $500,000,000 OR MORE.—

"(A) IN GENERAL.—The small life insurance company deduction shall not be allowed for any taxable year to any life insurance company which, at the close of such taxable year, has assets equal to or greater than $500,000,000.

"(B) ASSETS.—For purposes of this paragraph, the term 'assets' means all assets of the company.

"(C) VALUATION OF ASSETS.—For purposes of this paragraph, the amount attributable to—

"(i) real property and stock shall be the fair market value thereof, and

"(ii) any other asset shall be the adjusted basis of such asset for purposes of determining gain on sale or other disposition.

"(D) SPECIAL RULE FOR INTERESTS IN PARTNERSHIPS AND TRUSTS.—For purposes of this paragraph—

"(i) an interest in a partnership or trust shall not be treated as an asset of the company, but

"(ii) the company shall be treated as actually owning its proportionate share of the assets held by the partnership or trust (as the case may be).

"(c) TENTATIVE LICTI.—For purposes of this part—

"(1) IN GENERAL.—The term 'tentative LICTI' means life insurance company taxable income determined without regard to—

"(A) the special life insurance company deduction, and

"(B) the small life insurance company deduction.

"(2) EXCLUSION OF ITEMS ATTRIBUTABLE TO NONINSURANCE BUSINESSES.—The amount of the tentative LICTI for any tax-

able year shall be determined without regard to all items attributable to noninsurance businesses.

"(3) NONINSURANCE BUSINESS.—

"(A) IN GENERAL.—The term 'noninsurance business' means any activity which is not an insurance business.

"(B) CERTAIN ACTIVITIES TREATED AS INSURANCE BUSINESSES.—For purposes of subparagraph (A), any activity which is not an insurance business shall be treated as an insurance business if—

"(i) it is of a type traditionally carried on by life insurance companies for investment purposes, but only if the carrying on of such activity (other than in the case of real estate) does not constitute the active conduct of a trade or business, or

"(ii) it involves the performance of administrative services in connection with plans providing life insurance, pension, or accident and health benefits.

"(C) LIMITATION ON AMOUNT OF LOSS FROM NONINSURANCE BUSINESS WHICH MAY OFFSET INCOME FROM INSURANCE BUSINESS.—In computing the life insurance company taxable income of any life insurance company, any loss from a noninsurance business shall be limited under the principles of section 1503(c).

"(d) SPECIAL RULE FOR CONTROLLED GROUPS.—

"(1) SPECIAL LIFE INSURANCE COMPANY DEDUCTION AND SMALL LIFE INSURANCE COMPANY DEDUCTION DETERMINED ON CONTROLLED GROUP BASIS.—For purposes of subsections (a) and (b)—

"(A) all life insurance companies which are members of the same controlled group shall be treated as 1 life insurance company, and

"(B) any special life insurance company deduction and any small life insurance company deduction determined with respect to such group shall be allocated among the life insurance companies which are members of such group in proportion to their respective tentative LICTI's.

"(2) NONLIFE INSURANCE MEMBERS INCLUDED FOR ASSET TEST.—For purposes of subsection (b)(3), all members of the same controlled group (whether or not life insurance companies) shall be treated as 1 company.

"(3) CONTROLLED GROUP.—For purposes of this subsection, the term 'controlled group' means any controlled group of corporations (as defined in section 1563(a)); except that subsections (a)(4) and (b)(2)(D) of section 1563 shall not apply.

"(4) ELECTION WITH RESPECT TO LOSS FROM OPERATIONS OF MEMBER OF GROUP.—

"(A) IN GENERAL.—Any life insurance company which is a member of a controlled group may elect to have its loss from operations for any taxable year not taken into account for purposes of determining the amount of the special life insurance company deduction for the life insurance companies which are members of such group and which do not file a consolidated return with such life insurance company for the taxable year.

"(B) LIMITATION ON AMOUNT OF LOSS WHICH MAY OFFSET NONLIFE INCOME.—In the case of that portion of any loss from operations for any taxable year of a life insurance company which (but for subparagraph (A)) would have reduced tentative LICTI of other life insurance companies for such taxable year—

"(i) only 80 percent of such portion may be used to offset nonlife income, and

"(ii) to the extent such portion is used to offset nonlife income, the loss shall be treated as used at a rate of $1 for each 80 cents of income so offset.

For purposes of the preceding sentence, any such portion shall be used before the remaining portion of the loss from the same year and shall be treated as first being offset against income which is not nonlife income.

"(C) NONLIFE INCOME.—

"(i) IN GENERAL.—The term 'nonlife income' means the portion of the life insurance company's taxable income for which the special life insurance company deduction was not allowable and any income of a corporation not subject to tax under this part.

"(ii) SPECIAL RULE FOR TAXABLE YEARS BEGINNING BEFORE JANUARY 1, 1984.—In the case of a taxable year beginning before January 1, 1984, all life insurance company taxable income shall be treated as nonlife income.

"(5) ADJUSTMENTS TO PREVENT EXCESS DETRIMENT OR BENEFIT.—Under regulations prescribed by the Secretary, proper adjustments shall be made in the application of this subsection to prevent any excess detriment or benefit (whether from year-to-year or otherwise) arising from the application of this subsection.

"SEC. 807. RULES FOR CERTAIN RESERVES.

"(a) DECREASE TREATED AS GROSS INCOME.—If for any taxable year—

"(1) the opening balance for the items described in subsection (c), exceeds

"(2)(A) the closing balance for such items, reduced by

"(B) the sum of (i) the amount of the policyholders' share of tax-exempt interest, plus (ii) any excess described in section 809(a)(2) for the taxable year,

such excess shall be included in gross income under section 803(a)(2).

"(b) INCREASE TREATED AS DEDUCTION.—If for any taxable year—

"(1)(A) the closing balance for the items described in subsection (c), reduced by

"(B) the sum of (i) the amount of the policyholders' share of tax-exempt interest, plus (ii) any excess described in section 809(a)(2) for the taxable year, exceeds

"(2) the opening balance for such items,

such excess shall be taken into account as a deduction under section 805(a)(2).

"(c) ITEMS TAKEN INTO ACCOUNT.—The items referred to in subsections (a) and (b) are as follows:

"(1) The life insurance reserves (as defined in section 816(b)).

"(2) The unearned premiums and unpaid losses included in total reserves under section 816(c)(2).

"(3) The amounts (discounted at the appropriate rate of interest) necessary to satisfy the obligations under insurance and annuity contracts, but only if such obligations do not involve (at the time with respect to which the computation is made under this paragraph) life, accident, or health contingencies.

"(4) Dividend accumulations, and other amounts, held at interest in connection with insurance and annuity contracts.

"(5) Premiums received in advance, and liabilities for premium deposit funds.

"(6) Reasonable special contingency reserves under contracts of group term life insurance or group accident and health insurance which are established and maintained for the provision of insurance on retired lives, for premium stabilization, or for a combination thereof.

For purposes of paragraph (3), the appropriate rate of interest for any obligation is the higher of the prevailing State assumed interest rate as of the time such obligation first did not involve life, accident, or health contingencies or the rate of interest assumed by the company (as of such time) in determining the guaranteed benefit.

"(d) METHOD OF COMPUTING RESERVES FOR PURPOSES OF DETERMINING INCOME.—

"(1) IN GENERAL.—For purposes of this part (other than section 816), the amount of the life insurance reserves for any contract shall be the greater of—

"(A) the net surrender value of such contract, or

"(B) the reserve determined under paragraph (2).

In no event shall the reserve determined under the preceding sentence for any contract as of any time exceed the amount which would be taken into account with respect to such contract as of such time in determining statutory reserves (as defined in section 809(b)(4)(B)).

"(2) AMOUNT OF RESERVE.—The amount of the reserve determined under this paragraph with respect to any contract shall be determined by using—

"(A) the tax reserve method applicable to such contract,

"(B) the prevailing State assumed interest rate, and

"(C) the prevailing commissioners' standard tables for mortality and morbidity adjusted as appropriate to reflect the risks (such as substandard risks) incurred under the contract which are not otherwise taken into account.

"(3) TAX RESERVE METHOD.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'tax reserve method' means—

"(i) LIFE INSURANCE CONTRACTS.—The CRVM in the case of a contract covered by the CRVM.

"(ii) ANNUITY CONTRACTS.—The CARVM in the case of a contract covered by the CARVM.

"(iii) NONCANCELLABLE ACCIDENT AND HEALTH INSURANCE CONTRACTS.—In the case of any noncancellable

accident and health insurance contract, a 2-year full preliminary term method.

"(iv) OTHER CONTRACTS.—In the case of any contract not described in clause (i), (ii), or (iii)—

"(I) the reserve method prescribed by the National Association of Insurance Commissioners which covers such contract (as of the date of issuance), or

"(II) if no reserve method has been prescribed by the National Association of Insurance Commissioners which covers such contract, a reserve method which is consistent with the reserve method required under clause (i), (ii), or (iii) or under subclause (I) of this clause as of the date of the issuance of such contract (whichever is most appropriate).

"(B) DEFINITION OF CRVM AND CARVM.—For purposes of this paragraph—

"(i) CRVM.—The term 'CRVM' means the Commissioners' Reserve Valuation Method prescribed by the National Association of Insurance Commissioners which is in effect on the date of the issuance of the contract.

"(ii) CARVM.—The term 'CARVM' means the Commissoners' Annuities Reserve Valuation Method prescribed by the National Association of Insurance Commissioners which is in effect on the date of the issuance of the contract.

"(C) NO ADDITIONAL RESERVE DEDUCTION ALLOWED FOR DEFICIENCY RESERVES.—Nothing in any reserve method described under this paragraph shall permit any increase in the reserve because the net premium (computed on the basis of assumptions required under this subsection) exceeds the actual premiums or other consideration charged for the benefit.

"(4) PREVAILING STATE ASSUMED INTEREST RATE.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'prevailing State assumed interest rate' means, with respect to any contract, the highest assumed interest rate permitted to be used in computing life insurance reserves for insurance contracts or annuity contracts (as the case may be) under the insurance laws of at least 26 States. For purposes of the preceding sentence, the effect of the nonforfeiture laws of a State on interest rates for reserves shall not be taken into account.

"(B) WHEN RATE DETERMINED.—Except as provided in subparagraph (C), the prevailing State assumed rate with respect to any contract shall be determined as of the beginning of the calendar year in which the contract was issued.

"(C) ELECTION FOR NONANNUITY CONTRACTS.—In the case of a contract other than an annuity contract, the issuer may elect (at such time and in such manner as the Secretary shall by regulations prescribe) to determine the prevailing State assumed rate as of the beginning of the calendar

year preceding the calendar year in which the contract was issued.

"(D) RATE FOR NONCANCELLABLE ACCIDENT AND HEALTH INSURANCE CONTRACTS.—If there is no prevailing State assumed interest rate applicable under subparagraph (A) to any noncancellable accident and health insurance contract when it is issued, the prevailing State assumed interest rate for such contract shall be the prevailing State assumed interest rate which would be determined under subparagraph (A) for a whole life insurance contract issued on the date on which the noncancellable accident and health insurance contract is issued.

"(5) PREVAILING COMMISSIONERS' STANDARD TABLES.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'prevailing commissioners' standard tables' means, with respect to any contract, the most recent commissioners' standard tables prescribed by the National Association of Insurance Commissioners which are permitted to be used in computing reserves for that type of contract under the insurance laws of at least 26 States when the contract was issued.

"(B) INSURER MAY USE OLD TABLES FOR 3 YEARS WHEN TABLES CHANGE.—If the prevailing commissioners' standard tables as of the beginning of any calendar year (hereinafter in this subparagraph referred to as the 'year of change') is different from the prevailing commissioners' standard tables as of the beginning of the preceding calendar year, the issuer may use the prevailing commissioners' standard tables as of the beginning of the preceding calendar year with respect to any contract issued after the change and before the close of the 3-year period beginning on the first day of the year of change.

"(C) SPECIAL RULE FOR CONTRACTS FOR WHICH THERE ARE NO COMMISSIONERS' STANDARD TABLES.—If there are no commissioners' standard tables applicable to any contract when it is issued, the mortality and morbidity tables used for purposes of paragraph (2)(C) shall be determined under regulations prescribed by the Secretary.

"(D) SPECIAL RULE FOR CONTRACTS ISSUED BEFORE 1948.—If—

"(i) a contract was issued before 1948, and

"(ii) there were no commissioners' standard tables applicable to such contract when it was issued,

the mortality and morbidity tables used in computing statutory reserves for such contracts shall be used for purposes of paragraph (2)(C).

"(E) SPECIAL RULE WHERE MORE THAN 1 TABLE OR OPTION APPLICABLE.—If, with respect to any category of risks, there are 2 or more tables (or options under 1 or more tables) which meet the requirements of subparagraph (A) (or, where applicable, subparagraph (B) or (C)), the table (and option thereunder) which generally yields the lowest reserves shall be used for purposes of paragraph (2)(C).

"(e) SPECIAL RULES FOR COMPUTING RESERVES.—

"(1) NET SURRENDER VALUE.—For purposes of this section—

"(A) IN GENERAL.—The net surrender value of any contract shall be determined—

"(i) with regard to any penalty or charge which would be imposed on surrender, but

"(ii) without regard to any market value adjustment on surrender.

"(B) SPECIAL RULE FOR PENSION PLAN CONTRACTS.—In the case of a pension plan contract, the balance in the policyholder's fund shall be treated as the net surrender value of such contract. For purposes of the preceding sentence, such balance shall be determined with regard to any penalty or forfeiture which would be imposed on surrender but without regard to any market value adjustment.

"(2) ISSUANCE DATE IN CASE OF GROUP CONTRACTS.—For purposes of this section, in the case of a group contract, the date on which such contract is issued shall be the date as of which the master plan is issued (or, with respect to a benefit guaranteed to a participant after such date, the date as of which such benefit is guaranteed).

"(3) SUPPLEMENTAL BENEFITS.—

"(A) QUALIFIED SUPPLEMENTAL BENEFITS TREATED SEPARATELY.—For purposes of this part, the amount of the life insurance reserve for any qualified supplemental benefit—

"(i) shall be computed separately as though such benefit were under a separate contract, and

"(ii) shall, except to the extent otherwise provided in regulations, be the reserve taken into account for purposes of the annual statement approved by the National Association of Insurance Commissioners.

"(B) SUPPLEMENTAL BENEFITS WHICH ARE NOT QUALIFIED SUPPLEMENTAL BENEFITS.—In the case of any supplemental benefit described in subparagraph (D) which is not a qualified supplemental benefit, the amount of the reserve determined under paragraph (2) of subsection (d) shall, except to the extent otherwise provided in regulations, be the reserve taken into account for purposes of the annual statement approved by the National Association of Insurance Commissioners.

"(C) QUALIFIED SUPPLEMENTAL BENEFIT.—For purposes of this paragraph, the term 'qualified supplemental benefit' means any supplemental benefit described in subparagraph (D) if—

"(i) there is a separately identified premium or charge for such benefit, and

"(ii) any net surrender value under the contract attributable to any other benefit is not available to fund such benefit.

"(D) SUPPLEMENTAL BENEFITS.—For purposes of this paragraph, the supplemental benefits described in this subparagraph are any—

"(i) guaranteed insurability,

"(ii) accidental death or disability benefit,

"(iii) convertibility,

"(iv) disability waiver benefit, or

"(v) other benefit prescribed by regulations,

which is supplemental to a contract for which there is a reserve described in subsection (c).

"(4) CERTAIN CONTRACTS ISSUED BY FOREIGN BRANCHES OF DOMESTIC LIFE INSURANCE COMPANIES.—

"(A) IN GENERAL.—In the case of any qualified foreign contract, the amount of the reserve shall be not less than the minimum reserve required by the laws, regulations, or administrative guidance of the regulatory authority of the foreign country referred to in subparagraph (B) (but not to exceed the net level reserves for such contract).

"(B) QUALIFIED FOREIGN CONTRACT.—For purposes of subparagraph (A), the term 'qualified foreign contract' means any contract issued by a foreign life insurance branch (which has its principal place of business in a foreign country) of a domestic life insurance company if—

"(i) such contract is issued on the life or health of a resident of such country,

"(ii) such domestic life insurance company was required by such foreign country (as of the time it began operations in such country) to operate in such country through a branch, and

"(iii) such foreign country is not contiguous to the United States.

"(5) TREATMENT OF SUBSTANDARD RISKS.—

"(A) SEPARATE COMPUTATION.—Except to the extent provided in regulations, the amount of the life insurance reserve for any qualified substandard risk shall be computed separately under subsection (d)(1) from any other reserve under the contract.

"(B) QUALIFIED SUBSTANDARD RISK.—For purposes of subparagraph (A), the term 'qualified substandard risk' means any substandard risk if—

"(i) the insurance company maintains a separate reserve for such risk,

"(ii) there is a separately identified premium or charge for such risk,

"(iii) the amount of the net surrender value under the contract is not increased or decreased by reason of such risk, and

"(iv) the net surrender value under the contract is not regularly used to pay premium charges for such risk.

"(C) LIMITATION ON AMOUNT OF LIFE INSURANCE RESERVE.—The amount of the life insurance reserve determined for any qualified substandard risk shall in no event exceed the sum of the separately identified premiums charged for such risk plus interest less mortality charges for such risk.

"(D) LIMITATION ON AMOUNT OF CONTRACTS TO WHICH PARAGRAPH APPLIES.—The aggregate amount of insurance in force under contracts to which this paragraph applies shall not exceed 10 percent of the insurance in force (other

than term insurance) under life insurance contracts of the company.

"(6) SPECIAL RULES FOR CONTRACTS ISSUED BEFORE JANUARY 1, 1989, UNDER EXISTING PLANS OF INSURANCE, WITH TERM INSURANCE OR ANNUITY BENEFITS.—For purposes of this part—

"(A) IN GENERAL.—In the case of a life insurance contract issued before January 1, 1989, under an existing plan of insurance, the life insurance reserve for any benefit to which this paragraph applies shall be computed separately under subsection (d)(1) from any other reserve under the contract.

"(B) BENEFITS TO WHICH THIS PARAGRAPH APPLIES.—This paragraph applies to any term insurance or annuity benefit with respect to which the requirements of clauses (i) and (ii) of paragraph (3)(C) are met.

"(C) EXISTING PLAN OF INSURANCE.—For purposes of this paragraph, the term 'existing plan of insurance' means, with respect to any contract, any plan of insurance which was filed by the company using such contract in one or more States before January 1, 1984, and is on file in the appropriate State for such contract.

"(f) ADJUSTMENT FOR CHANGE IN COMPUTING RESERVES.—

"(1) 10-YEAR SPREAD.—

"(A) IN GENERAL.—For purposes of this part, if the basis for determining any item referred to in subsection (c) as of the close of any taxable year differs from the basis for such determination as of the close of the preceding taxable year, then so much of the difference between—

"(i) the amount of the item at the close of the taxable year, computed on the new basis, and

"(ii) the amount of the item at the close of the taxable year, computed on the old basis,

as is attributable to contracts issued before the taxable year shall be taken into account under the method provided in subparagraph (B).

"(B) METHOD.—The method provided in this subparagraph is as follows:

"(i) if the amount determined under subparagraph (A)(i) exceeds the amount determined under subparagraph (A)(ii), $\frac{1}{10}$ of such excess shall be taken into account, for each of the succeeding 10 taxable years, as a deduction under section 805(a)(2); or

"(ii) if the amount determined under subparagraph (A)(ii) exceeds the amount determined under subparagraph (A)(i), $\frac{1}{10}$ of such excess shall be included in gross income, for each of the 10 succeeding taxable years, under section 803(a)(2).

"(2) TERMINATION AS LIFE INSURANCE COMPANY.—Except as provided in section 381(c)(22) (relating to carryovers in certain corporate readjustments), if for any taxable year the taxpayer is not a life insurance company, the balance of any adjustments under this subsection shall be taken into account for the preceding taxable year.

"SEC. 808. POLICYHOLDER DIVIDENDS DEDUCTION.

"(a) POLICYHOLDER DIVIDEND DEFINED.—For purposes of this part, the term 'policyholder dividend' means any dividend or similar distribution to policyholders in their capacity as such.

"(b) CERTAIN AMOUNTS INCLUDED.—For purposes of this part, the term 'policyholder dividend' includes—

"(1) any amount paid or credited (including as an increase in benefits) where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management,

"(2) excess interest,

"(3) premium adjustments, and

"(4) experience-rated refunds.

"(c) AMOUNT OF DEDUCTION.—

"(1) IN GENERAL.—Except as limited by paragraph (2), the deduction for policyholder dividends for any taxable year shall be an amount equal to the policyholder dividends paid or accrued during the taxable year.

"(2) REDUCTION IN CASE OF MUTUAL COMPANIES.—In the case of a mutual life insurance company, the deduction for policyholder dividends for any taxable year shall be reduced by the amount determined under section 809.

"(d) DEFINITIONS.—For purposes of this section—

"(1) EXCESS INTEREST.—The term 'excess interest' means any amount in the nature of interest—

"(A) paid or credited to a policyholder in his capacity as such, and

"(B) determined at a rate in excess of the prevailing State assumed interest rate for such contract.

"(2) PREMIUM ADJUSTMENT.—The term 'premium adjustment' means any reduction in the premium under an insurance or annuity contract which (but for the reduction) would have been required to be paid under the contract.

"(3) EXPERIENCE-RATED REFUND.—The term 'experience-rated refund' means any refund or credit based on the experience of the contract or group involved.

"(e) TREATMENT OF POLICYHOLDER DIVIDENDS.—For purposes of this part, any policyholder dividend which—

"(1) increases the cash surrender value of the contract or other benefits payable under the contract, or

"(2) reduces the premium otherwise required to be paid,

shall be treated as paid to the policyholder and returned by the policyholder to the company as a premium.

"SEC. 809. REDUCTION IN CERTAIN DEDUCTIONS OF MUTUAL LIFE INSURANCE COMPANIES.

"(a) GENERAL RULE.—

"(1) POLICYHOLDER DIVIDENDS.—In the case of any mutual life insurance company, the amount of the deduction allowed under section 808 shall be reduced (but not below zero) by the differential earnings amount.

"(2) REDUCTION IN RESERVE DEDUCTION IN CERTAIN CASES.—In the case of any mutual life insurance company, if the differential earnings amount exceeds the amount allowable as a de-

duction under section 808 for the taxable year (determined without regard to this section), such excess shall be taken into account under subsections (a) and (b) of section 807.

"(3) DIFFERENTIAL EARNINGS AMOUNT.—For purposes of this section, the term 'differential earnings amount' means, with respect to any taxable year, an amount equal to the product of—

"(A) the life insurance company's average equity base for the taxable year, multiplied by

"(B) the differential earnings rate for such taxable year.

"(b) AVERAGE EQUITY BASE.—For purposes of this section—

"(1) IN GENERAL.—The term 'average equity base' means, with respect to any taxable year, the average of—

"(A) the equity base determined as of the close of the taxable year, and

"(B) the equity base determined as of the close of the preceding taxable year.

"(2) EQUITY BASE.—The term 'equity base' means an amount determined in the manner prescribed by regulations equal to—

"(A) the surplus and capital,

"(B) adjusted as provided in paragraphs (3), (4), (5), and (6) of this subsection.

"(3) INCREASE FOR NONADMITTED FINANCIAL ASSETS.—

"(A) IN GENERAL.—The amount of the surplus and capital shall be increased by the amount of the nonadmitted financial assets.

"(B) NONADMITTED FINANCIAL ASSETS.—For purposes of subparagraph (A), the term 'nonadmitted financial asset' means any nonadmitted asset of the company which is—

"(i) a bond,

"(ii) stock,

"(iii) real estate,

"(iv) a mortgage loan on real estate, or

"(v) any other invested asset.

"(4) INCREASE WHERE STATUTORY RESERVES EXCEED TAX RESERVES.—

"(A) IN GENERAL.—If—

"(i) the aggregate amount of statutory reserves, exceeds

"(ii) the aggregate amount of tax reserves,

the amount of the surplus and capital shall be increased by the amount of such excess.

"(B) DEFINITIONS.—For purposes of this paragraph—

"(i) STATUTORY RESERVES.—The term 'statutory reserves' means the aggregate amount set forth in the annual statement with respect to items described in section 807(c). Such term shall not include any reserve attributable to a deferred and uncollected premium if the establishment of such reserve is not permitted under section 811(c).

"(ii) TAX RESERVES.—The term 'tax reserves' means the aggregate of the items described in section 807(c) as determined for purposes of section 807.

"(5) *INCREASE BY AMOUNT OF CERTAIN OTHER RESERVES.—The amount of the surplus and capital shall be increased by the sum of—*

"(A) the amount of any mandatory securities valuation reserve,

"(B) the amount of any deficiency reserve, and

"(C) the amount of any voluntary reserve or similar liability not described in subparagraph (A) or (B).

"(6) ADJUSTMENT FOR NEXT YEAR'S POLICYHOLDER DIVIDENDS.—The amount of the surplus and capital shall be increased by 50 percent of the amount of any provision for policyholder dividends (or other similar liability) payable in the following taxable year.

"(c) DIFFERENTIAL EARNINGS RATE.—

"(1) IN GENERAL.—For purposes of this section, the differential earnings rate for any taxable year is the excess of—

"(A) the imputed earnings rate for the taxable year, over

"(B) the average mutual earnings rate for the second calendar year preceding the calendar year in which the taxable year begins.

"(2) TRANSITIONAL RULE.—The differential earnings rate—

"(A) for any taxable year beginning in 1984, or

"(B) for purposes of computing the amount of underpayment under section 6655 (including the application of section 6655(d)(3)) for any taxable year beginning in 1985,

shall be equal to 7.8 percent.

"(d) IMPUTED EARNINGS RATE.—

"(1) IN GENERAL.—For purposes of this section, the imputed earnings rate for any taxable year is—

"(A) 16.5 percent in the case of taxable years beginning in 1984, and

"(B) in the case of taxable years beginning after 1984, an amount which bears the same ratio to 16.5 percent as the current stock earnings rate for the taxable year bears to the base period stock earnings rate.

"(2) CURRENT STOCK EARNINGS RATE.—For purposes of this subsection, the term 'current stock earnings rate' means, with respect to any taxable year, the average of the stock earnings rates determined under paragraph (4) for the 3 calendar years preceding the calendar year in which the taxable year begins.

"(3) BASE PERIOD STOCK EARNINGS RATE.—For purposes of this subsection, the base period stock earnings rate is the average of the stock earnings rates determined under paragraph (4) for calendar years 1981, 1982, and 1983.

"(4) STOCK EARNINGS RATE.—

"(A) IN GENERAL.—For purposes of this subsection, the stock earnings rate for any calendar year is the numerical average of the earnings rates of the 50 largest stock companies.

"(B) EARNINGS RATE.—For purposes of subparagraph (A), the earnings rate of any stock company is the percentage (determined by the Secretary) which—

"(i) the statement gain or loss from operations for the calendar year of such company, is of

"(ii) such company's average equity base for such year.

"(C) 50 LARGEST STOCK COMPANIES.—For purposes of this paragraph, the term '50 largest stock companies' means a group (as determined by the Secretary) of stock life insurance companies which consists of the 50 largest stock life insurance companies which are subject to tax under this part. The Secretary may by regulations provide for exclusion from the group determined under the preceding sentence of any stock life insurance company if (i) the equity of such company is not great enough for such company to be 1 of the 50 largest stock life insurance companies if the determination were made on the basis of equity, and (ii) by reason of the small equity base of such company, it has an earnings rate which would seriously distort the stock earnings rate.

"(D) TREATMENT OF AFFILIATED GROUPS.—For purposes of this paragraph, all stock life insurance companies which are members of the same affiliated group shall be treated as one stock life insurance company.

"(e) AVERAGE MUTUAL EARNINGS RATE.—For purposes of this section, the average mutual earnings rate for any calendar year is the percentage (determined by the Secretary) which—

"(1) the aggregate statement gain or loss from operations for such year of mutual life insurance companies, is of

"(2) their aggregate average equity bases for such year.

"(f) RECOMPUTATION IN SUBSEQUENT YEAR.—

"(1) INCLUSION IN INCOME WHERE RECOMPUTED AMOUNT GREATER.—In the case of any mutual life insurance company, if—

"(A) the recomputed differential earnings amount for any taxable year, exceeds

"(B) the differential earnings amount determined under this section for such taxable year,

such excess shall be included in life insurance gross income for the succeeding taxable year.

"(2) DEDUCTION WHERE RECOMPUTED AMOUNT SMALLER.—In the case of any mutual life insurance company, if—

"(A) the differential earnings amount determined under this section for any taxable year, exceeds

"(B) the recomputed differential earnings amount for such taxable year,

such excess shall be allowed as a life insurance deduction for the succeeding taxable year.

"(3) RECOMPUTED DIFFERENTIAL EARNINGS AMOUNT.—For purposes of this subsection, the term 'recomputed differential earnings amount' means, with respect to any taxable year, the amount which would be the differential earnings amount for such taxable year if the average mutual earnings rate taken into account under subsection (c)(2) were the average mutual earnings rate for the calendar year in which the taxable year begins.

"(4) SPECIAL RULE WHERE COMPANY CEASES TO BE MUTUAL LIFE INSURANCE COMPANY.—Except as provided in section 381(c)(22), if—

"(A) a life insurance company is a mutual life insurance company for any taxable year, but

"(B) such life insurance company is not a mutual life insurance company for the succeeding taxable year,

any adjustment under paragraph (1) or (2) by reason of the recomputed differential earnings amount for the first of such taxable years shall be taken into account for the first of such taxable years.

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

"(1) STATEMENT GAIN OR LOSS FROM OPERATIONS.—The term 'statement gain or loss from operations' means the net gain or loss from operations required to be set forth in the annual statement—

"(A) determined with regard to policyholder dividends (as defined in section 808) but without regard to Federal income taxes,

"(B) determined on the basis of the tax reserves rather than statutory reserves, and

"(C) properly adjusted for realized capital gains and losses and other relevant items.

"(2) OTHER TERMS.—Except as otherwise provided in this section, the terms used in this section shall have the same respective meanings as when used in the annual statement.

"(3) DETERMINATIONS BASED ON AMOUNT SET FORTH IN ANNUAL STATEMENT.—Except as otherwise provided in this section or in regulations, all determinations under this section shall be made on the basis of the amounts required to be set forth on the annual statement.

"(4) ANNUAL STATEMENT.—The term 'annual statement' means the annual statement for life insurance companies approved by the National Association of Insurance Commissioners.

"(5) REDUCTION IN EQUITY BASE FOR PORTION OF EQUITY ALLOCABLE TO LIFE INSURANCE BUSINESS IN NONCONTIGUOUS WESTERN HEMISPHERE COUNTRIES.—The equity base of any mutual life insurance company shall be reduced by an amount equal to the portion of the equity base attributable to the life insurance business multiplied by a fraction—

"(A) the numerator of which is the portion of the tax reserves which is allocable to life insurance contracts issued on the life of residents of countries in the Western Hemisphere which are not contiguous to the United States, and

'(B) the denominator of which is the amount of the tax reserves allocable to life insurance contracts.

The preceding sentence shall not apply unless the fraction determined under the preceding sentence exceeds $\frac{1}{20}$.

"(6) SPECIAL RULE FOR CERTAIN CONTRACTS ISSUED BEFORE JANUARY 1, 1985.—In determining the amount of tax reserves of a mutual insurance company for purposes of subsection (b)(4), section 811(d) shall not apply with respect to any life insurance

contract issued before January 1, 1985, under a plan of life insurance in existence on July 1, 1983.

"(h) TREATMENT OF STOCK COMPANIES OWNED BY MUTUAL LIFE INSURANCE COMPANIES.—

"(1) TREATMENT AS MUTUAL LIFE INSURANCE COMPANIES FOR PURPOSES OF DETERMINING STOCK EARNINGS RATES AND MUTUAL EARNINGS RATES.—Solely for purposes of subsections (d) and (e), a stock life insurance company shall be treated as a mutual life insurance company if stock possessing—

"(A) at least 80 percent of the total combined voting power of all classes of stock of such stock life insurance company entitled to vote, or

"(B) at least 80 percent of the total value of shares of all classes of stock of such stock life insurance company,

is owned at any time during the calendar year directly (or through the application of section 318) by one or more mutual life insurance companies.

"(2) TREATMENT OF AFFILIATED GROUP WHICH INCLUDES MUTUAL PARENT AND STOCK SUBSIDIARY.—In the case of an affiliated group of corporations which includes a common parent which is a mutual life insurance company and one or more stock life insurance companies, for purposes of determining the average equity base of such common parent (and the statement gain or loss from operations)—

"(A) stock in such stock life insurance companies held by such common parent (and dividends on such stock) shall not be taken into account, and

"(B) such common parent and such stock life insurance companies shall be treated as though they were one mutual life insurance company.

"(3) ADJUSTMENT WHERE STOCK COMPANY NOT MEMBER OF AFFILIATED GROUP.—In the case of any stock life insurance company which is described in paragraph (1) but is not a member of an affiliated group described in paragraph (2), under regulations, proper adjustments shall be made in the average equity bases (and statement gains or losses from operations) of mutual life insurance companies owning stock in such company as may be necessary or appropriate to carry out the purposes of this section.

"(i) TRANSITIONAL RULE FOR CERTAIN HIGH SURPLUS MUTUAL LIFE INSURANCE COMPANIES.—

"(1) IN GENERAL.—For purposes of subsection (a)(3), the average equity base of a high surplus mutual life insurance company for any taxable year shall not include the applicable percentage of the excess equity base of such company for such taxable year.

"(2) DEFINITIONS.—For purposes of this subsection—

"(A) EXCESS EQUITY BASE.—The term 'excess equity base' means the excess of—

"(i) the average equity base of the company for the taxable year, over

"(ii) the amount which would be its average equity base if its equity percentage equaled the following percentage:

For taxable years begining	*The percentage is:*
1984	*14.5*
1985 or 1986	*14*
1987 or 1988	*13.5*

In no case shall the excess equity base for any taxable year be greater than the excess equity base for the company's first taxable year beginning in 1984.

"(B) APPLICABLE PERCENTAGE.—The term 'applicable percentage' means the percentage determined in accordance with the following table:

"For taxable years beginning in:	*The applicable percentage is:*
1984	*100*
1985	*80*
1986	*60*
1987	*40*
1988	*20*
1989 or thereafter	*0.*

"(C) HIGH SURPLUS MUTUAL LIFE INSURANCE COMPANY.—The term 'high surplus mutual life insurance company' means any mutual life insurance company if, for the taxable year beginning in 1984, its equity percentage exceeded 14.5 percent.

"(D) EQUITY PERCENTAGE.—The term 'equity percentage' means, with respect to any mutual life insurance company, the percentage which—

"(i) the average equity base of such company (determined under this section without regard to this subsection) for a taxable year bears to

"(ii) the average of—

"(I) the assets of such company as of the close of the preceding taxable year, and

"(II) the assets of such company as of the close of the taxable year.

For purposes of the preceding sentence, the assets of a company shall include all assets taken into account under this section in determining its equity base (after applying the principles of subsection (h)).

"SEC. 810. OPERATIONS LOSS DEDUCTION.

"(a) DEDUCTION ALLOWED.—There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of—

"(1) the operations loss carryovers to such year, plus

"(2) the operations loss carrybacks to such year.

For purposes of this part, the term 'operations loss deduction' means the deduction allowed by this subsection.

"(b) OPERATIONS LOSS CARRYBACKS AND CARRYOVERS.—

"(1) YEARS TO WHICH LOSS MAY BE CARRIED.—The loss from operations for any taxable year (hereinafter in this section referred to as the 'loss year') shall be—

"(A) an operations loss carryback to each of the 3 taxable years preceding the loss year,

"(B) an operations loss carryover to each of the 15 taxable years following the loss year, and

"(C) if the life insurance company is a new company for the loss year, an operations loss carryover to each of the 3

taxable years following the 15 taxable years described in subparagraph (B).

"(2) AMOUNT OF CARRYBACKS AND CARRYOVERS.—The entire amount of the loss from operations for any loss year shall be carried to the earliest of the taxable years to which (by reason of paragraph (1)) such loss may be carried. The portion of such loss which shall be carried to each of the other taxable years shall be the excess (if any) of the amount of such loss over the sum of the offsets (as defined in subsection (d)) for each of the prior taxable years to which such loss may be carried.

"(3) ELECTION FOR OPERATIONS LOSS CARRYBACKS.—In the case of a loss from operations for any taxable year, the taxpayer may elect to relinquish the entire carryback period for such loss. Such election shall be made by the due date (including extensions of time) for filing the return for the taxable year of the loss from operations for which the election is to be in effect, and, once made for any taxable year, such election shall be irrevocable for that taxable year.

"(c) COMPUTATION OF LOSS FROM OPERATIONS.—For purposes of this section—

"(1) IN GENERAL.—The term 'loss from operations' means the excess of the life insurance deductions for any taxable year over the life insurance gross income for such taxable year.

"(2) MODIFICATIONS.—For purposes of paragraph (1)—

"(A) the operations loss deduction shall not be allowed, and

"(B) the deductions allowed by sections 243 (relating to dividends received by corporations), 244 (relating to dividends received on certain preferred stock of public utilities), and 245 (relating to dividends received from certain foreign corporations) shall be computed without regard to section 246(b) as modified by section 805(a)(4).

"(d) OFFSET DEFINED.—

"(1) IN GENERAL.—For purposes of subsection (b)(2), the term 'offset' means, with respect to any taxable year, an amount equal to that increase in the operations loss deduction for the taxable year which reduces the life insurance company taxable income (computed without regard to paragraphs (2) and (3) of section 804) for such year to zero.

"(2) OPERATIONS LOSS DEDUCTION.—For purposes of paragraph (1), the operations loss deduction for any taxable year shall be computed without regard to the loss from operations for the loss year or for any taxable year thereafter.

"(e) NEW COMPANY DEFINED.—For purposes of this part, a life insurance company is a new company for any taxable year only if such taxable year begins not more than 5 years after the first day on which it (or any predecessor, if section 381(c)(22) applies) was authorized to do business as an insurance company.

"(f) APPLICATION OF SUBTITLES A AND F IN RESPECT OF OPERATION LOSSES.—Except as provided in section 805(b)(5), subtitles A and F shall apply in respect of operation loss carrybacks, operation loss carryovers, and the operations loss deduction under this part, in the same manner and to the same extent as such subtitles apply in

respect of net operating loss carrybacks, net operating loss carryovers, and the net operating loss deduction.

"(g) TRANSITIONAL RULE.—For purposes of this section and section 812 (as in effect before the enactment of the Life Insurance Tax Act of 1984), this section shall be treated as a continuation of such section 812.

"Subpart D—Accounting, Allocation, and Foreign Provisions

"SEC. 811. ACCOUNTING PROVISIONS.

"(a) METHOD OF ACCOUNTING.—All computations entering into the determination of the taxes imposed by this part shall be made—

"(1) under an accrual method of accounting, or

"(2) to the extent permitted under regulations prescribed by the Secretary, under a combination of an accrual method of accounting with any other method permitted by this chapter (other than the cash receipts and disbursements method).

To the extent not inconsistent with the preceding sentence or any other provision of this part, all such computations shall be made in a manner consistent with the manner required for purposes of the annual statement approved by the National Association of Insurance Commissioners.

"(b) AMORTIZATION OF PREMIUM AND ACCRUAL OF DISCOUNT.—

"(1) IN GENERAL.—The appropriate items of income, deductions, and adjustments under this part shall be adjusted to reflect the appropriate amortization of premium and the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures, or other evidences of indebtedness held by a life insurance company. Such amortization and accrual shall be determined—

"(A) in accordance with the method regularly employed by such company, if such method is reasonable, and

"(B) in all other cases, in accordance with regulations prescribed by the Secretary.

"(2) SPECIAL RULES.—

"(A) AMORTIZATION OF BOND PREMIUM.—In the case of any bond (as defined in section 171(d)), the amount of bond premium, and the amortizable bond premium for the taxable year, shall be determined under section 171(b) as if the election set forth in section 171(c) had been made.

"(B) CONVERTIBLE EVIDENCE OF INDEBTEDNESS.—In no case shall the amount of premium on a convertible evidence of indebtedness include any amount attributable to the conversion features of the evidence of indebtedness.

"(3) EXCEPTION.—No accrual of discount shall be required under paragraph (1) on any bond (as defined in section 171(d)), except in the case of discount which is—

"(A) interest to which section 103 applies, or

"(B) original issue discount (as defined in section 1232(b)).

"(c) NO DOUBLE COUNTING.—Nothing in this part shall permit—

"(1) a reserve to be established for any item unless the gross amount of premiums and other consideration attributable to such item are required to be included in life insurance gross income,

"(2) the same item to be counted more than once for reserve purposes, or

"(3) any item to be deducted (either directly or as an increase in reserves) more than once.

"(d) METHOD OF COMPUTING RESERVES ON CONTRACT WHERE INTEREST IS GUARANTEED BEYOND END OF TAXABLE YEAR.—For purposes of this part (other than section 816), amounts in the nature of interest to be paid or credited under any contract for any period which is computed at a rate which—

"(1) exceeds the prevailing State assumed interest rate for the contract for such period, and

"(2) is guaranteed beyond the end of the taxable year on which the reserves are being computed,

shall be taken into account in computing the reserves with respect to such contract as if such interest were guaranteed only up to the end of the taxable year.

"(e) SHORT TAXABLE YEARS.—If any return of a corporation made under this part is for a period of less than the entire calendar year (referred to in this subsection as 'short period'), then section 443 shall not apply in respect to such period, but life insurance company taxable income shall be determined, under regulations prescribed by the Secretary, on an annual basis by a ratable daily projection of the appropriate figures for the short period.

"SEC. 812. DEFINITION OF COMPANY'S SHARE AND POLICYHOLDERS' SHARE.

"(a) GENERAL RULE.—

"(1) COMPANY'S SHARE.—For purposes of section 805(a)(4), the term 'company's share' means, with respect to any taxable year, the percentage obtained by dividing—

"(A) the company's share of the net investment income for the taxable year, by

"(B) the net investment income for the taxable year.

"(2) POLICYHOLDERS' SHARE.—For purposes of section 807, the term 'policyholders' share' means, with respect to any taxable year, the excess of 100 percent over the percentage determined under paragraph (1).

"(b) COMPANY'S SHARE OF NET INVESTMENT INCOME.—

"(1) IN GENERAL.—For purposes of this section, the company's share of net investment income is the excess (if any) of—

"(A) the net investment income for the taxable year, over

"(B) the sum of—

"(i) the policy interest, for the taxable year, plus

"(ii) the gross investment income's proportionate share of policyholder dividends for the taxable year.

"(2) POLICY INTEREST.—For purposes of this subsection, the term 'policy interest' means—

"(A) required interest (at the prevailing State assumed rate) on reserves under section 807(c) (other than paragraph (2) thereof),

"(B) the deductible portion of excess interest, and

"(C) the deductible portion of any amount (whether or not a policyholder dividend), and not taken into account under subparagraph (A) or (B), credited to—

"(i) a policyholder's fund under a pension plan contract for employees (other than retired employees), or

"(ii) a deferred annuity contract before the annuity starting date.

"(3) GROSS INVESTMENT INCOME'S PROPORTIONATE SHARE OF POLICYHOLDER DIVIDENDS.—For purposes of paragraph (1), the gross investment income's proportionate share of policyholder dividends is—

"(A) the deduction for policyholders' dividends determined under sections 808 and 809 for the taxable year, but not including—

"(i) the deductible portion of excess interest,

"(ii) the deductible portion of policyholder dividends on contracts referred to in clauses (i) and (ii) of paragraph (2)(C), and

"(iii) the deductible portion of the premium and mortality charge adjustments with respect to contracts paying excess interest for such year,

multiplied by

"(B) the fraction—

"(i) the numerator of which is gross investment income for the taxable year (reduced by the policy interest for such year), and

"(ii) the denominator of which is life insurance gross income (including tax-exempt interest) reduced by the excess (if any) of the closing balance for the items described in section 807(c) over the opening balance for such items for the taxable year.

"(c) NET INVESTMENT INCOME.—For purposes of this section, the term 'net investment income' means 90 percent of gross investment income.

"(d) GROSS INVESTMENT INCOME.—For purposes of this section, the term 'gross investment income' means the sum of the following:

"(1) INTEREST, ETC.—The gross amount of income from—

"(A) interest (including tax-exempt interest), dividends, rents, and royalties,

"(B) the entering into of any lease, mortgage, or other instrument or agreement from which the life insurance company derives interest, rents, or royalties, and

"(C) the alteration or termination of any instrument or agreement described in subparagraph (B).

"(2) SHORT-TERM CAPITAL GAIN.—The amount (if any) by which the net short-term capital gain exceeds the net long-term capital loss.

"(3) TRADE OR BUSINESS INCOME.—The gross income from any trade or business (other than an insurance business) carried on by the life insurance company, or by a partnership of which the life insurance company is a partner. In computing gross income under this paragraph, there shall be excluded any item described in paragraph (1).

Except as provided in paragraph (2), in computing gross investment income under this subsection, there shall be excluded any gain from the sale or exchange of a capital asset, and any gain considered as gain from the sale or exchange of a capital asset.

"(e) DIVIDENDS FROM CERTAIN SUBSIDIARIES NOT INCLUDED IN GROSS INVESTMENT INCOME.—For purposes of this section, the term 'gross investment income' shall not include any dividend received by the life insurance company which is a 100-percent dividend (as defined in section 805(a)(4)(C)). Such term also shall not include any dividend described in section 805(a)(4)(D) (relating to certain dividends in the case of foreign corporations).

"(f) NO DOUBLE COUNTING.—Under regulations, proper adjustments shall be made in the application of this section to prevent an item from being counted more than once.

"SEC. 813. FOREIGN LIFE INSURANCE COMPANIES.

"(a) ADJUSTMENT WHERE SURPLUS HELD IN THE UNITED STATES IS LESS THAN SPECIFIED MINIMUM.—

"(1) IN GENERAL.—In the case of any foreign company taxable under this part, if—

"(A) the required surplus determined under paragraph (2), exceeds

"(B) the surplus held in the United States,

then its income effectively connected with the conduct of an insurance business within the United States shall be increased by an amount determined by multiplying such excess by such company's current investment yield.

"(2) REQUIRED SURPLUS.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'required surplus' means the amount determined by multiplying the taxpayer's total insurance liabilities on United States business by a percentage for the taxable year determined and proclaimed by the Secretary under subparagraph (B).

"(B) DETERMINATION OF PERCENTAGE.—The percentage determined and proclaimed by the Secretary under this subparagraph shall be based on such data with respect to domestic life insurance companies for the preceding taxable year as the Secretary considers representative. Such percentage shall be computed on the basis of a ratio the numerator of which is the excess of the assets over the total insurance liabilities, and the denominator of which is the total insurance liabilities.

"(3) CURRENT INVESTMENT YIELD.—For purposes of this subsection—

"(A) In general.—The term 'current investment yield' means the percent obtained by dividing—

"(i) the net investment income on assets held in the United States, by

"(ii) the mean of the assets held in the United States during the taxable year.

"(B) Determinations based on amount set forth in the annual statement.—Except as otherwise provided in regulations, determinations under subparagraph (A) shall be made on the basis of the amounts required to be set forth on the annual statement approved by the National Association of Insurance Commissioners.

"(4) Other definitions.—For purposes of this subsection—

"(A) Surplus held in the United States.—The surplus held in the United States is the excess of the assets (determined under section 806(b)(3)(C)) held in the United States over the total insurance liabilities on United States business.

"(B) Total insurance liabilities.—For purposes of this subsection, the term 'total insurance liabilities' means the sum of the total reserves (as defined in section 816(c)) plus (to the extent not included in total reserves) the items referred to in paragraphs (3), (4), (5), and (6) of section 807(c).

"(5) Reduction of section 881 taxes.—In the case of any foreign company taxable under this part, there shall be determined—

"(A) the amount which would be subject to taxes under section 881 if the amount taxable under such section were determined without regard to sections 103 and 894, and

"(B) the amount of the increase provided by paragraph (1).

The tax under section 881 (determined without regard to this paragraph) shall be reduced (but not below zero) by an amount which is the same proportion of such tax as the amount referred to in subparagraph (B) is of the amount referred to in subparagraph (A); but such reduction in taxes shall not exceed the increase in taxes under this part by reason of the increase provided by paragraph (1).

"(b) Adjustment to Limitation on Deduction for Policyholder Dividends in the Case of Foreign Mutual Life Insurance Companies.—For purposes of section 809, the equity base of any foreign mutual life insurance company as of the close of any taxable year shall be increased by the amount of any excess determined under paragraph (1) of subsection (a) with respect to such taxable year.

"(c) Cross Reference.—

"For taxation of foreign corporations carrying on life insurance business within the United States, see section 842.

"SEC. 814. CONTIGUOUS COUNTRY BRANCHES OF DOMESTIC LIFE INSURANCE COMPANIES.

"(a) Exclusion of Items.—In the case of a domestic mutual insurance company which—

"(1) is a life insurance company,

"(2) has a contiguous country life insurance branch, and

"(3) makes the election provided by subsection (g) with respect to such branch,

there shall be excluded from each item involved in the determination of life insurance company taxable income the items separately accounted for in accordance with subsection (c).

"(b) CONTIGUOUS COUNTRY LIFE INSURANCE BRANCH.—For purposes of this section, the term contiguous country life insurance branch means a branch which—

"(1) issues insurance contracts insuring risks in connection with the lives or health of residents of a country which is contiguous to the United States,

"(2) has its principal place of business in such contiguous country, and

"(3) would constitute a mutual life insurance company if such branch were a separate domestic insurance company.

For purposes of this section, the term 'insurance contract' means any life, health, accident, or annuity contract or reinsurance contract or any contract relating thereto.

"(c) SEPARATE ACCOUNTING REQUIRED.—Any taxpayer which makes the election provided by subsection (g) shall establish and maintain a separate account for the various income, exclusion, deduction, asset, reserve, liability, and surplus items properly attributable to the contracts described in subsection (b). Such separate accounting shall be made—

"(1) in accordance with the method regularly employed by such company, if such method clearly reflects income derived from, and the other items attributable to, the contracts described in subsection (b), and

"(2) in all other cases, in accordance with regulations prescribed by the Secretary.

"(d) RECOGNITION OF GAIN ON ASSETS IN BRANCH ACCOUNT.—If the aggregate fair market value of all the invested assets and tangible property which are separately accounted for by the domestic life insurance company in the branch account established pursuant to subsection (c) exceeds the aggregate adjusted basis of such assets for purposes of determining gain, then the domestic life insurance company shall be treated as having sold all such assets on the first day of the first taxable year for which the election is in effect at their fair market value on such first day. Notwithstanding any other provision of this chapter, the net gain shall be recognized to the domestic life insurance company on the deemed sale described in the preceding sentence.

"(e) TRANSACTIONS BETWEEN CONTIGUOUS COUNTRY BRANCH AND DOMESTIC LIFE INSURANCE COMPANY.—

"(1) REIMBURSEMENT FOR HOME OFFICE SERVICES, ETC.—Any payment, transfer, reimbursement, credit, or allowance which is made from a separate account established pursuant to subsection (c) to one or more other accounts of a domestic life insurance company as reimbursement for costs incurred for or with respect to the insurance (or reinsurance) of risks accounted for in such separate account shall be taken into account by the domestic life insurance company in the same manner as if such payment, transfer, reimbursement, credit, or allowance had been received from a separate person.

"(2) REPATRIATION OF INCOME.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), any amount directly or indirectly transferred or credited from a branch account established pursuant to subsection (c) to one or more other accounts of such company shall, unless such transfer or credit is a reimbursement to which paragraph (1) applies, be added to the income of the domestic life insurance company.

"(B) LIMITATION.—The addition provided by subparagraph (A) for the taxable year with respect to any contiguous country life insurance branch shall not exceed the amount by which—

"(i) the aggregate decrease in the tentative LICTI of the domestic life insurance company for the taxable year and for all prior taxable years resulting solely from the application of subsection (a) of this section with respect to such branch, exceeds

"(ii) the amount of additions to tentative LICTI pursuant to subparagraph (A) with respect to such contiguous country branch for all prior taxable years.

"(C) TRANSITIONAL RULE.—For purposes of this paragraph, in the case of a prior taxable year beginning before January 1, 1984, the term 'tentative LICTI' means life insurance company taxable income determined under this part (as in effect for such year) without regard to this paragraph.

"(f) OTHER RULES.—

"(1) TREATMENT OF FOREIGN TAXES.—

"(A) IN GENERAL.—No income, war profits, or excess profits taxes paid or accrued to any foreign country or possession of the United States which is attributable to income excluded under subsection (a) shall be taken into account for purposes of subpart A of part III of subchapter N (relating to foreign tax credit) or allowable as a deduction.

"(B) TREATMENT OF REPATRIATED AMOUNTS.—For purposes of sections 78 and 902, where any amount is added to the life insurance company taxable income of the domestic life insurance company by reason of subsection (e)(2), the contiguous country life insurance branch shall be treated as a foreign corporation. Any amount so added shall be treated as a dividend paid by a foreign corporation, and the taxes paid to any foreign country or possession of the United States with respect to such amount shall be deemed to have been paid by such branch.

"(2) UNITED STATES SOURCE INCOME ALLOCABLE TO CONTIGUOUS COUNTRY BRANCH.—For purposes of sections 881, 882, and 1442, each contiguous country life insurance branch shall be treated as a foreign corporation. Such sections shall be applied to each such branch in the same manner as if such sections contained the provisions of any treaty to which the United States and the contiguous country are parties, to the same extent such provisions would apply if such branch were incorporated in such contiguous country.

"(g) ELECTION.—A taxpayer may make the election provided by this subsection with respect to any contiguous country for any taxable year. An election made under this subsection for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked with the consent of the Secretary. The election provided by this subsection shall be made not later than the time prescribed by law for filing the return for the taxable year (including extensions thereof) with respect to which such election is made, and such election and any approved revocation thereof shall be made in the manner provided by the Secretary.

"(h) SPECIAL RULE FOR DOMESTIC STOCK LIFE INSURANCE COMPANIES.—At the election of a domestic stock life insurance company which has a contiguous country life insurance branch described in subsection (b) (without regard to the mutual requirement in subsection (b)(3)), the assets of such branch may be transferred to a foreign corporation organized under the laws of the contiguous country without the application of section 367 or 1491. Subsection (a) shall apply to the stock of such foreign corporation as if such domestic company were a mutual company and as if the stock were an item described in subsection (c). Subsection (e)(2) shall apply to amounts transferred or credited to such domestic company as if such domestic company and such foreign corporation constituted one domestic mutual life insurance company. The insurance contracts which may be transferred pursuant to this subsection shall include only those which are similar to the types of insurance contracts issued by a mutual life insurance company. Notwithstanding the first sentence of this subsection, if the aggregate fair market value of the invested assets and tangible property which are separately accounted for by the domestic life insurance company in the branch account exceeds the aggregate adjusted basis of such assets for purposes of determining gain, the domestic life insurance company shall be deemed to have sold all such assets on the first day of the taxable year for which the election under this subsection applies and the net gain shall be recognized to the domestic life insurance company on the deemed sale, but not in excess of the proportion of such net gain which equals the proportion which the aggregate fair market value of such assets which are transferred pursuant to this subsection is of the aggregate fair market value of all such assets.

"SEC. 815. DISTRIBUTIONS TO SHAREHOLDERS FROM PRE-1984 POLICYHOLDERS SURPLUS ACCOUNT.

"(a) GENERAL RULE.—In the case of a stock life insurance company which has an existing policyholders surplus account, the tax imposed by section 801 for any taxable year shall be the amount which would be imposed by such section for such year on the sum of—

"(1) life insurance company taxable income for such year (but not less than zero), plus

"(2) the amount of direct and indirect distributions during such year to shareholders from such account.

"(b) ORDERING RULE.—For purposes of this section, any distribution to shareholders shall be treated as made—

"(1) first out of the shareholders surplus account, to the extent thereof, *"(2) then out of the policyholders surplus account, to the extent thereof, and*

"(3) finally, out of other accounts.

"(c) SHAREHOLDERS SURPLUS ACCOUNT.—

"(1) IN GENERAL.—Each stock life insurance company which has an existing policyholders surplus account shall continue its shareholders surplus account for purposes of this part.

"(2) ADDITIONS TO ACCOUNT.—The amount added to the shareholders surplus account for any taxable year beginning after December 31, 1983, shall be the excess of—

"(A) the sum of—

"(i) the life insurance company's taxable income (but not below zero),

"(ii) the special deductions provided by section 806, and

"(iii) the deductions for dividends received provided by sections 243, 244, and 245 (as modified by section 805(a)(4)) and the amount of interest excluded from gross income under section 103, over

"(B) the taxes imposed for the taxable year by section 801 (determined without regard to this section).

"(3) SUBTRACTIONS FROM ACCOUNT.—There shall be subtracted from the shareholders surplus account for any taxable year the amount which is treated under this section as distributed out of such account.

"(d) POLICYHOLDERS SURPLUS ACCOUNT.—

"(1) IN GENERAL.—Each stock life insurance company which has an existing policyholders surplus account shall continue such account.

"(2) NO ADDITIONS TO ACCOUNT.—No amount shall be added to the policyholders surplus account for any taxable year beginning after December 31, 1983.

"(3) SUBTRACTIONS FROM ACCOUNT.—There shall be subtracted from the policyholders surplus account for any taxable year an amount equal to the sum of—

"(A) the amount which (without regard to subparagraph (B)) is treated under this section as distributed out of the policyholders surplus account, and

"(B) the amount by which the tax imposed for the taxable year by section 801 is increased by reason of this section.

"(e) EXISTING POLICYHOLDERS SURPLUS ACCOUNT.—For purposes of this section, the term 'existing policyholders surplus account' means any policyholders surplus account which has a balance as of the close of December 31, 1983.

"(f) OTHER RULES APPLICABLE TO POLICYHOLDERS SURPLUS ACCOUNT CONTINUED.—Except to the extent inconsistent with the provisions of this part, the provisions of subsections (d), (e), (f), and (g) of section 815 (and of sections 6603(c)(6), 6603(k), 6613(d)(6), 6601(d)(3), and 6611(f)(4)) as in effect before the enactment of the Life Insurance Tax Act of 1984 are hereby made applicable in respect of any policyholders surplus account for which there was a balance as of December 31, 1983.

"SUBPART E—DEFINITIONS AND SPECIAL RULES

"SEC. 816. LIFE INSURANCE COMPANY DEFINED.

"(a) LIFE INSURANCE COMPANY DEFINED.—For purposes of this subtitle, the term 'life insurance company' means an insurance company which is engaged in the business of issuing life insurance and annuity contracts (either separately or combined with accident and health insurance), or noncancellable contracts of health and accident insurance, if—

"(1) its life insurance reserves (as defined in subsection (b)), plus

"(2) unearned premiums, and unpaid losses (whether or not ascertained), on noncancellable life, accident, or health policies not included in life insurance reserves,

comprise more than 50 percent of its total reserves (as defined in subsection (c)). For purposes of the preceding sentence, the term 'insurance company' means any company more than half of the business of which during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies.

"(b) LIFE INSURANCE RESERVES DEFINED.—

"(1) IN GENERAL.—For purposes of this part, the term 'life insurance reserves' means amounts—

"(A) which are computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interest, and

"(B) which are set aside to mature or liquidate, either by payment or reinsurance, future unaccrued claims arising from life insurance, annuity, and noncancellable accident and health insurance contracts (including life insurance or annuity contracts combined with noncancellable accident and health insurance) involving, at the time with respect to which the reserve is computed, life, accident, or health contingencies.

"(2) RESERVES MUST BE REQUIRED BY LAW.—Except—

"(A) in the case of policies covering life, accident, and health insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, and

"(B) as provided in paragraph (3),

in addition to the requirements set forth in paragraph (1), life insurance reserves must be required by law.

"(3) ASSESSMENT COMPANIES.—In the case of an assessment life insurance company or association, the term 'life insurance reserves' includes—

"(A) sums actually deposited by such company or association with State officers pursuant to law as guaranty or reserve funds, and

"(B) any funds maintained, under the charter or articles of incorporation or association (or bylaws approved by a State insurance commissioner) of such company or association, exclusively for the payment of claims arising under

certificates of membership or policies issued on the assessment plan and not subject to any other use.

"(4) AMOUNT OF RESERVES.—For purposes of this subsection, subsection (a), and subsection (c), the amount of any reserve (or portion thereof) for any taxable year shall be the mean of such reserve (or portion thereof) at the beginning and end of the taxable year.

"(c) TOTAL RESERVES DEFINED.—For purposes of subsection (a), the term 'total reserves' means—

"(1) life insurance reserves,

"(2) unearned premiums, and unpaid losses (whether or not ascertained), not included in life insurance reserves, and

"(3) all other insurance reserves required by law.

"(d) ADJUSTMENTS IN RESERVES FOR POLICY LOANS.—For purposes only of determining under subsection (a) whether or not an insurance company is a life insurance company, the life insurance reserves, and the total reserves, shall each be reduced by an amount equal to the mean of the aggregates, at the beginning and end of the taxable year, of the policy loans outstanding with respect to contracts for which life insurance reserves are maintained.

"(e) GUARANTEED RENEWABLE CONTRACTS.—For purposes of this part, guaranteed renewable life, accident, and health insurance shall be treated in the same manner as noncancellable life, accident, and health insurance.

"(f) AMOUNTS NOT INVOLVING LIFE, ACCIDENT, OR HEALTH CONTINGENCIES.—For purposes only of determining under subsection (a) whether or not an insurance company is a life insurance company, amounts set aside and held at interest to satisfy obligations under contracts which do not contain permanent guarantees with respect to life, accident, or health contingencies shall not be included in reserves described in paragraph (1) or (3) of subsection (c).

"(g) BURIAL AND FUNERAL BENEFIT INSURANCE COMPANIES.—A burial or funeral benefit insurance company engaged directly in the manufacture of funeral supplies or the performance of funeral services shall not be taxable under this part but shall be taxable under section 821 or section 831.

"SEC. 817. TREATMENT OF VARIABLE CONTRACTS.

"(a) INCREASES AND DECREASES IN RESERVES.—For purposes of subsections (a) and (b) of section 807, the sum of the items described in section 807(c) taken into account as of the close of the taxable year with respect to any variable contract shall, under regulations prescribed by the Secretary, be adjusted—

"(1) by subtracting therefrom an amount equal to the sum of the amounts added from time to time (for the taxable year) to the reserves separately accounted for in accordance with subsection (c) by reason of appreciation in value of assets (whether or not the assets have been disposed of), and

"(2) by adding thereto an amount equal to the sum of the amounts subtracted from time to time (for the taxable year) from such reserves by reason of depreciation in value of assets (whether or not the assets have been disposed of).

The deduction allowable for items described in paragraphs (1) and (6) of section 805(a) with respect to variable contracts shall be re-

duced to the extent that the amount of such items is increased for the taxable year by appreciation (or increased to the extent that the amount of such items is decreased for the taxable year by depreciation) not reflected in adjustments under the preceding sentence.

"(b) ADJUSTMENT TO BASIS OF ASSETS HELD IN SEGREGATED ASSET ACCOUNT.—In the case of variable contracts, the basis of each asset in a segregated asset account shall (in addition to all other adjustments to basis) be—

"(1) increased by the amount of any appreciation in value, and

"(2) decreased by the amount of any depreciation in value,

to the extent such appreciation and depreciation are from time to time reflected in the increases and decreases in reserves or other items referred to in subsection (a) with respect to such contracts.

"(c) SEPARATE ACCOUNTING.—For purposes of this part (other than section 809), a life insurance company which issues variable contracts shall separately account for the various income, exclusion, deduction, asset, reserve, and other liability items properly attributable to such variable contracts. For such items as are not accounted for directly, separate accounting shall be made—

"(1) in accordance with the method regularly employed by such company, if such method is reasonable, and

"(2) in all other cases, in accordance with regulations prescribed by the Secretary.

"(d) VARIABLE CONTRACT DEFINED.—For purposes of this part, the term 'variable contract' means a contract—

"(1) which provides for the allocation of all or part of the amounts received under the contract to an account which, pursuant to State law or regulation, is segregated from the general asset accounts of the company,

"(2) which—

"(A) provides for the payment of annuities, or

"(B) is a life insurance contract, and

"(3) under which—

"(A) in the case of an annuity contract, the amounts paid in, or the amount paid out, reflect the investment return and the market value of the segregated asset account, or

"(B) in the case of a life insurance contract, the amount of the death benefit (or the period of coverage) is adjusted on the basis of the investment return and the market value of the segregated asset account.

If a contract ceases to reflect current investment return and current market value, such contract shall not be considered as meeting the requirements of paragraph (3) after such cessation.

"(e) PENSION PLAN CONTRACTS TREATED AS PAYING ANNUITY.—A pension plan contract which is not a life, accident, or health, property, casualty, or liability insurance contract shall be treated as a contract which provides for the payments of annuities for purposes of subsection (d).

"(f) OTHER SPECIAL RULES.—

"(1) LIFE INSURANCE RESERVES.—For purposes of subsection (b)(1)(A) of section 816, the reflection of the investment return and the market value of the segregated asset account shall be considered an assumed rate of interest.

"(2) ADDITIONAL SEPARATE COMPUTATIONS.—Under regulations prescribed by the Secretary, such additional separate computations shall be made, with respect to the items separately accounted for in accordance with subsection (c), as may be necessary to carry out the purposes of this section and this part.

"(g) VARIABLE ANNUITY CONTRACTS TREATED AS ANNUITY CONTRACTS.—For purposes of this part, the term 'annuity contract' includes a contract which provides for the payment of a variable annuity computed on the basis of—

"(1) recognized mortality tables, and

"(2)(A) the investment experience of a segregated asset account, or

"(B) the company-wide investment experience of the company.

Paragraph (2)(B) shall not apply to any company which issues contracts which are not variable contracts.

"(h) TREATMENT OF CERTAIN NONDIVERSIFIED CONTRACTS.—

"(1) IN GENERAL.—For purposes of subchapter L, section 72 (relating to annuities), and section 7702(a) (relating to definition of life insurance contract), a variable contract (other than a pension plan contract) which is otherwise described in this section and which is based on a segregated asset account shall not be treated as an annuity, endowment, or life insurance contract for any period (and any subsequent period) for which the investments made by such account are not, in accordance with regulations prescribed by the Secretary, adequately diversified. For purposes of the preceding sentence, beneficial interests in a regulated investment company or in a trust shall not be treated as 1 investment if all of the beneficial interests in such company or trust are held by 1 or more segregated asset accounts of 1 or more insurance companies.

"(2) SAFE HARBOR FOR DIVERSIFICATION.—A segregated asset account shall be treated as meeting the requirements of paragraph (1) for any quarter of a taxable year if as of the close of such quarter—

"(A) it meets the requirements of section 851(b)(4), and

"(B) no more than 55 percent of the value of the total assets of the account are assets described in section 851(b)(4)(A)(i).

"(3) SPECIAL RULE FOR VARIABLE LIFE INSURANCE CONTRACTS INVESTING IN UNITED STATES OBLIGATIONS.—In the case of a segregated asset account with respect to variable life insurance contracts, paragraph (1) shall not apply in the case of securities issued by the United States Treasury which are owned by a regulated investment company or by a trust all the beneficial interests in which are held by 1 or more segregated asset accounts of the company issuing the contract.

"(4) INDEPENDENT INVESTMENT ADVISORS PERMITTED.—Nothing in this subsection shall be construed as prohibiting the use of independent investment advisors.

"SEC. 818. OTHER DEFINITIONS AND SPECIAL RULES.

"(a) PENSION PLAN CONTRACTS.—For purposes of this part, the term 'pension plan contract' means any contract—

"(1) entered into with trusts which (as of the time the contracts were entered into) were deemed to be trusts described in section 401(a) and exempt from tax under section 501(a), (or trusts exempt from tax under section 165 of the Internal Revenue Code of 1939 or the corresponding provisions of prior revenue laws);

"(2) entered into under plans which (as of the time the contracts were entered into) were deemed to be plans described in section 403(a), or plans meeting the requirements of paragraphs (3), (4), (5), and (6) of section 165(a) of the Internal Revenue Code of 1939;

"(3) provided for employees of the life insurance company under a plan which, for the taxable year, meets the requirements of paragraphs (3), (4), (5), (6), (7), (8), (11), (12), (13), (14), (15), (16), (19), (20), and (22) of section 401(a);

"(4) purchased to provide retirement annuities for its employees by an organization which (as of the time the contracts were purchased) was an organization described in section 501(c)(3) which was exempt from tax under section 501(a) (or was an organization exempt from tax under section 101(6) of the Internal Revenue Code of 1939 or the corresponding provisions of prior revenue laws), or purchased to provide retirement annuities for employees described in section 403(b)(1)(A)(ii) by an employer which is a State, a political subdivision of a State, or an agency or instrumentality of any one or more of the foregoing;

"(5) entered into with trusts which (at the time the contracts were entered into) were individual retirement accounts described in section 408(a) or under contracts entered into with individual retirement annuities described in section 408(b); or

"(6) purchased by—

"(A) a governmental plan (within the meaning of section 414(d)), or

"(B) the Government of the United States, the government of any State or political subdivision thereof, or by any agency or instrumentality of the foregoing, for use in satisfying an obligation of such government, political subdivision, or agency or instrumentality to provide a benefit under a plan described in subparagraph (A).

"(b) Treatment of Capital Gains and Losses, Etc.—In the case of a life insurance company—

"(1) in applying section 1231(a), the term 'property used in the trade or business' shall be treated as including only—

"(A) property used in carrying on an insurance business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 1 year, and real property used in carrying on an insurance business, held for more than 1 year, which is not described in section 1231(b)(1) (A), (B), or (C), and

"(B) property described in section 1231(b)(2), and

"(2) in applying section 1221(2), the reference to property used in trade or business shall be treated as including only property used in carrying on an insurance business.

"(c) Gain on Property Held on December 31, 1958 and Certain Substituted Property Acquired After 1958.—

"(1) PROPERTY HELD ON DECEMBER 31, 1958.—In the case of property held by the taxpayer on December 31, 1958, if—

"(A) the fair market value of such property on such date exceeds the adjusted basis for determining gain as of such date, and

"(B) the taxpayer has been a life insurance company at all times on and after December 31, 1958,

the gain on the sale or other disposition of such property shall be treated as an amount (not less than zero) equal to the amount by which the gain (determined without regard to this subsection) exceeds the difference between the fair market value on December 31, 1958, and the adjusted basis for determining gain as of such date.

"(2) CERTAIN PROPERTY ACQUIRED AFTER DECEMBER 31, 1958.—In the case of property acquired after December 31, 1958, and having a substituted basis (within the meaning of section 1016(b))—

"(A) for purposes of paragraph (1), such property shall be deemed held continuously by the taxpayer since the beginning of the holding period thereof, determined with reference to section 1223,

"(B) the fair market value and adjusted basis referred to in paragraph (1) shall be that of that property for which the holding period taken into account includes December 31, 1958,

"(C) paragraph (1) shall apply only if the property or properties the holding periods of which are taken into account were held only by life insurance companies after December 31, 1958, during the holding periods so taken into account,

"(D) the difference between the fair market value and adjusted basis referred to in paragraph (1) shall be reduced (to not less than zero) by the excess of (i) the gain that would have been recognized but for this subsection on all prior sales or dispositions after December 31, 1958, of properties referred to in subparagraph (C), over (ii) the gain which was recognized on such sales or other dispositions, and

"(E) the basis of such property shall be determined as if the gain which would have been recognized but for this subsection were recognized gain.

"(3) PROPERTY DEFINED.—For purposes of paragraphs (1) and (2), the term 'property' does not include insurance and annuity contracts and property described in paragraph (1) of section 1221.

"(d) INSURANCE OR ANNUITY CONTRACT INCLUDES CONTRACTS SUPPLEMENTARY THERETO.—For purposes of this part, the term 'insurance or annuity contract' includes any contract supplementary thereto.

"(e) SPECIAL RULE FOR CONSOLIDATED RETURNS.—If an election under section 1504(c)(2) is in effect with respect to an affiliated group for the taxable year, all items of the members of such group which are not life insurance companies shall not be taken into ac-

count in determining the amount of the tentative LICTI of members of such group which are life insurance companies.

"(f) ALLOCATION OF CERTAIN ITEMS FOR PURPOSES OF FOREIGN TAX CREDIT, ETC.—

"(1) IN GENERAL.—Under regulations, in applying sections 861, 862, and 863 to a life insurance company, the deduction for policyholder dividends (determined under section 808(c)), reserve adjustments under subsections (a) and (b) of section 807, and death benefits and other amounts described in section 805(a)(1) shall be treated as items which cannot definitely be allocated to an item or class of gross income.

"(2) ELECTION OF ALTERNATIVE ALLOCATION.—

"(A) IN GENERAL.—On or before September 15, 1985, any life insurance company may elect to treat items described in paragraph (1) as properly apportioned or allocated among items of gross income to the extent (and in the manner) prescribed in regulations.

"(B) ELECTION IRREVOCABLE.—Any election under subparagraph (A), once made, may be revoked only with the consent of the Secretary."

(b) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Subclause (IV) of section 72(e)(5)(D)(i) is amended by striking out "section 805(d)(3)" and inserting in lieu thereof "section 818(a)(3)".

(2) Subsection (a) of section 80 (relating to restoration of value of certain securities) is amended by striking out "802" and inserting in lieu thereof "801".

(3)(A) Subparagraph (C) of section 243(b)(3) (relating to effect of election) is amended by striking out clause (iii), by adding "and" at the end of clause (ii), and by redesignating clause (iv) as clause (iii).

(B) Paragraph (6) of section 243(b) (relating to special rules for insurance companies) is amended by striking out "section 802" and inserting in lieu thereof "section 801".

(4) Subsection (d) of section 381 (relating to carryover in certain corporate acquisitions) is amended by striking out "section 812(f)" and inserting in lieu thereof "section 810".

(5) Paragraph (24) of section 401(a) (relating to qualified pension, profit-sharing, and stock bonus plans) is amended by striking out "section 805(d)(6)" and inserting in lieu thereof "section 818(a)(6)".

(6)(A) Paragraph (1) of section 453B(e) (relating to life insurance companies) is amended by striking out "section 801(a)" and inserting in lieu thereof "section 816(a)".

(B) Paragraph (2) of section 453B(e) is amended to read as follows:

"(2) SPECIAL RULE WHERE LIFE INSURANCE COMPANY ELECTS TO TREAT INCOME AS NOT RELATED TO INSURANCE BUSINESS.—Paragraph (1) shall not apply to any transfer or deemed transfer of an installment obligation if the life insurance company elects (at such time and in such manner as the Secretary may by regulations prescribe) to determine its life insurance company taxable income—

"(A) by returning the income on such installment obligation under the installment method prescribed in section 453, and

"(B) as if such income were an item attributable to a noninsurance business (as defined in section 806(c)(3))."

(7) Paragraph (5) of section 542(b) (relating to certain dividend income received from a nonincludible life insurance company) is amended by striking out "section 802" and inserting in lieu thereof "section 801".

(8) Subsection (b) of section 594 (relating to alternative tax for mutual savings banks conducting life insurance business) is amended by striking out "section 801" and inserting in lieu thereof "section 816".

(9) Paragraph (4) of section 832(b) (defining premiums earned) is amended by striking out "section 801(b)" and inserting in lieu thereof "section 816(b) but determined as provided in section 807" and by striking out "section 801" and inserting in lieu thereof "section 816".

(10) Section 841 (relating to credit for foreign taxes) is amended—

(A) by striking out "section 802," each place it appears and inserting in lieu thereof "section 801,", and

(B) by striking out "section 802(b)" and inserting in lieu thereof "section 801(b)".

(11)(A) Subsection (a) of section 844 (relating to special loss carryover rules) is amended—

(i) by striking out "section 812," and inserting in lieu thereof "section 810 (or the corresponding provisions of prior law),", and

(ii) by striking out "section 812(a)" and inserting in lieu thereof "section 810(a)".

(B) Subsection (b) of section 844 is amended—

(i) by striking out "section 812(a)" and inserting in lieu thereof "section 810(a)", and

(ii) by striking out "section 812(b)(1)(C)" in paragraph (2) and inserting in lieu thereof "section 810(b)(1)(C)".

(12) Section 891 (relating to doubling of rates of tax on citizens and corporations of certain foreign countries) is amended by striking out "802" and inserting in lieu thereof "801".

(13)(A) Subsection (b) of section 953 (relating to income from insurance of United States risks) is amended by striking out paragraph (1) and by redesignating paragraphs (2), (3), (4), and (5) as paragraphs (1), (2), (3), and (4), respectively.

(B) Paragraph (2) of section 953(b), as redesignated by subparagraph (A), is amended to read as follows:

"(2) The following provisions of subchapter L shall not apply:

"(A) The special life insurance company deduction and the small life insurance company deduction.

"(B) Section 805(a)(5) (relating to operations loss deduction).

"(C) Section 832(c)(5) (relating to certain capital losses)."

(C) Paragraph (3) of section 953(b), as redesignated by subparagraph (A), is amended by—

(i) striking out "section 809(c)(1)" and inserting in lieu thereof "section 803(a)(1)", and

(ii) by striking out "section 809(c)(2)" and inserting in lieu thereof "section 803(a)(2)", and

(iii) by striking out "section 809(d)(2)" and inserting in lieu thereof "section 805(a)(2)".

(D) Paragraph (2) of section 953(a) is amended by striking out ", (2), and (3)" and inserting in lieu thereof "and (2)".

(E) Paragraph (4) of section 953(b), as redesignated by subparagraph (A), is amended by striking out "paragraph (4)" and inserting in lieu thereof "paragraph (3)".

(14) Paragraph (17) of section 1016(a) is amended by striking out "section 818(b)" each place it appears and inserting in lieu thereof "section 811(b)".

(15) Paragraph (1) of section 1035(b) (defining endowment contract) is amended by striking out "section 801" and inserting in lieu thereof "section 816".

(16) Paragraph (1) of section 1201(b) (relating to cross references) is amended by striking out "section 802(a)(2)" and inserting in lieu thereof "section 801(a)(2)".

(17) Subparagraph (B) of section 1232A(c)(4) (relating to original issue discount) is amended by striking out "section 818(b)" and inserting in lieu thereof "section 811(b)".

(18)(A) Paragraph (1) of section 1351(a) (relating to treatment of recoveries of foreign expropriation losses) is amended by striking out "802" each place it appears and inserting in lieu thereof "801".

(B) Paragraph (2) of section 1351(c) (relating to amount of recovery) is amended by striking out "section 810(c)" and inserting in lieu thereof "section 807(c)".

(C) Paragraph (3) of section 1351(i) (relating to adjustments for succeeding years) is amended by striking out "section 812" and inserting in lieu thereof "section 810".

(19)(A) Subsection (c) of section 1503 (relating to special rules for application of certain losses against income of insurance companies taxed under section 802) is amended by striking out "section 802" each place it appears and inserting in lieu thereof "section 801".

(B) Paragraph (1) of section 1503(c) is amended by striking out the third sentence.

(C) The subsection heading of section 1503(c) is amended by striking out "SECTION 802" and inserting in lieu thereof "SECTION 801".

(20) Subsections (b)(2), (c)(1), and (c)(2)(A) of section 1504 (defining affiliated group) are each amended by striking out "section 802" and inserting in lieu thereof "section 801".

(21)(A) Subsection (a) of section 1561 (relating to limitations on certain multiple tax benefits in the case of certain controlled corporations) is amended—

(i) by striking out paragraphs (3) and (4), by adding "and" at the end of paragraph (1), and by striking out the comma at the end of paragraph (2) and inserting in lieu thereof a period, and

(ii) by striking out "paragraphs (2), (3), and (4)" in the last sentence and inserting in lieu thereof "paragraph (2)".

(B) Subsection (b) of section 1561 is amended—

(i) by striking out paragraphs (3) and (4) and by adding "and" at the end of paragraph (1), and

(ii) by striking out ", (2), (3), or (4)" and inserting in lieu thereof "or (2)".

(22) Subsections (a)(4) and (b)(2)(D) of section 1563 (defining controlled group of corporations) are each amended by striking out "section 802" and inserting in lieu thereof "section 801".

(23) Paragraph (2) of section 4371 (relating to imposition of tax on policies issued by foreign insurers) is amended by striking out "section 819" and inserting in lieu thereof "section 813".

(24)(A) Subsection (c) of section 6603 (relating to limitations on assessment and collection) is amended by striking out paragraph (6) and by redesignating paragraph (7) as paragraph (6).

(B) Subsection (k) of section 6603 (relating to reductions of policyholders surplus account of life insurance companies) is hereby repealed.

(25) Subsection (d) of section 6613 (relating to limitations on credit or refund) is amended by striking out paragraph (6) and by redesignating paragraph (7) as paragraph (6).

(26) Subsection (d) of section 6601 (relating to interest on underpayments, etc.) is amended by striking out paragraph (3) and by redesignating paragraph (4) as paragraph (3).

(27) Subsection (f) of section 6611 (relating to interest on overpayments) is amended by striking out paragraph (4).

SEC. 212. CERTAIN REINSURANCE AGREEMENTS.

(a) IN GENERAL.—Part IV of subchapter L of chapter 1 (relating to provisions of general application) is amended by adding at the end thereof the following new section:

"SEC. 845. CERTAIN REINSURANCE AGREEMENTS.

"(a) ALLOCATION IN CASE OF REINSURANCE AGREEMENT INVOLVING TAX AVOIDANCE OR EVASION.—In the case of 2 or more related persons (within the meaning of section 482) who are parties to a reinsurance agreement (or where one of the parties to a reinsurance agreement is, with respect to any contract covered by the agreement, in effect an agent of another party to such agreement or a conduit between related persons), the Secretary may—

"(1) allocate between or among such persons income (whether investment income, premium, or otherwise), deductions, assets, reserves, credits, and other items related to such agreement,

"(2) recharacterize any such items, or

"(3) make any other adjustment,

if he determines that such allocation, recharacterization, or adjustment is necessary to reflect the proper source and character of the taxable income (or any item described in paragraph (1) relating to such taxable income) of each such person.

"(b) REINSURANCE CONTRACT HAVING SIGNIFICANT TAX AVOIDANCE EFFECT.—If the Secretary determines that any reinsurance contract has a significant tax avoidance effect on any party to such contract, the Secretary may make proper adjustments with respect to

such party to eliminate such tax avoidance effect (including treating such contract with respect to such party as terminated on December 31 of each year and reinstated on January 1 of the next year)."

(b) CLERICAL AMENDMENT.—The table of sections for such part IV is amended by adding at the end thereof the following new item:

"Sec. 845. Certain reinsurance agreements."

PART II—EFFECTIVE DATE; TRANSITIONAL RULES

Subpart A—Effective Date

SEC. 215. EFFECTIVE DATE.

The amendments made by this subtitle shall apply to taxable years beginning after December 31, 1983.

Subpart B—Transitional Rules

SEC. 216. RESERVES COMPUTED ON NEW BASIS; FRESH START.

(a) RECOMPUTATION OF RESERVES.—

(1) IN GENERAL.—As of the beginning of the first taxable year beginning after December 31, 1983, for purposes of subchapter L of the Internal Revenue Code of 1954 (other than section 816 thereof), the reserve for any contract shall be recomputed as if the amendments made by this subtitle had applied to such contract when it was issued.

(2) PREMIUMS EARNED.—For the first taxable year beginning after December 31, 1983, in determining "premiums earned on insurance contracts during the taxable year" as provided in section 832(b)(4) of the Internal Revenue Code of 1954, life insurance reserves which are included in unearned premiums on outstanding business at the end of the preceding taxable year shall be determined as provided in section 807 of the Internal Revenue Code of 1954, as amended by this subtitle, as though section 807 was applicable to such reserves in such preceding taxable year.

(3) ISSUANCE DATE FOR GROUP CONTRACTS.—For purposes of this subsection, the issuance date of any group contract shall be determined under section 807(e)(2) of the Internal Revenue Code of 1954 (as added by this subtitle), except that if such issuance date cannot be determined, the issuance date shall be determined on the basis prescribed by the Secretary of the Treasury or his delegate for purposes of this subsection.

(b) FRESH START.—

(1) IN GENERAL.—Except as provided in paragraph (2), in the case of any insurance company, any change in the method of accounting (and any change in the method of computing reserves) between such company's first taxable year beginning after December 31, 1983, and the preceding taxable year which is required solely by the amendments made by this subtitle shall be treated as not being a change in the method of accounting (or change in the method of computing reserves) for purposes of the Internal Revenue Code of 1954.

(2) TREATMENT OF ADJUSTMENTS FROM YEARS BEFORE 1984.—

(A) ADJUSTMENTS ATTRIBUTABLE TO DECREASES IN RESERVES.—No adjustment under section 810(d) of the Inter-

nal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act) attributable to any decrease in reserves as a result of a change in a taxable year beginning before 1984 shall be taken into account in any taxable year beginning after 1983.

(B) ADJUSTMENTS ATTRIBUTABLE TO INCREASES IN RESERVES.—

(i) IN GENERAL.—Any adjustment under section 810(d) of the Internal Revenue Code of 1954 (as so in effect) attributable to an increase in reserves as a result of a change in a taxable year beginning before 1984 shall be taken into account in taxable years beginning after 1983 to the extent that—

(I) the amount of the adjustments which would be taken into account under such section in taxable years beginning after 1983 without regard to this subparagraph, exceeds

(II) the amount of any fresh start adjustment attributable to contracts for which there was such an increase in reserves as a result of such change.

(ii) FRESH START ADJUSTMENT.—For purposes of clause (i), the fresh start adjustment with respect to any contract is the excess (if any) of—

(I) the reserve attributable to such contract as of the close of the taxpayer's last taxable year beginning before January 1, 1984, over

(II) the reserve for such contract as of the beginning of the taxpayer's first taxable year beginning after 1983 as recomputed under subsection (a) of this section.

(C) RELATED INCOME INCLUSIONS NOT TAKEN INTO ACCOUNT TO THE EXTENT DEDUCTION DISALLOWED UNDER SUBPARAGRAPH (b).—No premium shall be included in income to the extent such premium is directly related to an increase in a reserve for which a deduction is disallowed by subparagraph (B).

(3) REINSURANCE TRANSACTIONS, AND RESERVE STRENGTHENING, AFTER SEPTEMBER 27, 1983.—

(A) IN GENERAL.—Paragraph (1) shall not apply (and section 807(f) of the Internal Revenue Code of 1954 as amended by this subtitle shall apply)—

(i) to any reserve transferred pursuant to—

(I) a reinsurance agreement entered into after September 27, 1983, and before January 1, 1984, or

(II) a modification of a reinsurance agreement made after September 27, 1983, and before January 1, 1984, and

(ii) to any reserve strengthening reported for Federal income tax purposes after September 27, 1983, for a taxable year ending before January 1, 1984.

Clause (ii) shall not apply to the computation of reserves on any contract issued if such computation employs the reserve practice used for purposes of the most recent annual state-

ment filed before September 27, 1983, for the type of contract with respect to which such reserves are set up.

(B) TREATMENT OF RESERVE ATTRIBUTABLE TO SECTION 818(C) ELECTION.—In the case of any reserve described in subparagraph (A), for purposes of section 807(f) of the Internal Revenue Code of 1954, any change in the treatment of any contract to which an election under section 818(c) of such Code (as in effect on the day before the date of the enactment of this Act) applied shall be treated as a change in the basis for determining the amount of any reserve.

(C) 10-YEAR SPREAD INAPPLICABLE WHERE NO 10-YEAR SPREAD UNDER PRIOR LAW.—In the case of any item to which section 807(f) of such Code applies by reason of subparagraph (A) or (B), such item shall be taken into account for the first taxable year beginning after December 31, 1983 (in lieu of over the 10-year period otherwise provided in such section) unless the item was required to have been taken into account over a period of 10 taxable years under section 810(d) of such Code (as in effect on the day before the date of the enactment of this Act).

(D) DISALLOWANCE OF SPECIAL LIFE INSURANCE COMPANY DEDUCTION AND SMALL LIFE INSURANCE COMPANY DEDUCTION.—Any amount included in income under section 807(f) of such Code by reason of subparagraph (A) or (B) (and any income attributable to expenses transferred in connection with the transfer of reserves described in subparagraph (A)) shall not be taken into account for purposes of determining the amount of special life insurance company deduction and the small life insurance company deduction.

(E) DISALLOWANCE OF DEDUCTIONS UNDER SECTION 809(d).—No deduction shall be allowed under paragraph (5) or (6) of section 809(d) of such Code (as in effect before the amendments made by this subtitle) with respect to any amount described in either such paragraph which is transferred in connection with the transfer of reserves described in subparagraph (A).

(4) ELECTIONS UNDER SECTION 818(C) AFTER SEPTEMBER 27, 1983, NOT TO TAKE EFFECT.—

(A) IN GENERAL.—Except as provided in subparagraph (B), any election after September 27, 1983, under section 818(c) of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act) shall not take effect.

(B) EXCEPTION FOR CERTAIN CONTRACTS ISSUED UNDER PLAN OF INSURANCE FIRST FILED AFTER MARCH 1, 1982, AND BEFORE SEPTEMBER 28, 1983.—Subparagraph (A) shall not apply to any election under such section 818(c) if more than 95 percent of the reserves computed in accordance with such election are attributable to risks under life insurance contracts issued by the taxpayer under a plan of insurance first filed after March 1, 1982, and before September 28, 1983.

(5) RECAPTURE OF REINSURANCE AFTER DECEMBER 31, 1983.—If (A) insurance or annuity contracts in force on December 31,

1983, are subject to a conventional coinsurance agreement entered into after December 31, 1981, and before January 1, 1984, and (B) such contracts are recaptured by the reinsured in any taxable year beginning after December 31, 1983, then—

(i) if the amount of the reserves with respect to the recaptured contracts, computed at the date of recapture, that the reinsurer would have taken into account under section 810(c) of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act) exceeds the amount of the reserves with respect to the recaptured contracts, computed at the date of recapture, taken into account by the reinsurer under section 807(c) of the Internal Revenue Code of 1954 (as amended by this subtitle), such excess (but not greater than the amount of such excess if computed on January 1, 1984) shall be taken into account by the reinsurer under the method described in section 807(f)(1)(B)(ii) of the Internal Revenue Code of 1954 (as amended by this subtitle) commencing with the taxable year of recapture, and

(ii) the amount, if any, taken into account by the reinsurer under clause (i) for purposes of part I of subchapter L of chapter 1 of the Internal Revenue Code of 1954 shall be taken into account by the reinsured under the method described in section 807(f)(1)(B)(i) of the Internal Revenue Code of 1954 (as amended by this subtitle) commencing with the taxable year of recapture.

The excess described in clause (i) shall be reduced by any portion of such excess to which section 807(f) of the Internal Revenue Code of 1954 applies by reason of paragraph (3) of this subsection. For purposes of this paragraph, the term "reinsurer" refers to the taxpayer that held reserves with respect to the recaptured contracts as of the end of the taxable year preceding the first taxable year beginning after December 31, 1983, and the term "reinsured" refers to the taxpayer to which such reserves are ultimately transferred upon termination.

(c) ELECTION NOT TO HAVE RESERVES RECOMPUTED.—

(1) IN GENERAL.—If a qualified life insurance company makes an election under this paragraph—

(A) subsection (a) shall not apply to such company, and

(B) as of the beginning of the first taxable year beginning after December 31, 1983, and thereafter, the reserve for any contract issued before the first day of such taxable year by such company shall be the statutory reserve for such contract (within the meaning of section 809(b)(4)(B)(i) of the Internal Revenue Code of 1954).

(2) ELECTION WITH RESPECT TO CONTRACTS ISSUED AFTER 1983 AND BEFORE 1989.—

(A) IN GENERAL.—If—

(i) a qualified life insurance company makes an election under paragraph (1), and

(ii) the tentative LICTI (within the meaning of section 806(c) of such Code) of such company for its first taxable year beginning after December 31, 1983, does not exceed $3,000,000,

such company may elect under this paragraph to have the reserve for any contract issued on or after the first day of such first taxable year and before January 1, 1989, be equal to the statutory reserve for such contract, adjusted as provided in subparagraph (B).

(B) ADJUSTMENT TO RESERVES.—If this paragraph applies to any contract, the statutory reserves for such contract shall be adjusted as provided under section 805(c)(1) of such Code (as in effect for taxable years beginning in 1982 and 1983), except that section 805(c)(1)(B)(ii) of such Code (as so in effect) shall be applied by substituting—

(i) the prevailing State assumed interest rate (within the meaning of section 807(c)(4) of such Code), for

(ii) the adjusted reserves rate.

(3) QUALIFIED LIFE INSURANCE COMPANY.—For purposes of this subsection, the term "qualified life insurance company" means any life insurance company which, as of December 31, 1983, had assets of less than $100,000,000 (determined in the same manner as under section 806(b)(3) of such Code).

(4) SPECIAL RULES FOR CONTROLLED GROUPS.—For purposes of applying the dollar limitations of paragraphs (2) and (3), rules similar to the rules of section 806(d) of such Code shall apply.

(5) ELECTIONS.—Any election under paragraph (1) or (2)—

(A) shall be made at such time and in such manner as the Secretary of the Treasury may prescribe, and

(B) once made, shall be irrevocable.

SEC. 217. OTHER SPECIAL RULES.

(a) NEW SECTION 814 TREATED AS CONTINUATION OF SECTION 819A.—For purposes of section 814 of the Internal Revenue Code of 1954 (relating to contiguous country branches of domestic life insurance companies)—

(1) any election under section 819A of such Code (as in effect on the day before the date of the enactment of this Act) shall be treated as an election under such section 814, and

(2) any reference to a provision of such section 814 shall be treated as including a reference to the corresponding provision of such section 819A.

(b) TREATMENT OF ELECTIONS UNDER SECTION 453B(e)(2).—If an election is made under section 453B(e)(2) before January 1, 1984, with respect to any installment obligation, any income from such obligation shall be treated as attributable to a noninsurance business (as defined in section 806(c)(3) of the Internal Revenue Code of 1954).

(c) DETERMINATION OF TENTATIVE LICTI WHERE CORPORATION MADE CERTAIN ACQUISITIONS IN 1980, 1981, 1982, AND 1983.—If—

(1) a corporation domiciled or having its principal place of business in Alabama, Arkansas, Oklahoma, or Texas acquired the assets of 1 or more insurance companies after 1979 and before April 1, 1983, and

(2) the bases of such assets in the hands of the corporation were determined under section 334(b)(2) of the Internal Revenue Code of 1954 or such corporation made an election under section 338 of such Code with respect to such assets,

then the tentative LICTI of the corporation holding such assets for taxable years beginning after December 31, 1983, shall, for purposes of determining the amount of the special deductions under section 806 of such Code, be increased by the deduction allowable under chapter 1 of such Code for the amortization of the cost of insurance contracts acquired in such asset acquisition (and any portion of any operations loss deduction attributable to such amortization).

(d) EFFECTIVE DATE FOR NEW SECTION 845.—

(1) Subsection (a) of section 845 of the Internal Revenue Code of 1954 (as added by this title) shall apply with respect to any risk reinsured on or after September 27, 1983.

(2) Subsection (b) of section 845 of such Code (as so added) shall apply with respect to risks reinsured after December 31, 1984.

(e) TREATMENT OF CERTAIN COMPANIES OPERATING BOTH AS STOCK AND MUTUAL COMPANY.—If, during the 10-year period ending on December 31, 1983, a company has, as authorized by the law of the State in which the company is domiciled, been operating as a mutual life insurance company with shareholders, such company shall be treated as a stock life insurance company.

(f) TREATMENT OF CERTAIN ASSESSMENT LIFE INSURANCE COMPANIES.—

(1) MORTALITY AND MORBIDITY TABLES.—In the case of a contract issued by an assessment life insurance company, the mortality and morbidity tables used in computing statutory reserves for such contract shall be used for purposes of paragraph (2)(C) of section 807(d) of the Internal Revenue Code of 1954 (as amended by this subtitle) if such tables were—

(A) in use since 1965, and

(B) developed on the basis of the experience of assessment life insurance companies in the State in which such assessment life insurance company is domiciled.

(2) TREATMENT OF CERTAIN MUTUAL ASSESSMENT LIFE INSURANCE COMPANIES.—In the case of any contract issued by a mutual assessment life insurance company which—

(A) has been in existence since 1965, and

(B) operates under chapter 13 or 14 of the Texas Insurance Code,

for purposes of part I of subchapter L of chapter 1 of the Internal Revenue Code of 1954, the amount of the life insurance reserves for such contract shall be equal to the amount taken into account with respect to such contract in determining statutory reserves.

(3) STATUTORY RESERVES.—For purposes of this subsection, the term "statutory reserves" has the meaning given to such term by section 809(b)(4)(B) of such Code.

(g) TREATMENT OF REINSURANCE AGREEMENTS REQUIRED BY NAIC.—Effective for taxable years beginning after December 31, [illegible], and before January 1, 1984, subsections (c)(1)(F) and (d)(12) of section 809 of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act) shall not apply to dividends to policyholders reimbursed to the taxpayer by a reinsurer in respect of accident and health policies reinsured under a reinsurance agreement entered into before June 30, 1955, pursuant to the

direction of the National Association of Insurance Commissioners and approved by the State insurance commissioner of the taxpayer's State of domicile. For purposes of subchapter L of chapter 1 of such Code (as in effect on the day before the date of the enactment of this Act) any such dividends shall be treated as dividends of the reinsurer and not the taxpayer.

(h) DETERMINATION OF ASSETS OF CONTROLLED GROUP FOR PURPOSES OF SMALL LIFE INSURANCE COMPANY DEDUCTION FOR 1984.—

(1) IN GENERAL.—For purposes of applying paragraph (2) of section 806(d) of the Internal Revenue Code of 1954 (relating to nonlife insurance members included for asset test) for the first taxable year beginning after December 31, 1983, the members of the controlled group referred to in such paragraph shall be treated as including only those members of such group which are described in paragraph (2) of this subsection if—

(A) an election under section 1504(c)(2) of such Code is not in effect for the controlled group for such taxable year,

(B) during such taxable year, the controlled group does not include a member which is taxable under part I of subchapter L of chapter 1 of such Code and which became a member of such group after September 27, 1983, and

(C) the sum of the contributions to capital received by members of the controlled group which are taxable under such part I during such taxable year from the members of the controlled group which are not taxable under such part does not exceed the aggregate dividends paid during such taxable year by the members of such group which are taxable under such part I.

(2) MEMBERS OF GROUP TAKEN INTO ACCOUNT.—For purposes of paragraph (1), the members of the controlled group which are described in this paragraph are—

(A) any financial institution to which section 585 or 593 of such Code applies,

(B) any lending or finance business (as defined by section 542(d)),

(C) any insurance company subject to tax imposed by subchapter L of chapter 1 of such Code, and

(D) any securities broker.

SPECIAL ELECTION TO TREAT INDIVIDUAL NONCANCELLABLE ACCIDENT AND HEALTH CONTRACTS AS CANCELLABLE.—

(1) IN GENERAL.—A mutual life insurance company may elect to treat all individual noncancellable (or guaranteed renewable) accident and health insurance contracts as though they were cancellable for purposes of section 816 of subchapter L of chapter 1 of the Internal Revenue Code of 1954.

(2) EFFECT OF ELECTION ON SUBSIDIARIES OF ELECTING PARENT.—

(A) TREATED AS MUTUAL LIFE INSURANCE COMPANY.—Any stock life insurance company which is a member of an affiliated group which has a common parent which made an election under paragraph (1), for purposes of part I of subchapter L of the Internal Revenue Code of 1954, such stock life insurance company shall be treated as though it were a mutual life insurance company.

then the tentative LICTI of the corporation holding such assets for taxable years beginning after December 31, 1983, shall, for purposes of determining the amount of the special deductions under section 806 of such Code, be increased by the deduction allowable under chapter 1 of such Code for the amortization of the cost of insurance contracts acquired in such asset acquisition (and any portion of any operations loss deduction attributable to such amortization).

(d) EFFECTIVE DATE FOR NEW SECTION 845.—

(1) Subsection (a) of section 845 of the Internal Revenue Code of 1954 (as added by this title) shall apply with respect to any risk reinsured on or after September 27, 1983.

(2) Subsection (b) of section 845 of such Code (as so added) shall apply with respect to risks reinsured after December 31, 1984.

(e) TREATMENT OF CERTAIN COMPANIES OPERATING BOTH AS STOCK AND MUTUAL COMPANY.—If, during the 10-year period ending on December 31, 1983, a company has, as authorized by the law of the State in which the company is domiciled, been operating as a mutual life insurance company with shareholders, such company shall be treated as a stock life insurance company.

(f) TREATMENT OF CERTAIN ASSESSMENT LIFE INSURANCE COMPANIES.—

(1) MORTALITY AND MORBIDITY TABLES.—In the case of a contract issued by an assessment life insurance company, the mortality and morbidity tables used in computing statutory reserves for such contract shall be used for purposes of paragraph (2)(C) of section 807(d) of the Internal Revenue Code of 1954 (as amended by this subtitle) if such tables were—

(A) in use since 1965, and

(B) developed on the basis of the experience of assessment life insurance companies in the State in which such assessment life insurance company is domiciled.

(2) TREATMENT OF CERTAIN MUTUAL ASSESSMENT LIFE INSURANCE COMPANIES.—In the case of any contract issued by a mutual assessment life insurance company which—

(A) has been in existence since 1965, and

(B) operates under chapter 13 or 14 of the Texas Insurance Code,

for purposes of part I of subchapter L of chapter 1 of the Internal Revenue Code of 1954, the amount of the life insurance reserves for such contract shall be equal to the amount taken into account with respect to such contract in determining statutory reserves.

(3) STATUTORY RESERVES.—For purposes of this subsection, the term "statutory reserves" has the meaning given to such term by section 809(b)(4)(B) of such Code.

(g) TREATMENT OF REINSURANCE AGREEMENTS REQUIRED BY NAIC.—Effective for taxable years beginning after December 31, 1981, and before January 1, 1984, subsections (c)(1)(F) and (d)(12) of section 809 of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act) shall not apply to dividends to policyholders reimbursed to the taxpayer by a reinsurer in respect of accident and health policies reinsured under a reinsurance agreement entered into before June 30, 1955, pursuant to the

direction of the National Association of Insurance Commissioners and approved by the State insurance commissioner of the taxpayer's State of domicile. For purposes of subchapter L of chapter 1 of such Code (as in effect on the day before the date of the enactment of this Act) any such dividends shall be treated as dividends of the reinsurer and not the taxpayer.

(h) DETERMINATION OF ASSETS OF CONTROLLED GROUP FOR PURPOSES OF SMALL LIFE INSURANCE COMPANY DEDUCTION FOR 1984.—

(1) IN GENERAL.—For purposes of applying paragraph (2) of section 806(d) of the Internal Revenue Code of 1954 (relating to nonlife insurance members included for asset test) for the first taxable year beginning after December 31, 1983, the members of the controlled group referred to in such paragraph shall be treated as including only those members of such group which are described in paragraph (2) of this subsection if—

(A) an election under section 1504(c)(2) of such Code is not in effect for the controlled group for such taxable year,

(B) during such taxable year, the controlled group does not include a member which is taxable under part I of subchapter L of chapter 1 of such Code and which became a member of such group after September 27, 1983, and

(C) the sum of the contributions to capital received by members of the controlled group which are taxable under such part I during such taxable year from the members of the controlled group which are not taxable under such part does not exceed the aggregate dividends paid during such taxable year by the members of such group which are taxable under such part I.

(2) MEMBERS OF GROUP TAKEN INTO ACCOUNT.—For purposes of paragraph (1), the members of the controlled group which are described in this paragraph are—

(A) any financial institution to which section 585 or 593 of such Code applies,

(B) any lending or finance business (as defined by section 542(d)),

(C) any insurance company subject to tax imposed by subchapter L of chapter 1 of such Code, and

(D) any securities broker.

(i) SPECIAL ELECTION TO TREAT INDIVIDUAL NONCANCELLABLE ACCIDENT AND HEALTH CONTRACTS AS CANCELLABLE.—

(1) IN GENERAL.—A mutual life insurance company may elect to treat all individual noncancellable (or guaranteed renewable) accident and health insurance contracts as though they were cancellable for purposes of section 816 of subchapter L of chapter 1 of the Internal Revenue Code of 1954.

(2) EFFECT OF ELECTION ON SUBSIDIARIES OF ELECTING PARENT.—

(A) TREATED AS MUTUAL LIFE INSURANCE COMPANY.—Any stock life insurance company which is a member of an affiliated group which has a common parent which made an election under paragraph (1), for purposes of part I of subchapter L of the Internal Revenue Code of 1954, such stock life insurance company shall be treated as though it were a mutual life insurance company.

(B) INCOME OF ELECTING PARENT TAKEN INTO ACCOUNT IN DETERMINING SMALL LIFE INSURANCE COMPANY DEDUCTION OF ANY SUBSIDIARY.—*For purposes of determining the amount of the small life insurance company deduction of any controlled group which includes a mutual company which made an election under paragraph (1), the taxable income of such electing company shall be taken into account under section 806(b)(2) of the Internal Revenue Code of 1954 (relating to phase-out of small life insurance company deduction).*

(3) ELECTION.—*An election under paragraph (1) shall apply to the company's first taxable year beginning after December 31, 1983, and all taxable years thereafter.*

(4) TIME AND MANNER.—*An election under paragraph (1) shall be made—*

(A) on the return of the taxpayer for its first taxable year beginning after December 31, 1983, and

(B) in such manner as the Secretary of the Treasury or his delegate may prescribe.

(j) REDUCTION IN EQUITY BASE FOR MUTUAL SUCCESSOR OF FRATERNAL BENEFIT SOCIETY.—*In the case of any mutual life insurance company which—*

(1) is the successor to a fraternal benefit society, and

(2) which assumed the surplus of such fraternal benefit society in 1950 or in March of 1961,

for purposes of section 809 of the Internal Revenue Code of 1954 (as amended by this subtitle), the equity base of such mutual life insurance company shall be reduced by the amount of the surplus so assumed plus earnings thereon, (i) for taxable years before 1984, at a 7 percent interest rate, and (ii) for taxable years 1984 and following, at the average mutual earnings rate for such year.

(k) SPECIAL RULE FOR CERTAIN DEBT-FINANCED ACQUISITION OF STOCK.—*If—*

(1) a life insurance company owns the stock of another corporation through a partnership of which it is a partner,

(2) the stock of the corporation was acquired on January 14, 1981, and

(3) such stock was acquired by debt financing,

then, for purposes of determining the special deductions under section 806 of the Internal Revenue Code of 1954 (as amended by this subtitle), the amount of tentative LICTI of such life insurance company shall be computed without taking into account any income, gain, loss, or deduction attributable to the ownership of such stock.

(l) TREATMENT OF LOSSES FROM CERTAIN GUARANTEED INTEREST CONTRACTS.—

(1) IN GENERAL.—*For purposes of determining the amount of the special deductions under section 806 of the Internal Revenue Code of 1954 (as amended by this subtitle), for any taxable year beginning before January 1, 1988, the amount of tentative LICTI of any qualified life insurance company shall be computed without taking into account any income, gain, loss, or deduction attributable to a qualified GIC.*

(2) Qualified life insurance company.—For purposes of this subsection, the term "qualified life insurance company" means any life insurance company if—

(A) the accrual of discount less amortization of premium for bonds and short-term investments (as shown in the first footnote to Exhibit 3 of its 1983 annual statement for life insurance companies approved by the National Association of Insurance Commissioners (but excluding separate accounts) filed in its state of domicile) exceeds $72,000,000 but does not exceed $73,000,000, and

(B) such life insurance company makes an election under this subsection on its return for its first taxable year beginning after December 31, 1983.

(3) Qualified GIC.—The term "qualified GIC" means any group contract—

(A) which is issued before January 1, 1984,

(B) which specifies the contract maturity or renewal date,

(C) under which funds deposited by the contract holder plus interest guaranteed at the inception of the contract for the term of the contract and net of any specified expenses are paid as directed by the contract holder, and

(D) which is a pension plan contract (as defined in section 818(a) of the Internal Revenue Code of 1954).

(4) Scope of election.—An election under this subsection shall apply to all qualified GIC's of a qualified life insurance company. Any such election, once made, shall be irrevocable.

(5) Income on underlying assets taken into account.—In determining the amount of any income attributable to a qualified GIC, income on any asset attributable to such contract (as determined in the manner provided by the Secretary of the Treasury or his delegate) shall be taken into account.

(6) Limitation on tax benefit.—The amount of any reduction in tax for any taxable year by reason of this subsection for any qualified life insurance company (or controlled group within the meaning of section 806(d)(3) of the Internal Revenue Code of 1954) shall not exceed the applicable amount set forth in the following table:

In the case of taxable years beginning in:	*The reduction may not exceed:*
1984	*$4,500,000*
1985	*$4,500,000*
1986	*$3,000,000*
1987	*$2,000,000*

(m) Special Rule for Certain Interests in Oil and Gas Properties.—

(1) In general.—For purposes of section 806 of the Internal Revenue Code of 1954, the ownership by a qualified life insurance company of any undivided interest in operating mineral interests with respect to any oil or gas properties held on December 31, 1983, shall be treated as an insurance business.

(2) Qualified life insurance company.—For purposes of paragraph (1), the term "qualified life insurance company" means a mutual life insurance company which—

(A) was originally incorporated in March of 1857, and

(B) has a cost to such company (as of December 31, 1983) in the operating mineral interests described in paragraph (1) in excess of $250,000,000.

SEC. 218. UNDERPAYMENTS OF ESTIMATED TAX FOR 1984.

No addition to the tax shall be made under section 6655 of the Internal Revenue Code of 1954 (relating to failure by corporation to pay estimated tax) with respect to any underpayment of an installment required to be paid before the date of the enactment of this Act to the extent—

(1) such underpayment was created or increased by any provision of this subtitle, and

(2) such underpayment is paid in full on or before the last date prescribed for payment of the first installment of estimated tax required to be paid after the date of the enactment of this Act.

SEC. 219. CLARIFICATION OF APPLICATION OF SECTION 6001.

Nothing in any provision of law shall be construed to prevent the Secretary of the Treasury or his delegate from exercising his authority under section 6001 of the Internal Revenue Code of 1954 to require (from time to time) life insurance companies to provide such data with respect to taxable years beginning before January 1, 1984, as may be necessary to carry out the provisions of section 809 of such Code (as added by this title).

Subtitle B—Taxation of Life Insurance Products

SEC. 221. DEFINITION OF LIFE INSURANCE CONTRACT.

(a) GENERAL RULE.—Chapter 79 (relating to definitions) is amended by adding at the end thereof the following new section:

"SEC. 7702. LIFE INSURANCE CONTRACT DEFINED.

"(a) GENERAL RULE.—For purposes of this title, the term 'life insurance contract' means any contract which is a life insurance contract under the applicable law, but only if such contract—

"(1) meets the cash value accumulation test of subsection (b), or

"(2)(A) meets the guideline premium requirements of subsection (c), and

"(B) falls within the cash value corridor of subsection (d).

"(b) CASH VALUE ACCUMULATION TEST FOR SUBSECTION (a)(1).—

"(1) IN GENERAL.—A contract meets the cash value accumulation test of this subsection if, by the terms of the contract, the cash surrender value of such contract may not at any time exceed the net single premium which would have to be paid at such time to fund future benefits under the contract.

"(2) RULES FOR APPLYING PARAGRAPH (1).—Determinations under paragraph (1) shall be made—

"(A) on the basis of interest at the greater of an annual effective rate of 4 percent or the rate or rates guaranteed on issuance of the contract,

"(B) on the basis of the rules of subparagraph (B)(i) (and, in the case of qualified additional benefits, subparagraph (B)(ii)) of subsection (c)(3), and

"(C) by taking into account under subparagraphs (A) and (C) of subsection (e)(1) only current and future death benefits and qualified additional benefits.

"(c) GUIDELINE PREMIUM REQUIREMENTS.—For purposes of this section—

"(1) IN GENERAL.—A contract meets the guideline premium requirements of this subsection if the sum of the premiums paid under such contract does not at any time exceed the guideline premium limitation as of such time.

"(2) GUIDELINE PREMIUM LIMITATION.—The term 'guideline premium limitation' means, as of any date, the greater of—

"(A) the guideline single premium, or

"(B) the sum of the guideline level premiums to such date.

"(3) GUIDELINE SINGLE PREMIUM.—

"(A) IN GENERAL.—The term 'guideline single premium' means the premium at issue with respect to future benefits under the contract.

"(B) BASIS ON WHICH DETERMINATION IS MADE.—The determination under subparagraph (A) shall be based on—

"(i) the mortality charges specified in the contract (or, if none is specified, the mortality charges used in determining the statutory reserves for such contract),

"(ii) any charges (not taken into account under clause (i)) specified in the contract (the amount of any charge not so specified shall be treated as zero), and

"(iii) interest at the greater of an annual effective rate of 6 percent or the rate or rates guaranteed on issuance of the contract.

"(C) WHEN DETERMINATION MADE.—Except as provided in subsection (f)(7), the determination under subparagraph (A) shall be made as of the time the contract is issued.

"(4) GUIDELINE LEVEL PREMIUM.—The term 'guideline level premium' means the level annual amount, payable over a period not ending before the insured attains age 95, computed on the same basis as the guideline single premium, except that paragraph (3)(B)(iii) shall be applied by substituting '4 percent' for '6 percent'.

"(d) CASH VALUE CORRIDOR FOR PURPOSES OF SUBSECTION (a)(2)(B).—For purposes of this section—

"(1) IN GENERAL.—A contract falls within the cash value corridor of this subsection if the death benefit under the contract at any time is not less than the applicable percentage of the cash surrender value.

"(2) APPLICABLE PERCENTAGE.—

"In the case of an insured with an attained age of the beginning of the contract year of:		*The applicable percentage shall decrease by a ratable portion for each full year:*	
More than	*But not more than:*	*From:*	*to:*
0	*40*	*250*	*250*
40	*45*	*250*	*215*
45	*50*	*215*	*185*
50	*55*	*185*	*150*
55	*60*	*150*	*130*
60	*65*	*130*	*120*
65	*70*	*120*	*115*
70	*75*	*115*	*105*

"In the case of an insured with an attained age of the beginning of the contract year of: More than	But not more than:	The applicable percentage shall decrease by a ratable portion for each full year: From:	to:
75	90	105	105
90	95	105	100

"(e) COMPUTATIONAL RULES.—

"(1) IN GENERAL.—For purposes of this section—

"(A) the death benefit (and any qualified additional benefit) shall be deemed not to increase,

"(B) the maturity date, including the date on which any benefit described in subparagraph (C) is payable, shall be no earlier than the day on which the insured attains age 95, and no later than the day on which the insured attains age 100, and

"(C) the amount of any endowment benefit (or sum of endowment benefits, including any cash surrender value on the maturity date described in subparagraph (B)) shall be deemed not to exceed the least amount payable as a death benefit at any time under the contract.

"(2) LIMITED INCREASES IN DEATH BENEFIT PERMITTED.—Notwithstanding paragraph (1)(A)—

"(A) for purposes of computing the guideline level premium, an increase in the death benefit which is provided in the contract may be taken into account but only to the extent necessary to prevent a decrease in the excess of the death benefit over the cash surrender value of the contract, and

"(B) for purposes of the cash value accumulation test, the increase described in subparagraph (A) may be taken into account if the contract will meet such test at all times assuming that the net level reserve (determined as if level annual premiums were paid for the contract over a period not ending before the insured attains age 95) is substituted for the net single premium.

"(f) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) PREMIUMS PAID.—

"(A) IN GENERAL.—The term 'premiums paid' means the premiums paid under the contract less amounts (other than amounts includible in gross income) to which section 72(e) applies and less any other amounts received with respect to the contract which are specified in regulations.

"(B) TREATMENT OF CERTAIN PREMIUMS RETURNED TO POLICYHOLDER.—If, in order to comply with the requirements of subsection (a)(2)(A), any portion of any premium paid during any contract year is returned by the insurance company (with interest) within 60 days after the end of a contract year, the amount so returned (excluding interest) shall be deemed to reduce the sum of the premiums paid under the contract during such year.

"(C) INTEREST RETURNED INCLUDIBLE IN GROSS INCOME.—Notwithstanding the provisions of section 72(e), the amount of any interest returned as provided in subparagraph (B) shall be includible in the gross income of the recipient.

"(2) CASH VALUES.—

"(A) Cash surrender value.—The cash surrender value of any contract shall be its cash value determined without regard to any surrender charge, policy loan, or reasonable termination dividends.

"(B) Net surrender value.—The net surrender value of any contract shall be determined with regard to surrender charges but without regard to any policy loan.

"(3) Death benefit.—The term 'death benefit' means the amount payable by reason of the death of the insured (determined without regard to any qualified additional benefits).

"(4) Future benefits.—The term 'future benefits' means death benefits and endowment benefits.

"(5) Qualified additional benefits.—

"(A) In general.—The term 'qualified additional benefits' means any—

"(i) guaranteed insurability,

"(ii) accidental death or disability benefit,

"(iii) family term coverage,

"(iv) disability waiver benefit, or

"(v) other benefit prescribed under regulations.

"(B) Treatment of qualified additional benefits.—For purposes of this section, qualified additional benefits shall not be treated as future benefits under the contract, but the charges for such benefits shall be treated as future benefits.

"(C) Treatment of other additional benefits.—In the case of any additional benefit which is not a qualified additional benefit—

"(i) such benefit shall not be treated as a future benefit, and

"(ii) any charge for such benefit which is not prefunded shall not be treated as a premium.

"(6) Premium payments not disqualifying contract.—The payment of a premium which would result in the sum of the premiums paid exceeding the guideline premium limitation shall be disregarded for purposes of subsection (a)(2) if the amount of such premium does not exceed the amount necessary to prevent the termination of the contract on or before the end of the contract year (but only if the contract will have no cash surrender value at the end of such extension period).

"(7) Adjustments.—

"(A) In general.—In the event of a change in the future benefits or any qualified additional benefit (or in any other terms) under the contract which was not reflected in any previous determination made under this section, under regulations prescribed by the Secretary, there shall be proper adjustments in future determinations made under this section.

"(B) Certain changes treated as exchange.—In the case of any change which reduces the future benefits under the contract, such change shall be treated as an exchange of the contract for another contract.

"(8) Correction of errors.—If the taxpayer establishes to the satisfaction of the Secretary that—

"(A) the requirements described in subsection (a) for any contract year were not satisfied due to reasonable error, and

"(B) reasonable steps are being taken to remedy the error, the Secretary may waive the failure to satisfy such requirements.

"(9) SPECIAL RULE FOR VARIABLE LIFE INSURANCE CONTRACTS.—In the case of any contract which is a variable contract (as defined in section 817), the determination of whether such contract meets the requirements of subsection (a) shall be made whenever the death benefits under such contract change but not less frequently than once during each 12-month period.

"(g) TREATMENT OF CONTRACTS WHICH DO NOT MEET SUBSECTION (a) TEST.—

"(1) INCOME INCLUSION.—

"(A) IN GENERAL.—If at any time any contract which is a life insurance contract under the applicable law does not meet the definition of life insurance contract under subsection (a), the income on the contract for any taxable year of the policyholder shall be treated as ordinary income received or accrued by the policyholder during such year.

"(B) INCOME ON THE CONTRACT.—For purposes of this paragraph, the term 'income on the contract' means, with respect to any taxable year of the policyholder, the excess of—

"(i) the sum of—

"(I) the increase in the net surrender value of the contract during the taxable year, and

"(II) the cost of life insurance protection provided under the contract during the taxable year, over

"(ii) the amount of premiums paid under the contract during the taxable year reduced by any policyholder dividends received during such taxable year.

"(C) CONTRACTS WHICH CEASE TO MEET DEFINITION.—If, during any taxable year of the policyholder, a contract which is a life insurance contract under the applicable law ceases to meet the definition of life insurance contract under subsection (a), the income on the contract for all prior taxable years shall be treated as received or accrued during the taxable year in which such cessation occurs.

"(D) COST OF LIFE INSURANCE PROTECTION.—For purposes of this paragraph, the cost of life insurance protection provided under the contract shall be the lesser of—

"(i) the cost of individual insurance on the life of the insured as determined on the basis of uniform premiums (computed on the basis of 5-year age brackets) prescribed by the Secretary by regulations, or

"(ii) the mortality charge (if any) stated in the contract.

"(2) TREATMENT OF AMOUNT PAID ON DEATH OF INSURED.—If any contract which is a life insurance contract under the applicable law does not meet the definition of life insurance contract under subsection (a), the excess of the amount paid by the reason of the death of the insured over the net surrender value

of the contract shall be deemed to be paid under a life insurance contract for purposes of section 101 and subtitle B.

"(3) CONTRACT CONTINUES TO BE TREATED AS INSURANCE CONTRACT.—If any contract which is a life insurance contract under the applicable law does not meet the definition of life insurance contract under subsection (a), such contract shall, notwithstanding such failure, be treated as an insurance contract for purposes of this title.

"(h) ENDOWMENT CONTRACTS RECEIVE SAME TREATMENT.—

"(1) IN GENERAL.—References in subsections (a) and (g) to a life insurance contract shall be treated as including references to a contract which is an endowment contract under the applicable law.

"(2) DEFINITION OF ENDOWMENT CONTRACT.—For purposes of this title (other than paragraph (1)), the term 'endowment contract' means a contract which is an endowment contract under the applicable law and which meets the requirements of subsection (a).

"(i) TRANSITIONAL RULE FOR CERTAIN 20-PAY CONTRACTS.—

"(1) IN GENERAL.—In the case of a qualified 20-pay contract, this section shall be applied by substituting '3 percent' for '4 percent' in subsection (b)(2).

"(2) QUALIFIED 20-PAY CONTRACT.—For purposes of paragraph (1), the term 'qualified 20-pay contract' means any contract which—

"(A) requires at least 20 nondecreasing annual premium payments, and

"(B) is issued pursuant to an existing plan of insurance.

"(3) EXISTING PLAN OF INSURANCE.—For purposes of this subsection, the term 'existing plan of insurance' means, with respect to any contract, any plan of insurance which was filed by the company issuing such contract in 1 or more States before September 28, 1983, and is on file in the appropriate State for such contract.

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

(b) 1-YEAR EXTENSION OF FLEXIBLE PREMIUM CONTRACT PROVISIONS.—

(1) IN GENERAL.—Paragraph (1) of section 266(c) of the Tax Equity and Fiscal Responsibility Act of 1982 is amended by striking out "January 1, 1984" and inserting in lieu thereof "January 1, 1985".

(2) TECHNICAL AMENDMENTS.—

(A) Paragraph (1) of section 101(f) is amended by striking out "flexible premium life insurance contract" and inserting in lieu thereof "flexible premium life insurance contract issued before January 1, 1985".

(B) The subsection heading of subsection (f) of section 101 is amended by striking out "FLEXIBLE PREMIUM CONTRACTS" and inserting in lieu thereof "FLEXIBLE PREMIUM CONTRACTS ISSUED BEFORE JANUARY 1, 1985".

(c) CLERICAL AMENDMENT.—The table of sections for chapter 79 is amended by adding at the end thereof the following new item:

"Sec. 7702. Life insurance contract defined.".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to contracts issued after December 31, 1984, in taxable years ending after such date.

(2) SPECIAL RULE FOR CERTAIN CONTRACTS ISSUED AFTER JUNE 30, 1984.—

(A) GENERAL RULE.—Except as otherwise provided in this paragraph, the amendments made by this section shall apply also to any contract issued after June 30, 1984, which provides an increasing death benefit and has premium funding more rapid that 10-year level premium payments.

(B) EXCEPTION FOR CERTAIN CONTRACTS.—Subparagraph (A) shall not apply to any contract if—

(i) such contract (whether or not a flexible premium contract) would meet the requirements of section 101(f) of the Internal Revenue Code of 1954,

(ii) such contract is not a flexible premium life insurance contract (within the meaning of section 101(f) of such Code) and would meet the requirements of section 7702 of such Code determined by—

(I) substituting "3 percent" for "4 percent" in section 7702(b)(2) of such Code, and

(II) treating subparagraph (B) of section 7702(e)(1) of such Code as if it read as follows: "the maturity date shall be the latest maturity date permitted under the contract, but not less than 20 years after the date of issue or (if earlier) age 95", or

(iii) under such contract—

(I) the premiums (including any policy fees) will be adjusted from time-to-time to reflect the level amount necessary (but not less than zero) at the time of such adjustment to provide a level death benefit assuming interest crediting and an annual effective interest rate of not less than 3 percent, or

(II) at the option of the insured, in lieu of an adjustment under subclause (I) there will be a comparable adjustment in the amount of the death benefit.

(C) CERTAIN CONTRACTS ISSUED BEFORE OCTOBER 1, 1984.—

(i) IN GENERAL.—Subparagraph (A) shall be applied by substituting "September 30, 1984" for "June 30, 1984" in clause (i) thereof in the case of a contract—

(I) which would meet the requirements of section 7702 of such Code if "3 percent" were substituted for "4 percent" in section 7702(b)(2) of such Code, and the rate or rates guaranteed on issuance of the contract were determined without regard to any mortality charges, and

(II) the cash surrender value of which does not at any time exceed the net single premium which would have to be paid at such time to fund future benefits under the contract.

(ii) DEFINITIONS.—For purposes of clause (i)—

(I) IN GENERAL.—Except as provided in subclause (II), terms used in clause (i) shall have the same meanings as when used in section 7702 of such Code.

(II) NET SINGLE PREMIUM.—The term "net single premium" shall be determined by substituting "3 percent" for "4 percent" in section 7702(b)(2) of such Code, by using the 1958 standard ordinary mortality and morbidity tables of the National Association of Insurance Commissioners, and by assuming a level death benefit.

(3) TRANSITIONAL RULE FOR CERTAIN EXISTING PLANS OF INSURANCE.—A plan of insurance on file in 1 or more States before September 28, 1983, shall be treated for purposes of section 7702(i)(3) of such Code as a plan of insurance on file in 1 or more States before September 28, 1983, without regard to whether such plan of insurance is modified after September 28, 1983, to permit the crediting of excess interest or similar amounts annually and not monthly under contracts issued pursuant to such plan of insurance.

(4) EXTENSION OF FLEXIBLE PREMIUM CONTRACT PROVISIONS.—The amendments made by subsection (b) shall take effect on January 1, 1984.

(5) SPECIAL RULE FOR MASTER CONTRACT.—For purposes of this subsection, in the case of a master contract, the date taken into account with respect to any insured shall be the first date on which such insured is covered under such contract.

(a) PENALTY ON PREMATURE DISTRIBUTIONS.—Paragraph (1) of section 72(q) (relating to 5-percent penalty for premature distributions from annuity contracts) is amended to read as follows:

"(1) IMPOSITION OF PENALTY.—If any taxpayer receives any amount under an annuity contract, the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 5 percent of the portion of such amount which is includible in gross income."

(b) REQUIRED DISTRIBUTIONS WHERE HOLDER DIES BEFORE ENTIRE INTEREST IS DISTRIBUTED.—Section 72 (relating to annuities; certain proceeds of endowment and life insurance contracts) is amended by redesignating subsection (s) and subsection (t) and by inserting after subsection (r) the following new subsection:

"(s) REQUIRED DISTRIBUTIONS WHERE HOLDER DIES BEFORE ENTIRE INTEREST IS DISTRIBUTED.—

"(1) IN GENERAL.—A contract shall not be treated as an annuity contract for purposes of this title unless it provides that—

"(A) if the holder of such contract dies on or after the annuity starting date and before the entire interest in such contract has been distributed, the remaining portion of such interest will be distributed at least as rapidly as

under the method of distributions being used as of the date of his death, and

"(B) if the holder of such contract dies before the annuity starting date, the entire interest in such contract will be distributed within 5 years after the death of such holder.

"(2) EXCEPTION FOR CERTAIN AMOUNTS PAYABLE OVER LIFE OF BENEFICIARY.—If—

"(A) any portion of the holder's interest is payable to (or for the benefit of) a designated beneficiary,

"(B) such portion will be distributed (in accordance with regulations) over the life of such designated beneficiary (or over a period not extending beyond the life expectancy of such beneficiary), and

"(C) such distributions begin not later than 1 year after the date of the holder's death or such later date as the Secretary may by regulations prescribe,

then for purposes of paragraph (1), the portion referred to in subparagraph (A) shall be treated as distributed on the day on which such distributions begin.

"(3) SPECIAL RULE WHERE SURVIVING SPOUSE BENEFICIARY.—If the designated beneficiary referred to in paragraph (2)(A) is the surviving spouse of the holder of the contract, paragraphs (1) and (2) shall be applied by treating such spouse as the holder of such contract.

"(4) DESIGNATED BENEFICIARY.—For purposes of this subsection, the term 'designated beneficiary' means any individual designated a beneficiary by the holder of the contract."

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to contracts issued after the day which is 6 months after the date of the enactment of this Act in taxable years ending after such date.

(2) TRANSITIONAL RULES FOR CONTRACTS ISSUED BEFORE EFFECTIVE DATE.—In the case of any contract (other than a single premium contract) which is issued on or before the day which is 6 months after the date of the enactment of this Act, for purposes of section 72(q)(1)(A) of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act), any investment in such contract which is made during any calendar year shall be treated as having been made on January 1 of such calendar year.

SEC. 223. GROUP-TERM LIFE INSURANCE PURCHASED FOR EMPLOYEES.

(a) SECTION 79 EXTENDED TO FORMER EMPLOYEES.—

(1) Section 79 (relating to group-term insurance purchased for employees) is amended by adding at the end thereof the following new subsection:

"(e) EMPLOYEE INCLUDES FORMER EMPLOYEE.—For purposes of this section, the term 'employee' includes a former employee."

(2) Paragraph (1) of section 79(b) is amended to read as follows:

"(1) the cost of group-term life insurance on the life of an individual which is provided under a policy carried directly or indirectly by an employer after such individual has terminated

his employment with such employer and is disabled (within the meaning of section 72(m)(7)),".

(b) AMOUNT OF INCLUSION IN CASE OF DISCRIMINATORY PLANS.—Paragraph (1) of section 79(d) (relating to nondiscrimination requirements) is amended to read as follows:

"(1) IN GENERAL.—In the case of a discriminatory group-term life insurance plan—

"(A) subsection (a)(1) shall not apply with respect to any key employee, and

"(B) the cost of group-term life insurance on the life of any key employee shall be determined without regard to subsection (c)."

(c) CLARIFICATION OF COORDINATION WITH SECTION 83.—Subsection (e) of section 83 (relating to application of section) is amended by striking out "or" at the end of paragraph (3), by striking out the period at the end of paragraph (4) and inserting in lieu thereof ", or", and by adding at the end thereof the following new paragraph:

"(5) the cost of group-term life insurance to which section 79 applies.".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 1983.

(2) INCLUSION OF FORMER EMPLOYEES IN THE CASE OF EXISTING GROUP-TERM INSURANCE PLANS.—

(A) IN GENERAL.—The amendments made by subsection (a) shall not apply—

(i) to any group-term life insurance plan of the employer in existence on January 1, 1984, or

(ii) to any group-term life insurance plan of the employer (or a successor employer) which is a comparable successor to a plan described in clause (i),

but only with respect to an individual who attained age 55 on or before January 1, 1984 and either was employed by such employer at any time during 1983 or retired from employment with such employer on or before January 1, 1984.

(B) SPECIAL RULE IN THE CASE OF DISCRIMINATORY GROUP-TERM LIFE INSURANCE PLAN.—In the case of any plan which, after December 31, 1986, is a discriminatory group-term life insurance plan (as defined in section 79(d) of the Internal Revenue Code of 1954), subparagraph (A) shall not apply in the case of any individual retiring under such plan after December 31, 1986.

(C) BENEFITS TO CERTAIN RETIRED INDIVIDUALS NOT TAKEN INTO ACCOUNT FOR PURPOSES OF DETERMINING WHETHER PLAN IS DISCRIMINATORY.—For purposes of determining whether after December 31, 1986, a plan described in subparagraph (A) meets the requirements of section 79(d) of the Internal Revenue Code of 1954 with respect to group-term life insurance for former employees, coverage provided to employees who retired on or before December 31, 1986, shall not be taken into account.

SEC. 224. TREATMENT OF CERTAIN EXCHANGES OF INSURANCE POLICIES.

(a) GENERAL RULE.—Paragraph (1) of section 1035(b) (defining endowment contract) is amended by striking out "a life insurance company as defined in section 801" and inserting in lieu thereof "an insurance company subject to tax under subchapter L".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to all exchanges whether before, on, or after the date of the enactment of this Act.

Subtitle C—Studies

SEC. 231. STUDIES.

(a) REVENUE REPORTS.—Not later than July 1, 1985, and July 1 of each calendar year thereafter, the Secretary of the Treasury shall submit to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate a report on—

(1) the aggregate amount of revenue received under part I of subchapter L of chapter 1 of the Internal Revenue Code of 1954 for the most recent taxable years for which data are available,

(2) a comparison between the amount of such revenue and the amount anticipated by reason of changes made by the Tax Equity and Fiscal Responsibility Act of 1982 or the Life Insurance Tax Act of 1984, and

(3) the reasons for any difference between such aggregate revenues and anticipated revenues.

(b) REPORT WITH RESPECT TO SEGMENT BALANCE, ETC.—

(1) IN GENERAL.—The Secretary of the Treasury (in consultation with the Joint Committee on Taxation, the Committee on Ways and Means of the House of Representatives, and the Committee on Finance of the Senate) shall conduct a full and complete study of the operation of part I of subchapter L of chapter 1 of the Internal Revenue Code of 1954 during 1984, 1985, and 1986. Such study shall also include an analysis of life insurance products and the taxation thereof. Such study shall also include an analysis of whether part I of such subchapter L operates as a disincentive to growing companies.

(2) ITEMS TO BE INCLUDED.—The study conducted under paragraph (1) shall include—

(A) an analysis of the portion of the taxes paid by mutual life insurance companies and stock life insurance companies, and

(B) any other data considered relevant by either stock life insurance companies or mutual life insurance companies in determining appropriate segment balance, such as the respective amounts of the following items held by each segment of the industry—

(i) equity,

(ii) life insurance reserves,

(iii) other types of reserves,

(iv) dividends paid to policyholders and shareholders,

(v) pension business,

(vi) total assets, and

(vii) gross receipts.

Such report shall also include an analysis of the extent to which taxes paid by stockholders of life insurance companies shall be included in analyzing segment balance.

(3) REPORTS.—

(A) INTERIM REPORTS.—The Secretary of the Treasury shall submit interim reports on the study conducted under this subsection to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate not later than July 1, 1986, 1987, and 1988.

(B) FINAL REPORT.—Not later than January 1, 1989, the Secretary of the Treasury shall submit a final report on the study conducted under this subsection to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate.

(c) AUTHORITY TO REQUIRE DATA.—The Secretary of the Treasury shall have authority to require reporting of such data with respect to life insurance companies and their products as may be necessary to carry out the purposes of this section.

TITLE III—REVISION OF PRIVATE FOUNDATION PROVISIONS

SEC. 301. LIMITATIONS ON DEDUCTION FOR CONTRIBUTIONS TO PRIVATE FOUNDATIONS.

(a) INCREASE IN PERCENTAGE LIMITATION FOR INDIVIDUALS.—

(1) IN GENERAL.—Clause (i) of section 170(b)(1)(B) (relating to percentage limitations for individuals) is amended by striking out "20 percent" and inserting in lieu thereof "30 percent".

(2) CARRYOVER OF EXCESS CONTRIBUTIONS.—Subparagraph (B) of section 170(b)(1) is amended by adding at the end thereof the following new sentence:

"If the aggregate of such contributions exceeds the limitation of the preceding sentence, such excess shall be treated (in a manner consistent with the rules of subsection (d)(1)) as a charitable contribution (to which subparagraph (A) does not apply) in each of the 5 succeeding taxable years in order of time."

(b) DEDUCTION ALLOWED FOR FULL FAIR MARKET VALUE OF CERTAIN STOCK CONTRIBUTED TO PRIVATE FOUNDATIONS.—Subsection (e) of section 170 (relating to certain contributions of ordinary income and capital gain property) is amended by adding at the end thereof the following new paragraph:

"(5) SPECIAL RULE FOR CONTRIBUTIONS OF STOCK FOR WHICH MARKET QUOTATIONS ARE READILY AVAILABLE.—

"(A) IN GENERAL.—Subparagraph (B)(ii) of paragraph (1) shall not apply to any contribution of qualified appreciated stock.

"(B) QUALIFIED APPRECIATED STOCK.—Except as provided in subparagraph (C), for purposes of this paragraph, the term 'qualified appreciated stock' means any stock of a corporation—

"(i) for which (as of the date of the contribution) market quotations are readily available on an established securities market, and

"(ii) which is capital gain property (as defined in subsection (b)(1)(C)(iv)).

"(C) DONOR MAY NOT CONTRIBUTE MORE THAN 10 PERCENT OF STOCK OF CORPORATION.—

"(i) IN GENERAL.—In the case of any donor, the term 'qualified appreciated stock' shall not include any stock of a corporation contributed by the donor in a contribution to which paragraph (1)(B)(ii) applies (determined without regard to this paragraph) to the extent that the amount of the stock so contributed (when increased by the aggregate amount of all prior such contributions by the donor of stock in such corporation) exceeds 10 percent (in value) of all of the outstanding stock of such corporation.

"(ii) SPECIAL RULE.—For purposes of clause (i), an individual shall be treated as making all contributions made by any member of his family (as defined in section 267(c)(4)).

"(D) TERMINATION.—This paragraph shall not apply to contributions made after December 31, 1994."

(c) 20-PERCENT LIMITATION RETAINED FOR CONTRIBUTIONS OF CAPITAL GAIN PROPERTY.—

(1) IN GENERAL.—Paragraph (1) of section 170(b) (relating to percentage limitations for individuals) is amended by redesignating subparagraphs (D) and (E) as subparagraphs (E) and (F), respectively, and by inserting after subparagraph (C) the following new subparagraph:

"(D) SPECIAL LIMITATION WITH RESPECT TO CONTRIBUTIONS OF CAPITAL GAIN PROPERTY TO ORGANIZATIONS NOT DESCRIBED IN SUBPARAGRAPH (A).—

"(i) IN GENERAL.—In the case of charitable contributions (other than charitable contributions to which subparagraph (A) applies) of capital gain property, the total amount of such contributions of such property taken into account under subsection (a) for any taxable year shall not exceed the lesser of—

"(I) 20 percent of the taxpayer's contribution base for the taxable year, or

"(II) the excess of 30 percent of the taxpayer's contribution base for the taxable year over the amount of the contributions of capital gain property to which subparagraph (C) applies.

For purposes of this subsection, contributions of capital gain property to which this subparagraph applies shall be taken into account after all other charitable contributions.

"(ii) CARRYOVER.—If the aggregate amount of contributions described in clause (i) exceeds the limitation of clause (i), such excess shall be treated (in a manner consistent with the rules of subsection (d)(1)) as a charitable contribution of capital gain property to which

clause (i) applies in each of the 5 succeeding taxable years in order of time."

(2) TECHNICAL AMENDMENTS.—

(A) Clause (vii) of section 170(b)(1)(A) is amended by striking out "subparagraph (D)" and inserting in lieu thereof "subparagraph (E)".

(B) The subparagraph heading and clause (i) of subparagraph (C) of section 170(b)(1) are amended to read as follows:

"(C) SPECIAL LIMITATION WITH RESPECT TO CONTRIBUTIONS DESCRIBED IN SUBPARAGRAPH (A) OF CERTAIN CAPITAL GAIN PROPERTY.—

"(i) In the case of charitable contributions described in subparagraph (A) of capital gain property to which subsection (e)(1)(B) does not apply, the total amount of contributions of such property which may be taken into account under subsection (a) for any taxable year shall not exceed 30 percent of the taxpayer's contribution base for such year. For purposes of this subsection, contributions of capital gain property to which this subparagraph applies shall be taken into account after all other charitable contributions (other than charitable contributions to which subparagraph (D) applies)."

(C) Subparagraph (B) of section 170(e)(1) is amended by striking out "subsection (b)(1)(D)" and inserting in lieu thereof "subsection (b)(1)(E)".

(d) EFFECTIVE DATES.—

(1) SUBSECTIONS (a) AND (c).—The amendments made by subsections (a) and (c) shall apply to contributions made in taxable years ending after the date of the enactment of this Act.

(2) SUBSECTION (b).—The amendment made by subsection (b) shall apply to contributions made after the date of the enactment of this Act in taxable years ending after such date.

SEC. 302. EXEMPTION FOR CERTAIN OPERATING FOUNDATIONS FROM EXCISE TAX ON INVESTMENT INCOME.

(a) GENERAL RULE.—Section 4940 (relating to excise tax based on investment income) is amended by adding at the end thereof the following new subsection:

"(d) EXEMPTION FOR CERTAIN OPERATING FOUNDATIONS.—

"(1) IN GENERAL.—No tax shall be imposed by this section on any private foundation which is an exempt operating foundation for the taxable year.

"(2) EXEMPT OPERATING FOUNDATION.—For purposes of this subsection, the term 'exempt operating foundation' means, with respect to any taxable year, any private foundation if—

"(A) such foundation is an operating foundation (as defined in section 4942(j)(3)),

"(B) such foundation has been publicly supported for at least 10 taxable years,

"(C) at all times during the taxable year, the governing body of such foundation—

"(i) consists of individuals at least 75 percent of whom are not disqualified individuals, and

"(ii) is broadly representative of the general public, and

"(D) at no time during the taxable year does such foundation have an officer who is a disqualified individual.

"(3) DEFINITIONS.—For purposes of this subsection—

"(A) PUBLICLY SUPPORTED.—A private foundation is publicly supported for a taxable year if it meets the requirements of section 170(b)(1)(A)(vi) or 509(a)(2) for such taxable year.

"(B) DISQUALIFIED INDIVIDUAL.—The term 'disqualified individual' means, with respect to any private foundation, an individual who is—

"(i) a substantial contributor to the foundation,

"(ii) an owner of more than 20 percent of—

"(I) the total combined voting power of a corporation,

"(II) the profits interest of a partnership, or

"(III) the beneficial interest of a trust or unincorporated enterprise,

which is a substantial contributor to the foundation, or

"(iii) a member of the family of any individual described in clause (i) or (ii).

"(C) SUBSTANTIAL CONTRIBUTOR.—The term 'substantial contributor' means a person who is described in section 507(d)(2).

"(D) FAMILY.—The term 'family' has the meaning given to such term by section 4946(d).

"(E) CONSTRUCTIVE OWNERSHIP.—The rules of paragraphs (3) and (4) of section 4946(a) shall apply for purposes of subparagraph (B)(ii)."

(b) REQUIREMENT OF EXPENDITURE RESPONSIBILITY NOT TO APPLY TO CERTAIN OPERATING FOUNDATIONS.—Paragraph (4) of section 4945(d) (defining taxable expenditure) is amended to read as follows:

"(4) as a grant to an organization unless—

"(A) such organization is described in paragraph (1), (2), or (3) of section 509(a) or is an exempt operating foundation (as defined in section 4940(d)(2)), or

"(B) the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h), or".

(c) EFFECTIVE DATE.—

(1) FOR SUBSECTION (a).—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1984.

(2) FOR SUBSECTION (b).—The amendment made by subsection (b) shall apply to grants made after December 31, 1984, in taxable years ending after such date.

(3) CERTAIN EXISTING FOUNDATIONS.—A foundation which was an operating foundation (as defined in section 4942(j)(3) of the Internal Revenue Code of 1954) as of January 1, 1983, shall be treated as meeting the requirements of section 4940(d)(2)(B) of such Code (as added by subsection (a)).

SEC. 303. REDUCTION IN EXCISE TAX ON INVESTMENT INCOME WHERE PRIVATE FOUNDATION MEETS CERTAIN DISTRIBUTION REQUIREMENTS.

(a) GENERAL RULE.—Section 4940 (relating to excise tax based on investment income) is amended by adding at the end thereof the following new subsection:

"(e) REDUCTION IN TAX WHERE PRIVATE FOUNDATION MEETS CERTAIN DISTRIBUTION REQUIREMENTS.—

"(1) IN GENERAL.—In the case of any private foundation which meets the requirements of paragraph (2) for any taxable year, subsection (a) shall be applied with respect to such taxable year by substituting '1 percent' for '2 percent'.

"(2) REQUIREMENTS.—A private foundation meets the requirements of this paragraph for any taxable year if—

"(A) the amount of the qualifying distributions made by the private foundation during such taxable year equals or exceeds the sum of—

"(i) an amount equal to the assets of such foundation for such taxable year multiplied by the average percentage payout for the base period, plus

"(ii) 1 percent of the net investment income of such foundation for such taxable year, and

"(B) the average percentage payout for the base period equals or exceeds 5 percent.

In the case of an operating foundation (as defined in section 4942(j)(3)), subparagraph (B) shall be applied by substituting '3⅓ percent' for '5 percent'.

"(3) AVERAGE PERCENTAGE PAYOUT FOR BASE PERIOD.—For purposes of this subsection—

"(A) IN GENERAL.—The average percentage payout for the base period is the average of the percentage payouts for taxable years in the base period.

"(B) PERCENTAGE PAYOUT.—The term 'percentage payout' means, with respect to any taxable year, the percentage determined by dividing—

"(i) the amount of the qualifying distributions made by the private foundation during the taxable year, by

"(ii) the assets of the private foundation for the taxable year.

"(C) SPECIAL RULE WHERE TAX REDUCED UNDER THIS SUBSECTION.—For purposes of this paragraph, if the amount of the tax imposed by this section for any taxable year in the base period is reduced by reason of this subsection, the amount of the qualifying distributions made by the private foundation during such year shall be reduced by the amount of such reduction in tax.

"(4) BASE PERIOD.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'base period' means, with respect to any taxable year, the 5 taxable years preceding such taxable year.

"(B) NEW PRIVATE FOUNDATIONS, ETC.—If an organization has not been a private foundation throughout the base period referred to in subparagraph (A), the base period

shall consist of the taxable years during which such foundation has been in existence.

"(5) OTHER DEFINITIONS.—For purposes of this subsection—

"(A) QUALIFYING DISTRIBUTION.—The term 'qualifying distribution' has the meaning given such term by section 4942(g).

"(B) ASSETS.—The assets of a private foundation for any taxable year shall be treated as equal to the excess determined under section 4942(e)(1).

"(6) TREATMENT OF SUCCESSOR ORGANIZATIONS, ETC.—In the case of—

"(A) a private foundation which is a successor to another private foundation, this subsection shall be applied with respect to such successor by taking into account the experience of such other foundation, and

"(B) a merger, reorganization, or division of a private foundation, this subsection shall be applied under regulations prescribed by the Secretary."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1984.

SEC. 304. AMENDMENT TO TAXES ON FAILURE TO DISTRIBUTE INCOME.

(a) LIMIT ON AMOUNT OF CERTAIN ADMINISTRATIVE EXPENSES TAKEN INTO ACCOUNT AS QUALIFYING DISTRIBUTIONS.—

(1) Subsection (g) of section 4942 (defining qualified distributions) is amended by adding at the end thereof the following new paragraph:

"(4) LIMITATION ON ADMINISTRATIVE EXPENSES ALLOCABLE TO MAKING OF CONTRIBUTIONS, GIFTS, AND GRANTS.—

"(A) IN GENERAL.—The amount of the grant administrative expenses paid during any taxable year which may be taken into account as qualifying distributions shall not exceed the excess (if any) of—

"(i) .65 percent of the sum of the net assets of the private foundation for such taxable year and the immediately preceding 2 taxable years, over

"(ii) the aggregate amount of grant administrative expenses paid during the 2 preceding taxable years which were taken into account as qualifying distributions.

"(B) GRANT ADMINISTRATIVE EXPENSES.—For purposes of this paragraph, the term 'grant administrative expenses' means any administrative expenses which are allocable to the making of qualified grants.

"(C) QUALIFIED GRANTS.—For purposes of this paragraph, the term 'qualified grant' means any contribution, gift, or grant which is a qualifying distribution.

"(D) NET ASSET.—For purposes of this paragraph, the term 'net assets' means, with respect to any taxable year, the excess determined under subsection (e)(1) for such taxable year.

"(E) TRANSITIONAL RULE.—In the case of any preceding taxable year which begins before January 1, 1985, the amount of the grant administrative expenses taken into ac-

count under subparagraph (A)(ii) shall not exceed .65 percent of the net assets of the private foundation for such taxable year.

"(F) TERMINATION.—This paragraph shall not apply to taxable years beginning after December 31, 1990."

(2) Subparagraph (A) of section 4942(g)(1) (defining qualifying distribution) is amended by striking out "including administrative expenses" and inserting in lieu thereof "including that portion of reasonable and necessary administrative expenses".

(b) REQUIRED DISTRIBUTION INCREASED BY AMOUNT OF CERTAIN REPAYMENTS, ETC.—Paragraph (1) of section 4942(d) (defining distributable amount) is amended to read as follows:

"(1) the sum of the minimum investment return plus the amounts described in subsection (f)(2)(C), reduced by".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1984.

SEC. 305. ABATEMENT OF FIRST TIER TAXES IN CERTAIN CASES.

(a) GENERAL RULE.—Subchapter C of chapter 42 (relating to abatement of second tier taxes) is amended by redesignating section 4962 as section 4963 and by inserting after section 4961 the following new section:

"SEC. 4962. ABATEMENT OF PRIVATE FOUNDATION FIRST TIER TAXES IN CERTAIN CASES.

"(a) GENERAL RULE.—If it is established to the satisfaction of the Secretary that—

"(1) a taxable event was due to reasonable cause and not to willful neglect, and

"(2) such event was corrected within the correction period for such event,

then any private foundation first tier tax imposed with respect to such event (including interest) shall not be assessed and, if assessed, the assessment shall be abated and, if collected, shall be credited or refunded as an overpayment.

"(b) PRIVATE FOUNDATION FIRST TIER TAX.—For purposes of this section, the term 'private foundation first tier tax' means any first tier tax imposed by subchapter A of chapter 42, except that such term shall not include the tax imposed by section 4941(a) (relating to initial tax on self-dealing)."

(b) CONFORMING AMENDMENTS.—

(1) The heading of subchapter C of chapter 42 is amended to read as follows:

"Subchapter C—Abatement of First and Second Tier Taxes in Certain Cases".

(2) The table of sections for subchapter C of chapter 42 is amended by striking out the item relating to section 4962 and inserting in lieu thereof the following:

"Sec. 4962. Abatement of private foundation first tier taxes in certain cases.

"Sec. 4963. Definitions."

(3) The table of subchapters for chapter 42 is amended by striking out the item relating to subchapter C and inserting in lieu thereof the following:

"SUBCHAPTER C. Abatement of first and second tier taxes in certain cases."

(4) Sections 4942(g)(2)(C), 6213(e), and 6503(g) are each amended by striking out "section 4962(e)" and inserting in lieu thereof "section 4963(e)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable events occurring after December 31, 1984.

SEC. 306. MISCELLANEOUS AMENDMENTS.

(a) DEFINITION OF FAMILY MEMBER.—Subsection (d) of section 4946 (defining members of family) is amended to read as follows:

"(d) MEMBERS OF FAMILY.—For purposes of subsection (a)(1), the family of any individual shall include only his spouse, ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren, and great grandchildren."

(b) REQUIREMENT THAT ANNUAL NOTICE INCLUDE TELEPHONE NUMBER OF THE PRIVATE FOUNDATION.—Subsection (d) of section 6104 (relating to public inspection of private foundations' annual returns) is amended by striking out "shall state the address of the private foundation's principal office" and inserting in lieu thereof "shall state the address and the telephone number of the private foundation's principal office".

(c) EFFECTIVE DATES.—The amendments made by this subsection shall take effect on January 1, 1985.

SEC. 307. 5-YEAR EXTENSION OF REQUIREMENT TO DISPOSE OF CERTAIN EXCESS HOLDINGS ATTRIBUTABLE TO LARGE GIFTS AND BEQUESTS.

(a) GENERAL RULE.—Subsection (c) of section 4943 (relating to taxes on excess business holdings) is amended by adding at the end thereof the following new paragraph:

"(7) 5-YEAR EXTENSION OF PERIOD TO DISPOSE OF CERTAIN LARGE GIFTS AND BEQUESTS.—The Secretary may extend for an additional 5-year period the period under paragraph (6) for disposing of excess business holdings in the case of an unusually large gift or bequest of diverse business holdings or holdings with complex corporate structures if—

"(A) the foundation establishes that—

"(i) diligent efforts to dispose of such holdings have been made within the initial 5-year period, and

"(ii) disposition within the initial 5-year period has not been possible (except at a price substantially below fair market value) by reason of such size and complexity or diversity of such holdings,

"(B) before the close of the initial 5-year period—

"(i) the private foundation submits to the Secretary a plan for disposing of all of the excess business holdings involved in the extension, and

"(ii) the private foundation submits the plan described in clause (i) to the Attorney General (or other appropriate State official) having administrative or supervisory authority or responsibility with respect to the foundation's disposition of the excess business holdings

involved and submits to the Secretary any response received by the private foundation from the Attorney General (or other appropriate State official) to such plan during such 5-year period, and

"(C) the Secretary determines that such plan can reasonably be expected to be carried out before the close of the extension period."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by subsection (a) shall apply to business holdings with respect to which the 5-year period described in section 4943(c)(6) of the Internal Revenue Code of 1954 ends on or after November 1, 1983.

(2) TRANSITIONAL RULE.—Any plan submitted to the Secretary of the Treasury or his delegate on or before the 60th day after the date of the enactment of this Act shall be treated as submitted before the close of the initial 5-year period referred to in section 4943(c)(7)(B) of the Internal Revenue Code of 1954 (as added by subsection (a)).

SEC. 308. DECREASES ATTRIBUTABLE TO STOCK ISSUANCES NOT TO REDUCE PERMITTED PERCENTAGE OF HOLDINGS WHERE DECREASE IS 2 PERCENT OR LESS.

(a) GENERAL RULE.—The second sentence of clause (ii) of section 4943(c)(4)(A) (relating to present holdings) is amended to read as follows:

"For purposes of the preceding sentence, any decrease in percentage holdings attributable to issuances of stock (or to issuances of stock coupled with redemptions of stock) shall be disregarded so long as—

"(I) the net percentage decrease disregarded under this sentence does not exceed 2 percent, and

"(II) the number of shares held by the foundation is not affected by any such issuance or redemption."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to increases and decreases occurring after the date of the enactment of this Act.

SEC. 309. AGGREGATION OF STOCK HOLDINGS OF PRIVATE FOUNDATION AND DISQUALIFIED PERSONS IN APPLYING 95 PERCENT OWNERSHIP TEST.

(a) GENERAL RULE.—Clause (i) of section 4943(c)(4)(B) (relating to present holdings) is amended by striking out "the private foundation has" and inserting in lieu thereof "the private foundation and all disqualified persons have".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect as if included in the amendment made by section 101(b) of the Tax Reform Act of 1969.

SEC. 310. 5-YEAR PERIOD TO DISPOSE OF EXCESS HOLDINGS RESULTING FROM CERTAIN ACQUISITIONS BY DISQUALIFIED PERSONS.

(a) GENERAL RULE.—Paragraph (6) of section 4943(c) (relating to 5-year period to dispose of gifts, bequests, etc.) is amended by adding at the end thereof the following new sentence:

"In any case where an acquisition by a disqualified person would result in a substitution under clause (i) or (ii) of subpara-

graph (D) of paragraph (4), the preceding sentence shall be applied with respect to such acquisition as if it did not contain the phrase 'or by a disqualified person' in the material preceding subparagraph (A).''

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to acquisitions after the date of the enactment of this Act.

SEC. 311. THE CONDUCTING OF CERTAIN GAMES OF CHANCE NOT TREATED AS UNRELATED TRADE OR BUSINESS.

(a) GENERAL RULE.—For purposes of section 513 of the Internal Revenue Code of 1954 (defining unrelated trade or business), the term "unrelated trade or business" does not include any trade or business which consists of conducting any game of chance if—

(1) such game of chance is conducted by a nonprofit organization,

(2) the conducting of such game by such organization does not violate any State or local law, and

(3) as of October 5, 1983—

(A) there was a State law in effect which permitted the conducting of such game of chance by such nonprofit organization, but

(B) the conducting of such game of chance by organizations which were not nonprofit organizations would have violated such law.

(b) EFFECTIVE DATE.—Subsection (a) shall apply to games of chance conducted after June 30, 1981, in taxable years ending after such date.

SEC. 312. TAX ON SELF-DEALING NOT TO APPLY TO CERTAIN STOCK PURCHASES.

(a) GENERAL RULE.—Section 4941 of the Internal Revenue Code of 1954 (relating to taxes on self-dealing) shall not apply to the purchase during 1978 of stock from a private foundation (and to any note issued in connection with such purchase) if—

(1) consideration for such purchase equaled or exceeded the fair market value of such stock,

(2) the purchaser of such stock did not make any contribution to such foundation at any time during the 5-year period ending on the date of such purchase,

(3) the aggregate contributions to such foundation by the purchaser before such date were less than $10,000 and less than 2 percent of the total contributions received by the foundation as of such date, and

(4) such purchase was pursuant to the settlement of litigation involving the purchaser.

(b) STATUTE OF LIMITATIONS.—If credit or refund of any overpayment of tax resulting from subsection (a) is prevented at any time before the close of the 1-year period beginning on the date of the enactment of this Act by the operation of any law or rule of law, refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefor is filed before the close of such 1-year period.

SEC. 313. PERSON CEASES TO BE SUBSTANTIAL CONTRIBUTOR AFTER 10 YEARS WITH NO CONNECTION TO FOUNDATION.

(a) GENERAL RULE.—Paragraph (2) of section 507(d) (defining substantial contributor) is amended by adding at the end thereof the following new subparagraph:

"(C) PERSON CEASES TO BE SUBSTANTIAL CONTRIBUTOR IN CERTAIN CASES.—

"(i) IN GENERAL.—A person shall cease to be treated as a substantial contributor with respect to any private foundation as of the close of any taxable year of such foundation if—

"(I) during the 10-year period ending at the close of such taxable year such person (and all related persons) have not made any contribution to such private foundation,

"(II) at no time during such 10-year period was such person (or any related person) a foundation manager of such private foundation, and

"(III) the aggregate contributions made by such person (and related persons) are determined by the Secretary to be insignificant when compared to the aggregate amount of contributions to such foundation by one other person.

For purposes of subclause (III), appreciation on contributions while held by the foundation shall be taken into account.

"(ii) RELATED PERSON.—For purposes of clause (i), the term 'related person' means, with respect to any person, any other person who would be a disqualified person (within the meaning of section 4946) by reason of his relationship to such person. In the case of a contributor which is a corporation, the term also includes any officer or director of such corporation."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1984.

SEC. 314. TECHNICAL AMENDMENTS.

(a) AMENDMENTS OF INTERNAL REVENUE CODE OF 1954.—

(1) Subparagraph (B) of section 4942(a)(2) (relating to taxes on failure to distribute income) is amended by striking out "subsection (j)(4)" and inserting in lieu thereof "subsection (j)(2)".

(2) Paragraph (1) of section 4942(f) (defining adjusted net income) is amended by striking out "subsection (d)" and inserting in lieu thereof "subsection (j)".

(3) Paragraph (3) of section 6603(n) (relating to special rule for chapter 42 and similar taxes) is amended by striking out "section 4942(g)(2)(B)(i)(II)" and inserting in lieu thereof "section 4942(g)(2)(B)(ii)".

(4) The amendments made by this subsection shall take effect on the date of the enactment of this Act.

(b) AMENDMENT OF 1969 TAX REFORM ACT.—

(1) Subparagraph (A) of section 101(l)(4) of the Tax Reform Act of 1969 is amended by striking out "by substituting '51 percent' for '50 percent' " and inserting in lieu thereof "as if it did

not contain the phrase ', but in no event shall the percentage so substituted be more than 50 percent' ".

(2) The amendment made by paragraph (1) shall apply as if included in section 101(l)(4) of the Tax Reform Act of 1969.

(c) EXCEPTION TO DEFINITION OF DISQUALIFIED PERSONS.—

(1) Subsection (d) of section 4943 (relating to definitions and special rules with respect to taxes on excess business holdings) is amended by adding at the end thereof the following new paragraph:

"(4) DISQUALIFIED PERSON.—The term 'disqualified person' (as defined in section 4946(a)) does not include a plan described in section 4975(e)(7) with respect to the holdings of a private foundation described in paragraph (4) and (5) of subsection (c).".

(2) The amendment made by paragraph (1) shall apply with respect to taxable years beginning after the date of the enactment of this Act.

TITLE IV—TAX SIMPLIFICATION

Subtitle A—Revision and Simplification of Estimated Income Tax for Individuals

SEC. 411. REVISION OF PENALTY FOR FAILURE TO PAY ESTIMATED INCOME TAX.

Section 6654 (relating to addition to the tax for failure by individual to pay estimated income tax) is amended to read as follows:

"SEC. 6654. FAILURE BY INDIVIDUAL TO PAY ESTIMATED INCOME TAX.

"(a) ADDITION TO THE TAX.—Except as otherwise provided in this section, in the case of any underpayment of estimated tax by an individual, there shall be added to the tax under chapter 1 and the tax under chapter 2 for the taxable year an amount determined by applying—

"(1) the applicable annual rate established under section 6621,

"(2) to the amount of the underpayment,

"(3) for the period of the underpayment.

"(b) AMOUNT OF UNDERPAYMENT; PERIOD OF UNDERPAYMENT.—For purposes of subsection (a)—

"(1) AMOUNT.—The amount of the underpayment shall be the excess of—

"(A) the required installment, over

"(B) the amount (if any) of the installment paid on or before the due date for the installment.

"(2) PERIOD OF UNDERPAYMENT.—The period of the underpayment shall run from the due date for the installment to whichever of the following dates is the earlier—

"(A) the 15th day of the 4th month following the close of the taxable year, or

"(B) with respect to any portion of the underpayment, the date on which such portion is paid.

"(3) ORDER OF CREDITING PAYMENTS.—For purposes of paragraph (2)(B), a payment of estimated tax shall be credited

against unpaid required installments in the order in which such installments are required to be paid.

"(c) NUMBER OF REQUIRED INSTALLMENTS; DUE DATES.—For purposes of this section—

"(1) PAYABLE IN 4 INSTALLMENTS.—There shall be 4 required installments for each taxable year.

"(2) TIME FOR PAYMENT OF INSTALLMENTS.—

"In the case of the following required installments:	The due date is:
1st	April 15
2nd	June 15
3rd	September 15
4th	January 15 of the following taxable year.

"(d) AMOUNT OF REQUIRED INSTALLMENTS.—For purposes of this section—

"(1) AMOUNT.—

"(A) IN GENERAL.—Except as provided in paragraph (2), the amount of any required installment shall be 25 percent of the required annual payment.

"(B) REQUIRED ANNUAL PAYMENT.—For purposes of subparagraph (A), the term 'required annual payment' means the lesser of—

"(i) 80 percent of the tax shown on the return for the taxable year (or, if no return is filed, 80 percent of the tax for such year), or

"(ii) 100 percent of the tax shown on the return of the individual for the preceding taxable year.

Clause (ii) shall not apply if the preceding taxable year was not a taxable year of 12 months or if the individual did not file a return for such preceding taxable year.

"(2) LOWER REQUIRED INSTALLMENT WHERE ANNUALIZED INCOME INSTALLMENT IS LESS THAN AMOUNT DETERMINED UNDER PARAGRAPH (1).—

"(A) IN GENERAL.—In the case of any required installment, if the individual establishes that the annualized income installment is less than the amount determined under paragraph (1)—

"(i) the amount of such required installment shall be the annualized income installment, and

"(ii) any reduction in a required installment resulting from the application of this subparagraph shall be recaptured by increasing the amount of the next required installment determined under paragraph (1) by the amount of such reduction (and by increasing subsequent required installments to the extent that the reduction has not previously been recaptured under this clause).

"(B) DETERMINATION OF ANNUALIZED INCOME INSTALLMENT.—In the case of any required installment, the annualized income installment is the excess (if any) of—

"(i) an amount equal to the applicable percentage of the tax for the taxable year computed by placing on an annualized basis the taxable income, alternative mini-

mum taxable income, and adjusted self-employment income for months in the taxable year ending before the due date for the installment, over

"(ii) the aggregate amount of any prior required installments for the taxable year.

"(C) SPECIAL RULES.—For purposes of this paragraph—

"(i) ANNUALIZATION.—The taxable income, alternative minimum taxable income, and adjusted self-employment income shall be placed on an annualized basis under regulations prescribed by the Secretary.

"(ii) APPLICABLE PERCENTAGE.—

"In the case of the following required installments:	*The applicable percentage is:*
1st	*20*
2nd	*40*
3rd	*60*
4th	*80*

"(iii) ADJUSTED SELF-EMPLOYMENT INCOME.—The term 'adjusted self-employment income' means self-employment income (as defined in section 1402(b)); except that section 1402(b) shall be applied by placing wages (within the meaning of section 1402(b)) for months in the taxable year ending before the due date for the installment on an annualized basis consistent with clause (i).

"(e) EXCEPTIONS.—

"(1) WHERE TAX IS SMALL AMOUNT.—No addition to tax shall be imposed under subsection (a) for any taxable year if the tax shown on the return for such taxable year (or, if no return is filed, the tax), reduced by the credit allowable under section 31, is less than $500.

"(2) WHERE NO TAX LIABILITY FOR PRECEDING TAXABLE YEAR.—No addition to tax shall be imposed under subsection (a) for any taxable year if—

"(A) the preceding taxable year was a taxable year of 12 months,

"(B) the individual did not have any liability for tax for the preceding taxable year, and

"(C) the individual was a citizen or resident of the United States throughout the preceding taxable year.

"(3) WAIVER IN CERTAIN CASES.—

"(A) IN GENERAL.—No addition to tax shall be imposed under subsection (a) with respect to any underpayment to the extent the Secretary determines that by reason of casualty, disaster, or other unusual circumstances the imposition of such addition to tax would be against equity and good conscience.

"(B) NEWLY RETIRED OR DISABLED INDIVIDUALS.—No addition to tax shall be imposed under subsection (a) with respect to any underpayment if the Secretary determines that—

"(i) the taxpayer—

"(I) retired after having attained age 62, or

"(II) became disabled,
in the taxable year for which estimated payments were required to be made or in the taxable year preceding such taxable year, and

"(ii) such underpayment was due to reasonable cause and not to willful neglect.

"(f) TAX COMPUTED AFTER APPLICATION OF CREDITS AGAINST TAX.—For purposes of this section, the term 'tax' means—

"(1) the tax imposed by chapter 1, plus

"(2) the tax imposed by chapter 2, minus

"(3) the sum of—

"(A) the credits against tax allowed by part IV of subchapter A of chapter 1, other than the credit against tax provided by section 31 (relating to tax withheld on wages), plus

"(B) to the extent allowed under regulations prescribed by the Secretary, any overpayment of the tax imposed by section 4986 (determined without regard to section 4995(a)(4)(B)).

"(g) APPLICATION OF SECTION IN CASE OF TAX WITHHELD ON WAGES.—

"(1) IN GENERAL.—For purposes of applying this section, the amount of the credit allowed under section 31 for the taxable year shall be deemed a payment of estimated tax, and an equal part of such amount shall be deemed paid on each due date for such taxable year, unless the taxpayer establishes the dates on which all amounts were actually withheld, in which case the amounts so withheld shall be deemed payments of estimated tax on the dates on which such amounts were actually withheld.

"(2) SEPARATE APPLICATION.—The taxpayer may apply paragraph (1) separately with respect to—

"(A) wage withholding, and

"(B) all other amounts withheld for which credit is allowed under section 31.

"(h) SPECIAL RULE WHERE RETURN FILED ON OR BEFORE JANUARY 31.—If, on or before January 31 of the following taxable year, the taxpayer files a return for the taxable year and pays in full the amount computed on the return as payable, then no addition to tax shall be imposed under subsection (a) with respect to any underpayment of the 4th required installment for the taxable year.

"(i) SPECIAL RULES FOR FARMERS AND FISHERMEN.—For purposes of this section—

"(1) IN GENERAL.—If an individual is a farmer or fisherman for any taxable year—

"(A) there shall be only 1 required installment for the taxable year,

"(B) the due date for such installment shall be January 15 of the following taxable year,

"(C) the amount of such installment shall be equal to the required annual payment (determined under subsection (d)(1)(B) by substituting '66⅔ percent' for '80 percent', and

"(D) subsection (h) shall be applied—

"(i) by substituting 'March 1' for 'January 31', and

"(ii) by treating the required installment described in subparagraph (A) of this paragraph as the 4th required installment.

"(2) FARMER OR FISHERMAN DEFINED.—An individual is a farmer or fisherman for any taxable year if—

"(A) the individual's gross income from farming or fishing (including oyster farming) for the taxable year is at least 66⅔ percent of the total gross income from all sources for the taxable year, or

"(B) such individual's gross income from farming or fishing (including oyster farming) shown on the return of the individual for the preceding taxable year is at least 66⅔ percent of the total gross income from all sources shown on such return.

"(j) FISCAL YEARS AND SHORT YEARS.—

"(1) FISCAL YEARS.—In applying this section to a taxable year beginning on any date other than January 1, there shall be substituted, for the months specified in this section, the months which correspond thereto.

"(2) SHORT TAXABLE YEAR.—This section shall be applied to taxable years of less than 12 months in accordance with regulations prescribed by the Secretary.

"(k) ESTATES AND TRUSTS.—This section shall not apply to any estate or trust.

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

SEC. 412. REPEAL OF REQUIREMENT OF DECLARATIONS, ETC.

(a) GENERAL RULE.—The following provisions are hereby repealed:

(1) Section 6015 (relating to declaration of estimated income tax by individuals).

(2) Section 6073 (relating to time for filing declarations of estimated income tax by individuals).

(3) Section 6153 (relating to installment payments of estimated income tax by individuals).

(b) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Subsection (g) of section 871 is amended by striking out paragraph (6) and by redesignating paragraphs (7) and (8) as paragraphs (6) and (7), respectively.

(2) Subsection (b) of section 1403 is amended by striking out paragraph (3).

(3) Paragraph (2) of section 6012(b) is amended by striking out "or section 6015(a)".

(4) Paragraph (1) of section 6020(b) is amended by striking out "(other than a declaration of estimated tax required under section 6015)".

(5) Paragraph (1) of section 6201(b) is amended to read as follows:

"(1) ESTIMATED INCOME TAX.—No unpaid amount of estimated income tax required to be paid under section 6154 or 6654 shall be assessed."

(6) Paragraph (5) of section 6362(e) is amended by striking out "and section 6015 and other provisions relating to declarations

of estimated income" and inserting in lieu thereof "and provisions relating to estimated income tax".

(7) Subsection (h) of section 6601 is amended to read as follows:

"(h) EXCEPTION AS TO ESTIMATED TAX.—This section shall not apply to any failure to pay any estimated tax required to be paid by section 6154 or 6654."

(8) Subsection (d) of section 6651 is amended to read as follows:

"(d) EXCEPTION FOR ESTIMATED TAX.—This section shall not apply to any failure to pay any estimated tax required to be paid by section 6154 or 6654."

(9) Section 7203 is amended by striking out "(other than a return required under the authority of section 6015)".

(10) Subsection (a) of section 7216 is amended—

(A) by striking out "or declarations or amended declarations of estimated tax under section 6015,", and

(B) by striking out "return or declaration" each place it appears and inserting in lieu thereof "return".

(11) Paragraph (34) of section 7701(a) is hereby repealed.

(c) CLERICAL AMENDMENTS.—

(1) The table of sections for subpart B of part II of subchapter A of chapter 61 is amended by striking out the item relating to section 6015.

(2) The table of sections for part V of subchapter A of chapter 61 is amended by striking out the item relating to section 6073.

(3) The table of sections for subchapter A of chapter 62 is amended by striking out the item relating to section 6153.

SEC. 413. CREDITING OF INCOME TAX OVERPAYMENT AGAINST ESTIMATED TAX LIABILITY.

The application of the Internal Revenue Code of 1954 with respect to the crediting of a prior year overpayment of income tax against the estimated tax shall be determined—

(1) without regard to Revenue Ruling 83-111 (and without regard to any other regulation, ruling, or decision reaching the same result as, or a result similar to, the result set forth in such Revenue Ruling); and

(2) with full regard to the rules (including Revenue Ruling 77-475) before Revenue Ruling 83-111.

SEC. 414. EFFECTIVE DATES.

(a) SECTIONS 411 AND 412.—

(1) IN GENERAL.—The amendments made by sections 411 and 412 shall apply with respect to taxable years beginning after December 31, 1984.

(2) WAIVER AUTHORITY.—The provisions of paragraph (3) of section 6654(e) of the Internal Revenue Code of 1954 (as amended by section 411) shall also apply with respect to underpayments for taxable years beginning in 1984.

(b) SECTION 413.—The provisions of section 413 shall take effect on January 1, 1984.

Subtitle B—Domestic Relations

SEC. 421. TREATMENT OF TRANSFERS OF PROPERTY BETWEEN SPOUSES OR INCIDENT TO DIVORCE.

(a) GENERAL RULE.—Part III of subchapter O of chapter 1 (relating to common nontaxable exchanges) is amended by adding at the end thereof the following new section:

"SEC. 1041. TRANSFERS OF PROPERTY BETWEEN SPOUSES OR INCIDENT TO DIVORCE.

"(a) GENERAL RULE.—No gain or loss shall be recognized on a transfer of property from an individual to (or in trust for the benefit of)—

"(1) a spouse, or

"(2) a former spouse, but only if the transfer is incident to the divorce.

"(b) TRANSFER TREATED AS GIFT; TRANSFEREE HAS TRANSFEROR'S BASIS.—In the case of any transfer of property described in subsection (a)—

"(1) for purposes of this subtitle, the property shall be treated as acquired by the transferee by gift, and

"(2) the basis of the transferee in the property shall be the adjusted basis of the transferor.

"(c) INCIDENT TO DIVORCE.—For purposes of subsection (a)(2), a transfer of property is incident to the divorce if such transfer—

"(1) occurs within 1 year after the date on which the marriage ceases, or

"(2) is related to the cessation of the marriage.

"(d) SPECIAL RULE WHERE SPOUSE IS NONRESIDENT ALIEN.—Paragraph (1) of subsection (a) shall not apply if the spouse of the individual making the transfer is a nonresident alien."

(b) TECHNICAL AMENDMENTS.—

(1) REPEAL OF SECTION 72(k).—Subsection (k) of section 72 (relating to payments in discharge of alimony) is hereby repealed.

(2) REPEAL OF SECTION 101(e).—Subsection (e) of section 101 (relating to alimony, etc., payments) is hereby repealed.

(3) COORDINATION WITH SECTION 453B.—Section 453B (relating to gain or loss on disposition of installment obligations) is amended by adding at the end thereof the following new subsection:

"(g) TRANSFERS BETWEEN SPOUSES OR INCIDENT TO DIVORCE.—In the case of any transfer described in subsection (a) of section 1041—

"(1) subsection (a) of this section shall not apply, and

"(2) the same tax treatment with respect to the transferred installment obligation shall apply to the transferee as would have applied to the transferor."

(4) TERM INTERESTS.—Paragraph (1) of section 1001(e) (relating to certain term interest) is amended by striking out "section 1014 or 1015" and inserting in lieu thereof "section 1014, 1015, or 1041".

(5) COORDINATION WITH SECTION 1015.—Section 1015 (relating to basis of property acquired by gifts and transfers in trust) is amended by adding at the end thereof the following new subsection:

"(e) GIFTS BETWEEN SPOUSES.—In the case of any property acquired by gift in a transfer described in section 1041(a), the basis of such property in the hands of the transferee shall be determined under section 1041(b)(2) and not this section."

(6) COORDINATION WITH SECTION 1239.—

(A) Subsection (b) of section 1239, as amended by this Act, is amended by striking out paragraph (1) and by redesignating paragraphs (2) and (3) as paragraphs (1) and (2), respectively.

(B) Subparagraph (C) of section 453(h)(1) (relating to special rule where obligor and shareholder are related persons) is amended by striking out "the obligor of any installment obligation and the shareholder are related persons" and inserting in lieu thereof "the obligor of any installment obligation and the shareholder are married to each other or are related persons".

(C) The subsection heading for section 453(g) is amended by striking out "SPOUSE OR".

(7) COORDINATION WITH SECTION 47.—Section 47 (relating to certain dispositions, etc., of section 38 property) is amended by adding at the end thereof the following new subsection:

"(e) TRANSFERS BETWEEN SPOUSES OR INCIDENT TO DIVORCE.—In the case of any transfer described in subsection (a) of section 1041—

"(1) subsection (a) of this section shall not apply, and

"(2) the same tax treatment under this section with respect to the transferred property shall apply to the transferee as would have applied to the transferor."

(c) CLERICAL AMENDMENT.—The table of sections for such part III is amended by adding at the end thereof the following:

"Sec. 1041. Transfers of property between spouses or incident to divorce."

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to transfers after the date of the enactment of this Act in taxable years ending after such date.

(2) ELECTION TO HAVE AMENDMENTS APPLY TO TRANSFERS AFTER 1983.—If both spouses or former spouses make an election under this paragraph, the amendments made by this section shall apply to all transfers made by such spouses (or former spouses) after December 31, 1983.

(3) EXCEPTION FOR TRANSFERS PURSUANT TO EXISTING DECREES.—Except in the case of an election under paragraph (2), the amendments made by this section shall not apply to transfers under any instrument in effect on or before the date of the enactment of this Act unless both spouses (or former spouses) elect to have such amendments apply to transfers under such instrument.

(4) ELECTION.—Any election under paragraph (2) or (3) shall be made in such manner, at such time, and subject to such conditions, as the Secretary of the Treasury or his delegate may by regulations prescribe.

SEC. 422. TAX TREATMENT OF ALIMONY AND SEPARATE MAINTENANCE PAYMENTS.

(a) GENERAL RULE.—Section 71 (relating to alimony and separate maintenance payments) is amended to read as follows:

"SEC. 71. ALIMONY AND SEPARATE MAINTENANCE PAYMENTS.

"(a) GENERAL RULE.—Gross income includes amounts received as alimony or separate maintenance payments.

"(b) ALIMONY OR SEPARATE MAINTENANCE PAYMENTS DEFINED.—For purposes of this section—

"(1) IN GENERAL.—The term 'alimony or separate maintenance payment' means any payment in cash if—

"(A) such payment is received by (or on behalf of) a spouse under a divorce or separation instrument,

"(B) the divorce or separation instrument does not designate such payment as a payment which is not includible in gross income under this section and not allowable as a deduction under section 215,

"(C) in the case of an individual legally separated from his spouse under a decree of divorce or of separate maintenance, the payee spouse and the payor spouse are not members of the same household at the time such payment is made, and

"(D) there is no liability to make any such payment for any period after the death of the payee spouse and there is no liability to make any payment (in cash or property) as a substitute for such payments after the death of the payee spouse (and the divorce or separation instrument states that there is no such liability).

"(2) DIVORCE OR SEPARATION INSTRUMENT.—The term 'divorce or separation instrument' means—

"(A) a decree of divorce or separate maintenance or a written instrument incident to such a decree,

"(B) a written separation agreement, or

"(C) a decree (not described in subparagraph (A)) requiring a spouse to make payments for the support or maintenance of the other spouse.

"(c) PAYMENTS TO SUPPORT CHILDREN.—

"(1) IN GENERAL.—Subsection (a) shall not apply to that part of any payment which the terms of the divorce or separation instrument fix (in terms of an amount of money or a part of the payment) as a sum which is payable for the support of children of the payor spouse.

"(2) TREATMENT OF CERTAIN REDUCTIONS RELATED TO CONTINGENCIES INVOLVING CHILD.—For purposes of paragraph (1), if any amount specified in the instrument will be reduced—

"(A) on the happening of a contingency specified in the instrument relating to a child (such as attaining a specified age, marrying, dying, leaving school, or a similar contingency), or

"(B) at a time which can clearly be associated with a contingency of a kind specified in paragraph (1),

an amount equal to the amount of such reduction will be treated as an amount fixed as payable for the support of children of the payor spouse.

"(3) SPECIAL RULE WHERE PAYMENT IS LESS THAN AMOUNT SPECIFIED IN INSTRUMENT.—For purposes of this subsection, if any payment is less than the amount specified in the instrument, then so much of such payment as does not exceed the sum payable for support shall be considered a payment for such support.

"(d) SPOUSE.—For purposes of this section, the term 'spouse' includes a former spouse.

"(e) EXCEPTION FOR JOINT RETURNS.—This section and section 215 shall not apply if the spouses make a joint return with each other.

"(f) SPECIAL RULES TO PREVENT EXCESS FRONT-LOADING OF ALIMONY PAYMENTS.—

"(1) REQUIREMENT THAT PAYMENTS BE FOR MORE THAN 6 YEARS.—Alimony or separate maintenance payments (in excess of $10,000 during any calendar year) paid by the payor spouse to the payee spouse shall not be treated as alimony or separate maintenance payments unless such payments are to be made by the payor spouse to the payee spouse in each of the 6 post-separation years (not taking into account any termination contingent on the death of either spouse or the remarriage of the payee spouse).

"(2) RECOMPUTATION WHERE PAYMENTS DECREASE BY MORE THAN $10,000.—If there is an excess amount determined under paragraph (3) for any computation year—

"(A) the payor spouse shall include such excess amount in gross income for the payor spouse's taxable year beginning in the computation year, and

"(B) the payee spouse shall be allowed a deduction in computing adjusted gross income for such excess amount for the payee spouse's taxable year beginning in the computation year.

"(3) DETERMINATION OF EXCESS AMOUNT.—The excess amount determined under this paragraph for any computation year is the sum of—

"(A) the excess (if any) of—

"(i) the amount of alimony or separate maintenance payments paid by the payor spouse during the immediately preceding post-separation year, over

"(ii) the amount of the alimony or separate maintenance payments paid by the payor spouse during the computation year increased by $10,000, plus

"(B) a like excess for each of the other preceding post-separation years.

In determining the amount of the alimony or separate maintenance payments paid by the payor spouse during any preceding post-separation year, the amount paid during such year shall be reduced by any excess previously determined in respect of such year under this paragraph.

"(4) DEFINITIONS.—For purposes of this subsection—

"(A) POST-SEPARATION YEAR.—The term 'post-separation year' means any calendar year in the 6 calendar year period beginning with the first calendar year in which the payor spouse paid to the payee spouse alimony or separate maintenance payments to which this section applies.

"(B) COMPUTATION YEAR.—The term 'computation year' means the post-separation year for which the excess under paragraph (3) is being determined.

"(5) EXCEPTIONS.—

"(A) WHERE PAYMENTS CEASE BY REASON OF DEATH OR REMARRIAGE.—Paragraph (2) shall not apply to any post-separation year (and subsequent post-separation years) if—

"(i) either spouse dies before the close of such post-separation year or the payee spouse remarries before the close of such post-separation year, and

"(ii) the alimony or separate maintenance payments cease by reason of such death or remarriage.

"(B) SUPPORT PAYMENTS.—For purposes of this subsection, the term 'alimony or separate maintenance payment' shall not include any payment received under a decree described in subsection (b)(2)(C).

"(C) FLUCTUATING PAYMENTS NOT WITHIN CONTROL OF PAYOR SPOUSE.—For purposes of this subsection, the term 'alimony or separate maintenance payment' shall not include any payment to the extent it is made pursuant to a continuing liability (over a period of not less than 6 years) to pay a fixed portion of the income from a business or property or from compensation for employment or self-employment.

(b) AMENDMENT OF SECTION 215.—Section 215 (relating to deduction for alimony, etc., payments) is amended to read as follows:

"SEC. 215. ALIMONY, ETC., PAYMENTS.

"(a) GENERAL RULE.—In the case of an individual, there shall be allowed as a deduction an amount equal to the alimony or separate maintenance payments paid during such individual's taxable year.

"(b) ALIMONY OR SEPARATE MAINTENANCE PAYMENTS DEFINED.—For purposes of this section, the term 'alimony or separate maintenance payment' means any alimony or separate maintenance payment (as defined in section 71(b)) which is includible in the gross income of the recipient under section 71.

"(c) REQUIREMENT OF IDENTIFICATION NUMBER.—The Secretary may prescribe regulations under which—

"(1) any individual receiving alimony or separate maintenance payments is required to furnish such individual's taxpayer identification number to the individual making such payments, and

"(2) the individual making such payments is required to include such taxpayer identification number on such individual's return for the taxable year in which such payments are made.

"(d) COORDINATION WITH SECTION 682.—No deduction shall be allowed under this section with respect to any payment if, by reason of section 682 (relating to income of alimony trusts), the amount thereof is not includible in such individual's gross income."

(c) PENALTY FOR FAILURE TO SUPPLY IDENTIFYING NUMBER.—Section 6676 (relating to failure to supply identifying number) is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) PENALTY FOR FAILURE TO SUPPLY IDENTIFYING NUMBER UNDER SECTION 215.—If any person who is required by regulations prescribed under section 215—

"(1) to furnish his taxpayer identification number to another person, or

"(2) to include on his return the taxpayer identification number of another person,

fails to comply with such requirement at the time prescribed by such regulations, such person shall, unless it is shown that such failure is due to reasonable cause and not to willful neglect, pay a penalty of $50 for each such failure."

(d) TECHNICAL AMENDMENTS.—

(1) Subparagraph (B) of section 219(b)(4) (relating to certain divorced individuals) is amended by striking out all that follows "gross income" and inserting in lieu thereof "under section 71 (relating to alimony and separate maintenance payments) by reason of a payment under a decree of divorce or separate maintenance or a written instrument incident to such a decree."

(2) Subsection (b) of section 682 (relating to income of an estate or trust in case of divorce, etc.) is amended—

(A) by striking out "or section 71", and

(B) by striking out the last sentence.

(3) Paragraph (17) of section 7701(a) (defining husband and wife) is amended by striking out "71, 152(b)(4), 215, and 682" and inserting in lieu thereof "152(b)(4) and 682".

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply with respect to divorce or separation instruments (as defined in section 71(b)(2) of the Internal Revenue Code of 1954, as amended by this section) executed after December 31, 1984.

(2) MODIFICATIONS OF INSTRUMENTS EXECUTED BEFORE JANUARY 1, 1985.—The amendments made by this section shall also apply to any divorce or separation instrument (as so defined) executed before January 1, 1985, but modified on or after such date if the modification expressly provides that the amendments made by this section shall apply to such modification.

(3) REQUIREMENT OF IDENTIFICATION NUMBER.—Section 215(c) of the Internal Revenue Code of 1954 (as amended by subsection (b)) and the amendments made by subsection (c) shall apply to payments made after December 31, 1984.

SEC. 423. DEPENDENCY EXEMPTION IN THE CASE OF CHILD OF DIVORCED PARENTS, ETC.

(a) GENERAL RULE.—Subsection (e) of section 152 (relating to support test in case of child of divorced parents, etc.) is amended to read as follows:

"(e) SUPPORT TEST IN CASE OF CHILD OF DIVORCED PARENTS, ETC.—

"(1) CUSTODIAL PARENT GETS EXEMPTION.—Except as otherwise provided in this subsection, if—

"(A) a child (as defined in section 151(e)(3)) receives over half of his support during the calendar year from his parents—

"(i) who are divorced or legally separated under a decree of divorce or separate maintenance,

"(ii) who are separated under a written separation agreement, or

"(iii) who live apart at all times during the last 6 months of the calendar year, and

"(B) such child is in the custody of one or both of his parents for more than one-half of the calendar year,

such child shall be treated, for purposes of subsection (a), as receiving over half of his support during the calendar year from the parent having custody for a greater portion of the calendar year (hereinafter in this subsection referred to as the 'custodial parent').

"(2) EXCEPTION WHERE CUSTODIAL PARENT RELEASES CLAIM TO EXEMPTION FOR THE YEAR.—A child of parents described in paragraph (1) shall be treated as having received over half of his support during a calendar year from the noncustodial parent if—

"(A) the custodial parent signs a written declaration (in such manner and form as the Secretary may by regulations prescribe) that such custodial parent will not claim such child as a dependent for any taxable year beginning in such calendar year, and

"(B) the noncustodial parent attaches such written declaration to the noncustodial parent's return for the taxable year beginning during such calendar year.

For purposes of this subsection, the term 'noncustodial parent' means the parent who is not the custodial parent.

"(3) EXCEPTION FOR MULTIPLE-SUPPORT AGREEMENT.—This subsection shall not apply in any case where over half of the support of the child is treated as having been received from a taxpayer under the provisions of subsection (c).

"(4) EXCEPTION FOR CERTAIN PRE-1985 INSTRUMENTS.—

"(A) IN GENERAL.—A child of parents described in paragraph (1) shall be treated as having received over half his support during a calendar year from the noncustodial parent if—

"(i) a qualified pre-1985 instrument between the parents applicable to the taxable year beginning in such calendar year provides that the noncustodial parent shall be entitled to any deduction allowable under section 151 for such child, and

"(ii) the noncustodial parent provides at least $600 for the support of such child during such calendar year.

For purposes of this subparagraph, amounts expended for the support of a child or children shall be treated as received from the noncustodial parent to the extent that such parent provided amounts for such support.

"(B) QUALIFIED PRE-1985 INSTRUMENT.—For purposes of this paragraph, the term 'qualified pre-1985 instrument' means any decree of divorce or separate maintenance or written agreement—

"(i) which is executed before January 1, 1985,

"(ii) which on such date contains the provision described in subparagraph (A)(i), and

"(iii) which is not modified on or after such date in a modification which expressly provides that this paragraph shall not apply to such decree or agreement.

"(5) SPECIAL RULE FOR SUPPORT RECEIVED FROM NEW SPOUSE OF PARENT.—For purposes of this subsection, in the case of the remarriage of a parent, support of a child received from the parent's spouse shall be treated as received from the parent.

"(6) CROSS REFERENCE.—

"For provision treating child as dependent of both parents for purposes of medical expense deduction, see section 213(d)(4)."

(b) TREATMENT AS DEPENDENT OF BOTH PARENTS FOR MEDICAL EXPENSE DEDUCTION.—

(1) Subsection (d) of section 213 (relating to definitions) is amended by redesignating paragraphs (4), (5), and (6) as paragraphs (5), (6), and (7), respectively, and by inserting after paragraph (3) the following new paragraph:

"(4) SPECIAL RULE IN THE CASE OF CHILD OF DIVORCED PARENTS, ETC.—Any child to whom section 152(e) applies shall be treated as a dependent of both parents for purposes of this section."

(2) Subsection (b) of section 105 is amended by adding at the end thereof the following new sentence: "Any child to whom section 152(e) applies shall be treated as a dependent of both parents for purposes of this subsection."

(3) Paragraph (6) of section 213(d) (as redesignated by paragraph (1)) is amended by striking out "the limitations of paragraph (4)" and inserting in lieu thereof "the limitations of paragraph (5)".

(c) TREATMENT OF CERTAIN MARRIED INDIVIDUALS LIVING APART.—

(1) Subsection (b) of section 143 (relating to certain married individuals living apart) is amended to read as follows:

"(b) CERTAIN MARRIED INDIVIDUALS LIVING APART.—For purposes of those provisions of this title which refer to this subsection, if—

"(1) an individual who is married (within the meaning of subsection (a)) and who files a separate return maintains as his home a household which constitutes for more than one-half of the taxable year the principal place of abode of a child (within the meaning of section 151(e)(3)) with respect to whom such individual is entitled to a deduction for the taxable year under section 151 (or would be so entitled but for paragraph (2) or (4) of section 152(e)),

"(2) such individual furnishes over one-half of the cost of maintaining such household during the taxable year, and

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

such individual shall not be considered as married."

(2) Subparagraph (A) of section 2(b)(1) (defining head of household) is amended—

(A) by striking out "which constitutes for such taxable year" and inserting in lieu thereof "which constitutes for more than one-half of such taxable year", and

(B) by striking out "under section 151" in clause (i) and inserting in lieu thereof "under section 151 (or would be so entitled but for paragraph (2) or (4) of section 152(e))".

(3) Paragraph (1) of section 43(c) (defining eligible individual) is amended—

(A) by inserting after "section 151(e)(3))" in subparagraph (A)(i) the following: "or would be so entitled but for paragraph (2) or (4) of section 152(e)", and

(B) by striking out "the child has the same principal place of abode as the individual" in subparagraph (B) and inserting in lieu thereof "the child has the same principal place of abode as the individual for more than one-half of the taxable year".

(4) Paragraph (5) of section 44A(f) (relating to special dependency test in case of divorced parents, etc.) is amended to read as follows:

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

"(A) paragraph (2) or (4) of section 152(e) applies to any child with respect to any calendar year, and

"(B) such child is under the age of 15 or is physically or mentally incapable of caring for himself,

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

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1984.

SEC. 424. INNOCENT SPOUSE RELIEVED OF LIABILITY IN CERTAIN CASES.

(a) GENERAL RULE.—Subsection (e) of section 6013 (relating to spouse relieved of liability in certain cases) is amended to read as follows:

"(e) SPOUSE RELIEVED OF LIABILITY IN CERTAIN CASES.—

"(1) IN GENERAL.—Under regulations prescribed by the Secretary, if—

"(A) a joint return has been made under this section for a taxable year,

"(B) on such return there is a substantial understatement of tax attributable to grossly erroneous items of one spouse,

"(C) the other spouse establishes that in signing the return he or she did not know, and had no reason to know, that there was such substantial understatement, and

"(D) taking into account all the facts and circumstances, it is inequitable to hold the other spouse liable for the deficiency in tax for such taxable year attributable to such substantial understatement,

then the other spouse shall be relieved of liability for tax (including interest, penalties, and other amounts) for such taxable year to the extent such liability is attributable to such substantial understatement.

"(2) GROSSLY ERRONEOUS ITEMS.—For purposes of this subsection, the term 'grossly erroneous items' means, with respect to any spouse—

"(A) any item of gross income attributable to such spouse which is omitted from gross income, and

"(B) any claim of a deduction, credit, or basis by such spouse in an amount for which there is no basis in fact or law.

"(3) SUBSTANTIAL UNDERSTATEMENT.—For purposes of this subsection, the term 'substantial understatement' means any understatement (as defined in section 6661(b)(2)(A)) which exceeds $500.

"(4) UNDERSTATEMENT MUST EXCEED SPECIFIED PERCENTAGE OF SPOUSE'S INCOME.—

"(A) ADJUSTED GROSS INCOME OF $20,000 OR LESS.—If the spouse's adjusted gross income for the preadjustment year is $20,000 or less, this subsection shall apply only if the liability described in paragraph (1) is greater than 10 percent of such adjusted gross income.

"(B) ADJUSTED GROSS INCOME OF MORE THAN $20,000.—If the spouse's adjusted gross income for the preadjustment year is more than $20,000, subparagraph (A) shall be applied by substituting '25 percent' for '10 percent'.

"(C) PREADJUSTMENT YEAR.—For purposes of this paragraph, the term 'preadjustment year' means the most recent taxable year of the spouse ending before the date the deficiency notice is mailed.

"(D) COMPUTATION OF SPOUSE'S ADJUSTED GROSS INCOME.—If the spouse is married to another spouse at the close of the preadjustment year, the spouse's adjusted gross income shall include the income of the new spouse (whether or not they file a joint return).

"(E) EXCEPTION FOR OMISSIONS FROM GROSS INCOME.—This paragraph shall not apply to any liability attributable to the omission of an item from gross income.

"(5) SPECIAL RULE FOR COMMUNITY PROPERTY INCOME.—For purposes of this subsection, the determination of the spouse to whom items of gross income (other than gross income from property) are attributable shall be made without regard to community property laws."

(b) TREATMENT OF COMMUNITY INCOME.—

(1) IN GENERAL.—Section 66 (relating to treatment of community income where spouses live apart) is amended by redesignating subsection (b) as subsection (d) and by inserting after subsection (a) the following new subsections:

"(b) SECRETARY MAY DISREGARD COMMUNITY PROPERTY LAWS WHERE SPOUSE NOT NOTIFIED OF COMMUNITY INCOME.— The Secretary may disallow the benefits of any community property law to any taxpayer with respect to any income if such taxpayer acted as if solely entitled to such income and failed to notify the taxpayer's

spouse before the due date (including extensions) for filing the return for the taxable year in which the income was derived of the nature and amount of such income.

"(c) SPOUSE RELIEVED OF LIABILITY IN CERTAIN OTHER CASES.—Under regulations prescribed by the Secretary, if—

"(1) an individual does not file a joint return for any taxable year,

"(2) such individual does not include in gross income for such taxable year an item of community income properly includible therein which, in accordance with the rules contained in section 879(a), would be treated as the income of the other spouse,

"(3) the individual establishes that he or she did not know of, and had no reason to know of, such item of community income, and

"(4) taking into account all facts and circumstances, it is inequitable to include such item of community income in such individual's gross income,

then, for purposes of this title, such item of community income shall be included in the gross income of the other spouse (and not in the gross income of the individual)."

(2) CLERICAL AMENDMENTS.—

*(A) The section heading of section 66 is amended by striking out "**WHERE SPOUSES LIVE APART**".*

(B) The subsection heading of subsection (a) of section 66 is amended by striking out "GENERAL RULE" and inserting in lieu thereof "TREATMENT OF COMMUNITY INCOME WHERE SPOUSES LIVE APART".

(C) The table of sections for part I of subchapter B of chapter 1 is amended by striking out "where spouses live apart" in the item relating to section 66.

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by subsections (a) and (b) shall apply to all taxable years to which the Internal Revenue Code of 1954 applies. Corresponding provisions shall be deemed to be included in the Internal Revenue Code of 1939 and shall apply to all taxable years to which such Code applies.

(2) AUTHORITY TO DISREGARD COMMUNITY PROPERTY LAWS.—Subsection (b) of section 66 of the Internal Revenue Code of 1954, as added by subsection (b), shall apply to taxable years beginning after December 31, 1984.

SEC. 425. TREATMENT OF CERTAIN PROPERTY SETTLEMENTS FOR PURPOSES OF ESTATE AND GIFT TAXES.

(a) DEDUCTION ALLOWED AGAINST ESTATE TAX FOR TRANSFERS SATISFYING SECTION 2516.—

(1) IN GENERAL.—Subsection (b) of section 2043 (relating to transfers for insufficient consideration) is amended to read as follows:

"(b) MARITAL RIGHTS NOT TREATED AS CONSIDERATION.—

"(1) IN GENERAL.—For purposes of this chapter, a relinquishment or promised relinquishment of dower or curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent's property or estate, shall not be

considered to any extent a consideration 'in money or money's worth'.

"(2) EXCEPTION.—For purposes of section 2053 (relating to expenses, indebtedness, and taxes), a transfer of property which satisfies the requirements of paragraph (1) of section 2516 (relating to certain property settlements) shall be considered to be made for an adequate and full consideration in money or money's worth."

(2) CROSS REFERENCE.—Subsection (e) of section 2053 (relating to deduction for expenses, indebtedness, and taxes) is amended to read as follows:

"(e) MARITAL RIGHTS.—

"For provisions treating certain relinquishments of marital rights as consideration in money or money's worth, see section 2043(b)(2)."

(b) SECTION 2516 EXTENDED TO AGREEMENTS ENTERED INTO WITHIN 1 YEAR AFTER DIVORCE.—Section 2516 (relating to certain property settlements) is amended by striking out so much of such section as precedes paragraph (1) thereof and inserting in lieu thereof the following:

"Where a husband and wife enter into a written agreement relative to their marital and property rights and divorce occurs within the 3-year period beginning on the date 1 year before such agreement is entered into (whether or not such agreement is approved by the divorce decree), any transfers of property or interests in property made pursuant to such agreement—".

(c) EFFECTIVE DATES.—

(1) SUBSECTION (a).—The amendments made by subsection (a) shall apply to estates of decedents dying after the date of the enactment of this Act.

(2) SUBSECTION (b).—The amendment made by subsection (b) shall apply to transfers after the date of the enactment of this Act.

SEC. 426. INCOME FROM SHELTERED WORKSHOPS NOT TAKEN INTO ACCOUNT IN DETERMINING DEPENDENCY EXEMPTION.

(a) IN GENERAL.—Subsection (e) of section 151 (relating to additional personal exemption for dependents) is amended by adding at the end thereof the following new paragraph:

"(5) CERTAIN INCOME OF HANDICAPPED DEPENDENTS NOT TAKEN INTO ACCOUNT.—

"(A) IN GENERAL.—For purposes of paragraph (1)(A), the gross income of an individual who is permanently and totally disabled shall not include income attributable to services performed by the individual at a sheltered workshop if—

"(i) the availability of medical care at such workshop is the principal reason for his presence there, and

"(ii) the income arises solely from activities at such workshop which are incident to such medical care.

"(B) SHELTERED WORKSHOP DEFINED.—For purposes of subparagraph (A), the term 'sheltered workshop' means a school—

"(i) which provides special instruction or training designed to alleviate the disability of the individual, and

"(ii) which is operated by—

"(I) an organization described in section 501(c)(3) and exempt from tax under section 501(a), or

"(II) a State, a possession of the United States, any political subdivision of any of the foregoing, the United States, or the District of Columbia.

"(C) PERMANENT AND TOTAL DISABILITY DEFINED.—An individual shall be treated as permanently and totally disabled for purposes of this paragraph if such individual would be so treated under paragraph (3) of section 37(e)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1984.

Subtitle C—Revision of At-Risk Rules

SEC. 431. REVISION OF INVESTMENT CREDIT AT-RISK RULES.

(a) IN GENERAL.—So much of paragraph (8) of section 46(c) (relating to limitation to amount at risk) as precedes subparagraph (F) thereof is amended to read as follows:

"(8) CERTAIN NONRECOURSE FINANCING EXCLUDED FROM CREDIT BASE.—

"(A) LIMITATION.—The credit base of any property to which this paragraph applies shall be reduced by the nonqualified nonrecourse financing with respect to such property (as of the close of the taxable year in which placed in service).

"(B) PROPERTY TO WHICH PARAGRAPH APPLIES.—This paragraph applies to any property which—

"(i) is placed in service during the taxable year by a taxpayer described in section 465(a)(1), and

"(ii) is used in connection with an activity with respect to which any loss is subject to limitation under section 465.

"(C) CREDIT BASE DEFINED.—For purposes of this paragraph, the term 'credit base' means—

"(i) in the case of new section 38 property, the basis of the property, or

"(ii) in the case of used section 38 property, the cost of such property.

"(D) NONQUALIFIED NONRECOURSE FINANCING.—

"(i) IN GENERAL.—For purposes of this paragraph and paragraph (9), the term 'nonqualified nonrecourse financing' means any nonrecourse financing which is not qualified commercial financing.

"(ii) QUALIFIED COMMERCIAL FINANCING.—For purposes of this paragraph, the term 'qualified commercial financing' means any financing with respect to any property if—

"(I) such property is acquired by the taxpayer from a person who is not a related person,

"(II) the amount of the nonrecourse financing with respect to such property does not exceed 80 percent of the credit base of such property, and

"(III) such financing is borrowed from a qualified person or represents a loan from any Federal, State, or local government or instrumentality thereof, or is guaranteed by any Federal, State, or local government.

Such term shall not include any convertible debt.

"(iii) NONRECOURSE FINANCING.—For purposes of this subparagraph, the term 'nonrecourse financing' includes—

"(I) any amount with respect to which the taxpayer is protected against loss through guarantees, stop-loss agreements, or other similar arrangements, and

"(II) except to the extent provided in regulations, any amount borrowed from a person who has an interest (other than as a creditor) in the activity in which the property is used or from a related person to a person (other than the taxpayer) having such an interest.

In the case of amounts borrowed by a corporation from a shareholder, subclause (II) shall not apply to an interest as a shareholder.

"(iv) QUALIFIED PERSON.—For purposes of this paragraph, the term 'qualified person' means any person which is actively and regularly engaged in the business of lending money and which is not—

"(I) a related person with respect to the taxpayer,

"(II) a person from which the taxpayer acquired the property (or a related person to such person), or

"(III) a person who receives a fee with respect to the taxpayer's investment in the property (or a related person to such person).

"(v) RELATED PERSON.—For purposes of clause (i), the term 'related person' has the meaning given such term by section 168(e)(4). Except as otherwise provided in regulations prescribed by the Secretary, the determination of whether a person is a related person shall be made as of the close of the taxable year in which the property is placed in service.

"(E) APPLICATION TO PARTNERSHIPS AND S CORPORATIONS.—For purposes of this paragraph and paragraph (9)—

"(i) IN GENERAL.—Except as otherwise provided in this subparagraph, in the case of any partnership or S corporation, the determination of whether a partner's or shareholder's allocable share of any financing is nonqualified nonrecourse financing shall be made at the partner or shareholder level.

"(ii) SPECIAL RULE FOR CERTAIN RECOURSE FINANCING OF S CORPORATION.—A shareholder of an S corporation shall be treated as liable for his allocable share of any financing provided by a qualified person to such corporation if—

"(I) such financing is recourse financing (determined at the corporate level), and

"(II) such financing is provided with respect to qualified business property of such corporation.

"(iii) QUALIFIED BUSINESS PROPERTY.—For purposes of clause (ii), the term 'qualified business property' means any property if—

"(I) such property is used by the corporation in the active conduct of a trade or business,

"(II) during the entire 12-month period ending on the last day of the taxable year, such corporation had at least 3 full-time employees who were not owner-employees (as defined in section 465(c)(7)(E)(i)) and substantially all the services of whom were services directly related to such trade or business, and

"(III) during the entire 12-month period ending on the last day of such taxable year, such corporation had at least 1 full-time employee substantially all of the services of whom were in the active management of the trade or business.

Such term shall not include any master sound recording or other tangible or intangible asset associated with literary, artistic, or musical properties.

"(iv) DETERMINATION OF ALLOCABLE SHARE.—The determination of any partner's or shareholder's allocable share of any financing shall be made in the same manner as the credit allowable by section 38 with respect to such property."

(b) TREATMENT OF SUBSEQUENT INCREASES AND DECREASES IN NONQUALIFIED NONRECOURSE FINANCING.—

(1) SUBSEQUENT DECREASES.—Paragraph (9) of section 46(c) (relating to subsequent increases in the taxpayer's amount at risk with respect to the property) is amended to read as follows:

"(9) SUBSEQUENT DECREASES IN NONQUALIFIED NONRECOURSE FINANCING WITH RESPECT TO THE PROPERTY.—

"(A) IN GENERAL.—If, at the close of a taxable year following the taxable year in which the property was placed in service, there is a net decrease in the amount of nonqualified nonrecourse financing with respect to such property, such net decrease shall be taken into account as additional qualified investment in such property in accordance with subparagraph (C).

"(B) CERTAIN TRANSACTIONS NOT TAKEN INTO ACCOUNT.—For purposes of this paragraph, nonqualified nonrecourse financing shall not be treated as decreased through the surrender or other use of property financed by nonqualified nonrecourse financing.

"(C) MANNER IN WHICH TAKEN INTO ACCOUNT.—

"(i) CREDIT DETERMINED BY REFERENCE TO TAXABLE YEAR PROPERTY PLACED IN SERVICE.—For purposes of determining the amount of credit allowable under section 38 and the amount of credit subject to the early disposition or cessation rules under section 47, any in-

crease in a taxpayer's qualified investment in property by reason of this paragraph shall be deemed to be additional qualified investment made by the taxpayer in the year in which the property referred to in subparagraph (A) was first placed in service.

"(ii) CREDIT ALLOWED FOR YEAR OF DECREASE IN NONQUALIFIED NONRECOURSE FINANCING.—Any credit allowable under this subpart for any increase in qualified investment by reason of this paragraph shall be treated as earned during the taxable year of the decrease in the amount of nonqualified nonrecourse financing."

(2) SUBSEQUENT INCREASES.—So much of subsection (d) of section 47 (relating to property ceasing to be at risk) as precedes paragraph (3) thereof is amended to read as follows:

"(d) INCREASES IN NONQUALIFIED NONRECOURSE FINANCING.—

"(1) IN GENERAL.—If, as of the close of the taxable year, there is a net increase with respect to the taxpayer in the amount of nonqualified nonrecourse financing (within the meaning of section 46(c)(8)) with respect to any property to which section 46(c)(8) applied, then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in credits allowed under section 38 for all prior taxable years which would have resulted from reducing the qualified investment taken into account with respect to such property by the amount of such net increase.

"(2) TRANSFERS OF DEBT MORE THAN 1 YEAR AFTER INITIAL BORROWING NOT TREATED AS INCREASING NONQUALIFIED NONRECOURSE FINANCING.—For purposes of paragraph (1), the amount of nonqualified nonrecourse financing (within the meaning of section 46(c)(8)(D)) with respect to the taxpayer shall not be treated as increased by reason of a transfer of (or agreement to transfer) any evidence of an indebtedness if such transfer occurs (or such agreement is entered into) more than 1 year after the date such indebtedness was incurred."

(c) CLARIFICATION OF COORDINATION OF SECTION 48(d) WITH AT-RISK RULES.—Subsection (d) of section 48 (relating to certain leased property) is amended by adding at the end thereof the following new paragraph:

"(6) COORDINATION WITH AT-RISK RULES.—

"(A) EXTENSION OF AT-RISK RULES TO CERTAIN LESSORS.—

"(i) IN GENERAL.—If—

"(I) a lessor makes an election under this subsection with respect to any at-risk property leased to an at-risk lessee, and

"(II) but for this clause, section 46(c)(8) would not apply to such property in the hands of the lessor,

section 46(c)(8) shall apply to the lessor with respect to such property.

"(ii) EXCEPTIONS.—Clause (i) shall not apply—

"(I) if the lessor manufactured or produced the property,

"(II) if the property has a readily ascertainable fair market value, or

"(III) in circumstances which the Secretary determines by regulations to be circumstances where the application of clause (i) is not necessary to carry out the purposes of section 46(c)(8).

"(B) REQUIREMENT THAT LESSOR BE AT RISK.—In the case of any property which, in the hands of the lessor, is property to which section 46(c)(8) applies, the amount of the credit allowable to the lessee under section 38 with respect to such property by reason of an election under this subsection shall at no time exceed the credit which would have been allowable to the lessor with respect to such property (determined without regard to section 46(e)(3)) if—

"(i) the lessor's basis in such property were equal to the lessee acquisition amount, and

"(ii) no election had been made under this subsection.

"(C) LESSEE SUBJECT TO AT-RISK LIMITATIONS.—

"(i) IN GENERAL.—In the case of any lease where—

"(I) the lessee is an at-risk lessee,

"(II) the property is at-risk property, and

"(III) the at-risk percentage is less than the required percentage,

any credit allowable under section 38 to the lessee by reason of an election under this subsection (hereinafter in this paragraph referred to as the 'total credit') shall be allowable only as provided in subparagraph (D).

"(ii) AT-RISK PERCENTAGE.—For purposes of this paragraph, the term 'at-risk percentage' means the percentage obtained by dividing—

"(I) the present value (as of the time the lease is entered into) of the aggregate lease at-risk payments, by

"(II) the lessee acquisition amount.

For purposes of subclause (I), the present value shall be determined by using a discount rate equal to the rate in effect under section 6621 as of the time the lease is entered into.

"(iii) REQUIRED PERCENTAGE.—For purposes of clause (i)(III), the term 'required percentage' means the sum of—

"(I) 2 times the sum of the percentages applicable to the property under section 46(a), plus

"(II) 10 percent.

In the case of 3-year property, such term means 60 percent of the required percentage determined under the preceding sentence.

"(iv) LESSEE ACQUISITION AMOUNT.—For purposes of this paragraph, the term 'lessee acquisition amount' means the amount for which the lessee is treated as having acquired the property by reason of an election under this subsection.

"(v) LEASE AT-RISK PAYMENT.—For purposes of this paragraph, the term 'lease at-risk payment' means any rental payment—

"(I) which the lessee is required to make under the lease in all events, and

"(II) with respect to which the lessee is not protected against loss through nonrecourse financing, guarantees, stop-loss agreements, or other similar arrangements.

"(D) YEAR FOR WHICH CREDIT ALLOWABLE.—

"(i) IN GENERAL.—Except as provided in clause (ii), in any case to which subparagraph (C)(i) applies, the portion of the total credit allowable for any taxable year shall be an amount which bears the same ratio to such total credit as—

"(I) the aggregate rental payments made by the lessee under the lease during such taxable year, bears to

"(II) the lessee acquisition amount.

"(ii) REMAINING AMOUNT ALLOWABLE FOR YEAR IN WHICH AGGREGATE RENTAL PAYMENTS EXCEED REQUIRED PERCENTAGE OF ACQUISITION AMOUNT.—The total credit (to the extent not allowable for a preceding taxable year) shall be allowable for the first taxable year as of the close of which the aggregate rental payments made by the lessee under the lease equal or exceed the required percentage (as defined in subparagraph (C)(iii)) of the lessee acquisition amount.

"(E) DEFINITION OF AT-RISK LESSEE AND AT-RISK PROPERTY.—For purposes of this paragraph—

"(i) AT RISK LESSEE.—The term 'at-risk lessee' means any lessee who is a taxpayer described in section 465(a)(1).

"(ii) AT-RISK PROPERTY.—The term 'at-risk property' means any property used by an at-risk lessee in connection with an activity with respect to which any loss is subject to limitation under section 465.

"(F) SPECIAL RULES FOR SUBPARAGRAPHS (C) AND (D).—

"(i) SUBPARAGRAPHS (C) AND (D) APPLY IN LIEU OF OTHER AT-RISK RULES.—In the case of any election under this subsection, paragraphs (8) and (9) of section 46(c) and subsection (d) of section 47 shall only apply with respect to the lessor.

"(ii) APPLICATION TO PARTNERSHIPS AND S CORPORATIONS.—For purposes of subparagraphs (C) and (D), rules similar to the rules of subparagraph (E) of section 46(c)(8) shall apply.

"(iii) SUBSEQUENT REDUCTIONS IN AT-RISK AMOUNT.—Under regulations prescribed by the Secretary, the principles of subsection (d) of section 47 shall apply for purposes of subparagraphs (C) and (D).

"(G) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this paragraph, including regulations—

"(i) providing for such adjustments as may be appropriate where expenses connected with the lease are borne by the lessor, and

"(ii) providing the extent to which contingencies in the lease will be disregarded."

(d) TECHNICAL AMENDMENTS.—

(1) Clause (i) of section 46(c)(8)(F) (relating to special rule for certain energy property) is amended to read as follows:

"(i) IN GENERAL.—Subparagraph (A) shall not apply with respect to qualified energy property."

(2) Subclause (III) of section 46(c)(8)(F)(ii) (defining qualified energy property) is amended to read as follows:

"(III) as of the close of the taxable year in which the property is placed in service, not more than 75 percent of the basis of such property is attributable to nonqualified nonrecourse financing, and".

(3) Subclause (IV) of section 46(c)(8)(F)(ii) is amended by striking out "nonrecourse financing (other than financing described in section 46(c)(8)(B)(ii))" and inserting in lieu thereof "nonqualified nonrecourse financing".

(4) Subparagraph (A) of section 47(d)(3) is amended by striking out "ceasing to be at risk" and inserting in lieu thereof "increasing the amount of nonqualified nonrecourse financing (within the meaning of section 46(c)(8))".

(5) Clause (i) of section 47(d)(3)(B) is amended by striking out "other than a loan described in section 46(c)(8)(B)(ii)".

(e) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to property placed in service after the date of the enactment of this Act in taxable years ending after such date; except that such amendments shall not apply to any property to which the amendments made by section 211(f) of the Economic Recovery Tax Act of 1981 do not apply.

(2) AMENDMENTS MAY BE ELECTED RETROACTIVELY.—At the election of the taxpayer, the amendments made by this section shall apply as if included in the amendments made by section 211(f) of the Economic Recovery Tax Act of 1981. Any election made under the preceding sentence shall apply to all property of the taxpayer to which the amendments made by such section 211(f) apply and shall be made at such time and in such manner as the Secretary of the Treasury or his delegate may by regulations prescribe.

SEC. 432. EXCLUSION OF ACTIVE BUSINESSES OF QUALIFIED C CORPORATIONS FROM AT-RISK RULES, ETC.

(a) EXCLUSION OF ACTIVE BUSINESSES OF QUALIFIED C CORPORATIONS FROM AT-RISK RULES.—Subsection (c) of section 465 (relating to deductions limited to amount at risk) is amended by adding at the end thereof the following new paragraph:

"(7) EXCLUSION OF ACTIVE BUSINESSES OF QUALIFIED C CORPORATIONS.—

"(A) IN GENERAL.—In the case of a taxpayer which is a qualified C corporation—

"(i) each qualifying business carried on by such taxpayer shall be treated as a separate activity, and

"(ii) subsection (a) shall not apply to losses from such business.

"(B) QUALIFIED C CORPORATION.—For purposes of subparagraph (A), the term 'qualified C corporation' means any corporation described in subparagraph (B) of subsection (a)(1) which is not—

"(i) a personal holding company (as defined in section 542(a)),

"(ii) a foreign personal holding company (as defined in section 552(a)), or

"(iii) a personal service corporation (as defined in section 269A(b) but determined by substituting '5 percent' for '10 percent' in section 269A(b)(2)).

"(C) QUALIFYING BUSINESS.—For purposes of this paragraph, the term 'qualifying business' means any active business if—

"(i) during the entire 12-month period ending on the last day of the taxable year, such corporation had at least 1 full-time employee substantially all the services of whom were in the active management of such business,

"(ii) during the entire 12-month period ending on the last day of the taxable year, such corporation had at least 3 full-time, nonowner employees substantially all of the services of whom were services directly related to such business,

"(iii) the amount of the deductions attributable to such business which are allowable to the taxpayer solely by reason of sections 162 and 404 for the taxable year exceeds 15 percent of the gross income from such business for such year, and

"(iv) such business is not an excluded business.

"(D) SPECIAL RULES FOR APPLICATION OF SUBPARAGRAPH (C).—

"(i) PARTNERSHIPS IN WHICH TAXPAYER IS A QUALIFIED CORPORATE PARTNER.—In the case of an active business of a partnership, if—

"(I) the taxpayer is a qualified corporate partner in the partnership, and

"(II) during the entire 12-month period ending on the last day of the partnership's taxable year, there was at least 1 full-time employee of the partnership (or of a qualified corporate partner) substantially all the services of whom were in the active management of such business,

then the taxpayer's proportionate share (determined on the basis of its profits interest) of the activities of the partnership in such business shall be treated as activities of the taxpayer (and clause (i) of subparagraph (C) shall not apply in determining whether such business is a qualifying business of the taxpayer).

"(ii) QUALIFIED CORPORATE PARTNER.—For purposes of clause (i), the term 'qualified corporate partner' means any corporation if—

"(I) such corporation is a general partner in the partnership,

"(II) such corporation has an interest of 20 percent or more in the profits and losses of the partnership, and

"(III) such corporation has contributed property to the partnership in an amount not less than the lesser of $500,000 or 10 percent of the net worth of the corporation.

For purposes of subclause (III), any contribution of property other than money shall be taken into account at its fair market value.

"(iii) DEDUCTION FOR OWNER EMPLOYEE COMPENSATION NOT TAKEN INTO ACCOUNT.—For purposes of clause (iii) of subparagraph (C), there shall not be taken into account any deduction in respect of compensation for personal services rendered by any employee (other than a non-owner employee) of the taxpayer or any member of such employee's family (within the meaning of section 318(a)(1)).

"(iv) SPECIAL RULE FOR BANKS.—For purposes of clause (iii) of subparagraph (C), in the case of a bank (as defined in section 581) or a financial institution to which section 591 applies—

"(I) gross income shall be determined without regard to the exclusion of interest from gross income under section 103, and

"(II) in addition to the deductions described in such clause, there shall also be taken into account the amount of the deductions which are allowable for amounts paid or credited to the accounts of depositors or holders of accounts as dividends or interest on their deposits or withdrawable accounts under section 163 or 591.

"(v) SPECIAL RULE FOR LIFE INSURANCE COMPANIES.—

"(I) IN GENERAL.—Clause (iii) of subparagraph (C) shall not apply to any insurance business of a qualified life insurance company.

"(II) INSURANCE BUSINESS.—For purposes of subclause (I), the term 'insurance business' means any business which is not a noninsurance business (within the meaning of section 806(c)(3)).

"(III) QUALIFIED LIFE INSURANCE COMPANY.—For purposes of subclause (I), the term 'qualified life insurance company' means any company which would be a life insurance company as defined in section 816 if unearned premiums were not taken into account under subsections (a)(2) and (c)(2) of section 816.

"(E) DEFINITIONS.—For purposes of this paragraph—

"(i) NON-OWNER EMPLOYEE.—The term 'non-owner employee' means any employee who does not own, at any time during the taxable year, more than 5 percent in value of the outstanding stock of the taxpayer. For purposes of the preceding sentence, section 318 shall apply, except that '5 percent' shall be substituted for '50 percent' in section 318(a)(2)(C).

"(ii) EXCLUDED BUSINESS.—The term 'excluded business' means—

"(I) equipment leasing (as defined in paragraph (6)), and

"(II) any business involving the use, exploitation, sale, lease, or other disposition of master sound recordings, motion picture films, video tapes, or tangible or intangible assets associated with literary, artistic, musical, or similar properties.

"(iii) SPECIAL RULES RELATING TO COMMUNICATIONS INDUSTRY, ETC.—

"(I) BUSINESS NOT EXCLUDED WHERE TAXPAYER NOT COMPLETELY AT RISK.—A business involving the use, exploitation, sale, lease, or other disposition of property described in subclause (II) of clause (ii) shall not constitute an excluded business by reason of such subclause if the taxpayer is at risk with respect to all amounts paid or incurred (or chargeable to capital account) in such business.

"(II) CERTAIN LICENSED BUSINESSES NOT EXCLUDED.—For purposes of subclause (II) of clause (ii), the provision of radio, television, cable television, or similar services pursuant to a license or franchise granted by the Federal Communications Commission or any other Federal, State, or local authority shall not constitute an excluded business by reason of such subclause.

"(F) AFFILIATED GROUP TREATED AS 1 TAXPAYER.—For purposes of this paragraph—

"(i) IN GENERAL.—Except as provided in clause (iii), the component members of an affiliated group of corporations shall be treated as a single taxpayer.

"(ii) AFFILIATED GROUP OF CORPORATIONS.—The term 'affiliated group of corporations' means an affiliated group (as defined in section 1504(a)) which files or is required to file consolidated income tax returns.

"(iii) COMPONENT MEMBER.—The term 'component member' means an includible corporation (as defined in section 1504) which is a member of the affiliated group.

"(G) LOSS OF 1 MEMBER OF AFFILIATED GROUP MAY NOT OFFSET INCOME OF PERSONAL HOLDING COMPANY OR PERSONAL SERVICE CORPORATION.—Nothing in this paragraph shall permit any loss of a member of an affiliated group to be used as an offset against the income of any other member of such group which is a personal holding company (as defined in section 542(a)) or a personal service corpo-

ration (as defined in section 269A(b) but determined by substituting '5 percent' for '10 percent' in section 269A(b)(2)).''

(b) ACTIVITIES TREATED AS SEPARATE ACTIVITIES BY STATUTE MAY BE AGGREGATED WHERE TAXPAYER ACTIVELY PARTICIPATES IN THE MANAGEMENT OF EACH ACTIVITY.—Paragraph (2) of section 465(c) (relating to activities to which risk applies) is amended to read as follows:

''(2) SEPARATE ACTIVITIES.—For purposes of this section—

''(A) IN GENERAL.—Except as provided in subparagraph (B), a taxpayer's activity with respect to each—

''(i) film or video tape,

''(ii) section 1245 property which is leased or held for leasing,

''(iii) farm,

''(iv) oil and gas property (as defined under section 614), or

''(v) geothermal property (as defined under section 614),

shall be treated as a separate activity.

''(B) AGGREGATION RULES.—

''(i) SPECIAL RULE FOR LEASES OF SECTION 1245 PROPERTY BY PARTNERSHIPS OR S CORPORATIONS.—In the case of any partnership or S corporation, all activities with respect to section 1245 properties which—

''(I) are leased or held for lease, and

''(II) are placed in service in any taxable year of the partnership or S corporation,

shall be treated as a single activity.

''(ii) OTHER AGGREGATION RULES.—Rules similar to the rules of subparagraphs (B) and (C) of paragraph (3) shall apply for purposes of this paragraph.''

(c) CORPORATIONS CONSIDERED AT RISK WITH RESPECT TO AMOUNTS BORROWED FROM SHAREHOLDERS, ETC.—Paragraph (3) of section 465(b) (relating to certain borrowed amounts excluded) is amended to read as follows:

''(3) CERTAIN BORROWED AMOUNTS EXCLUDED.—

''(A) IN GENERAL.—Except to the extent provided in regulations, for purposes of paragraph (1)(B), amounts borrowed shall not be considered to be at risk with respect to an activity if such amounts are borrowed from any person who has an interest in such activity or from a related person to a person (other than the taxpayer) having such an interest.

''(B) EXCEPTIONS.—

''(i) INTEREST AS CREDITOR.—Subparagraph (A) shall not apply to an interest as a creditor in the activity.

''(ii) INTEREST AS SHAREHOLDER WITH RESPECT TO AMOUNTS BORROWED BY CORPORATION.—In the case of amounts borrowed by a corporation from a shareholder, subparagraph (A) shall not apply to an interest as a shareholder.

''(C) RELATED PERSON DEFINED.—For purposes of subparagraph (A), the term 'related person' has the meaning given such term by section 168(e)(4).''

(d) EFFECTIVE DATE.—*The amendments made by this section shall apply to taxable years beginning after December 31, 1983; except that any loss from an activity described in section 465(c)(7)(A) of the Internal Revenue Code of 1954 (as amended by this section) which (but for the amendments made by this section) would have been treated as a deduction for the taxpayer's first taxable year beginning after December 31, 1983, under section 465(a)(2) of such Code shall be allowed as a deduction for such first taxable year notwithstanding such amendments.*

Subtitle D—Miscellaneous Treasury Administrative Provisions

PART I—PROVISIONS NOT RELATING TO DISTILLED SPIRITS TAX

SEC. 441. SIMPLIFICATION OF CERTAIN REPORTING REQUIREMENTS.

(a) REPORT ON POSSESSIONS CORPORATIONS.—*The Secretary of the Treasury shall, for the calendar year 1981 and each second calendar year thereafter, submit a report to the Congress within 24 months following the close of such calendar year setting forth an analysis of the operation and effect of sections 936 and 934(b) of the Internal Revenue Code of 1954.*

(b) HIGH INCOME TAXPAYER REPORT.—

(1) Section 2123 of the Tax Reform Act of 1976 is amended to read as follows:

"SEC. 2123. HIGH INCOME TAXPAYER REPORT.

"The Secretary of the Treasury shall publish annually information on the amount of tax paid by individual taxpayers with high total incomes. Total income for this purpose is to be calculated and set forth by adding to adjusted gross income any items of tax preference excluded from, or deducted in arriving at, adjusted gross income, and by subtracting any investment expenses incurred in the production of such income to the extent of the investment income. These data are to include the number of such individuals with total income over $200,000 who owe no Federal income tax (after credits) and the deductions, exclusions, or credits used by them to avoid tax."

(2) The amendment made by paragraph (1) shall apply to information published after the date of the enactment of this Act.

(c) INTERNATIONAL BOYCOTT REPORTS.—

(1) Section 1067 of the Tax Reform Act of 1976 is amended to read as follows:

"SEC. 1067. REPORTS BY THE SECRETARY.

"(a) GENERAL RULE.—*As soon after the close of each 4-year period as the data become available, the Secretary shall transmit a report to the Committee on Ways and Means of the House of Representatives and to the Committee on Finance of the Senate setting forth for such 4-year period—*

"(1) the number of reports filed under section 999(a) of the Internal Revenue Code of 1954 for taxable years ending with or within each calendar year in such 4-year period,

"(2) the number of such reports with respect to each such calendar year on which the taxpayer indicated international boycott participation or cooperation (within the meaning of section 999(b)(3) of such Code), and

"(3) a detailed description of the manner in which the provisions of such Code relating to international boycott activity have been administered during such 4-year period.

"(b) 4-YEAR PERIOD.—For purposes of subsection (a), the term '4-year period' means the period consisting of 4 calendar years beginning with calendar year 1982 and each subsequent fourth calendar year."

(2) The amendment made by paragraph (1) shall apply to reports for periods after December 31, 1981.

SEC. 442. REMOVAL OF $1,000,000 LIMITATION ON WORKING CAPITAL FUND.

The last sentence of section 322(a) of title 31, United States Code (placing a $1,000,000 limitation on the working capital fund for the Department of the Treasury), is hereby repealed.

SEC. 443. INCREASE IN LIMITATION ON REVOLVING FUND FOR REDEMPTION OF REAL PROPERTY.

Subsection (a) of section 7810 (relating to revolving fund for redemption of real property) is amended by striking out "$1,000,000" and inserting in lieu thereof "$10,000,000".

SEC. 444. REMOVAL OF $1,000,000 LIMITATION ON SPECIAL AUTHORITY TO DISPOSE OF OBLIGATIONS.

Subsection (b) of section 324 of title 31, United States Code (relating to disposing and extending the maturity of obligations), is amended by striking out the last sentence.

SEC. 445. SECRETARY OF THE TREASURY AUTHORIZED TO ACCEPT GIFTS AND BEQUESTS.

Section 321 of title 31, United States Code, is amended by adding at the end thereof the following new subsection:

"(d)(1) The Secretary of the Treasury may accept, hold, administer, and use gifts and bequests of property, both real and personal, for the purpose of aiding or facilitating the work of the Department of the Treasury. Gifts and bequests of money and the proceeds from sales of other property received as gifts or bequests shall be deposited in the Treasury in a separate fund and shall be disbursed on order of the Secretary of the Treasury. Property accepted under this paragraph, and the proceeds thereof, shall be used as nearly as possible in accordance with the terms of the gift or bequest.

"(2) For purposes of the Federal income, estate, and gift taxes, property accepted under paragraph (1) shall be considered as a gift or bequest to or for the use of the United States.

"(3) The Secretary of the Treasury may invest and reinvest the fund in public debt securities with maturities suitable for the needs of the fund and bearing interest at rates determined by the Secretary of the Treasury, taking into consideration the current average market yield on outstanding marketable obligations of the United States of comparable maturities. Income accruing from the securities, and from any other property accepted under paragraph (1), shall be deposited to the credit of the fund, and shall be disbursed on order of the Secretary of the Treasury for purposes as nearly as possible in accordance with the terms of the gifts or bequests.

"(4) The Secretary of the Treasury shall, not less frequently than annually, make a public disclosure of the amount (and sources) of the gifts and bequests received under this subsection, and the purposes for which amounts in the separate fund established under this subsection are expended."

SEC. 446. EXTENSION OF PERIOD FOR COURT REVIEW OF JEOPARDY ASSESSMENT WHERE PROMPT SERVICE NOT MADE ON THE UNITED STATES.

(a) GENERAL RULE.—Paragraph (2) of section 7429(b) (relating to judicial review) is amended by adding at the end thereof the following new sentence:

"If the court determines that proper service was not made on the United States within 5 days after the date of the commencement of the action, the running of the 20-day period set forth in the preceding sentence shall not begin before the day on which proper service was made on the United States."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to actions commenced after the date of the enactment of this Act.

SEC. 447. EXTENSION OF PERIOD DURING WHICH ADDITIONAL TAX SHOWN ON AMENDED RETURN MAY BE ASSESSED.

(a) GENERAL RULE.—Subsection (c) of section 6603 (relating to exceptions) is amended by adding at the end thereof the following new paragraph:

"(7) SPECIAL RULE FOR CERTAIN AMENDED RETURNS.—Where, within the 60-day period ending on the day on which the time prescribed in this section for the assessment of any tax imposed by subtitle A for any taxable year would otherwise expire, the Secretary receives a written document signed by the taxpayer showing that the taxpayer owes an additional amount of such tax for such taxable year, the period for the assessment of such additional amount shall not expire before the day 60 days after the day on which the Secretary receives such document."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to documents received by the Secretary of the Treasury (or his delegate) after the date of the enactment of this Act.

SEC. 448. TREATMENT OF CERTAIN GUARANTEED DRAFTS ISSUED BY FINANCIAL INSTITUTIONS.

(a) GENERAL RULE.—Paragraph (2) of section 6311(b) (relating to liability of banks and others) is amended—

(1) by striking out "or cashier's check" and inserting in lieu thereof "or cashier's check (or other guaranteed draft)",

(2) by striking out "the amount of such check" and inserting in lieu thereof "the amount of such check (or draft)",

(3) by striking out "the bank or trust company" and inserting in lieu thereof "the financial institution", and

(4) by striking out "such bank" each place it appears and inserting in lieu thereof "such financial institution".

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall take effect on the date of the enactment of this Act.

SEC. 449. DISCLOSURE OF WINDFALL PROFIT TAX INFORMATION TO STATE TAX OFFICIALS.

(a) General Rule.—Paragraph (1) of section 6103(d) (relating to disclosure to State tax officials) is amended by striking out "44, 51" and inserting in lieu thereof "44, 45, 51".

(b) Effective Date.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

SEC. 450. FINANCIAL REPORTING OF INVESTMENT TAX CREDITS.

(a) In General—Paragraph (1) of section 101(c) of the Revenue Act of 1971 (85 Stat. 499) (relating to accounting for investment credit in certain financial reports and reports to Federal agencies) is amended—

(1) by inserting "and" at the end of subparagraph (A),

(2) by striking out ", and" at the end of subparagraph (B) and inserting in lieu thereof a period, and

(3) by striking out subparagraph (C).

(b) Effective Date.—The amendments made by this section shall take effect as if included in the Revenue Act of 1971.

PART II—PROVISIONS RELATING TO DISTILLED SPIRITS

SEC. 451. REPEAL OF OCCUPATIONAL TAX ON MANUFACTURERS OF STILLS AND CONDENSERS; NOTICES OF MANUFACTURE AND SET UP OF STILLS.

(a) In General.—Subpart C of part II of subchapter A of chapter 51 (relating to manufacturers of stills) is amended to read as follows:

"Subpart C—Manufacturers of Stills

"SEC. 5101. NOTICE OF MANUFACTURE OF STILL; NOTICE OF SET UP OF STILL.

"(a) Notice Requirements.—

"(1) Notice of manufacture of still.—The Secretary may, pursuant to regulations, require any person who manufactures any still, boiler, or other vessel to be used for the purpose of distilling, to give written notice, before the still, boiler, or other vessel is removed from the place of manufacture, setting forth by whom it is to be used, its capacity, and the time of removal from the place of manufacture.

"(2) Notice of set up of still.—The Secretary may, pursuant to regulations, require that no still, boiler, or other vessel be set up without the manufacturer of the still, boiler, or other vessel first giving written notice to the Secretary of that purpose.

"(b) PENALTIES, ETC.—

"(1) For penalty and forfeiture for failure to give notice of manufacture, or for setting up a still without first giving notice, when required by the Secretary, see sections 5615(2) and 5687.

"(2) For penalty and forfeiture for failure to register still or distilling apparatus when set up, see section 5601(a)(1) and 5615(1).

"SEC. 5102. DEFINITION OF MANUFACTURER OF STILLS.

"Any person who manufactures any still or condenser to be used in distilling shall be deemed a manufacturer of stills."

(b) TECHNICAL AMENDMENTS.—

(1) Paragraph (2) of section 5179(b) (relating to registration of stills) is amended to read as follows:

"(2) For provisions requiring notification to set up a still, boiler, or other vessel for distilling, see section 5101(a)(2)."

(2) Paragraph (2) of section 5615 (relating to property subject to forfeiture) is amended to read as follows:

"(2) DISTILLING APPARATUS REMOVED WITHOUT NOTICE OR SET UP WITHOUT NOTICE.—Any still, boiler, or other vessel to be used for the purpose of distilling—

"(A) which is removed without notice having been given when required by section 5101(a)(1), or

"(B) which is set up without notice having been given when required by section 5101(a)(2); and".

(3) Subsection (a) of section 5691 (relating to penalties for nonpayment of special taxes relating to liquors) is amended by striking out "limited retail dealer, or manufacturer of stills" and inserting in lieu thereof "or limited retail dealer".

SEC. 452. ALLOWANCE OF DRAWBACK CLAIMS EVEN WHERE CERTAIN REQUIREMENTS NOT MET.

Section 5134 (relating to drawback) is amended by adding at the end thereof the following new subsection:

"(c) ALLOWANCE OF DRAWBACK EVEN WHERE CERTAIN REQUIREMENTS NOT MET.—

"(1) IN GENERAL.—No claim for drawback under this section shall be denied in the case of a failure to comply with any requirement imposed under this subpart or any rule or regulation issued thereunder upon the claimant's establishing to the satisfaction of the Secretary that distilled spirits on which the tax has been paid or determined were in fact used in the manufacture or production of medicines, medicinal preparations, food products, flavors, or flavoring extracts, which were unfit for beverage purposes.

"(2) PENALTY.—

"(A) IN GENERAL.—In the case of a failure to comply with any requirement imposed under this subpart or any rule or regulation issued thereunder, the claimant shall be liable for a penalty of $1,000 for each failure to comply unless it is shown that the failure to comply was due to reasonable cause.

"(B) PENALTY MAY NOT EXCEED AMOUNT OF CLAIM.—The aggregate amount of the penalties imposed under subparagraph (A) for failures described in paragraph (1) in respect of any claim shall not exceed the amount of such claim (determined without regard to subparagraph (A)).

"(3) PENALTY TREATED AS TAX.—The penalty imposed by paragraph (2) shall be assessed, collected, and paid in the same manner as taxes, as provided in section 6662(a)."

SEC. 453. DISCLOSURE OF ALCOHOL FUEL PRODUCERS TO ADMINISTRATORS OF STATE ALCOHOL LAWS.

(a) IN GENERAL.—Subsection (l) of section 6103 (relating to confidentiality and disclosure of returns and return information) is amended by adding at the end thereof the following new paragraph:

"(9) DISCLOSURE OF ALCOHOL FUEL PRODUCERS TO ADMINISTRATORS OF STATE ALCOHOL LAWS.—Notwithstanding any other provision of this section, the Secretary may disclose—

"(A) the name and address of any person who is qualified to produce alcohol for fuel use under section 5181, and

"(B) the location of any premises to be used by such person in producing alcohol for fuel,

to any State agency, body, or commission, or its legal representative, which is charged under the laws of such State with responsibility for administration of State alcohol laws solely for use in the administration of such laws."

(b) TECHNICAL AMENDMENTS.—

(1) Subparagraph (A) of section 6103(p)(3) (relating to records of inspection and disclosure) is amended by striking out "(5), or (7)" and inserting in lieu thereof "(5), (7), (8), or (9)".

(2) The material preceding subparagraph (A) of paragraph (4) of section 6103(p) is amended by striking out "or (7)" and inserting in lieu thereof "(7), (8), or (9)".

(3) Clause (i) of section 6103(p)(4)(F) is amended by striking out "(l) (6) or (7)" and inserting in lieu thereof "(l) (6), (7), (8), or (9)".

(4) Paragraph (2) of section 7213(a) (relating to unauthorized disclosure of information) is amended by striking out "or (8)" and inserting in lieu thereof "(8), or (9)".

(5) Section 127(a)(1) of Public Law 96-249 is amended by striking out "Subsection (i)" and inserting in lieu thereof "Subsection (l)".

(6) The paragraph (7) of section 6103(l) added by Public Law 96-265 is hereby redesignated as paragraph (8).

SEC. 454. REPEAL OF STAMP REQUIREMENT FOR DISTILLED SPIRITS.

(a) IN GENERAL.—Section 5205 (relating to stamps) is hereby repealed.

(b) BOTTLES MUST HAVE OTHER ANTITAMPERING CLOSURE.—Section 5301 is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) CLOSURES.—The immediate container of distilled spirits withdrawn from bonded premises, or from customs custody, on determination of tax shall bear a closure or other device which is designed so as to require breaking in order to gain access to the con-

tents of such container. The preceding sentence shall not apply to containers of bulk distilled spirits."

(c) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) The second sentence of section 5062(b) (relating to drawback in case of exportation) is amended by striking out "stamped or restamped, and".

(2) Paragraph (2) of section 5066(a) (relating to bottled distilled spirits eligible for export with benefit of drawback) is amended by striking out "stamped or restamped, and marked," and inserting in lieu thereof "marked".

(3) Subsection (b) of section 5116 (relating to cross references) is amended to read as follows:

"(b) CROSS REFERENCE.—

"For provisions relating to containers of distilled spirits, see section 5206."

(4) Subsection (c) of section 5204 (relating to gauging) is amended—

(A) by striking out "STAMPING," in the heading, and

(B) by striking out "stamping," in the text.

(5)(A) Section 5206 (relating to containers) is amended by redesignating subsections (d) and (e) as subsections (e) and (f), respectively, and by inserting after subsection (c) the following new subsection:

"(d) EFFACEMENT OF MARKS AND BRANDS ON EMPTIED CONTAINERS.—Every person who empties, or causes to be emptied, any container of distilled spirits bearing any mark or brand required by law (or regulations pursuant thereto) shall at the time of emptying such container efface and obliterate such mark or brand; except that the Secretary may, by regulations, waive any requirement of this subsection where he determines that no jeopardy to the revenue will be involved."

(B) Subsection (f) of section 5206, as redesignated by subparagraph (A), is amended by adding at the end thereof the following new paragraphs:

"(3) For provisions relating to the marking and branding of containers of distilled spirits by proprietors, see section 5204(c).

"(4) For penalties and forfeitures relating to marks and brands, see sections 5604 and 5613."

(6) Paragraph (4) of section 5207(a) (relating to records and reports) is amended by striking out subparagraph (D), by adding "and" at the end of subparagraph (B), and by striking out ", and" at the end of subparagraph (C) and inserting in lieu thereof a period.

(7) Subsection (c) of section 5215 (relating to return of tax determined distilled spirits to bonded premises) is amended—

(A) by striking out "RESTAMPING" in the heading and inserting in lieu thereof "RECLOSING", and

(B) by striking out "restamping" in the text and inserting in lieu thereof "reclosing".

(8) Section 5235 (relating to bottling of alcohol for industrial purposes) is amended by striking out "stamped," in the first sentence and by striking out the second sentence.

(9) Subsection (c) of section 5301 (relating to regulation of traffic in containers of distilled spirits) is amended—

(A) by striking out "stamping" in paragraphs (1) and (3) and inserting in lieu thereof "tax determination", and

(B) by striking out ", if the liquor bottles are to be again stamped under the provisions of this chapter".

(10) Subsection (a) of section 5555 (relating to records, statements, and returns) is amended by striking out "or for the affixing of any stamp required to be affixed by this chapter,".

(11)(A) Section 5604 (relating to penalties relating to stamps, marks, brands, and containers) is amended to read as follows:

"SEC. 5604. PENALTIES RELATING TO MARKS, BRANDS, AND CONTAINERS.

"(a) IN GENERAL.—Any person who shall—

"(1) transport, possess, buy, sell, or transfer any distilled spirits unless the immediate container bears the type of closure or other device required by section 5301(d);

"(2) with intent to defraud the United States, empty a container bearing the closure or other device required by section 5301(d) without breaking such closure or other device,

"(3) empty, or cause to be emptied, any distilled spirits from an immediate container bearing any mark or brand required by law without effacing and obliterating such mark or brand as required by section 5206(d),

"(4) place any distilled spirits in any bottle, or reuse any bottle for the purpose of containing distilled spirits, which has once been filled and fitted with a closure or other device under the provisions of this chapter, without removing and destroying such closure or other device,

"(5) willfully and unlawfully remove, change, or deface any mark, brand, label, or seal affixed to any case of distilled spirits, or to any bottle contained therein,

"(6) with intent to defraud the United States, purchase, sell, receive with intent to transport, or transport any empty cask or package having thereon any mark or brand required by law to be affixed to any cask or package containing distilled spirits, or

"(7) change or alter any mark or brand on any cask or package containing distilled spirits, or put into any cask or package spirits of greater strength than is indicated by the inspection mark thereon, or fraudulently use any cask or package having any inspection mark thereon, for the purpose of selling other spirits, or spirits of quantity or quality different from the spirits previously inspected,

shall be fined not more than $10,000 or imprisoned not more than 5 years, or both, for each such offense.

"(b) CROSS REFERENCES.—

"For provisions relating to the authority of internal revenue officers to enforce provisions of this section, see sections 5203, 5557, and 7608."

(B) The table of sections for part I of subchapter J of chapter 51 is amended by striking out the item relating to section 5604 and inserting in lieu thereof the following:

"Sec. 5604. Penalties relating to marks, brands, and containers."

(12)(A) Subsection (b) of section 5613 (relating to forfeiture of distilled spirits not stamped, marked, or branded as required by law) is amended to read as follows:

"(b) CONTAINERS WITHOUT CLOSURES.—All distilled spirits found in any container which is required by this chapter to bear a closure or other device and which does not bear a closure or other device in compliance with this chapter shall be forfeited to the United States."

*(B) The section heading of section 5613 is amended by striking out "**STAMPED**" and inserting in lieu thereof "**CLOSED**".*

(C) The item relating to section 5613 in the table of sections for part I of subchapter J of chapter 51 is amended by striking out "stamped" and inserting in lieu thereof "closed".

(13) Subsection (b) of section 6801 (relating to authority for establishment, alteration, and distribution) is amended by striking out "several stamp taxes;" and all that follows and inserting in lieu thereof "several stamp taxes."

(14) The table of sections for part I of subchapter C of chapter 51 is amended by striking out the item relating to section 5205.

SEC. 455. COOKING WINE MAY BE FORTIFIED USING DISTILLED SPIRITS.

(a) IN GENERAL.—Subsection (a) of section 5214 (relating to withdrawal of distilled spirits from bonded premises free of tax or without payment of tax) is amended by striking out the period at the end of paragraph (12) and inserting in lieu thereof "; or", and by adding at the end thereof the following new paragraph:

"(13) without payment of tax for use on bonded wine cellar premises in the production of wine or wine products which will be rendered unfit for beverage use and removed pursuant to section 5362(d)."

(b) LIABILITY FOR TAX.—

(1) Paragraph (1) of section 5005(e) (relating to withdrawals without payment of tax) is amended by striking out "or (10)" and inserting in lieu thereof "(10), or (13)".

(2) Paragraph (2) of section 5005(e) is amended by inserting "used in the production of nonbeverage wine or wine products," after "used in the production of wine,".

(c) TECHNICAL AMENDMENT.—Section 5354 (relating to bonds for bonded wine cellars) is amended by striking out "wine spirits" each place it appears and inseting in lieu thereof "distilled spirits".

SEC. 456. EFFECTIVE DATES.

(a) IN GENERAL.—Except as otherwise provided in this section the amendments made by this part shall take effect on the first day of the first calendar month which begins more than 90 days after the date of the enactment of this Act.

(b) REPEAL OF STAMP REQUIREMENT.—The amendments made by section 454 shall take effect on July 1, 1985.

(c) FORTIFICATION OF COOKING WINE.—The amendments made by section 455 shall take effect on the date of the enactment of this Act.

Subtitle E—Tax Court Provisions

SEC. 461. INCREASE IN JURISDICTIONAL LIMIT FOR SMALL CASES.

(a) INCREASE IN JURISDICTIONAL LIMIT FOR SMALL TAX CASES.—

(1) IN GENERAL.—Subsection (a) of section 7463 (relating to disputes involving $5,000 or less) is amended by striking out "$5,000" each place it appears and inserting in lieu thereof "$10,000".

(2) CLERICAL AMENDMENTS.—

(A) The section heading for section 7463 is amended by striking out "$5,000" and inserting in lieu thereof "$10,000".

(B) The table of sections for part II of subchapter C of chapter 76 is amended by striking out "$5,000" in the item relating to section 7463 and inserting in lieu thereof "$10,000".

(b) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

SEC. 462. ANNUITIES TO SURVIVORS OF TAX COURT JUDGES.

(a) ENTITLEMENT TO ANNUITY.—Subsection (h) of section 7448 (relating to entitlement to annuity) is amended—

(1) by striking out "$900 per year divided by the number of such children or $360 per year," in paragraph (2) and inserting in lieu thereof "$4,644 per year divided by the number of such children or $1,548 per year,"; and

(2) by striking out "$480 per year" in paragraph (3) and inserting in lieu thereof "$5,580 per year divided by the number of such children or $1,860 per year, whichever is lesser".

(b) EFFECTIVE DATE.—The amendments made by this subsection (a) shall apply to annuities payable with respect to months beginning after the date of the enactment of this Act.

SEC. 463. PROCEEDINGS WHICH MAY BE ASSIGNED TO COMMISSIONERS.

(a) IN GENERAL.—Subsection (d) of section 7456 (relating to proceedings which may be assigned to commissioners) is amended to read as follows:

"(d) PROCEEDINGS WHICH MAY BE ASSIGNED TO COMMISSIONERS.—The chief judge may assign—

"(1) any declaratory judgment proceeding,

"(2) any proceeding under section 7463,

"(3) any proceeding where neither the amount of the deficiency placed in dispute (within the meaning of section 7463) nor the amount of any claimed overpayment exceeds $10,000; and

"(4) any other proceeding which the chief judge may designate,

to be heard by the commissioners of the court, and the court may authorize a commissioner to make the decision of the court with respect to any proceeding described in paragraph (1), (2), or (3), subject to such conditions and review as the court may provide."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect as if enacted as part of the Miscellaneous Revenue Act of 1982.

SEC. 464. SPECIAL TRIAL JUDGES.

(a) IN GENERAL.—Subsection (a) of section 7456 (relating to administration of oaths and procurement of testimony) is amended by striking out "commissioner" each place it appears and inserting in lieu thereof "special trial judge".

(b) APPOINTMENT AND COMPENSATION.—Subsection (c) of section 7456 (relating to commissioners) is amended—

(1) by striking out "COMMISSIONERS" in the heading and inserting in lieu thereof "SPECIAL TRIAL JUDGES";

(2) by striking out "commissioners" and inserting in lieu thereof "special trial judges"; and

(3) by striking out "commissioner" and inserting in lieu thereof "special trial judge".

(c) PROCEEDINGS WHICH MAY BE ASSIGNED TO SPECIAL TRIAL JUDGES.—Subsection (d) of section 7456 (relating to proceedings which may be assigned to commissioners), as amended by section 463, is amended—

(1) by striking out "COMMISSIONERS" in the heading and inserting in lieu thereof "SPECIAL TRIAL JUDGES";

(2) by striking out "commissioners" and inserting in lieu thereof "special trial judges"; and

(3) by striking out "commissioner" and inserting in lieu thereof "special trial judge".

(d) CONFORMING AMENDMENT.—Subsection (c) of section 7471 (cross reference relating to compensation and travel and subsistence allowances of commissioners) is amended by striking out "COMMISSIONERS" in the heading and inserting in lieu thereof "SPECIAL TRIAL JUDGES", and by striking out "commissioners" and inserting in lieu thereof "special trial judges".

(e) EFFECTIVE DATE.—

(1) The amendments made by this section shall take effect on the date of the enactment of this Act.

(2) Any reference in any law to a commissioner of the Tax Court shall be treated as a reference to a special trial judge of the Tax Court.

SEC. 465. PUBLICITY OF TAX COURT PROCEEDINGS.

(a) IN GENERAL.—Section 7461 (relating to publicity of proceedings) is amended to read as follows:

"SEC. 7461. PUBLICITY OF PROCEEDINGS.

"(a) GENERAL RULE.—Except as provided in subsection (b), all reports of the Tax Court and all evidence received by the Tax Court and its divisions, including a transcript of the stenographic report of the hearings, shall be public records open to the inspection of the public.

"(b) EXCEPTIONS.—

"(1) TRADE SECRETS OR OTHER CONFIDENTIAL INFORMATION.—The Tax Court may make any provision which is necessary to prevent the disclosure of trade secrets or other confidential information, including a provision that any document or information be placed under seal to be opened only as directed by the court.

"(2) EVIDENCE, ETC.—After the decision of the Tax Court in any proceeding has become final, the Tax Court may, upon

motion of the taxpayer or the Secretary, permit the withdrawal by the party entitled thereto of originals of books, documents, and records, and of models, diagrams, and other exhibits, introduced in evidence before the Tax Court or any division; or the Tax Court may, on its own motion, make such other disposition thereof as it deems advisable."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

Subtitle F—Simplification of Income Tax Credits

SEC. 471. CREDITS GROUPED TOGETHER IN MORE LOGICAL ORDER.

(a) CREDITS DIVIDED INTO 4 CATEGORIES.—The table of subparts for part IV of subchapter A of chapter 1 (relating to credits against tax) is amended to read as follows:

"Subpart A. Nonrefundable personal credits.
"Subpart B. Foreign tax credit, etc.
"Subpart C. Refundable credits.
"Subpart D. Business-related credits."

(b) EXISTING CREDITS ASSIGNED TO APPROPRIATE CATEGORY.—Part IV of subchapter A of chapter 1 is amended by striking out the heading and table of sections for subpart A and inserting in lieu thereof the following:

"Subpart A—Nonrefundable Personal Credits

"Sec. 21. Expenses for household and dependent care services necessary for gainful employment.
"Sec. 22. Credit for the elderly and the permanently and totally disabled.
"Sec. 23. Residential energy credit.
"Sec. 24. Contributions to candidates for public office.
"Sec. 25. Limitation based on tax liability; definition of tax liability.

"Subpart B—Foreign Tax Credit, Etc.

"Sec. 27. Taxes of foreign countries and possessions of the United States; possession tax credit.
"Sec. 28. Clinical testing expenses for certain drugs for rare diseases or conditions.
"Sec. 29. Credit for producing fuel from a nonconventional source.
"Sec. 30. Credit for increasing research activities.

"Subpart C—Refundable Credits

"Sec. 31. Tax withheld on wages.
"Sec. 32. Earned income.
"Sec. 33. Tax withheld at source on nonresident aliens and foreign corporations.
"Sec. 34. Certain uses of gasoline and special fuels.
"Sec. 35. Overpayments of tax.

"Subpart D—Business Related Credits

(c) SECTIONS MOVED TO APPROPRIATE PLACE IN PART IV.—

(1) DESIGNATION.—The following sections of such part IV are henceforth to be designated in accordance with the following table:

Old section number:	*New section number:*	*New subpart designation:*
44A	*21*	*A*
37	*22*	*A*
44C	*23*	*A*
41	*24*	*A*
33	*27*	*B*
44H	*28*	*B*
44D	*29*	*B*
44F	*30*	*B*
31	*31*	*C*
43	*32*	*C*
32	*33*	*C*
39	*34*	*C*
45	*35*	*C*
44E	*40*	*D*
44G	*41*	*D*

(2) PLACED IN APPROPRIATE SUBPARTS.—Each section for which paragraph (1) provides a new section number is hereby moved to the appropriate place in the appropriate subpart of such part IV.

SEC. 472. UNIFORM LIMITATION ON PERSONAL NONREFUNDABLE CREDITS.

Subpart A of part IV of subchapter A of chapter 1 is amended by adding after section 24 the following new section:

"SEC. 25. LIMITATION BASED ON TAX LIABILITY; DEFINITION OF TAX LIABILITY.

"(a) LIMITATION BASED ON AMOUNT OF TAX.—The aggregate amount of credits allowed by this subpart for the taxable year shall not exceed the taxpayer's tax liability for such taxable year.

"(b) TAX LIABILITY.—For purposes of this section—

"(1) IN GENERAL.—The term 'tax liability' means the tax imposed by this chapter for the taxable year.

"(2) EXCEPTION FOR CERTAIN TAXES.—For purposes of paragraph (1), any tax imposed by any of the following provisions shall not be treated as tax imposed by this chapter:

"(A) section 56 (relating to corporate minimum tax),

"(B) subsection (m)(5)(B), (o)(2), or (q) of section 72 (relating to additional tax on certain distributions),

"(C) section 408(f) (relating to additional tax on income from certain retirement accounts),

"(D) section 531 (relating to accumulated earnings tax),
"(E) section 541 (relating to personal holding company tax),
"(F) section 1351(d)(1) (relating to recoveries of foreign expropriation losses),
"(G) section 1374 (relating to tax on certain capital gains of S corporations), and
"(H) section 1375 (relating to tax imposed when passive investment income of corporation having subchapter C earnings and profits exceeds 25 percent of gross receipts).

"(c) SIMILAR RULE FOR ALTERNATIVE MINIMUM TAX FOR TAXPAYERS OTHER THAN CORPORATIONS.—

"For treatment of tax imposed by section 55 as not imposed by this chapter, see section 55(c)."

SEC. 473. UNIFORM CARRYOVER PROVISIONS FOR BUSINESS-RELATED CREDITS.

Subpart D of part IV of subchapter A of chapter 1 is amended by inserting before section 40 the following new sections:

"SEC. 38. GENERAL BUSINESS CREDIT.

"(a) ALLOWANCE OF CREDIT.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the sum of—
"(1) the business credit carryforwards carried to such taxable year,
"(2) the amount of the current year business credit, plus
"(3) the business credit carrybacks carried to such taxable year.

"(b) CURRENT YEAR BUSINESS CREDIT.—For purposes of this subpart, the amount of the current year business credit is the sum of the following credits determined for the taxable year:
"(1) the investment credit determined under section 46(a),
"(2) the targeted jobs credit determined under section 51(a),
"(3) the alcohol fuels credit determined under section 40(a), plus
"(4) the employee stock ownership credit determined under section 41(a).

"(c) LIMITATION BASED ON AMOUNT OF TAX.—
"(1) IN GENERAL.—The credit allowed under subsection (a) for any taxable year shall not exceed the sum of—
"(A) so much of the taxpayer's net tax liability for the taxable year as does not exceed $25,000, plus
"(B) 85 percent of so much of the taxpayer's net tax liability for the taxable year as exceeds $25,000.
"(2) NET TAX LIABILITY.—For purposes of paragraph (1), the term 'net tax liability' means the tax liability (as defined in section 25(b)), reduced by the sum of the credits allowable under subparts A and B of this part.
"(3) SPECIAL RULES.—
"(A) MARRIED INDIVIDUALS.—In the case of a husband or wife who files a separate return, the amount specified under subparagraphs (A) and (B) of paragraph (1) shall be $12,500 in lieu of $25,000. This subparagraph shall not apply if the spouse of the taxpayer has no business credit

carryforward or carryback to, and has no current year business credit for, the taxable year of such spouse which ends within or with the taxpayer's taxable year.

"(B) CONTROLLED GROUPS.—In the case of a controlled group, the $25,000 amount specified under subparagraphs (A) and (B) of paragraph (1) shall be reduced for each component member of such group by apportioning $25,000 among the component members of such group in such manner as the Secretary shall by regulations prescribe. For purposes of the preceding sentence, the term 'controlled group' has the meaning given to such term by section 1563(a).

"(C) LIMITATIONS WITH RESPECT TO CERTAIN PERSONS.—In the case of a person described in subparagraph (A) or (B) of section 46(e)(1), the $25,000 amount specified under subparagraphs (A) and (B) of paragraph (1) shall equal such person's ratable share (as determined under section 46(e)(2)) of such amount.

"(D) ESTATES AND TRUSTS.—In the case of an estate or trust, the $25,000 amount specified under subparagraphs (A) and (B) of paragraph (1) shall be reduced to an amount which bears the same ratio to $25,000 as the portion of the income of the estate or trust which is not allocated to beneficiaries bears to the total income of the estate or trust.

"(d) SPECIAL RULES FOR CERTAIN REGULATED COMPANIES.—In the case of any taxpayer to which section 46(f) applies, for purposes of sections 46(f), 47(a), 196(a), and 404(i) and any other provision of this title where it is necessary to ascertain the extent to which the credits determined under section 40(a), 41(a), 46(a), or 51(a) are used in a taxable year or as a carryback or carryforward, the order in which such credits are used shall be determined on the basis of the order in which they are listed in subsection (b).

"SEC. 39. CARRYBACK AND CARRYFORWARD OF UNUSED CREDITS.

"(a) IN GENERAL.—

"(1) 3 YEAR CARRYBACK AND 15 YEAR CARRYFORWARD.—If the sum of the business credit carryforwards to the taxable year plus the amount of the current year business credit for the taxable year exceeds the amount of the limitation imposed by subsection (c) of section 38 for such taxable year (hereinafter in this section referred to as the 'unused credit year'), such excess (to the extent attributable to the amount of the current year business credit) shall be—

"(A) a business credit carryback to each of the 3 taxable years preceding the unused credit year, and

"(B) a business credit carryforward to each of the 15 taxable years following the unused credit year,

and, subject to the limitations imposed by subsections (b) and (c), shall be taken into account under the provisions of section 38(a) in the manner provided in section 38(a).

"(2) AMOUNT CARRIED TO EACH YEAR.—

"(A) ENTIRE AMOUNT CARRIED TO FIRST YEAR.—The entire amount of the unused credit for an unused credit year shall be carried to the earliest of the 18 taxable years to

which (by reason of paragraph (1)) such credit may be carried.

"(B) AMOUNT CARRIED TO OTHER 17 YEARS.—The amount of the unused credit for the unused credit year shall be carried to each of the other 17 taxable years to the extent that such unused credit may not be taken into account under section 38(a) for a prior taxable year because of the limitations of subsections (b) and (c).

"(b) LIMITATION ON CARRYBACKS.—The amount of the unused credit which may be taken into account under section 38(a)(3) for any preceding taxable year shall not exceed the amount by which the limitation imposed by section 38(c) for such taxable year exceeds the sum of—

"(1) the amounts determined under paragraphs (1) and (2) of section 38(a) for such taxable year, plus

"(2) the amounts which (by reason of this section) are carried back to such taxable year and are attributable to taxable years preceding the unused credit year.

"(c) LIMITATION ON CARRYFORWARDS.—The amount of the unused credit which may be taken into account under section 38(a)(1) for any succeeding taxable year shall not exceed the amount by which the limitation imposed by section 38(c) for such taxable year exceeds the sum of the amounts which, by reason of this section, are carried to such taxable year and are attributable to taxable years preceding the unused credit year.

"(d) TRANSITIONAL RULES.—

"(1) CARRYFORWARDS.—

"(A) IN GENERAL.—Any carryforward from an unused credit year under section 46, 50A, 53, 44E, or 44G which has not expired before the beginning of the first taxable year beginning after December 31, 1983, shall be aggregated with other such carryforwards from such unused credit year and shall be a business credit carryforward to each taxable year beginning after December 31, 1983, which is 1 of the first 15 taxable years after such unused credit year.

"(B) AMOUNT CARRIED FORWARD.—The amount carried forward under subparagraph (A) to any taxable year shall be properly reduced for any amount allowable as a credit with respect to such carryforward for any taxable year before the year to which it is being carried.

"(2) CARRYBACKS.—In determining the amount allowable as a credit for any taxable year beginning before January 1, 1984, as the result of the carryback of a general business tax credit from a taxable year beginning after December 31, 1983—

"(A) paragraph (1) of subsection (b) shall be applied as if it read as follows:

" '(1) the sum of the credits allowable for such taxable year under sections 38, 40, 44B, 44E, and 44G (as in effect before enactment of the Tax Reform Act of 1984), plus', and

"(B) for purposes of section 38(c) the net tax liability for such taxable year shall be the tax liability (as so defined in section 25(b)) reduced by the sum of the credits allowable for such taxable year under sections 33, 37, 41, 44A, 44C, 44D, 44F, and 44H (as so in effect)."

SEC. 474. TECHNICAL AND CONFORMING AMENDMENTS

(a) REFERENCES TO OLD AND NEW PROVISIONS.—Whenever in this section reference is made to an old or new section or other provision, the reference is to the provision before (in the case of "old") or after (in the case of "new") the changes made by section 471 of this Act.

(b) OLD SECTION 21.—

(1) REDESIGNATION.—Old section 21 (relating to effect of changes) is redesignated as section 15.

(2) CONFORMING AMENDMENTS.—Sections 441(f)(2)(A) and 6013(c) are each amended by striking out "21" and inserting in lieu thereof "15".

(3) TABLE OF SECTIONS.—The table of sections for part III of subchapter A of chapter 1 is amended by striking out the item relating to section 21 and inserting in lieu thereof the following:

"Sec. 15. Effect of changes."

(c) NEW SECTION 21.—New section 21 (relating to expenses for household and dependent care services necessary for gainful employment) is amended—

(1) by striking out subsection (b) and by redesignating subsections (c), (d), (e), (f), and (g) as subsections (b), (c), (d), (e), and (f), respectively,

(2) by striking out "subsection (c)(1)" in subsection (a) and inserting in lieu thereof "subsection (b)(1)",

(3) by striking out "subsection (c)(2)" in subsection (a) and inserting in lieu thereof "subsection (b)(2)",

(4) by striking out "subsection (c)(1)(C)" in paragraph (2) of subsection (d) (as redesignated by paragraph (1)) and inserting in lieu thereof "subsection (b)(1)(C)",

(5) by striking out "subsection (d)(1)" in subparagraph (A) of subsection (d)(2) (as redesignated by paragraph (1)) and inserting in lieu thereof, "subsection (c)(1)",

(6) by striking out "subsection (d)(2)" in subparagraph (B) of subsection (d)(2) (as redesignated by paragraph (1)) and inserting in lieu thereof "subsection (c)(2)", and

(7) by striking out "subsection (c)(1)" in subsection (e)(5) (as redesignated by paragraph (1)) and inserting in lieu thereof "subsection (b)(1)".

(d) NEW SECTION 22.—New Section 22 (relating to the credit for the elderly and the permanently and totally disabled) is amended—

(1) by striking out "Section 37 amount" each place it appears in the text and inserting in lieu thereof "section 22 amount",

(2) by striking out the heading of subsection (c) and inserting in lieu thereof "(c) SECTION 22 AMOUNT.—", and

(3) by amending subsection (d) to read as follows:

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

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

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

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

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

(e) NEW SECTION 23.—Subsection (b) of new section 23 (relating to residential energy credit) is amended by striking out paragraphs (5) and (6) and inserting in lieu thereof the following:

"(5) CARRYFORWARD OF UNUSED CREDIT.—

"(A) IN GENERAL.—If the credit allowable under subsection (a) for any taxable year exceeds the limitation imposed by section 25(a) for such taxable year reduced by the sum of the credits allowable under this subpart (other than this section), such excess shall be carried to the succeeding taxable year and added to the credit allowable under subsection (a) for such succeeding taxable year.

"(B) NO CARRYFORWARD TO TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1987.—No amount may be carried under subparagraph (A) to any taxable year beginning after December 31, 1987."

(f) NEW SECTION 24.—Subsection (b) of new section 24 (relating to contributions to candidates for political office) is amended by striking out paragraph (2) and by redesignating paragraph (3) as paragraph (2).

(g) NEW SECTION 28.—

(1) New section 28 is amended—

(A) by striking out "section 44F" each place it appears and inserting in lieu thereof "section 30", and

(B) by striking out "section 44F(b)" in subsection (c)(2) and inserting in lieu thereof "section 30(b)," and

(C) by striking out "section 44F(f)" in subsection (d)(4) and inserting in lieu thereof "section 30(f)".

(2) Paragraph (2) of new section 28(d) is amended to read as follows:

"(2) LIMITATION BASED ON AMOUNT OF TAX.—The credit allowed by this section for any taxable year shall not exceed the taxpayer's tax liability for the taxable year (as defined in section 25(b)), reduced by the sum of the credits allowable under subpart A and section 27."

(h) NEW SECTION 29.—Paragraph (5) of new section 29(b) (relating to credit for producing fuel from a nonconventional source) is amended to read as follows:

"(5) APPLICATION WITH OTHER CREDITS.—The credit allowed by subsection (a) for a taxable year shall not exceed the taxpayer's tax liability for the taxable year (as defined in section 25(b)), reduced by the sum of the credits allowable under subpart A and sections 27 and 28."

(i) NEW SECTION 30.—

(1) New section 30 (relating to credit for increasing research activities) is amended—

(A) by striking out "in computing the credit under section 40 or 44B" in subsection (b)(2)(D)(iii) and inserting in lieu thereof "in determining the targeted jobs credit under section 51(a)", and

(B) by amending subparagraph (A) of subsection (g)(1) to read as follows:

"(A) IN GENERAL.—Except as provided in subparagraph (B), the credit allowed by subsection (a) for any taxable year shall not exceed the taxpayer's tax liability for the taxable

year (as defined in section 25(b)), reduced by the sum of the credits allowable under subpart A and sections 27, 28, and 29."

(2) NEW SECTION 30 TREATED AS CONTINUATION OF OLD SECTION 44F.—For purposes of determining—

(A) whether any excess credit under old section 44F for a taxable year beginning before January 1, 1984, is allowable as a carryover under new section 30, and

(B) the period during which new section 30 is in effect, new section 30 shall be treated as a continuation of old section 44F (and shall apply only to the extent old section 44F would have applied).

(j) NEW SECTION 33.—New section 33 (relating to tax withheld at source on nonresident aliens and foreign corporations and on tax-free covenant bonds) is amended to read as follows:

"SEC. 33. TAX WITHHELD AT SOURCE ON NONRESIDENT ALIENS AND FOREIGN CORPORATIONS.

"There shall be allowed as a credit against the tax imposed by this subtitle the amount of tax withheld at source under subchapter A of chapter 3 (relating to withholding of tax on nonresident aliens and on foreign corporations)."

(k) NEW SECTION 40.—New section 40 (relating to alcohol used as fuel) is amended—

(1) by amending subsection (a) to read as follows:

"(a) GENERAL RULE.—For purposes of section 38, the alcohol fuels credit determined under this section for the taxable year is an amount equal to the sum of—

"(1) the alcohol mixture credit, plus

"(2) the alcohol credit.",

(2) by striking out "the credit allowable under this section" in subsection (c) and inserting in lieu thereof "the credit determined under this section",

(3) by striking out "credit was allowable" each place it appears in paragraph (3) of subsection (d) and inserting in lieu thereof "credit was determined",

(4) by striking out subsection (e) and redesignating subsection (f) as subsection (e),

(5) by amending paragraph (2) of subsection (e) (as redesignated by paragraph (4)) to read as follows:

"(2) NO CARRYOVERS TO YEARS AFTER 1994.—No amount may be carried under section 39 by reason of this section (treating the amount allowed by reason of this section as the first amount allowed by this subpart) to any taxable year beginning after December 31, 1994.", and

(6) by adding at the end thereof the following new subsection:

"(f) ELECTION TO HAVE ALCOHOL FUELS CREDIT NOT APPLY.—

"(1) IN GENERAL.—A taxpayer may elect to have this section not apply for any taxable year.

"(2) TIME FOR MAKING ELECTION.—An election under paragraph (1) for any taxable year may be made (or revoked) at any time before the expiration of the 3-year period beginning on the last date prescribed by law for filing the return for such taxable year (determined without regard to extensions).

"(3) MANNER OF MAKING ELECTION.—An election under paragraph (1) (or revocation thereof) shall be made in such manner as the Secretary may by regulations prescribe."

(l) NEW SECTION 41.—New section 41 (relating to employee stock ownership plan) is amended—

(1) by amending paragraph (1) of subsection (a) to read as follows:

"(1) AMOUNT OF CREDIT.—In the case of a corporation which elects to have this section apply for the taxable year and which meets the requirements of subsection (c)(1), for purposes of section 38, the amount of the employee stock ownership credit determined under this section for the taxable year is an amount equal to the amount of the credit determined under paragraph (2) for such taxable year.",

(2) by amending subsection (b) to read as follows:

"(b) CERTAIN REGULATED COMPANIES.—No credit attributable to compensation taken into account for the ratemaking purposes involved shall be determined under this section with respect to a taxpayer if—

"(1) the taxpayer's cost of service for ratemaking purposes or in its regulated books of account is reduced by reason of any portion of such credit which results from the transfer of employer securities or cash to a tax credit employee stock ownership plan which meets the requirements of section 409;

"(2) the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of such credit which results from a transfer described in paragraph (1) to such employee stock ownership plan; or

"(3) any portion of the amount of such credit which results from a transfer described in paragraph (1) to such employee stock ownership plan is treated for ratemaking purposes in any way other than as though it had been contributed by the taxpayer's common shareholders.

Under regulations prescribed by the Secretary, rules similar to the rules of paragraphs (4) and (7) of section 46(f) shall apply for purposes of the preceding sentence.", and

(3) by striking out "the credit allowed under this section" in subsection (c)(3) and inserting in lieu thereof "the credit determined under this section".

(m) REPEAL OF CERTAIN OLD PROVISIONS.—

(1) Old sections 38, 40, 44, and 44B are hereby repealed.

(2) Old subpart C of part IV of subchapter A of chapter 1 is hereby repealed.

(n) REDESIGNATION OF OLD SUBPARTS.—

(1) Old subparts B and D of part IV of subchapter A of chapter 1 are redesignated as subparts E and F, respectively.

(2) The subpart heading for subpart F of part IV of subchapter A of chapter 1 (as so redesignated) is amended to read as follows:

"Subpart F—Rules for Computing Targeted Jobs Credit".

(3) The table of subparts for such part IV (as amended by subsection (a) of section 471) is amended by adding at the end thereof the following:

"Subpart E. Rules for computing credit for investment in certain depreciable property.
"Subpart F. Rules for computing targeted jobs credit."

(o) INVESTMENT TAX CREDIT.—

(1) Section 46 (relating to amount of investment tax credit) is amended by striking out subsections (a) and (b) and inserting in lieu thereof the following:

"(a) AMOUNT OF INVESTMENT CREDIT.—For purposes of section 38, the amount of the investment credit determined under this section for any taxable year shall be an amount equal to the sum of the following percentages of the qualified investment (as determined under subsections (c) and (d)):

"(1) the regular percentage,

"(2) in the case of energy property, the energy percentage, and

"(3) in the case of that portion of the basis of any property which is attributable to qualified rehabilitation expenditures, the rehabilitation percentage.

"(b) DETERMINATION OF PERCENTAGES.—For purposes of subsection (a)—

"(1) REGULAR PERCENTAGE.—The regular percentage is 10 percent.

"(2) ENERGY PERCENTAGE.—

"(A) IN GENERAL.—The energy percentage shall be determined in accordance with the following table:

"Column A—Description	Column B—Percentage	Column C—Period	
		For the period:	
In the case of:	The energy percentage is:	Beginning on:	And ending on:
(i) GENERAL RULE.—Property not described in any of the following provisions of this column.	10 percent.	Oct. 1, 1978.	Dec. 31, 1982.
(ii) SOLAR WIND, OR GEOTHERMAL PROPERTY.—Property described in section 48(l)(2)(A)(ii) or 48(l)(3)(A)(vii).	A. 10 percent.	Oct. 1, 1978.	Dec. 31, 1979.
	B. 15 percent.	Jan. 1, 1980.	Dec. 31, 1985.
(iii) OCEAN THERMAL PROPERTY.—Property described in section 48(l)(3)(A)(ix).	15 percent.	Jan. 1, 1980.	Dec. 31, 1985.
(iv) QUALIFIED HYDROELECTRIC GENERATING PROPERTY.—Property described in section 48(l)(2)(A)(vii).	11 percent.	Jan. 1, 1980.	Dec. 31, 1985.
(v) QUALIFIED INTERCITY BUSES.—Property described in section 48(l)(2)(A)(ix).	10 percent.	Jan. 1, 1980.	Dec. 31, 1985.
(vi) BIOMASS PROPERTY.—Property described in section 48(l)(15).....	10 percent.	Oct. 1, 1978.	Dec. 31, 1985.

"Column A—Description	Column B—Percentage	Column C—Period	
		For the period:	
In the case of:	The energy percentage is:	Beginning on:	And ending on:
(vii) CHLOR-ALKALI ELECTROLYTIC CELLS.—Property described in section 48(l)(5)(M).	10 percent.	Jan. 1, 1980.	Dec. 31, 1982.

"(B) PERIODS FOR WHICH PERCENTAGE NOT SPECIFIED.—In the case of any energy property, the energy percentage shall be zero for any period for which an energy percentage is not specified for such property under subparagraph (A) (as modified by subparagraphs (C) and (D)).

"(C) LONGER PERIOD FOR CERTAIN LONG-TERM PROJECTS.—For the purpose of applying the energy percentage contained in clause (i) of subparagraph (A) with respect to property which is part of a project with a normal construction period of 2 years or more (within the meaning of subsection (d)(2)(A)(i)), 'December 31, 1990' shall be substituted for 'December 31, 1982' if—

"(i) before January 1, 1983, all engineering studies in connection with the commencement of the construction of the project have been completed and all environmental and construction permits required under Federal, State, or local law in connection with the commencement of the construction of the project have been applied for, and

"(ii) before January 1, 1986, the taxpayer has entered into binding contracts for the acquisition, construction, reconstruction, or erection of equipment specially designed for the project and the aggregate cost to the taxpayer of that equipment is at least 50 percent of the reasonably estimated cost for all such equipment which is to be placed in service as part of the project upon its completion.

"(D) LONGER PERIOD FOR CERTAIN HYDROELECTRIC GENERATING PROPERTY.—If an application has been docketed by the Federal Energy Regulatory Commission before January 1, 1986, with respect to the installation of any qualified hydroelectric generating property, for purposes of applying the energy percentage contained in clause (iv) of subparagraph (A) with respect to such property, 'December 31, 1988' shall be substituted for 'December 31, 1985'.

"(3) SPECIAL RULE FOR CERTAIN ENERGY PROPERTY.—The regular percentage shall not apply to any energy property which, but for section 48(l)(1), would not be section 38 property. In the case of any qualified hydroelectric generating property which is a fish passageway, the preceding sentence shall not apply to any

period after 1979 for which the energy percentage for such property is greater than zero.

"(4) REHABILITATION PERCENTAGE.—

"(A) IN GENERAL.—

"In the case of qualified rehabilitation expenditures with respect to a:	***The rehabilitation percentage is:***
30-year building	*15*
40-year building	*20*
Certified historic structure	*25.*

"(B) REGULAR AND ENERGY PERCENTAGES NOT TO APPLY.—The regular percentages and the energy percentages shall not apply to that portion of the basis of any property which is attributable to qualified rehabilitation expenditures.

"(C) DEFINITIONS.—For purpose of this paragraph—

"(i) 30-YEAR BUILDING.—The term '30-year building' means a qualified rehabilitated building other than a 40-year building and other than a certified historic structure.

"(ii) 40-YEAR BUILDING.—The term '40-year building' means a qualified rehabilitated building (other than a certified historic structure) which would meet the requirements of section 48(g)(1)(B) if '40' were substituted for '30' each place it appears in subparagraph (B) thereof.

"(iii) CERTIFIED HISTORIC STRUCTURE.—The term 'certified historic structure' means a qualified rehabilitated building which meets the requirements of section 48(g)(3)."

(2) Subclause (II) of section 46(c)(8)(F)(ii) is amended by striking out "section 46(a)(2)(C)" and inserting in lieu thereof "subsection (b)(2)".

(3)(A) Paragraph (1) of section 46(e) is amended—

(i) by striking out "and the $25,000 amount specified under subparagraphs (A) and (B) of subsection (a)(3)", and

(ii) by striking out "such items" and inserting in lieu thereof "such qualified investment".

(B) Paragraph (2) of section 46(e) is amended by striking out "the items described therein" and inserting in lieu thereof "qualified investment".

(4)(A) Paragraphs (1) and (2) of section 46(f) are each amended by striking out "no credit shall be allowed by section 38" and inserting in lieu thereof "no credit determined under subsection (a) shall be allowed by section 38".

(B) Paragraphs (1) and (2) of section 46(f) are each amended by striking out "the credit allowable by section 38" each place it appears and inserting in lieu thereof "the credit determined under subsection (a) and allowable by section 38".

(C) Subparagraph (B) of section 46(f)(4) is amended by striking out "the credit allowed by section 38" and inserting in lieu thereof "the credit determined under subsection (a) and allowed by section 38".

(5) Paragraph (8) of section 46(f) is amended—

(A) by striking out "the credit allowable under section 38" each place it appears and inserting in lieu thereof "the credit determined under subsection (a) and allowable under section 38", and

(B) by striking out "(within the meaning of subsection (a)(7)(C))" and inserting in lieu thereof "(within the meaning of the first sentence of subsection (c)(3)(B))".

(6) Paragraph (2) of section 46(g) is amended by striking out "the limitation of subsection (a)(3)" and inserting in lieu thereof "the limitation of section 38(c)".

(7) Paragraph (1) of section 46(h) is amended—

(A) by striking out "the credit allowable to the organization under section 38" and inserting in lieu thereof "the credit determined under subsection (a) and allowable to the organization under section 38", and

(B) by striking out "the limitation contained in subsection (a)(3)" and inserting in lieu thereof "the limitation contained in section 38(c)".

(8) Paragraphs (5) and (6) of section 47(a) are each amended by striking out "under section 46(b)" and inserting in lieu thereof "under section 39".

(9) Subsection (c) of section 47 is amended by striking out "subpart A" and inserting in lieu thereof "subpart A, B, or D".

(10) Subparagraph (B) of section 48(c)(3) is amended by striking out "section 46(b)" and inserting in lieu thereof "section 39".

(11) Subparagraph (B) of section 48(d)(1) is amended by striking out "section 46(a)(6)" and inserting in lieu thereof "section 38(c)(3)(B)".

(12) Subsection (f) of section 48 is amended—

(A) by adding "and" at the end of paragraph (1),

(B) striking out ", and" at the end of paragraph (2) and inserting in lieu thereof a period, and

(C) by striking out paragraph (3).

(13) Paragraph (1) of section 48(l) is amended by striking out "section 46(a)(2)(C)" and inserting in lieu thereof "section 46(b)(2)".

(14) Subsection (m) of section 48 is amended by striking out "subsection (a)(2)" and inserting in lieu thereof "subsection (b)".

(15) Subsection (n) of section 48 (relating to requirements for allowance of employee plan percentage) is hereby repealed; except that paragraph (4) of section 48(n) of the Internal Revenue Code of 1954 (as in effect before its repeal by this paragraph) shall continue to apply in the case of any recapture under section 47(f) of such Code of a credit allowable for a taxable year beginning before January 1, 1984.

(16) Subsection (o) of section 48 (defining certain credits) is amended by striking out paragraphs (3), (4), (5), (6), and (7) and by redesignating paragraph (8) as paragraph (3).

(17) Subsection (q) of section 48 is amended—

(A) by striking out "section 46(a)(2)" each place it appears and inserting in lieu thereof "section 46(a)", and

(B) by striking out "section 46(a)(2)(B)" each place it appears and inserting in lieu therof "section 46(b)(1)".

(18) Subsection (r) of section 48 is amended by striking out "section 381(c)(23)" and inserting in lieu thereof "section 381(c)(26)".

(p) TARGETED JOBS CREDIT.—

(1) Subsection (a) of section 51 (relating to amount of targeted jobs credit) is amended to read as follows:

"(a) DETERMINATION OF AMOUNT.—For purposes of section 38, the amount of the targeted jobs credit determined under this section for the taxable year shall be the sum of—

"(1) 50 percent of the qualified first-year wages for such year, and

"(2) 25 percent of the qualified second-year wages for such year."

(2) Subsection (g) of section 51 is amended by striking out "the credit provided by section 44B" and inserting in lieu thereof "the targeted jobs credit determined under this subpart".

(3) Section 51 is amended by adding at the end thereof the following new subsection:

"(j) ELECTION TO HAVE TARGETED JOBS CREDIT NOT APPLY.—

"(1) IN GENERAL.—A taxpayer may elect to have this section not apply for any taxable year.

"(2) TIME FOR MAKING ELECTION.—An election under paragraph (1) for any taxable year may be made (or revoked) at any time before the expiration of the 3-year period beginning on the last date prescribed by law for filing the return for such taxable year (determined without regard to extensions).

"(3) MANNER OF MAKING ELECTION.—An election under paragraph (1) (or revocation thereof) shall be made in such manner as the Secretary may by regulations prescribe."

(4) Subsection (a) of section 52 is amended by striking out "the credit (if any) allowable by section 44B to each such member" and inserting in lieu thereof "the credit (if any) determined under section 51(a) with respect to each such member".

(5) Subsection (b) of section 52 is amended by striking out "the credit (if any) allowable by section 44B" and inserting in lieu thereof "the credit (if any) determined under section 51(a)".

(6) Subsection (c) of section 52 is amended by striking out "credit shall be allowed under section 44B" and inserting in lieu thereof "credit shall be allowed under section 38 for any targeted jobs credit determined under this subpart".

(7) Paragraph (2) of section 52(d) is amended by striking out ", subject to section 53, a credit under section 44B" and inserting in lieu thereof ", subject to section 38(c), a credit under section 38(a)".

(8) Section 53 (relating to limitation based on amount of tax) is hereby repealed.

(9) The table of sections for old subpart D of part IV of subchapter A of chapter 1 is amended by striking out the item relating to section 53.

(q) SECTION 55.—

(1) Paragraph (1) of section 55(c) (relating to credits) is amended—

(A) by striking out "subpart A of part IV" and inserting in lieu thereof "subpart A, B, or D of part IV", and

(B) by striking out "section 33(a)" each place it appears and inserting in lieu thereof "section 27(a)".

(2) Clause (i) of section 55(c)(2)(B) is amended by striking out "section 33(a)" and inserting in lieu thereof "section 27(a)".

(3) Paragraph (3) of section 55(c) is amended to read as follows:

"(3) CARRYOVER AND CARRYBACK OF CERTAIN CREDITS.—In the case of any taxable year for which a tax is imposed by this section, for purposes of determining the amount of any carryover or carryback to any other taxable year of any credit allowable under section 23, 30 or 38, the amount of the limitation under section 25, 30(g), or 38(c) (as the case may be) shall be deemed to be—

"(A) the amount of such limitation for such taxable year (determined without regard to this paragraph), reduced (but not below zero) by

"(B) the amount of the tax imposed by this section for the taxable year, reduced by—

"(i) the amount of the credit allowable under section 27(a),

"(ii) in the case of the limitation under section 30(g), the amount of such tax taken into account under this subparagraph with respect to the limitation under section 25, and

"(iii) in the case of the limitation under section 38(c), the amount of such tax taken into account under this subparagraph with respect to limitations under sections 25 and 30(g)."

(4) Paragraph (2) of section 55(f) is amended by striking out "allowable under subpart A of part IV of this subchapter (other than under sections 31, 39, and 43)" and inserting in lieu thereof "allowable under subparts A, B, and D of part IV of this subchapter".

(r) TECHNICAL AND CONFORMING AMENDMENTS TO OTHER PROVISIONS.—

(1) SECTION 56.—

(A) Subsection (c) of section 56 (defining regular tax deduction) is amended—

(i) by striking out "subpart A of part IV other than sections 39 and 44G" and inserting in lieu thereof "subparts A, B, and D of part IV", and

(ii) by amending the last sentence to read as follows: "For purposes of the preceding sentence, the amount of the credit determined under section 38 for any taxable year shall be determined without regard to the employee stock ownership credit determined under section 41."

(B) Subparagraph (A) of section 56(e)(1) is amended by striking out clauses (i), (ii), (iii), and (iv) and inserting in lieu thereof the following:

"(i) section 27 (relating to foreign tax credit), and

"(ii) section 38 (relating to general business credit), exceed".

(2) SECTION 86.—Paragraph (1) of section 86(f) (relating to treatment as pension or annuity for certain purposes) is amend-

ed by striking out "section 43(c)(2)" and inserting in lieu thereof "section 32(c)(2)".

(3) SECTION 87.—Section 87 (relating to alcohol fuel credit included in income) is amended to read as follows:

"SEC. 87. ALCOHOL FUEL CREDIT.

"Gross income includes the amount of the alcohol fuel credit determined with respect to the taxpayer for the taxable year under section 40(a)."

(4) SECTION 103.—Clause (iv) of section 103(b)(6)(F) (relating to certain capital expenditures not taken into account) is amended by striking out "section 44F(b)(2)(A)" and inserting in lieu thereof "section 30(b)(2)(A)".

(5) SECTION 108.—Subparagraph (B) of section 108(b)(2) (relating to reduction of tax attributes in title 11 case or insolvency) is amended to read as follows:

"(B) RESEARCH CREDIT AND GENERAL BUSINESS CREDIT.—Any carryover to or from the taxable year of a discharge of an amount for purposes of determining the amount allowable as a credit under—

"(i) section 30 (relating to credit for increasing research activities), or

"(ii) section 38 (relating to general business credit).

For purposes of this subparagraph, there shall not be taken into account any portion of a carryover which is attributable to the employee stock ownership credit determined under section 41."

(6) SECTION 129.—

(A) Paragraph (2) of section 129(b) (relating to earned income limitation) is amended by striking out "section 44A(e)(2)" and inserting in lieu thereof "section 21(d)(2)".

(B) Paragraph (1) of section 129(e) (defining dependent care assistance) is amended by striking out "section 44A(c)(2)" and inserting in lieu thereof "section 21(b)(2)".

(C) Paragraph (2) of section 129(e) (defining earned income) is amended by striking out "section 43(c)(2)" and inserting in lieu thereof "section 32(c)(2)".

(7) SECTION 168.—

(A) Clause (i) of section 168(i)(1)(D), as added by section 208(a) of the Tax Equity and Fiscal Responsibility Act of 1982, is amended by striking out "subpart A of part IV" and inserting in lieu thereof "subparts A, B, and D of part IV".

(B) Clause (iii) of section 168(i)(1)(D), as added by section 208(a) of the Tax Equity and Fiscal Responsibility Act of 1982, is amended by striking out "under the last sentence of section 53(a)" and inserting in lieu thereof "under section 25(b)(2)".

(C) Subparagraph (A) of section 168(i)(4), as added section 208(a) of the Tax Equity and Fiscal Responsibility Act of 1982, is amended by striking out "subpart A of part IV of subchapter A of this chapter" and inserting in lieu thereof "section 38".

(D) Clause (i) of section 168(i)(1)(D), as added by section 209(b) of the Tax Equity and Fiscal Responsibility Act of 1982, is amended by striking out "subpart A of part IV" and inserting in lieu thereof "subparts A, B, and D of part IV".

(E) Clause (iii) of section 168(i)(1)(D), as added by section 209(b) of the Tax Equity and Fiscal Responsibility Act of 1982, is amended by striking out "under the last sentence of section 53(a)" and inserting in lieu thereof "under section 25(b)(2)".

(8) SECTION 196.—

(A) Section 196 (relating to deduction for certain unused investment credits) is amended to read as follows:

"SEC. 196. DEDUCTION FOR CERTAIN UNUSED BUSINESS CREDITS.

"(a) ALLOWANCE OF DEDUCTION.—If any portion of the qualified business credits determined for any taxable year has not, after the application of section 38(c), been allowed to the taxpayer as a credit under section 38 for any taxable year, an amount equal to the credit not so allowed shall be allowed to the taxpayer as a deduction for the first taxable year following the last taxable year for which such credit could, under section 39, have been allowed as a credit.

"(b) TAXPAYER'S DYING OR CEASING TO EXIST.—If a taxpayer dies or ceases to exist before the first taxable year following the last taxable year for which the qualified business credits could, under section 39, have been allowed as a credit, the amount described in subsection (a) (or the proper portion thereof) shall, under regulations prescribed by the Secretary, be allowed to the taxpayer as a deduction for the taxable year in which such death or cessation occurs.

"(c) QUALIFIED BUSINESS CREDITS.—For purposes of this section, the term 'qualified business credits' means—

"(1) the investment credit determined under section 46(a) (but only to the extent attributable to property the basis of which is reduced by section 48(q)),

"(2) the targeted jobs credit determined under section 51(a), and

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

"(d) SPECIAL RULE FOR INVESTMENT TAX CREDIT.—In the case of the investment credit determined under section 46(a) (other than a credit to which section 48(q)(3) applies), subsection (a) shall be applied by substituting "an amount equal to 50 percent of" for "an amount equal to".

(B) The table of sections for part VI of subchapter B of chapter 1 is amended by striking out the item relating to section 196 and inserting in lieu thereof:

"Sec. 196. Deduction for certain unused business credits."

(9) SECTION 213.—Subsection (e) of section 213 (relating to exclusion of amounts allowed for care of certain dependents) is amended by striking out "section 44A" and inserting in lieu thereof "section 21".

(10) SECTION 280c.—

(A) Section 280C (relating to certain expenses for which credits are allowable) is amended by striking out subsection

(a) and by redesignating subsections (b) and (c) as subsections (a) and (b), respectively.

(B) Subsection (a) of section 280C (as so redesignated) is amended—

(i) by striking out the first sentence and inserting in lieu thereof the following: "No deduction shall be allowed for that portion of the wages or salaries paid or incurred for the taxable year which is equal to the amount of the credit determined for the taxable year under section 51(a).", and

(ii) by striking out "SECTION 44B CREDIT" in the subsection heading and inserting in lieu thereof "TARGETED JOBS CREDIT".

(C) Subsection (b) of section 280C (as so redesignated) is amended by striking out "44H" each place it appears and inserting in lieu thereof "29".

(D) Paragraph (3) of section 280C(b) (as so redesignated) is amended—

(i) by striking out "section 44F(f)(5)" and inserting in lieu thereof "section 30(f)(5)",

(ii) by striking out "section 44F(f)(1)(B)" and inserting in lieu thereof "section 30(f)(1)(B)",

(iii) by striking out "section 44F(f)(1)" and inserting in lieu thereof "section 30(f)(1)".

(11) SECTION 381.—Subsection (c) of section 381 is amended—

(A) by striking out paragraphs (23), (24), (26), (27), and (30),

(B) by redesignating paragraphs (25), (28), and (29) as paragraphs (23), (24), and (25), respectively,

(C) by striking out "44F" each place it appears in paragraph (25) (as so redesignated) and inserting in lieu thereof "30", and

(D) by adding at the end thereof the following new paragraph:

"(26) CREDIT UNDER SECTION 38.—The acquiring corporation shall take into account (to the extent proper to carry out the purposes of this section and section 38, and under such regulations as may be prescribed by the Secretary) the items required to be taken into account for purposes of section 38 in respect of the distributor or transferor corporation."

(12) SECTION 383.—

(A) Section 383 (as in effect on the day before the date of the enactment of the Tax Reform Act of 1976) is amended—

(i) by striking out "with respect to any unused investment credit" and all that follows and inserting in lieu thereof the following: "with respect to any unused business credit of the corporation which can otherwise be carried forward under section 39, to any unused credit of the corporation which could otherwise be carried forward under section 30(g)(2), to any excess foreign taxes of the corporation which could otherwise be carried forward under section 904(c), and to any net capital loss of the corporation which can otherwise be carried forward under section 1212.", and

(ii) by striking out the section heading and inserting in lieu thereof the following:

"SEC. 383. SPECIAL LIMITATIONS ON UNUSED BUSINESS CREDITS, RESEARCH CREDITS, FOREIGN TAXES, AND CAPITAL LOSSES."

(B) Section 383 (as amended by the Tax Reform Act of 1976) is amended—

(i) by striking out "with respect to any unused investment credit" and all that follows and inserting in lieu thereof the following: "with respect to any unused business credit of the corporation under section 39, to any unused credit of the corporation under section 30(g)(2), to any excess foreign taxes of the corporation under section 904(c), and to any net capital loss of the corporation under section 1212.", and

(ii) by striking out the section heading and inserting in lieu thereof the following:

"SEC. 383. SPECIAL LIMITATIONS ON UNUSED BUSINESS CREDITS, RESEARCH CREDITS, FOREIGN TAXES, AND CAPITAL LOSSES."

(C) The table of sections for part V of subchapter C of chapter 1 is amended by striking out the item relating to section 383 and inserting in lieu thereof the following:

"Sec. 383. Special limitations on unused business credits, research credits, foreign taxes, and capital losses."

(13) Paragraph (21) of section 401(a) is amended by striking out "allowable—" and all that follows and inserting in lieu thereof "allowable under section 41 if the employer made the transfer described in section 41(c)(1)(B)."

(14) SECTION 404.—Subsection (i) of section 404 (relating to deductibility of unused portions of employee stock ownership credit) is amended to read as follows:

"(i) DEDUCTIBILITY OF UNUSED PORTIONS OF EMPLOYEE STOCK OWNERSHIP CREDIT.—

"(1) UNUSED CREDIT CARRYOVERS.—If any portion of the employee stock ownership credit determined under section 41 for any taxable year has not, after the application of section 38(c), been allowed under section 38 for any taxable year, such portion shall be allowed as a deduction (without regard to any limitations provided under this section) for the last taxable year to which such portion could have been allowed as a credit under section 39.

"(2) REDUCTIONS IN CREDIT.—There shall be allowed as a deduction (subject to the limitations provided under this section) an amount equal to any reduction of the credit allowed under section 41 resulting from a final determination of such credit to the extent such reduction is not taken into account under section 41(c)(3)."

(15) SECTION 409.—

(A) Section 409 (relating to qualifications for tax credit employee stock ownership plans), as redesignated by section 491 of this Act, is amended by striking out "44G" each place it appears in subsections (b), (g), (i), (m), and (n) and inserting in lieu thereof "41".

(B) Paragraph (1) of section 409(b), as so redesignated, is amended by striking out "48(n)(1)(A) or".

(C) Subsection (g) of section 409, as so redesignated, is amended by adding at the end thereof the following new sentence: "For purposes of the preceding sentence, the references to section 48(n)(1) and the employee plan credit shall refer to such section and credit as in effect before the enactment of the Tax Reform Act of 1984."

(D) Subparagraph (A) of section 409(i)(1), as so redesignated, is amended by striking out "48(n)(1) or".

(E) Subsection (k) of section 409, as so redesignated, is amended by adding at the end thereof the following new sentence: "For purposes of this subsection, the reference to the matching employee plan credit shall refer to such credit as in effect before the enactment of the Tax Reform Act of 1984."

(16) SECTION 527(g)(1).—Paragraph (1) of section 527(g) (relating to treatment of newsletter funds) is amended by striking out "section 41(c)(2)" and inserting in lieu thereof "section 24(c)(2)".

(17) SECTION 642(a)(2).—Paragraph (2) of section 642(a) (relating to credit for political contributions) is amended by striking out "section 41" and inserting in lieu thereof "section 24".

(18) SECTION 691(b).—Subsection (b) of section 691 (relating to allowance of deductions and credit) is amended by striking out "section 33" each place it appears and inserting in lieu thereof "section 27".

(19) SECTIONS 874(a) AND 882(c)(2).—Sections 874(a) and 882(c)(2) are each amended—

(A) by striking out "32" and inserting in lieu thereof "33", and

(B) by striking out "section 39" and inserting in lieu thereof "section 34".

(20) SECTION 901(a).—Subsection (a) of section 901 (relating to allowance of foreign tax credit) is amended by striking out the last sentence and inserting in lieu thereof the following: "The credit shall not be allowed against any tax treated as a tax not imposed by this chapter under section 25(b)."

(21) SECTION 904(g).—Subsection (g) of section 904 (relating to limitation on foreign tax credit) is amended to read as follows:

"(g) COORDINATION WITH NONREFUNDABLE PERSONAL CREDITS.—In the case of an individual, for purposes of subsection (a), the tax against which the credit is taken is such tax reduced by the sum of the credits allowable under subpart A of part IV of subchapter A of this chapter."

(22) SECTION 936.—

(A) Clause (i)(I)(a) of section 936(h)(5)(C) is amended by striking out "section 44F(b)" and inserting in lieu thereof "section 30(b)".

(B) Clause (i)(IV)(c) of section 936(h)(5)(C) is amended—

(i) by striking out "section 44F" and inserting in lieu thereof "section 30", and

(ii) by striking out "section 44F(f)" and inserting in lieu thereof "section 30(f)".

(23) SECTION 1016(a)(21).—Paragraph (21) of section 1016(a) (relating to adjustments to basis) is amended—

(A) by striking out "section 44C(e)" and inserting in lieu thereof "section 23(e)", and

(B) by striking out "section 44C" and inserting in lieu thereof "section 23".

(24) SECTION 1033(g)(3)(A).—Subparagraph (A) of section 1033(g)(3) (relating to election to treat outdoor advertising displays as real property) is amended by striking out "the credit allowed by section 38 (relating to investment in certain depreciable property)" and inserting in lieu thereof "the investment credit determined under section 46(a)".

(25) SECTION 1351(i).—Subsection (i) of section 1351 (relating to adjustments for succeeding years) is amended—

(A) by striking out "section 33" and inserting in lieu thereof "section 27", and

(B) by striking out "section 38 (relating to investment credit)" and inserting in lieu thereof "section 38 (relating to general business credit)".

(26) SECTION 1366(f).—Paragraph (1) of section 1366(f) (relating to special rules) is amended by striking out "section 39" each place it appears and inserting in lieu thereof "section 34".

(27) SECTION 1374(b).—Subsection (b) of section 1374 (relating to amount of tax imposed on certain capital gains) is amended by striking out "section 39" and inserting in lieu thereof "section 34".

(28) SECTION 1375(c).—Paragraph (1) of section 1375(c) (relating to disallowance of credit) is amended by striking out "section 39" and inserting in lieu thereof "section 34".

(29) SECTION 1451.—

(A) Chapter 3 (relating to withholding of tax on nonresident aliens and foreign corporations and tax-free covenant bonds) is amended by striking out subchapter B and by redesignating subchapter C as subchapter B.

(B) The table of subchapters for chapter 3 is amended by striking out the items relating to subchapters B and C and inserting in lieu thereof the following:

"SUBCHAPTER B. Application of withholding provisions."

(C) The heading of chapter 3 is amended by striking out ***"AND TAX-FREE COVENANT BONDS"****.*

(D) The table of chapters for subtitle A is amended by striking out "and tax-free covenant bonds" in the item relating to chapter 3.

(E) Section 12 is amended by striking out paragraph (6) and by redesignating paragraphs (7) and (8) as paragraphs (6) and (7), respectively.

(F) Subsection (f) of section 164 (as in effect before its redesignation by the Social Security Amendments of 1983) is amended by striking out paragraph (1) and by redesignating paragraphs (2) and (3) as paragraphs (1) and (2), respectively.

(G) Subsection (a) of section 1441 is amended by striking out "except in the cases provided for in section 1451 and".

(H) Paragraph (3) of section 1441(c) is amended by striking out "section 1451" and inserting in lieu thereof "section

1451 (as in effect before its repeal by the Tax Reform Act of 1984)".

(I) Subsection (a) of section 1442 is amended—

(i) by striking out "or section 1451", and

(ii) by striking out "; except that, in the case of interest described in section 1451 (relating to tax-free covenant bonds), the deduction and withholding shall be at the rate specified therein".

(J) Paragraph (2) of section 6049(b) (relating to amounts not treated as interest) is amended—

(i) by adding "and" at the end of subparagraph (C),

(ii) by striking out ", and" at the end of subparagraph (D) and inserting in lieu thereof a period, and

(iii) by striking out subparagraph (E).

(K) Paragraph (16) of section 7701(a) is amended by striking out "1451,".

(30) SECTION 3507.—Subsections (b), (c), and (e) of section 3507 (relating to advanced payment of earned income credit) are each amended by striking out "section 43" each place it appears and inserting in lieu thereof "section 32".

(31) SECTION 6096(b).—Subsection (b) of section 6096 (defining income tax liability) is amended by striking out "allowable under sections 33, 37, 38, 40, 41, 42, 44, 44A, 44B, 44C, 44D, 44E, 44F, 44G, and 44H" and inserting in lieu thereof "allowable under part IV of subchapter A of chapter 1 (other than subpart C thereof)".

(32) SECTION 6201(a)(4).—Paragraph (4) of section 6201(a) (relating to erroneous credit under section 39 or 43) is amended—

(A) by striking out "section 39" and inserting in lieu thereof "section 34",

(B) by striking out "section 43" and inserting in lieu thereof "section 32", and

(C) by striking out "SECTION 39 OR 43" in the paragraph heading and inserting in lieu thereof "SECTION 32 OR 34".

(33) SECTION 6211(b).—

(A) Paragraph (1) of section 6211(b) is amended by striking out "without regard to so much of the credit under section 32 as exceeds 2 percent of the interest on obligations described in section 1451" and inserting in lieu thereof "without regard to the credit under section 33".

(B) Paragraph (4) of section 6211(b) is amended by striking out "section 39" and inserting in lieu thereof "section 34".

(34) SECTION 6213(h)(3).—Paragraph (3) of section 6213(h) is amended by striking out "section 39" and inserting in lieu thereof "section 32 or 34".

(35) SECTION 6362(c)(1).—Paragraph (1) of section 6362(c) (relating to qualified resident tax which is a percentage of the Federal tax) is amended by striking out "sections 31 and 39" and inserting in lieu thereof "sections 31 and 34".

(36) SECTION 6401(b).—Subsection (b) of section 6401 (relating to excessive credits treated as overpayments) is amended to read as follows:

"(b) EXCESSIVE CREDITS.—

"(1) In general.—If the amount allowable as credits under subpart C of part IV of subchapter A of chapter 1 (relating to refundable credits) exceeds the tax imposed by subtitle A (reduced by the credits allowable under subparts A, B, and D of such part IV), the amount of such excess shall be considered an overpayment.

"(2) Special rule for credit under section 33.—For purposes of paragraph (1), any credit allowed under section 33 (relating to withholding of tax on nonresident aliens and on foreign corporations) for any taxable year shall be treated as a credit allowable under subpart C of part IV of subchapter A of chapter 1 only if an election under subsection (g) or (h) of section 6013 is in effect for such taxable year."

(37) Section 6411.—

(A) So much of subsection (a) of section 6411 as precedes paragraph (2) thereof (relating to tentative carryback and refund adjustments) is amended to read as follows:

"(a) Application for Adjustment.—A taxpayer may file an application for a tentative carryback adjustment of the tax for the prior taxable year affected by a net operating loss carryback provided in section 172(b), by a business credit carryback provided in section 39, by a research credit carryback provided in section 30(g)(2) or by a capital loss carryback provided in section 1212(a)(1), from any taxable year. The application shall be verified in the manner prescribed by section 6065 in the case of a return of such taxpayer and shall be filed, on or after the date of filing for the return for the taxable year of the net operating loss, net capital loss, or unused business credit from which the carryback results and within a period of 12 months after such taxable year or, with respect to any portion of a research credit carryback or a business credit carryback attributable to a net operating loss carryback or a net capital loss carryback from a subsequent taxable year, within a period of 12 months from the end of such subsequent taxable year (or, with respect to any portion of a business credit carryback attributable to a research credit carryback from a subsequent taxable year within a period of 12 months from the end of such subsequent taxable year), in the manner and form required by regulations prescribed by the Secretary. The applications shall set forth in such detail and with such supporting data and explanation as such regulations shall require—

"(1) The amount of the net operating loss, net capital loss, unused research credit, or unused business credit;".

(B) Subsections (b) and (c) of section 6411 are each amended by striking out "unused investment credit, unused work incentive program credit, unused new employee credit, unused research credit, or unused employee stock ownership credit" each place it appears and inserting in lieu thereof "unused research credit, or unused business credit".

(38) Sections 6420(g)(2), etc.—Sections 6420(g)(2), 6421(i)(3), and 6427(i)(3) are each amended by striking out "section 39" and inserting in lieu thereof "section 34".

(39) Section 6603(p).—Section 6603 is amended by striking out subsection (p) and by redesignating subsection (q) as subsection (p).

(40) SECTION 6613(d)(4)(C).—Subparagraph (C) of section 6613(d)(4) (defining credit carryback) is amended to read as follows:

"(C) CREDIT CARRYBACK DEFINED.—For purposes of this paragraph, the term 'credit carryback' means any business carryback under section 39 and any research credit carryback under section 30(g)(2)."

(41) SECTION 7871.—Subparagraph (A) of section 7871(a)(6) is amended by striking out "section 41(c)(4)" and inserting in lieu thereof "section 24(c)(4)".

(42) SECTION 9502(d).—Paragraph (3) of section 9502(d) (relating to transfers from the Airport and Airway Trust Fund on account of certain section 39 credits) is amended—

(A) by striking out "section 39" and inserting in lieu thereof "section 34", and

(B) by striking out "SECTION 39 CREDITS" in the heading and inserting in lieu thereof "SECTION 34 CREDITS".

(43) SECTION 9503(c).—Clause (ii) of section 9503(c)(2)(A) (relating to transfers from the Highway Trust Fund for certain repayments and credits) is amended by striking out "section 39" and inserting in lieu thereof "section 34".

SEC. 475. EFFECTIVE DATES.

(a) GENERAL RULE.—The amendments made by this title shall apply to taxable years beginning after December 31, 1983, and to carrybacks from such years.

(b) TAX-FREE COVENANT BONDS.—The amendments made by subsections (j) and (r)(29) of section 474 shall not apply with respect to obligations issued before January 1, 1984.

(c) CLARIFICATION OF EFFECT OF AMENDMENTS ON INVESTMENT TAX CREDIT.—Nothing in the amendments made by section 474(o) shall be construed as reducing the amount of any credit allowable for qualified investment in taxable years beginning before January 1, 1984.

Subtitle G—Miscellaneous Simplification Provisions

SEC. 481. PREFERRED STOCK ELIGIBLE UNDER SECTION 1244.

(a) GENERAL RULE.—Subsections (c)(1) and (d)(2) of section 1244 (relating to losses on small business stock) are each amended by striking out "common stock" and inserting in lieu thereof "stock".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to stock issued after the date of the enactment of this Act in taxable years ending after such date.

SEC. 482. MEDICAL CARE DEDUCTION ALLOWED FOR LODGING AWAY FROM HOME IN CERTAIN CASES.

(a) IN GENERAL.—Subsection (d) of section 213 (relating to definitions for purposes of the deduction for medical, dental, etc., expenses), as amended by section 423(b), is amended by redesignating paragraphs (2), (3), (4), (5), (6), and (7) as paragraphs (3), (4), (5), (6), (7), and (8), respectively, and by inserting after paragraph (1) the following new paragraph:

"(2) AMOUNTS PAID FOR CERTAIN LODGING AWAY FROM HOME TREATED AS PAID FOR MEDICAL CARE.—Amounts paid for lodging (not lavish or extravagant under the circumstances) while away from home primarily for and essential to medical care referred to in paragraph (1)(A) shall be treated as amounts paid for medical care if—

"(A) the medical care referred to in paragraph (1)(A) is provided by a physician in a licensed hospital (or in a medical care facility which is related to, or the equivalent of, a licensed hospital), and

"(B) there is no significant element of personal pleasure, recreation, or vacation in the travel away from home.

The amount taken into account under the preceding sentence shall not exceed $50 for each night for each individual."

(b) TECHNICAL AMENDMENT.—

(1) Paragraph (7) of section 213(d), as redesignated by subsection (a), is amended by striking out "paragraph (5)" and inserting in lieu thereof "paragraph (6)".

(2) Paragraph (6) of section 152(e), as amended by section 423 of this Act, is amended by striking out "section 213(d)(4)" and inserting in lieu thereof "section 213(d)(5)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1983.

Subtitle H—Repeal of Certain Obsolete Provisions

SEC. 491. TERMINATION OF RULES RELATING TO QUALIFIED BOND PURCHASE PLANS AND RETIREMENT BONDS WITH RESPECT TO BONDS ISSUED AFTER DECEMBER 31, 1983.

(a) QUALIFIED BOND PURCHASE PLANS.—Section 405 (relating to qualified bond purchase plans) is hereby repealed.

(b) RETIREMENT BONDS.—Section 409 (relating to retirement bonds) is hereby repealed.

(c) EXISTING BONDS MAY BE ROLLED OVER INTO QUALIFIED EMPLOYER PLANS.—

(1) Subparagraph (A) of section 405(d)(3) (as in effect before its repeal by subsection (a)) is amended to read as follows:

"(A) IN GENERAL.—If—

"(i) any qualified bond is redeemed,

"(ii) any portion of the excess of the proceeds from such redemption over the basis of such bond is transferred to an individual retirement plan which is maintained for the benefit of the individual redeeming such bond, or to a qualified trust (as defined in section 402(a)(5)(D)(iii)) for the benefit of such individual, and

"(iii) such transfer is made on or before the 60th day after the individual received the proceeds of such redemption,

then gross income shall not include the proceeds to the extent so transferred and the transfer shall be treated as a rollover contribution described in section 408(d)(3)."

(2) Subsection (e) of section 402 (relating to tax on lump-sum distributions) is amended by adding at the end thereof the following new paragraph:

"(5) SPECIAL RULE WHERE PORTION OF LUMP-SUM DISTRIBUTION ATTRIBUTABLE TO ROLLOVER OF BOND PURCHASED UNDER QUALIFIED BOND PURCHASE PLAN.—If any portion of a lump-sum distribution is attributable to a transfer described in section 405(d)(3)(A)(ii) (as in effect before its repeal by the Tax Reform Act of 1984), paragraphs (1) and (3) of this subsection and paragraph (2) of subsection (a) shall not apply to such portion."

(d) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Paragraph (2) of section 55(f) (defining regular tax) is amended by striking "409(c),".

(2) Paragraph (7) of section 62 (defining adjusted gross income) is amended—

(A) by striking out "the deductions allowed by section 404 and section 405(c)" and inserting in lieu thereof "the deduction allowed by section 404", and

(B) by striking out "ANNUITY, AND BOND PURCHASE" in the heading and inserting in lieu thereof "AND ANNUITY".

(3) Paragraph (1) of section 72(o) is amended by striking out "402, 403, and 405" and inserting in lieu thereof "402 and 403".

(4) Paragraph (4) of section 72(o) is amended by striking out "408(d)(3), and 409(b)(3)(C)" and inserting in lieu thereof "and 408(d)(3)".

(5) Subparagraph (D) of section 172(d)(4) is amended by striking out "or section 405(c)".

(6) Paragraph (2) of section 219(d) is amended by striking out "405(d)(3), 408(d)(3), or 409(b)(3)(C)" and inserting in lieu thereof "or 408(d)(3)".

(7) Paragraph (1) of section 219(e) is amended by striking out the last sentence.

(8) Paragraph (3) of section 219(e) is amended by striking out subparagraph (C), by adding "and" at the end of subparagraph (B) and by redesignating subparagraph (D) as subparagraph (C).

(9) Clause (iv) of section 402(a)(5)(D) is amended by striking out subclause (III) and by redesignating subclauses (IV) and (V) as subclauses (III) and (IV), respectively.

(10) Clause (i) of section 402(a)(5)(F), as amended by this Act, is amended by striking out ", (II), or (III)" and inserting in lieu thereof "or (II)".

(11) Clause (ii) of section 402(a)(5)(F), as amended by this Act, is amended by striking out "(IV) or (V)" and inserting in lieu thereof "(III) or (IV)".

(12) The last sentence of section 403(b)(1) is amended by striking out "or 409(b)(3)(C)".

(13) Subsection (a) of section 406 is amended by striking out ", an annuity plan described in section 403(a), or a bond purchase plan described in section 405(a)" and inserting in lieu thereof "or an annuity plan described in section 403(a)".

(14) Paragraph (3) of section 406(a) is amended by striking out ", 403(a), or 405(a)" and inserting in lieu thereof "or 403(a)".

(15) Subsection (d) of section 406 is amended—

(A) by striking out "sections 404 and 405(c)" and inserting in lieu thereof "section 404",

(B) by striking out "annuity, or bond purchase" and inserting in lieu thereof "or annuity", and

(C) by striking out "(or section 405(c))" in paragraph (2) thereof.

(16) Paragraph (1) of section 407(a) is amended by striking out ", an annuity plan described in section 403(a), or a bond purchase plan described in section 405(a)" and inserting in lieu thereof "or an annuity plan described in section 403(a)".

(17) Subparagraph (B) of section 407(a)(1) is amended by striking out ", 403(a), or 405(a)" and inserting in lieu thereof "or 403(a)".

(18) Subsection (d) of section 407 is amended—

(A) by striking out "sections 404 and 405(c)" and inserting in lieu thereof "section 404",

(B) by striking out "annuity, or bond purchase" and inserting in lieu thereof "or annuity", and

(C) by striking out "(or section 405(c))" in paragraph (2) thereof.

(19) Paragraph (1) of section 408(a) is amended by striking out "403(b)(8), 405(d)(3), or 409(b)(3)(C)" and inserting in lieu thereof "or 403(b)(8)".

(20) Clause (i) of section 408(d)(3)(A) is amended by striking out "or retirement bond".

(21) Subparagraph (B) of section 408(d)(3) is amended by striking out ", individual retirement annuity, or a retirement bond" and inserting in lieu thereof "or an individual retirement annuity".

(22) Clause (ii) of section 408(d)(3)(D) (relating to partial rollovers) is amended by striking out "bond,".

(23) Paragraph (6) of section 408(d) is amended—

(A) by striking out ", individual retirement annuity, or retirement bond" and inserting in lieu thereof "or an individual retirement annuity", and

(B) by striking out ", annuity, or bond" and inserting in lieu thereof "or annuity".

(24) Subparagraph (E) of section 408(k)(3) is amended by striking out ", 403(a), or 405(a)" and inserting in lieu thereof "or 403(a)".

(25) Paragraph (2) of section 412(a) is amended by striking out "or 405(a)".

(26) Subsection (h) of section 414 is amended by striking out "or 405(a)".

(27) Subsection (l) of section 414 is amended by striking out "or 405".

(28) Paragraph (2) of section 415(a) is amended by striking out subparagraph (D), by striking out "or" at the end of subparagraph (C), by adding "or" at the end of subparagraph (B), and by striking out "405(a),".

(29) Subparagraph (A) of section 415(b)(2) is amended by striking out "408(d)(3), and 409(b)(3)(C)" and inserting in lieu thereof "and 408(d)(3)".

(30) Subparagraph (B) of section 415(b)(2) is amended by striking out "408(d)(3) and 409(b)(3)(C)" and inserting in lieu thereof "and 408(d)(3)".

(31) Paragraph (2) of section 415(c) is amended by striking out "405(d)(3), 408(d)(3), and 409(b)(3)(C)" and inserting in lieu thereof "and 408(d)(3)".

(32) Paragraph (1) of section 415(k) is amended by striking out subparagraphs (C) and (H), by redesignating subparagraphs (D), (E), (F), and (G) as subparagraphs (C), (D), (E), and (F), respectively, by striking out ", or" at the end of subparagraph (F) (as so redesignated) and inserting in lieu thereof a period, and by adding "or" at the end of subparagraph (E) (as so redesignated).

(33) Paragraph (2) of section 457(e) is amended by striking out subparagraph (C) and by redesignating subparagraphs (D) and (E) as subparagraphs (C) and (D), respectively.

(34) Subsection (e) of section 2039 is amended—

(A) by striking out paragraph (3),

(B) by striking out ", or" at the end of paragraph (2) and inserting in lieu thereof a period,

(C) by adding "or" at the end of paragraph (1),

(D) by striking out "405(d)(3), 408(d)(3), or 409(b)(3)(C)" and inserting in lieu thereof "or 408(d)(3)", and

(E) by striking out ", annuity, or bond" each place it appears and inserting in lieu thereof "or annuity".

(35) Paragraph (5) of section 2517(a) is amended by striking out ", an individual retirement annuity described in section 408(b), or a retirement bond described in section 409(a)" and inserting in lieu thereof "or an individual retirement annuity described in section 408(b)".

(36) Paragraph (5) of section 3121(a) is amended by striking out subparagraph (C) and by redesignating subparagraphs (D) through (G) as subparagraphs (C) through (F), respectively.

(37) Paragraph (5) of section 3306(b) is amended by striking out subparagraph (C) and by redesignating subparagraphs (D) through (G) as subparagraphs (C) through (F), respectively.

(38) Paragraph (12) of section 3401(a) is amended by striking out subparagraph (C) and by redesignating subparagraph (D) as subparagraph (C).

(39) Subsection (e) of section 209 of the Social Security Act is amended by inserting "(as in effect before the enactment of the Tax Reform Act of 1984)" after "Internal Revenue Code of 1954" in paragraph (4) thereof.

(40) Subsection (a) of section 4972 is amended by striking out the last sentence and inserting in lieu thereof "This section applies only to plans which include a trust described in section 401(a) or which are described in section 403(a)."

(41) Subsection (a) of section 4973 is amended—

(A) by striking out paragraph (3),

(B) by striking out "or" at the end of paragraph (2),

(C) by adding "or" at the end of paragraph (1),

(D) by striking out ", annuities, or bonds" and inserting in lieu thereof "or annuities", and

(E) by striking out ", annuity, or bond" and inserting in lieu thereof "or annuity".

(42) Subparagraph (A) of section 4973(b)(1) is amended by striking out "408(d)(3), and 409(b)(3)(C)" and inserting in lieu thereof "and 408(d)(3)".

(43) The last sentence of section 4973(b) is amended by striking out ", individual retirement annuity, or bond" and inserting in lieu thereof "or the individual retirement annuity".

(44) Paragraph (1) of section 4973(c) is amended by striking out ", 408(d)(3)(A)(iii), or 409(b)(3)(C)" and inserting in lieu thereof "or 408(d)(3)(A)(iii)".

(45) The last sentence of section 4975(d) is amended by striking out ", individual retirement annuity, or an individual retirement bond (as defined in section 408 or 409)" and inserting in lieu thereof "or an individual retirement annuity (as defined in section 408)".

(46) Paragraph (1) of section 4975(e) is amended—

(A) by striking out "or 405(a)",

(B) by striking out "or a retirement bond described in section 409",

(C) by striking out "annuity, or bond" and inserting in lieu thereof "or annuity", and

(D) by striking out "account, or bond" and inserting in lieu thereof "or account".

(47) Section 6047 is amended by striking out subsection (c) and by redesignating subsections (d), (e), and (f) as subsections (c), (d), and (e), respectively.

(48) Subsection (e) of section 6058 is amended by striking out paragraph (2) and by redesignating paragraphs (3) and (4) as paragraphs (2) and (3), respectively.

(49) Clause (i) of section 6104(a)(1)(B) is amended by striking out ", 403(a), or 405(a)" and inserting in lieu thereof "or 403(a)".

(50) Subsection (f) of section 6652 is amended by striking out "and bond purchase".

(51) Section 7207 is amended by striking out "or (c)".

(52) Subsection (c) of section 7476 is amended by striking out paragraph (3), by striking out ", or" at the end of paragraph (2) and inserting in lieu thereof a period, and by adding ", or" at the end of paragraph (1).

(53) Paragraph (37) of section 7701(a) is amended by striking out subparagraph (C), by striking out ", and" at the end of subparagraph (B) and inserting in lieu thereof a period, and by adding "and" at the end of subparagraph (A).

(54) The table of sections of subpart A of part I of subchapter D of chapter 1 is amended by striking out the items relating to sections 405 and 409.

*(55) The section heading for section 4973 is amended by striking out "**CERTAIN INDIVIDUAL RETIREMENT ANNUITIES, AND CERTAIN RETIREMENT BONDS**" and inserting in lieu thereof "**AND CERTAIN INDIVIDUAL RETIREMENT ANNUITIES**".*

(56) The table of sections for chapter 43 is amended by striking out "certain individual retirement annuities, and certain retirement bonds" in the item relating to section 4973 and inserting in lieu thereof "and certain individual retirement annuities".

(57) The section heading for section 6047 is amended by striking out "AND BOND PURCHASE".

(58) The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by striking out "and bond purchase" in the item relating to section 6047.

(59) The first sentence of section 3107 of title 31, United States Code, is amended by inserting before the period ", as in effect before the enactment of the Tax Reform Act of 1984".

(e) SECTION 409A REDESIGNATED AS SECTION 409.—

(1) The section heading for section 409A is amended by striking out "SEC. 409A." and inserting in lieu thereof "SEC. 409.".

(2) Subsection (c)(1)(A)(i) of old section 44G is amended by striking out "section 409A" and inserting in lieu thereof "section 409".

(3) Paragraph (6) of old section 44G(c) is amended by striking out "section 409A(l)" and inserting in lieu thereof "section 409(l)".

(4) Paragraph (22) of section 401(a) is amended by striking out "section 409A" and inserting in lieu thereof "section 409".

(5) Paragraph (23) of section 401(a) is amended by striking out "section 409A(h)" each place it appears and inserting in lieu thereof "section 409(h)".

(6) Clause (ii) of section 415(c)(6)(B) is amended by striking out "section 409A" and inserting in lieu thereof "section 409".

(7) Paragraph (7) of section 4975(e) is amended—

(A) by striking out "section 409A(h)" and inserting in lieu thereof "section 409(h)",

(B) by striking out "section 409A(e)(4)" and inserting in lieu thereof "section 409(e)(4)", and

(C) by striking out "section 409A(e)" and inserting in lieu thereof "section 409(e)".

(8) Paragraph (8) of section 4975(e) is amended by striking out "section 409A(l)" and inserting in lieu thereof "section 409(l)".

(9) Paragraphs (1) and (3) of section 6699(a) are each amended by striking out "section 409A" and inserting in lieu thereof "section 409".

(10) The table of sections for subpart A of part I of subchapter D of chapter 1 is amended by striking out "Sec. 409A" and inserting in lieu thereof "Sec. 409".

(f) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments and repeals made by subsections (a), (b), and (d) shall apply to obligations issued after December 31, 1983.

(2) SUBSECTION (c).—The amendment made by subsection (c) shall apply to redemptions after the date of the enactment of this Act in taxable years ending after such date.

(3) SUBSECTION (e).—The amendments made by subsection (e) shall take effect on January 1, 1984.

(4) BONDS UNDER QUALIFIED BOND PURCHASE PLANS MAY BE REDEEMED AT ANY TIME.—Notwithstanding—

(A) subparagraph (D) of section 405(b)(1) of the Internal Revenue Code of 1954 (as in effect before its repeal by this section), and

(B) the terms of any bond described in subsection (b) of such section 405,

such a bond may be redeemed at any time after the date of the enactment of this Act in the same manner as if the individual redeeming the bond had attained age 59½.

(5) TREATMENT OF TAX IMPOSED UNDER SECTION 409(C).—For purposes of section 26(b) of the Internal Revenue Code of 1954 (as amended by this Act), any tax imposed by section 409(c) of such Code (as in effect before its repeal by this section) shall be treated as a tax imposed by section 408(f) of such Code.

SEC. 492. REPEAL OF RULES RELATING TO GAINS FROM DISPOSITION OF PROPERTY USED IN FARMING WHERE FARM LOSSES OFFSET NONFARM INCOME.

(a) IN GENERAL.—Section 1251 (relating to gain from disposition of property used in farming where farm losses offset nonfarm income) is hereby repealed.

(b) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) SECTION 170.—

(A) The second sentence of section 170(e)(1) (relating to certain contributions of ordinary income and capital gain property) is amended by striking out "1251(c),".

(B) Subparagraph (C) of section 170(e)(3) (relating to special rule for certain contributions of inventory and other property) is amended by striking out "1251,".

(2) SECTION 341.—Paragraph (12) of section 341(e) (relating to nonapplication of section 1245(a)) is amended by striking out "1251(c),".

(3) SECTION 453b.—The second sentence of section 453B(d)(2) (relating to liquidations to which section 337 applies) is amended by striking out "1251(c),".

(4) SECTION 751.—The second sentence of subsection (c) of section 751 (defining unrealized receivables) is amended—

(A) by striking out "farm recapture property (as defined in section 1251(e)(1)),", and

(B) by striking out "1251(c),".

(5) SECTION 1252.—The second sentence of section 1252(a)(1) (relating to gains from disposition of farm land) is amended by striking out ", except that this section shall not apply to the extent section 1251 applies to such gain".

(c) CLERICAL AMENDMENT.—The table of sections for part IV of subchapter P of chapter 1 is amended by striking out the item relating to section 1251.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1983.

TITLE V—EMPLOYEE BENEFIT PROVISIONS

Subtitle A—Welfare Benefit Plans

SEC. 511. TREATMENT OF FUNDED WELFARE BENEFIT PLANS.

(a) GENERAL RULE.—Part I of subchapter D of chapter 1 (relating to pension, profit sharing, stock bonus plans, etc.) is amended by adding at the end thereof the following new subpart:

"Subpart D—Treatment of Welfare Benefit Funds

"SEC. 419. TREATMENT OF FUNDED WELFARE BENEFIT PLANS.

"(a) GENERAL RULE.—Contributions paid or accrued by an employer to a welfare benefit fund—

"(1) shall not be deductible under section 162 or 212, but

"(2) if they testify the requirements of either of such sections, shall (subject to the limitation of subsection (b)) be deductible under this section for the taxable year in which paid.

"(b) LIMITATION.—The amount of the deduction allowable under subsection (a)(2) for any taxable year shall not exceed the welfare benefit fund's qualified cost for the taxable year.

"(c) QUALIFIED COST.—For purposes of this section—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, the term 'qualified cost' means, with respect to any taxable year, the sum of—

"(A) the qualified direct cost for such taxable year, and

"(B) subject to the limitation of section 419A(b), any addition to a qualified asset account for the taxable year.

"(2) REDUCTION FOR FUNDS AFTER-TAX INCOME.—In the case of any welfare benefit fund, the qualified cost for any taxable year shall be reduced by such fund's after-tax income for such taxable year.

"(3) QUALIFIED DIRECT COST.—

"(A) IN GENERAL.—The term 'qualified direct cost' means, with respect to any taxable year, the aggregate amount which would have been allowable as a deduction to the employer with respect to the benefits provided during the taxable year, if—

"(i) such benefits were provided directly by the employer, and

"(ii) the employer used the cash receipts and disbursements method of accounting.

"(B) TIME WHEN BENEFITS PROVIDED.—For purposes of subparagraph (A), a benefit shall be treated as provided when such benefit would be includible in the gross income of the employee if provided directly by the employer (or

would be so includible but for any provision of this chapter excluding such benefit from gross income).

"(C) 60-MONTH AMORTIZATION OF CHILD CARE FACILITIES.—

"(i) IN GENERAL.—In determining qualified direct costs with respect to any child care facility for purposes of subparagraph (A), in lieu of depreciation the adjusted basis of such facility shall be allowable as a deduction ratably over a period of 60 months beginning with the month in which the facility is placed in service.

"(ii) CHILD CARE FACILITY.—The term 'child care facility' means any tangible property which qualifies under regulations prescribed by the Secretary as a child care center primarily for children of employees of the employer; except that such term shall not include any property—

"(I) not of a character subject to depreciation; or

"(II) located outside the United States.

"(4) AFTER-TAX INCOME.—

"(A) IN GENERAL.—The term 'after-tax income' means, with respect to any taxable year, the gross income of the welfare benefit fund reduced by the sum of—

"(i) the deductions allowed by this chapter which are directly connected with the production of such gross income, and

"(ii) the tax imposed by this chapter on the fund for the taxable year.

"(B) TREATMENT OF CERTAIN AMOUNTS.—In determining the gross income of any welfare benefit fund—

"(i) contributions and other amounts received from employees shall be taken into account, but

"(ii) contributions from the employer shall not be taken into account.

"(5) ITEM ONLY TAKEN INTO ACCOUNT ONCE.—No item may be taken into account more than once in determining the qualified cost of any welfare benefit fund.

"(d) CARRYOVER OF EXCESS CONTRIBUTIONS.—If—

"(1) the amount of the contributions paid (or deemed paid under this subsection) by the employer during any taxable year to a welfare benefit fund, exceeds.

"(2) the limitation of subsection (b),

such excess shall be treated as an amount paid by the employer to such fund during the succeeding taxable year.

"(e) WELFARE BENEFIT FUND.—For purposes of this section—

"(1) IN GENERAL.—The term 'welfare benefit fund' means any fund—

"(A) which is part of a plan of an employer, and

"(B) through which the employer provides welfare benefits to employees or their beneficiaries.

"(2) WELFARE BENEFIT.—The term 'welfare benefit' means any benefit other than a benefit with respect to which—

"(A) section 83(h) applies,

"(B) section 404 applies (determined without regard to section 404(b)(2)),

"(C) section 404A applies, or

"(D) an election under section 463 applies.

"(3) FUND.—The term 'fund' means—

"(A) any organization described in paragraph (7), (9), (17), or (20) of section 501(c),

"(B) any trust, corporation, or other organization not exempt from the tax imposed by this chapter, and

"(C) to the extent provided in regulations, any account held for an employer by any person.

"(f) METHOD OF CONTRIBUTIONS, ETC., HAVING THE EFFECT OF A PLAN.—If—

"(1) there is no plan, but

"(2) there is a method or arrangement of employer contributions or benefits which has the effect of a plan,

this section shall apply as if there were a plan.

"(g) EXTENSION TO PLANS FOR INDEPENDENT CONTRACTORS.—If any fund would be a welfare benefit fund (as modified by subsection (f)) but for the fact that there is no employee-employer relationship—

"(1) this section shall apply as if there were such a plan, and

"(2) any reference in this section to the employer shall be treated as a reference to the person for whom services are provided, and any reference in this section to an employee shall be treated as a reference to the person providing the services.

"Sec. 419A. QUALIFIED ASSET ACCOUNT; LIMITATION ON ADDITIONS TO ACCOUNT.

"(a) GENERAL RULE.—For purposes of this subpart, the term 'qualified asset account' means any account consisting of assets set aside to provide for the payment of—

"(1) disability benefits,

"(2) medical benefits,

"(3) SUB or severance pay benefits, or

"(4) life insurance benefit.

"(b) LIMITATION ON ADDITIONS TO ACCOUNT.—No addition to any qualified asset account may be taken into account under section 419(c)(1)(B) to the extent such addition results in the amount in such account exceeding the account limit.

"(c) ACCOUNT LIMIT.—For purposes of this section—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, the account limit for any qualified asset account for any taxable year is the amount reasonably and actuarially necessary to fund—

"(A) claims incurred but unpaid (as of the close of such taxable year) for benefits referred to in subsection (a), and

"(B) administrative costs with respect to such claims.

"(2) ADDITIONAL RESERVE FOR POST-RETIREMENT MEDICAL AND LIFE INSURANCE BENEFITS.—The account limit for any taxable year may include a reserve funded over the working lives of the covered employees and actuarially determined on a level basis (using assumptions that are reasonable in the aggregate) as necessary for—

"(A) medical benefits provided for retired employees (determined on the basis of current medical costs), or

"(B) life insurance benefits provided to retired employees

"(3) AMOUNT TAKEN INTO ACCOUNT FOR SUB OR SEVERENCE PAY BENEFITS.—

"(A) IN GENERAL.—The account limit for any taxable year with respect to SUB or severance pay benefits is 75 percent of the sum of—

"(i) the average annual qualified direct costs for SUB or severance pay benefits for any 2 of the immediately preceding 7 taxable years (as selected by the fund), and

"(ii) the average annual administrative costs during such 2 preceding taxable years allocable to SUB or severance pay benefits.

"(B) SPECIAL RULE FOR CERTAIN NEW PLANS.—In the case of any new plan for which SUB or severance pay benefits are not available to any key employee, the Secretary shall, by regulations, provide for an interim amount to be taken into account under paragraph (1).

"(4) LIMITATION ON AMOUNTS TO BE TAKEN INTO ACCOUNT.—

"(A) DISABILITY BENEFITS.—For purposes of paragraph (1), disability benefits payable to any individual shall not be taken into account to the extent such benefits are payable at an annual rate in excess of the lower of—

"(i) 75 percent of such individual's average compensation for his high 3 years (within the meaning of section 415(b)(3)), or

"(ii) the limitation in effect under section 415(b)(1)(A).

"(B) LIMITATION ON SUB OR SEVERANCE PAY BENEFITS.—For purposes of paragraph (3), any SUB or severance pay benefit payable to any individual shall not be taken into account to the extent such benefit is payable at an annual rate in excess of 150 percent of the limitation in effect under section 415(c)(1)(A).

"(5) SPECIAL LIMITATION WHERE NO ACTUARIAL CERTIFICATION.—

"(A) IN GENERAL.—Unless there is an actuarial certification of the account limit determined under paragraph (1) for any taxable year, the account limit for such taxable year shall not exceed the sum of the safe harbor limits for such taxable year.

"(B) SAFE HARBOR LIMITS.—

"(i) SHORT-TERM DISABILITY BENEFITS.—In the case of short-term disability benefits, the safe harbor limit for any taxable year is 17.5 percent of the sum of—

"(I) the qualified direct costs for the immediately preceding taxable year with respect to such benefits, and

"(II) the administrative costs for such preceding taxable year allocable to such benefits.

"(ii) MEDICAL BENEFITS.—In the case of medical benefits, the safe harbor limit for any taxable year is 35 percent of the sum of—

"(I) the qualified direct costs for the immediately preceding taxable year with respect to medical benefits, and

"(II) the administrative costs for such preceding taxable year allocable to medical benefits.

"(iii) SUB OR SEVERANCE PAY BENEFITS.—In the case of SUB or severance pay benefits, the safe harbor limit for any taxable year is the amount determined under paragraph (3).

"(iv) LONG-TERM DISABILITY OR LIFE INSURANCE BENEFITS.—In the case of any long-term disability benefit or life insurance benefit, the safe harbor limit for any taxable year shall be the amount prescribed by regulations.

"(d) REQUIREMENT OF SEPARATE ACCOUNTS FOR POST-RETIREMENT MEDICAL OR LIFE INSURANCE BENEFITS PROVIDED TO KEY EMPLOYEES.—

"(1) IN GENERAL.—In the case of any employee who is a key employee—

"(A) a separate account shall be established for any medical benefits or life insurance benefits provided with respect to such employee after retirement, and

"(B) medical benefits and life insurance benefits provided with respect to such employee after retirement may only be paid from such separate account.

"(2) COORDINATION WITH SECTION 415.—For purposes of section 415, any amount attributable to medical benefits allocated to an account established under paragraph (1) shall be treated as an annual addition to a defined contribution plan for purposes of section 415(c).

"(3) KEY EMPLOYEE.—For purposes of this section, the term 'key employee' means any employee who, at any time during the plan year or any preceding plan year, is or was a key employee as defined in section 416(i).

"(e) SPECIAL LIMITATIONS ON RESERVES FOR MEDICAL BENEFITS OR LIFE INSURANCE BENEFITS PROVIDED TO RETIRED EMPLOYEES.—

"(1) BENEFITS MUST BE NONDISCRIMINATORY.—No reserve may be taken into account under subsection (c)(2) for medical benefits or life insurance benefits provided to retired employees unless the plan meets the requirements of section 505(b)(1) with respect to such benefits.

"(2) TAXABLE LIFE INSURANCE BENEFITS NOT TAKEN INTO ACCOUNT.—No life insurance benefit may be taken into account under subsection (c)(2) to the extent—

"(A) such benefit is includible in gross income under section 79, or

"(B) such benefit would be includible in gross income under section 101(b) (determined by substituting '$50,000' for '$5,000').

"(f) DEFINITIONS AND OTHER SPECIAL RULES.—For purposes of this section—

"(1) SUB OR SEVERANCE PAY BENEFIT.—The term 'SUB or severance pay benefit' means—

"(A) any supplemental unemployment compensation benefit (as defined in section 501(c)(17)(D)), and

"(B) any severance pay benefit.

"(2) MEDICAL BENEFIT.—The term 'medical benefit' means a benefit which consists of the providing (directly or through insurance) of medical care (as defined in section 213(d)).

"(3) LIFE INSURANCE BENEFIT.—The term 'life insurance benefit' includes any other death benefit.

"(4) VALUATION.—For purposes of this section, the amount of the qualified asset account shall be the value of the assets in such account (as determined under regulations).

"(5) HIGHER LIMIT IN CASE OF COLLECTIVELY BARGAINED PLANS.—Not later than July 1, 1985, the Secretary shall by regulations provide for special account limits in the case of any qualified asset account under a welfare benefit fund established under a collective bargaining agreement.

"(6) EXCEPTION FOR 10-OR-MORE EMPLOYER PLANS.—

"(A) IN GENERAL.—This subpart shall not apply in the case of any welfare benefit fund which is part of a 10 or more employer plan. The preceding sentence shall not apply to any plan which maintains experience-rating arrangements with respect to individual employers.

"(B) 10 OR MORE EMPLOYER PLAN.—For purposes of subparagraph (A), the term '10 or more employer plan' means a plan—

"(i) to which more than 1 employer contributes, and

"(ii) to which no employer normally contributes more than 10 percent of the total contributions contributed under the plan by all employers.

"(7) ADJUSTMENTS FOR EXISTING EXCESS RESERVES.—

"(A) INCREASE IN ACCOUNT LIMIT.—The account limit for any of the first 4 taxable years to which this section applies shall be increased by the applicable percentage of any existing excess reserves.

"(B) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A)—

"In the case of:	*The applicable percentage is:*
The first taxable year to which this section applies	*80*
The second taxable year to which this section applies	*60*
The third taxable year to which this section applies	*40*
The fourth taxable year to which this section applies	*20.*

"(C) EXISTING EXCESS RESERVE.—For purposes of this paragraph, the term 'existing excess reserve' means the excess (if any) of—

"(i) the amount of assets set aside for purposes described in subsection (a) as of the close of the first taxable year ending after the date of the enactment of the Tax Reform Act of 1984, over

"(ii) the account limit which would have applied under this section to such taxable year if this section had applied to such taxable year.

"(g) EMPLOYER TAXED ON INCOME OF WELFARE BENEFIT FUND IN CERTAIN CASES.—

"(1) IN GENERAL.—In the case of any welfare benefit fund which is not an organization described in paragraph (7), (9), (17), or (20) of section 501(c), the employer shall include in gross income for any taxable year an amount equal to such fund's deemed unrelated income for the fund's taxable year ending within the employer's taxable year.

"(2) DEEMED UNRELATED INCOME.—For purposes of paragraph (1), the deemed unrelated income of any welfare benefit fund referred to in paragraph (1) shall be the amount which would have been its unrelated business taxable income under section 512(a)(3) if such fund were an organization described in paragraph (7), (9), (17), or (20) of section 501(c).

"(h) AGGREGATION RULES.—For purposes of this subpart—

"(1) AGGREGATION OF FUNDS.—At the election of the employer, 2 or more welfare benefit funds of such employer may be treated as 1 fund.

"(2) TREATMENT OF RELATED EMPLOYERS.—Rules similar to the rules of subsections (b), (c), (m), and (n) of section 414 shall apply.

"(i) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this subpart. Such regulations may provide that the plan administrator of any welfare benefit fund which is part of a plan to which more than 1 employer contributes shall submit such information to the employers contributing to the fund as may be necessary to enable the employers to comply with the provisions of this section."

(b) AMENDMENTS TO TAX ON UNRELATED BUSINESS INCOME.—

(1) EXTENSION OF SECTION 512(A)(3) TO SUPPLEMENTAL UNEMPLOYMENT BENEFIT AND GROUP LEGAL TRUSTS.—

(A) Paragraph (3) of section 512(a) (relating to special rules applicable to organizations described in section 501(c) (7) or (9)) is amended by striking out "section 501(c) (7) or (9)" each place it appears (including in the paragraph heading) and inserting in lieu thereof "paragraph (7), (9), (17), or (20) of section 501(c)".

(B) Clause (ii) of section 512(a)(3)(B) is amended by striking out "section 501(c)(9)" and inserting lieu thereof "paragraph (9), (17), or (20) of section 501(c)".

(2) LIMITATION ON DEDUCTION FOR SET-ASIDE.—Paragraph (3) of section 512(a) is amended by adding at the end thereof the following new subparagraph:

"(E) LIMITATION ON AMOUNT OF SETASIDE IN THE CASE OF ORGANIZATIONS DESCRIBED IN PARAGRAPH (9), (17), OR (20) OF SECTION 501(C).—

"(i) IN GENERAL.—In the case of any organization described in paragraph (9), (17), or (20) of section 501(c), a set-aside for any purpose specified in clause (ii) of subparagraph (B) may be taken into account under subparagraph (B) only to the extent that such set-aside does not result in an amount of assets set aside for such purpose in excess of the account limit determined under section 419A(c) for the taxable year (not taking into account any reserve for medical benefits provided to retired employees).

"(ii) NO SET ASIDE FOR FACILITIES.—No set aside for assets used in the provision of benefits described in clause (ii) of subparagraph (B) shall be taken into account.

"(iii) TREATMENT OF EXISTING RESERVES FOR MEDICAL BENEFITS OR LIFE INSURANCE BENEFITS PROVIDED TO RETIRED EMPLOYEES.—

"(I) Clause (i) shall not apply to any income attributable to an existing reserve for medical or life insurance benefits for retired employees.

"(II) For purposes of subclause (I), the term 'existing reserve for medical benefits or life insurance benefits for retired employees' means the amount of assets set aside as of the close of the last plan year ending before the date of the enactment of the Tax Reform Act of 1984 for purposes of providing medical benefits or life insurance benefits to retired employees.

"(III) All payments during taxable years to which this subparagraph applies of medical benefits or life insurance benefits to retired employees shall be charged against the reserve referred to in subclause (II).

"(iv) TREATMENT OF TAX EXEMPT ORGANIZATIONS.—This paragraph shall not apply to any organization if substantially all of the contributions to such organization are made by employers who were exempt from tax under this chapter throughout the 5-taxable year period ending with the taxable year in which the contributions are made."

(c) TAX ON CERTAIN FUNDED WELFARE BENEFIT PLANS.—

(1) IN GENERAL.—Chapter 43 (relating to qualified pension, etc., plans) is amended by adding at the end thereof the following new section:

"SEC. 4976. TAXES WITH RESPECT TO FUNDED WELFARE BENEFIT PLANS.

"(a) GENERAL RULE.—If—

"(1) an employer maintains a welfare benefit fund, and

"(2) there is a disqualified benefit provided during any taxable year,

there is hereby imposed on such employer a tax equal to 100 percent of such disqualified benefit.

"(b) DISQUALIFIED BENEFIT.—For purposes of subsection (a), the term 'disqualified benefit' means—

"(1) any medical benefit or life insurance benefit provided with respect to a key employee other than from a separate account established for such owner under section 419A(d), and

"(2) any medical or life insurance benefit provided with respect to a retired employee unless the plan meets the requirements of section 505(b)(1) with respect to such benefit, and

"(3) any portion of such fund reverting to the benefit of the employer.

"(c) DEFINITIONS.—For purposes of this section, the terms used in this section shall have the same respective meanings as when used in subpart D of part I of subchapter D of chapter 1."

(2) CONFORMING AMENDMENT.—The table of sections for chapter 43 (relating to qualified pension, etc., plans) is amended by adding at the end thereof the following new item:

"Sec. 4977. Taxes with respect to funded welfare benefit plans."

(d) CLERICAL AMENDMENT.—The table of subparts for part I of subchapter D of chapter 1 is amended by adding at the end thereof the following new item:

"Subpart D. Treatment of welfare benefit funds."

(e) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to contributions paid or accrued after December 31, 1985, in taxable years ending after such date.

(2) SPECIAL RULE FOR COLLECTIVE BARGAINING AGREEMENTS.—In the case of plan maintained pursuant to 1 or more collective bargaining agreements—

(A) between employee representatives and 1 or more employers, and

(B) in effect on July 1, 1985 (or ratified on or before such date),

the amendments made by this section and section 514 shall not apply to years beginning before the date on which the last of the collective bargaining agreements relating to the plan terminates (determined without regard to any extension thereof agreed to after July 1, 1985).

(3) SPECIAL RULE FOR PARAGRAPH (2).—For purposes of paragraph (2), any plan amendment made pursuant to a collective bargaining agreement relating to the plan which amends the plan solely to conform to any requirement added by this section shall not be treated as a termination of such collective bargaining agreement.

(4) SPECIAL EFFECTIVE DATE FOR CONTRIBUTIONS OF FACILITIES.—Notwithstanding paragraphs (1) and (2), the amendments made by this section shall apply in the case of—

(A) any contribution after June 22, 1984, of a facility to a welfare benefit fund, and

(B) any other contribution after June 22, 1984, to a welfare benefit fund to be used to acquire a facility.

(5) BINDING CONTRACT EXCEPTION TO PARAGRAPH (4).—Paragraph (4) shall not apply to any facility—

(A) which is acquired pursuant to a binding contract in effect on June 22, 1984, and at all times thereafter, or

(B) any facility the construction of which began before June 22, 1984.

SEC. 512. TREATMENT OF UNFUNDED DEFERRED BENEFITS.

(a) GENERAL RULE.—Subsection (b) of section 404 (relating to method of contributions, etc., having the effect of a plan) is amended to read as follows:

"(b) METHOD OF CONTRIBUTIONS, ETC., HAVING THE EFFECT OF A PLAN; UNFUNDED DEFERRED BENEFITS.—

"(1) METHOD OF CONTRIBUTIONS, ETC., HAVING THE EFFECT OF A PLAN.—If—

"(A) there is no plan, but

"(B) there is a method or arrangement of employer contributions or compensation which has the effect of a stock bonus, pension, profit-sharing, or annuity plan, or other plan deferring the receipt of compensation (including a plan described in paragraph (2)),

subsection (a) shall apply if there were such a plan.

"(2) PLANS PROVIDING UNFUNDED DEFERRED BENEFITS.—

"(A) IN GENERAL.—For purposes of this section, any plan providing for deferred benefits (other than compensation) for employees, their spouses, or their dependents shall be treated as a plan deferring the receipt of compensation. In the case of such a plan, for purposes of this section, the determination of when an amount is includible in gross income shall be made without regard to any provisions of this chapter excluding such benefits from gross income.

"(B) EXCEPTION FOR CERTAIN BENEFITS.—Subparagraph (A) shall not apply to—

"(i) any benefit provided through a welfare benefit fund (as defined in section 419(e)), or

"(ii) to any benefit with respect to which an election under section 463 applies."

(b) CROSS REFERENCE.—Subsection (j) of section 162 (relating to cross references) is amended by adding at the end thereof the following new paragraph:

"(3) For special rules relating to—

"(A) funded welfare benefit plans, see section 419, and

"(B) deferred compensation and other deferred benefits, see section 404."

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to amounts paid or incurred after the date of the enactment of this Act in taxable years ending after such date.

(2) EXCEPTION FOR CERTAIN EXTENDED VACATION PAY PLANS.—In the case of any extended vacation pay plan maintained pursuant to a collective bargaining agreement—

(A) between employee representatives and 1 or more employers, and

(B) in effect on June 22, 1984,

the amendments made by this section shall not apply before the date on which such collective bargaining agreement terminates (determined without regard to any extension thereof agreed to after June 22, 1984). For purposes of the preceding sentence, any plan amendment made pursuant to a collective bargaining agreement relating to the plan which amends the plan solely to conform to any requirement added by this section shall not be treated as a termination of such collective bargaining agreement.

SEC. 513. ADDITIONAL REQUIREMENTS FOR TAX-EXEMPT STATUS OF CERTAIN ORGANIZATIONS.

(a) GENERAL RULE.—Part I of subchapter F of chapter 1 (relating to exempt organizations) is amended by adding at the end thereof the following new section:

"SEC. 505. ADDITIONAL REQUIREMENTS FOR ORGANIZATIONS DESCRIBED IN PARAGRAPH (9), (17), OR (20) OF SECTION 501(c).

"(a) CERTAIN REQUIREMENTS MUST BE MET IN THE CASE OF ORGANIZATIONS DESCRIBED IN PARAGRAPH (9), (17), OR (20) OF SECTION 501(c).—

"(1) VOLUNTARY EMPLOYEES' BENEFICIARY ASSOCIATIONS, ETC.—An organization described in paragraph (9) or (20) of subsection (c) of section 501 which is part of a plan of an employer shall not be exempt from tax under section 501(a) unless such plan meets the requirements of subsection (b) of this section.

"(3) EXCEPTION FOR COLLECTIVE BARGAINING AGREEMENTS.—Paragraph (1) shall not apply to any organization which is part of a plan maintained pursuant to 1 or more collective bargaining agreements between 1 or more employee organizations and 1 or more employers.

"(b) NONDISCRIMINATION REQUIREMENTS.—

"(1) IN GENERAL.—Except as provided in paragraph (2), a plan meets the requirements of this subsection only if—

"(A) each class of benefits under the plan is provided under a classification of employees which is set forth in the plan and which is found by the Secretary not to be discriminatory in favor of employees who are highly compensated individuals, and

"(B) in the case of each class of benefits, such benefits do not discriminate in favor of employees who are highly compensated employees.

A life insurance, disability, severance pay, or supplemental unemployment compensation benefit shall not be considered to fail to meet the requirements of subparagraph (B) merely because the benefits available bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of employees covered by the plan.

"(2) EXCLUSION OF CERTAIN EMPLOYEES.—For purposes of paragraph (1), there may be excluded from consideration—

"(A) employees who have not completed 3 years of service,

"(B) employees who have not attained age 21,

"(C) seasonal employees or less than half-time employees,

"(D) employees not included in the plan who are included in a unit of employees covered by an agreement between employee representatives and 1 or more employers which the Secretary finds to be a collective bargaining agreement if the class of benefits involved was the subject of good faith bargaining between such employee representatives and such employer or employers, and

"(E) employees who are nonresident aliens and who receive no earned income (within the meaning of section 911(d)(2)) from the employer which constitutes income from sources within the United States (within the meaning of section 861(a)(3)).

"(3) APPLICATION OF SUBSECTION WHERE OTHER NONDISCRIMINATION RULES PROVIDED.—In the case of any benefit for which a provision of this chapter other than this subsection provides nondiscrimination rules, paragraph (1) shall not apply but the requirements of this subsection shall be met only if the nondiscrimination rules so provided are satisfied with respect to such benefit.

"(4) AGGREGATION RULES.—For purposes of this subsection—

"(A) AGGREGATION OF PLANS.—At the election of the employer, 2 or more plans of such employer may be treated as 1 plan.

"(B) TREATMENT OF RELATED EMPLOYERS.—Rules similar to the rules of subsections (b), (c), (m), and (n) of section 414 shall apply. For purposes of the preceding sentence, section 414(n) shall be applied without regard to paragraph (5).

"(5) HIGHLY COMPENSATED INDIVIDUAL.—For purposes of this subsection, the term 'highly compensated individual' has the meaning given such term by section 105(h)(5). For purposes of the preceding sentence, section 105(h)(5) shall be applied by substituting '10 percent' for '25 percent'.

"(c) REQUIREMENT THAT ORGANIZATION NOTIFY SECRETARY THAT IT IS APPLYING FOR TAX-EXEMPT STATUS.—

"(1) IN GENERAL.—An organization shall not be treated as an organization described in paragraph (9), (17), or (20) of section 501(c)—

"(A) unless it has given notice to the Secretary, in such manner as the Secretary may by regulations prescribe, that it is applying for recognition of such status, or

"(B) for any period before the giving of such notice, if such notice is given after the time prescribed by the Secretary by regulations for giving notice under this subsection.

"(2) SPECIAL RULE FOR EXISTING ORGANIZATIONS.—In the case of any organization in existence on the date of the enactment of the Tax Reform Act of 1984, the time for giving notice under paragraph (1) shall not expire before the date 1 year after such date of the enactment."

(b) CLERICAL AMENDMENT.—The table of sections for part I of subchapter F of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 505. Additional requirements for organizations described in paragraph (9), (17), or (20) of section 501(c)."

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to years beginning after December 31, 1984.

(2) TREATMENT OF CERTAIN BENEFITS IN PAY STATUS AS OF JANUARY 1, 1985.—For purposes of determining whether a plan meets the requirements of section 505(b) of the Internal Revenue Code of 1954 (as added by subsection (a)), there may (at the election of the employer) be excluded from consideration all disability or severance payments payable to individuals who are in pay status as of January 1, 1985. The preceding sentence shall not apply to any payment to the extent such payment is increased by any plan amendment adopted after June 22, 1984.

Subtitle B—Provisions Relating to Pension Plans

SEC. 521. REQUIRED DISTRIBUTIONS.

(a) QUALIFIED PENSION PLANS.—

(1) IN GENERAL.—Paragraph (9) of section 401(a) (relating to required distributions), as in effect before the amendments made by section 242 of the Tax Equity and Fiscal Responsibility Act of 1982, is amended to read as follows:

"(9) REQUIRED DISTRIBUTIONS.—

"(A) IN GENERAL.—A trust shall not constitute a qualified trust under this subsection unless the plan provides that the entire interest of each employee—

"(i) will be distributed to such employee not later than the required beginning date, or

"(ii) will be distributed, beginning not later than the required beginning date, in accordance with regulations, over the life of such employee or over the lives of such employee and a designated beneficiary (or over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a designated beneficiary).

"(B) REQUIRED DISTRIBUTION WHERE EMPLOYEE DIES BEFORE ENTIRE INTEREST IS DISTRIBUTED.—

"(i) WHERE DISTRIBUTIONS HAVE BEGUN UNDER SUBPARAGRAPH (A)(ii).—A trust shall not constitute a qualified trust under this section unless the plan provides that if—

"(I) the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii), and

"(II) the employee dies before his entire interest has been distributed to him,

the remaining portion of such interest will be distributed at least as rapidly as under the method of distributions being used under subparagraph (A)(ii) as of the date of his death.

"(ii) 5-YEAR RULE FOR OTHER CASES.—A trust shall not constitute a qualified trust under this section unless the plan provides that, if an employee dies before the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii), the entire interest of the employee will be distributed within 5 years after the death of such employee.

"(iii) EXCEPTION TO 5-YEAR RULE FOR CERTAIN AMOUNTS PAYABLE OVER LIFE OF BENEFICIARY.—If—

"(I) any portion of the employee's interest is payable to (or for the benefit of) a designated beneficiary,

"(II) such portion will be distributed (in accordance with regulations) over the life of such desig-

nated beneficiary (or over a period not extending beyond the life expectancy of such beneficiary), and

"(III) such distributions begin not later than 1 year after the date of the employee's death or such later date as the Secretary may by regulations prescribe,

for purposes of clause (ii), the portion referred to in subclause (I) shall be treated as distributed on the date on which such distributions begin.

"(iv) SPECIAL RULE FOR SURVIVING SPOUSE OF EMPLOYEE.—If the designated beneficiary referred to in clause (iii)(I) is the surviving spouse of the employee—

"(I) the date on which the distributions are required to begin under clause (iii)(III) shall not be earlier than the date on which the employee would have attained age 70½, and

"(II) if the surviving spouse dies before the distributions to such spouse begin, this subparagraph shall be applied as if the surviving spouse were the employee.

"(C) REQUIRED BEGINNING DATE.—For purposes of this paragraph, the term 'required beginning date' means April 1 of the calendar year following the later of—

"(i) the calendar year in which the employee attains age 70½, or

"(ii) the calendar year in which the employee retires.

Except as provided in section 409A(d), clause (ii) shall not apply in the case of an employee who is a 5-percent owner (as defined in section 416) with respect to the plan year ending in the calendar year in which the employee attains 70½.

"(D) LIFE EXPECTANCY.—For purposes of this paragraph, the life expectancy of an employee and the employee's spouse (other than in the case of a life annuity) may be redetermined but not more frequently than annually.

"(E) DESIGNATED BENEFICIARY.—For purposes of this paragraph, the term 'designated beneficiary' means any individual designated as a beneficiary by the employee.

"(F) TREATMENT OF PAYMENTS TO CHILDREN.—Under regulations prescribed by the Secretary, for purposes of this paragraph, any amount paid to a child shall be treated as if it had been paid to the surviving spouse if such amount will become payable to the surviving spouse upon such child reaching majority (or other designated event permitted under regulations)."

(2) REPEAL OF SECTION 242.—Section 242 of the Tax Equity and Fiscal Responsibility Act of 1982 is hereby repealed.

(b) INDIVIDUAL RETIREMENT ACCOUNTS AND ANNUITIES.—

(1) INDIVIDUAL RETIREMENT ACCOUNTS.—Section 408(a) (relating to individual retirement accounts) is amended by striking out paragraphs (6) and (7) and inserting in lieu thereof the following new paragraph:

"(6) Under regulations prescribed by the Secretary, rules similar to the rules of section 401(a)(9) (relating to required distribu-

tions) shall apply to the distribution of the entire interest of an individual for whose benefit the trust is maintained."

(2) INDIVIDUAL RETIREMENT ANNUITIES.—Section 408(b) (relating to individual retirement annuities) is amended by striking out paragraphs (3) and (4), by redesignating paragraph (5) as paragraph (4), and by inserting after paragraph (2) the following new paragraph:

"(3) Under regulations prescribed by the Secretary, rules similar to the rules of section 401(a)(9) (relating to required distributions) shall apply to the distribution of the entire interest of the owner."

(c) SPECIAL RULE FOR CUSTODIAL ACCOUNTS.—Paragraph (7) of section 403(b) (relating to custodial accounts for regulated investment company stock) is amended by adding at the end thereof the following new subparagraph:

"(D) DISTRIBUTION REQUIREMENTS.—For purposes of determining when the interest of an employee in a custodial account must be distributed, such account shall be treated in the same manner as an annuity contract."

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to years beginning after December 31, 1984.

(2) REPEAL OF SECTION 242 OF TEFRA.—The amendment made by subsection (a)(2) shall take effect as if included in the Tax Equity and Fiscal Responsibility Act of 1982.

(3) TRANSITION RULE.—A trust forming part of a plan shall not be disqualified under paragraph (9) of section 401(a) of the Internal Revenue Code of 1954, as amended by subsection (a)(1), by reason of distributions under a designation (before January 1, 1984) by any employee in accordance with a designation described in section 242(b)(2) of the Tax Equity and Fiscal Responsibility Act of 1982 (as in efffect before the amendments made by this Act).

(4) SPECIAL RULE FOR GOVERNMENTAL PLANS.—In the case of a governmental plan (within the meaning of section 414(d) of the Internal Revenue Code of 1954), paragraph (1) shall be applied by substituting "1986" for "1984".

(5) SPECIAL RULE FOR COLLECTIVE BARGAINING AGREEMENTS.—In the case of a plan maintained pursuant to one or more collective bargaining agreements ratified on or before the date of the enactment of this Act between employee representatives and one or more employers, the amendments made by this section shall not apply to years beginning before the earlier of—

(A) the date on which the last of the collective bargaining agreements relating to the plan terminates (determined without regard to any extension thereof agreed to after the date of the enactment of this Act), or

(B) January 1, 1988.

For purposes of subparagraph (A), any plan amendment made pursuant to a collective bargaining agreement relating to the plan which amends the plan solely to conform to any requirement added by this section shall not be treated as a termination of such collective bargaining agreement.

SEC. 522. ROLLOVER OF CERTAIN PARTIAL DISTRIBUTIONS PERMITTED.

(a) GENERAL RULE.—

(1) QUALIFIED TRUSTS.—Clause (i) of section 402(a)(5)(A) (relating to rollover amounts) is amended to read as follows—

"(i) any portion of the balance to the credit of an employee in a qualified trust is paid to him,".

(2) QUALIFIED ANNUITIES.—Clause (i) of section 403(a)(4)(A) (relating to rollover amounts) is amended to read as follows:

"(i) any portion of the balance to the credit of an employee in an employee annuity described in paragraph (1) is paid to him,".

(3) SECTION 403(b) ANNUITIES.—Clause (i) of section 403(b)(8)(A) (relating to rollover amounts) is amended to read as follows:

"(i) any portion of the balance to the credit of an employee in an annuity contract described in paragraph (1) is paid to him,".

(b) SPECIAL RULES FOR ROLLOVERS OF PARTIAL DISTRIBUTIONS.—Paragraph (5) of section 402(a) is amended by redesignating subparagraphs (D) and (E) as subparagraphs (E) and (F), respectively, and by inserting after subparagraph (C) the following new subparagraph:

"(D) SPECIAL RULES FOR PARTIAL DISTRIBUTIONS.—

"(i) REQUIREMENTS.—Subparagraph (A) shall apply to a partial distribution only if—

"(I) such distribution is of an amount equal to at least 50 percent of the balance to the credit of the employee in a qualified trust (determined immediately before such distribution and without regard to subsection (e)(4)(C)),

"(II) such distribution is not one of a series of periodic payments, and

"(III) the employee elects (at such time and in such manner as the Secretary shall by regulations prescribe) to have subparagraph (A) apply to such partial distribution.

"(ii) PARTIAL DISTRIBUTIONS MAY BE TRANSFERRED ONLY TO INDIVIDUAL RETIREMENT PLANS.—In the case of a partial distribution, a plan described in subclause (IV) or (V) of subparagraph (E)(iv) shall not be treated as an eligible retirement plan.

"(iii) DENIAL OF 10-YEAR AVERAGING AND CAPITAL GAINS TREATMENT FOR SUBSEQUENT DISTRIBUTIONS.—If an election under clause (i) is made with respect to any partial distribution paid to any employee—

"(I) paragraph (2) of this subsection,

"(II) paragraphs (1) and (3) of subsection (e), and

"(III) paragraph (2) of section 403(a),

shall not apply to any distribution (paid after such partial distribution) of the balance to the credit of such employee under the plan under which such partial distribution was made (or under any other plan which, under subsection (e)(4)(C), would be aggregated with such plan).

"(iv) SPECIAL RULE FOR UNREALIZED APPRECIATION.—If an election under clause (i) is made with respect to any partial distribution, the second and third sentences of paragraph (1) shall not apply to such distribution."

(c) PARTIAL DISTRIBUTIONS PAID TO SPOUSE OF EMPLOYEE AFTER EMPLOYEE'S DEATH ELIGIBLE FOR ROLLOVER.—Paragraph (7) of section 402(a) (relating to rollover where spouse receives lump-sum distribution at death of employee) is amended to read as follows:

"(7) ROLLOVER WHERE SPOUSE RECEIVES DISTRIBUTIONS AFTER DEATH OF EMPLOYEE.—If any distribution attributable to an employee is paid to the spouse of the employee after the employee's death, paragraph (5) shall apply to such distribution in the same manner as if the spouse were the employee.".

(d) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) The following provisions are each amended by striking out "qualifying rollover distribution" each place it appears and inserting in lieu thereof "qualified total distribution"—

(A) section 402(a)(5)(B),

(B) section 402(a)(5)(E)(i) (as redesignated by subsection (b)), and

(C) section 402(a)(6)(E)(i).

(2) Subparagraph (B) of section 402(a)(5) is amended by adding at the end thereof the following new sentence: "In the case of any partial distribution, the maximum amount transferred to which subparagraph (A) applies shall not exceed the portion of such distribution which is includible in gross income (determined without regard to subparagraph (A))."

(3) Clause (ii) of section 402(a)(5)(E) (as redesignated by subsection (b)) is amended by striking out "gross income" and inserting in lieu thereof "gross income (determined without regard to this paragraph)".

(4) Clause (v) of subparagraph (E) of section 402(a)(5) (as redesignated by subsection (b)) is amended to read as follows:

"(v) PARTIAL DISTRIBUTION.—The term 'partial distribution' means any distribution to an employee of any portion of the balance to the credit of such employee in a qualified trust; except that such term shall not include any distribution which is a qualified total distribution."

(5) Subparagraph (F) of section 402(a)(5) (as redesignated by subsection (b)) is amended by striking out "subparagraph (D)(iv)" each place it appears and inserting in lieu thereof "subparagraph (E)(iv)".

(6) Paragraph (6) of section 402(a) is amended by striking out "paragraph (5)(D)(i)" each place it appears and inserting in lieu thereof "paragraph (5)(E)(i)".

(7) Clauses (iii) and (iv) of section 402(a)(6)(D) are each amended by striking out "employee contributions" and inserting in lieu thereof "employee contributions" (or, in the case of a partial distribution, the amount not includible in gross income)".

(8) Clause (i) of section 402(a)(6)(E) is amended by striking out "paragraph (5) (D)(i)(II)" and inserting in lieu thereof "paragraph (5)(D) or (5)(E)(i)(II)".

(9) Subparagraph (B) of section 403(a)(4) is amended by striking out "(B) through (E)" and inserting in lieu thereof "(B) through (F)".

(10) Subparagraph (B) of section 403(b)(8) is amended to read as follows:

"(B) SPECIAL RULES FOR PARTIAL DISTRIBUTIONS.—

"(i) IN GENERAL.—In the case of any distribution other than a total distribution, rules similar to the rules of clauses (i) and (ii) of section 402(a)(5)(D) shall apply.

"(ii) TOTAL DISTRIBUTION.—For purposes of subparagraph (A), the term 'total distribution' means one or more distributions from an annuity contract described in paragraph (1) which would constitute a lump-sum distribution within the meaning of section 402(e)(4)(A) (determined without regard to subparagraphs (B) and (H) of section 402(e)(4)) if such annuity contract were described in subsection (a), or 1 or more distributions of accumulated deductible employee contributions (within the meaning of section 72(o)(5)).

"(iii) AGGREGATION OF ANNUITY CONTRACTS.—For purposes of this paragraph, all annuity contracts described in paragraph (1) purchased by an employer shall be treated as a single contract, and section 402(e)(4)(C) shall not apply."

(11) Subparagraph (C) of section 403(b)(8) is amended by striking out "(D)(v), and (E)(i)" and inserting in lieu thereof "(F)(i)".

(12) Clause (ii) of section 408(d)(3)(A) is amended by striking out "rollover contribution from an employee's trust" and inserting in lieu thereof "rollover contribution of a qualified total distribution (as defined in section 402(a)(5)(E)(i)) from an employee's trust".

(13) Subparagraph (C) of section 409(b)(3) is amended by striking out the second sentence and inserting in lieu thereof the following new sentences: "This subparagraph does not apply in the case of a transfer to such an employee's trust or such an annuity unless no part of the value of such proceeds is attributable to any source other than a qualified rollover contribution. For purposes of the preceding sentence, the term 'qualified rollover contribution' means any rollover contribution of a qualified total distribution (as defined in section 402(a)(5)(E)(i)) which is from such an employee's trust or annuity plan (other than an annuity plan or a trust forming part of a plan under which the individual was an employee within the meaning of section 401(c)(1) at the time contributions were made on his behalf under such plan), and which did not qualify as a rollover contribution by reason of section 402(a)(7)."

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions made after the date of the amendment of this Act, in taxable years ending after such date.

SEC. 523. TREATMENT OF DISTRIBUTIONS WHERE SUBSTANTIALLY ALL CONTRIBUTIONS ARE EMPLOYEE CONTRIBUTIONS.

(a) IN GENERAL.—Subsection (e) of section 72 (relating to amounts not received as annuities) is amended by adding at the end thereof the following new paragraph:

"(7) SPECIAL RULES FOR PLANS WHERE SUBSTANTIALLY ALL CONTRIBUTIONS ARE EMPLOYEE CONTRIBUTIONS.—

"(A) IN GENERAL.—In the case of any plan or contract to which this paragraph applies, subparagraph (D) of paragraph (5) shall not apply to any amount received from such plan or contract.

"(B) PLANS OR CONTRACTS TO WHICH THIS PARAGRAPH APPLIES.—This paragraph shall apply to any trust or contract—

"(i) which is described in clause (i) or subclause (I), (II), or (III) of clause (ii) of paragraph (5)(D), and

"(ii) with respect to which 85 percent of the total contributions during a representative period are derived from employee contributions.

"(C) SPECIAL RULE FOR CERTAIN FEDERAL PLANS.—If the Federal Government or an instrumentality thereof maintains more than 1 plan, subparagraph (B) shall be applied by aggregating all such plans which are actively administered by the Federal Government or such instrumentality.

(b) CONFORMING AMENDMENTS.—

(1) Subparagraph (D) of section 72(e)(5) (relating to contracts under qualified plans) is amended by striking out "This" and inserting in lieu thereof "Except as provided in paragraph (7), this".

(2) Paragraph (3) of section 72(p) (defining qualified employer plan) is amended by inserting "other than a plan described in subsection (e)(7)" after "section 219(e)(3)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to any amount received or loan made after the 90th day after the date of the enactment of this Act.

SEC. 524. PROVISIONS RELATING TO TOP-HEAVY PLANS.

(a) DEFINITION OF KEY EMPLOYEE.—

(1) IN GENERAL.—Clause (i) of section 416(i)(1)(A) (defining key employee) is amended by inserting "having an annual compensation greater than 150 percent of the amount in effect under section 415(c)(1)(A) for any such plan year" after "employer".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to plan years beginning after December 31, 1983.

(b) ACCRUED BENEFIT OF INDIVIDUAL NOT EMPLOYED WITHIN LAST 5 YEARS DISREGARDED.—

(1) IN GENERAL.—Paragraph (4) of section 416(g) (relating to other special rules) is amended by adding at the end thereof the following new subparagraph:

"(E) BENEFITS NOT TAKEN INTO ACCOUNT IF EMPLOYEE NOT EMPLOYED FOR LAST 5 YEARS.—If any individual has not received any compensation from any employer maintaining the plan (other than benefits under the plan) at any

time during the 5-year period ending on the determination date, any accrued benefit for such individual (and the account of such individual) shall not be taken into account."

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to plan years beginning after December 31, 1984.

(c) SALARY REDUCTION ARRANGEMENTS MAY BE TAKEN INTO ACCOUNT.—

(1) IN GENERAL.—Paragraph (2) of section 416(c) (relating to minimum benefits for defined contribution plans) is amended by striking out subparagraph (C).

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to plan years beginning after December 31, 1984.

(d) CERTAIN GOVERNMENTAL PLANS EXEMPT FROM TOP-HEAVY PLAN RULES.—

(1) IN GENERAL.—Paragraph (10)(B) of section 401(a) (relating to plan requirements regarding top-heavy plans) is amended by adding at the end thereof the following new clause:

"(iii) EXEMPTION FOR GOVERNMENTAL PLANS.—This subparagraph shall not apply to any governmental plan."

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to plan years beginning after December 31, 1983.

(e) QUALIFICATION REQUIREMENTS MODIFIED IF REGULATIONS NOT ISSUED.—

(1) IN GENERAL.—If the Secretary of the Treasury or his delegate does not publish final regulations under section 416 of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act) before January 1, 1985, the Secretary shall publish before such date plan amendment provisions which may be incorporated in a plan to meet the requirements of section 401(a)(10)(B)(ii) of such Code.

(2) EFFECT OF INCORPORATION.—If a plan is amended to incorporate the plan amendment provisions described in paragraph (1), such plan shall be treated as meeting the requirements of section 401(a)(10)(B)(ii) of the Internal Revenue Code of 1954 during the period such amendment is in effect but not later than 6 months after the final regulations described in paragraph (1) are published.

(3) FAILURE BY SECRETARY TO PUBLISH.—If the Secretary of the Treasury or his delegate does not publish plan amendment provisions described in paragraph (1), the plan shall be treated as meeting the requirements of section 401(a)(10)(B) of the Internal Revenue Code of 1954 if—

(A) such plan is amended to incorporate such requirements by reference, except that

(B) in the case of any optional requirement under section 416 of such Code, if such amendment does not specify the manner in which such requirement will be met, the employer shall be treated as having elected the requirement with respect to each employee which provides the maximum vested accrued benefit for such employee.

SEC. 525. REPEAL OF ESTATE TAX EXCLUSION FOR QUALIFIED PENSION PLAN BENEFITS.

(a) IN GENERAL.—Section 2039 (relating to inclusion in the gross estate of annuities) is amended by striking out subsections (c), (d), (e), (f), and (g) and inserting in lieu thereof the following new subsection:

"(c) EXCEPTION OF CERTAIN ANNUITY INTERESTS CREATED BY COMMUNITY PROPERTY LAWS.—

"(1) IN GENERAL.—In the case of an employee on whose behalf contributions or payments were made by his employer or former employer under a trust, plan, or contract to which this subsection applies, if the spouse of such employee predeceases such employee, then notwithstanding any provision of law, there shall be excluded from the gross estate of such spouse the value of any interest of such spouse in such trust, plan, or contract, to the extent such interest—

"(A) is attributable to such contributions or payments, and

"(B) arises solely by reason of such spouse's interest in community income under the community property laws of a State.

"(2) TRUSTS, PLANS, AND CONTRACTS TO WHICH SUBSECTION APPLIES.—This subsection shall apply to—

"(A) any trust, plan, or contract which at the time of the decedent's separation from employment (by death or otherwise), or if earlier, at the time of termination of the plan—

"(i) formed part of a plan which met the requirements of section 401(a), or

"(ii) was purchased pursuant to a plan described in section 403(a), or

"(B) a retirement annuity contract purchased for an employee by an employer which is—

"(i) an organization referred to in clause (ii) or (vi) of section 170(b)(1)(A), or

"(ii) a religious organization (other than a trust) exempt from taxation under section 501(a).

"(3) AMOUNT CONTRIBUTED BY EMPLOYEE.—For purposes of this subsection—

"(A) contributions or payments made by the decedent's employer or former employer under a trust, plan, or contract described in paragraph (2)(A) shall not be considered to be contributed by the decedent, and

"(B) contributions or payments made by the decedent's employer or former employer toward the purchase of an annuity contract described in paragraph (2)(B) shall not be considered to be contributed by the decedent to the extent excludable from gross income under section 403(b)."

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to the estates of decedents dying after December 31, 1984.

(2) EXCEPTION FOR PARTICIPANTS IN PAY STATUS.—The amendments made by this section shall not apply to the estate of any decedent who—

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(A) was a participant in any plan who was in pay status on December 31, 1984, and

(B) irrevocably elected the form of the benefit before the date of the enactment of this Act.

(3) PAY STATUS RULE EXTENDED TO $100,000 LIMITATION.—Subsection (c) of section 245 of the Tax Equity and Fiscal Responsibility Act of 1982 is amended by inserting ", except that such amendments shall not apply to the estate of any decedent who was a participant in any plan who was in pay status on December 31, 1982, and irrevocably elected before January 1, 1983, the form of benefit".

SEC. 526. AFFILIATED SERVICE GROUPS, EMPLOYEE LEASING ARRANGEMENTS, AND COLLECTIVE BARGAINING AGREEMENTS.

(a) ATTRIBUTION RULES FOR AFFILIATED SERVICE GROUPS.—

(1) IN GENERAL.—Subparagraph (B) of section 414(m)(6), as in effect for taxable years beginning after December 31, 1983, is amended by striking out "section 267(c)" and inserting in lieu thereof "section 318(a)".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to taxable years beginning after December 31, 1984.

(b) EMPLOYEE LEASING EXCEPTION ONLY APPLIES TO NON-EMPLOYEES.—

(1) IN GENERAL.—Paragraph (2) of section 414(n) (defining leased employee) is amended by striking out "any person" in the material preceding subparagraph (A) and inserting in lieu thereof "any person who is not an employee of the recipient and".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to taxable years beginning after December 31, 1983.

(c) DETERMINATION OF WHETHER THERE IS A COLLECTIVE BARGAINING AGREEMENT.—

(1) IN GENERAL.—Subsection (a) of section 7701 (relating to definitions) is amended by adding at the end thereof the following new paragraph:

"(46) DETERMINATION OF WHETHER THERE IS A COLLECTIVE BARGAINING AGREEMENT.—In determining whether there is a collective bargaining agreement between employee representatives and 1 or more employers, the term 'employee representatives' shall not include any organization more than one-half of the members of which are employees who are owners, officers, or executives of the employer."

(2) EFFECTIVE DATE.—The amendment made by this subsection shall take effect on April 1, 1984.

(d) ADDITIONAL REGULATIONS.—

(1) IN GENERAL.—Section 414 (relating to definitions and special rules) is amended by adding at the end thereof the following new subsection:

"(o) REGULATIONS.—The Secretary shall prescribe such regulations (which may provide rules in addition to the rules contained in subsections (m) and (n)) as may be necessary to prevent the avoidance of

any employee benefit requirement listed in subsection (m)(4) or (n)(3) through the use of—

"(1) separate organizations,

"(2) employee leasing, or

"(3) other arrangements."

(2) CONFORMING AMENDMENT.—Subsection (m) of section 414 is amended by striking out paragraph (6).

(3) EFFECTIVE DATE.—The amendments made by this subsection shall take effect on the date of the enactment of this Act.

SEC. 527. PROVISIONS RELATING TO CASH OR DEFERRED ARRANGEMENTS.

(a) PARTICIPATION AND DISCRIMINATION STANDARDS.—Subparagraph (A) of section 401(k)(3) is amended to read as follows:

"(A) A cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement unless—

"(i) those employees eligible to benefit under the arrangement satisfy the provisions of subparagraph (A) or (B) of section 410(b)(1), and

"(ii) the actual deferral percentage for highly compensated employees (as defined in paragraph (4)) for such year bears a relationship to the actual deferral percentage for all other eligible employees for such plan year which meets either of the following tests:

"(I) The actual deferral percentage for the group of highly compensated employees is not more than the actual deferral percentage of all other eligible employees multiplied by 1.5.

"(II) The excess of the actual deferral percentage for the group of highly compensated employees over that of all other eligible employees is not more than 3 percentage points, and the actual deferral percentage for the group of highly compensated employees is not more than the actual deferral percentage of all other eligible employees multiplied by 2.5.

If 2 or more plans which include cash or deferred arrangements are considered as 1 plan for purposes of section 401(a)(4) or 410(b), the cash or deferred arrangements included in such plans shall be treated as 1 arrangement for purposes of this subparagraph.

The deferral percentage taken into account under this subparagraph for any employee who is a participant under 2 or more cash or deferred arrangements of the employer shall be the sum of the deferral percentages for such employee under each of such arrangements."

(b) APPLICATION TO PRE-ERISA MONEY PURCHASE PLAN.—

(1) GENERAL RULE.—Paragraphs (1) and (2) of section 401(k) (relating to cash or deferred arrangements) are each amended by inserting "(or a pre-ERISA money purchase plan)" after "stock bonus plan".

(2) DEFINITION OF PRE-ERISA MONEY PURCHASE PLAN.—Subsection (k) of section 401 is amended by adding at the end thereof the following new paragraph:

"(5) PRE-ERISA MONEY PURCHASE PLAN.—For purposes of this subsection, the term 'pre-ERISA money purchase plan' means a pension plan—

"(A) which is a defined contribution plan (as defined in section 414(i)),

"(B) which was in existence on June 27, 1974, and which, on such date, included a salary reduction arrangement, and

"(C) under which neither the employee contributions nor the employer contributions may exceed the levels provided for by the contribution formula in effect under the plan on such date."

(3) TECHNICAL AMENDMENT.—Subparagraph (B) of section 401(k)(2) is amended by striking out ", hardship or the attainment of age 59½," and inserting in lieu thereof "(or in the case of a profit sharing or stock bonus plan, hardship or the attainment of age 59½)".

(c) EFFECTIVE DATES.—

(1) SUBSECTION (a).—

(A) IN GENERAL.—Except as provided in subparagraph (B), the amendment made by subsection (a) shall apply to plan years beginning after December 31, 1984.

(B) EXCEPTION FOR CERTAIN EXISTING PLANS.—The amendment made by subsection (a) shall not apply to any plan—

(i) which was maintained by a State on June 8, 1984, and

(ii) with respect to which a determination letter had been issued by the Secretary on December 6, 1982.

(2) SUBSECTION (b).—

(A) IN GENERAL.—The amendments made by this section shall apply with respect to plan years beginning after the date of the enactment of this Act.

(B) TRANSITIONAL RULE.—Rules similar to the rules under section 135(c)(2) of the Revenue Act of 1978 shall apply with respect to any pre-ERISA money purchase plan (as defined in section 401(k)(5) of the Internal Revenue Code of 1954) for plan years beginning after December 31, 1979, and on or before the date of the enactment of this Act.

SEC. 528. TREATMENT OF CERTAIN MEDICAL, ETC., BENEFITS UNDER SECTION 415.

(a) GENERAL RULE.—Section 415 (relating to limitations on benefits and contributions under qualified plan) is amended by adding at the end thereof the following new subsection:

"(l) TREATMENT OF CERTAIN MEDICAL BENEFITS.—

"(1) IN GENERAL.—For purposes of this section, contributions allocated to any individual medical account which is part of a defined benefit plan shall be treated as an annual addition to a defined contribution plan for purposes of subsection (c).

"(2) INDIVIDUAL MEDICAL BENEFIT ACCOUNT.—For purposes of paragraph (1), the term 'individual medical benefit account' means any separate account—

"(A) which is established for a participant under a defined benefit plan, and

"(B) from which benefits described in section 401(h) are payable solely to such participant, his spouse, or his dependents."

(b) REQUIREMENT THAT SEPARATE ACCOUNT BE MAINTAINED FOR 5-PERCENT OWNER.—Subsection (h) of section 401 (relating to medical, etc., benefits for retired employees and their spouses and dependents) is amended by striking out "and" at the end of paragraph (4), by striking out the period at the end of paragraph (5) and inserting in lieu thereof ", and", and by adding at the end thereof the following new paragraph:

"(6) in the case of an employee who is a 5-percent owner, a separate account is established and maintained for such benefits payable to such employee (and his spouse and dependents) and such benefits (to the extent attributable to plan years beginning after March 31, 1984, for which the employee is a 5-percent owner) are only payable to such employee (and his spouse and dependents) from such separate account.

For purposes of paragraph (6), the term '5-percent owner' means any employee who, at any time during the plan year or any preceding plan year during which contributions were made on behalf of such employee, is or was a 5-percent owner (as defined in section 416(i)(1)(B))."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after March 31, 1984.

SEC. 529. CERTAIN ALIMONY TREATED AS COMPENSATION.

(a) IN GENERAL.—Paragraph (1) of section 219(f) (defining compensation) is amended by adding at the end thereof the following new sentence: "The term 'compensation' shall include any amount includible in the individual's gross income under paragraph (1) of section 71(a) (relating to decree of divorce or separate maintenance)."

(b) CONFORMING AMENDMENT.—Subsection (b) of section 219 is amended by striking out paragraph (4).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1984.

Subtitle C—Tax Treatment of Fringe Benefits

SEC. 531. EXCLUSION OF CERTAIN FRINGE BENEFITS FROM GROSS INCOME.

(a) EXCLUSION OF CERTAIN FRINGES BENEFITS.—

(1) IN GENERAL.—Part III of subchapter B of chapter 1 (relating to items specifically excluded from gross income) is amended by redesignating section 132 as section 133 and by inserting after section 131 the following new section:

"SEC. 132. CERTAIN FRINGE BENEFITS.

"(a) EXCLUSION FROM GROSS INCOME.—Gross income shall not include any fringe benefit which qualifies as a—

"(1) no-additional-cost service,

"(2) qualified employee discount,

"(3) working condition fringe, or

"(4) de minimis fringe.

"(b) NO-ADDITIONAL-COST SERVICE DEFINED.*—For purposes of this section, the term 'no-additional-cost service' means any service provided by an employer to an employee for use by such employee if—*

"(1) such service is offered for sale to customers in the ordinary course of the line of business of the employer in which the employee is performing services, and

"(2) the employer incurs no substantial additional cost (including forgone revenue) in providing such service to the employee (determined without regard to any amount paid by the employee for such service).

"(c) QUALIFIED EMPLOYEE DISCOUNT DEFINED.*—For purposes of this section—*

"(1) QUALIFIED EMPLOYEE DISCOUNT.*—The term 'qualified employee discount' means any employee discount with respect to qualified property or services to the extent such discount does not exceed—*

"(A) in the case of property, the gross profit percentage of the price at which the property is being offered by the employer to customers, or

"(B) in the case of services, 20 percent of the price at which the services are being offered by the employer to customers.

"(2) GROSS PROFIT PERCENTAGE.*—*

"(A) IN GENERAL.*—The term 'gross profit percentage' means the percent which—*

"(i) the excess of the aggregate sales price of property sold by the employer to customers over the aggregate cost of such property to the employer, is of

"(ii) the aggregate sale price of such property.

"(B) DETERMINATION OF GROSS PROFIT PERCENTAGE.*—Gross profit percentage shall be determined on the basis of—*

"(i) all property offered to customers in the ordinary course of the line of business of the employer in which the employee is performing services (or a reasonable classification of property selected by the employer), and

"(ii) the employer's experience during a representative period.

"(3) EMPLOYEE DISCOUNT DEFINED.*—The term 'employee discount' means the amount by which—*

"(A) the price at which the property or services are provided to the employee by the employer, is less than

"(B) the price at which such property or services are being offered by the employer to customers.

"(4) QUALIFIED PROPERTY OR SERVICES.*—The term 'qualified property or services' means any property (other than real property and other than personal property of a kind held for investment) or services which are offered for sale to customers in the ordinary course of the line of business of the employer in which the employee is peforming services.*

"(d) WORKING CONDITION FRINGE DEFINED.*—For purposes of this section, the term 'working condition fringe' means any property or services provided to an employee of the employer to the extent that,*

if the employee paid for such property or services, such payment would be allowable as a deduction under section 162 or 167.

"(e) DE MINIMIS FRINGE DEFINED.—For purposes of this section—

"(1) IN GENERAL.—The term 'de minimis fringe' means any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees) so small as to make accounting for it unreasonable or administratively impracticable.

"(2) TREATMENT OF CERTAIN EATING FACILITIES.—The operation by an employer of any eating facility for employees shall be treated as a de minimis fringe if—

"(A) such facility is located on or near the business premises of the employer, and

"(B) revenue derived from such facility normally equals or exceeds the direct operating costs of such facility.

The preceding sentence shall apply with respect to any officer, owner, or highly compensated employee only if access to the facility is available on substantially the same terms to each member of a group of employees which is defined under a reasonable classification set up by the employer which does not discriminate in favor of officers, owners, or highly compensated employees.

"(f) CERTAIN INDIVIDUALS TREATED AS EMPLOYEES FOR PURPOSES OF SUBSECTIONS (a)(1) AND (2).—For purposes of paragraphs (1) and (2) of subsection (a)—

"(1) RETIRED AND DISABLED EMPLOYEES AND SURVIVING SPOUSE OF EMPLOYEE TREATED AS EMPLOYEE.—With respect to a line of business of an employer, the term 'employee' includes—

"(A) any individual who was formerly employed by such employer in such line of business and who separated from service with such employer in such line of business by reason of retirement or disability, and

"(B) any widow or widower of any individual who died while employed by such employer in such line of business or while an employee within the meaning of subparagraph (A).

"(2) SPOUSE AND DEPENDENT CHILDREN.—

"(A) IN GENERAL.—Any use by the spouse or a dependent child of the employee shall be treated as use by the employee.

"(B) DEPENDENT CHILD.—For purposes of subparagraph (A), the term 'dependent child' means any child (as defined in section 151(e)(3)) of the employee—

"(i) who is a dependent of the employee, or

"(ii) both of whose parents are deceased.

For purposes of the preceding sentence, any child to whom section 152(e) applies shall be treated as the dependent of both parents.

"(g) SPECIAL RULES RELATING TO EMPLOYER.—For purposes of this section—

"(1) CONTROLLED GROUPS, ETC.—All employees treated as employed by a single employer under subsection (b), (c), or (m) of

section 414 shall be treated as employed by a single employer for purposes of this section.

"(2) RECIPROCAL AGREEMENTS.—For purposes of paragraph (1) of subsection (a), any service provided by an employer to an employee of another employer shall be treated as provided by the employer of such employee if—

"(A) such service is provided pursuant to a written agreement between such employers, and

"(B) neither of such employers incurs any substantial additional cost (including forgone revenue) in providing such service or pursuant to such agreement.

"(h) SPECIAL RULES.—

"(1) EXCLUSIONS UNDER SUBSECTION (a) (1) AND (2) APPLY TO OFFICERS, ETC., ONLY IF NO DISCRIMINATION.—Paragraphs (1) and (2) of subsection (a) shall apply with respect to any fringe benefit described therein provided with respect to any officer, owner, or highly compensated employee only if such fringe benefit is available on substantially the same terms to each member of a group of employees which is defined under a reasonable classification set up by the employer which does not discriminate in favor of officers, owners, or highly compensated employees.

"(2) SPECIAL RULE FOR LEASED SECTIONS OF DEPARTMENT STORES.—

"(A) IN GENERAL.—For purposes of paragraph (2) of subsection (a), in the case of a leased section of a department store—

"(i) such section shall be treated as part of the line of business of the person operating the department store, and

"(ii) employees in the leased section shall be treated as employees of the person operating the department store.

"(B) LEASED SECTION OF DEPARTMENT STORE.—For purposes of subparagraph (A), a leased section of a department store is any part of a department store where over-the-counter sales of property are made under a lease or similar arrangement where it appears to the general public that individuals making such sales are employed by the person operating the department store.

"(3) AUTO SALESMEN.—

"(A) IN GENERAL.—For purposes of subsection (a)(3), qualified automobile demonstration use shall be treated as a working condition fringe.

"(B) QUALIFIED AUTOMOBILE DEMONSTRATION USE.—For purposes of subparagraph (A), the term 'qualified automobile demonstration use' means any use of an automobile by a full-time automobile salesman in the sales area in which the automobile dealer's sales office is located if—

"(i) such use in provided primarily to facilitate the salesman's performance of services for the employer, and

"(ii) there are substantial restrictions on the personal use of such automobile by such salesman.

"(4) PARKING.—The term 'working condition fringe' includes parking provided to an employee on or near the business premises of the employer.

"(5) ON-PREMISES GYMS AND OTHER ATHLETIC FACILITIES.—

"(A) IN GENERAL.—Gross income shall not include the value of any on-premises athletic facility provided by an employer to his employees.

"(B) ON-PREMISES ATHLETIC FACILITY.—For purposes of this paragraph, the term 'on-premises athletic facility' means any gym or other athletic facility—

"(i) which is located on the premises of the employer,

"(ii) which is operated by the employer, and

"(iii) substantially all the use of which is by employees of the employer, their spouses, and their dependent children (within the meaning of subsection (f)).

"(i) CUSTOMERS NOT TO INCLUDE EMPLOYEES.—For purposes of this section (other than subsection (c)(2)(B)), the term 'customers' shall only include customers who are not employees.

"(j) SECTION NOT TO APPLY TO FRINGE BENEFITS EXPRESSLY PROVIDED FOR ELSEWHERE.—This section (other than subsection (e)) shall not apply to any fringe benefits of a type the tax treatment of which is expressly provided for in any other section of this chapter.

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

(2) CLERICAL AMENDMENT.—The table of sections for such part III is amended by striking out the item relating to section 132 and inserting in lieu thereof the following:

"Sec. 132. Certain fringe benefits.
"Sec. 133. Cross references to other Acts."

(b) CAFETERIA PLAN.—

(1) DEFINITION OF CAFETERIA PLAN.—Paragraph (1) of section 125(d) (defining cafeteria plan) is amended to read as follows:

"(1) IN GENERAL.—The term 'cafeteria plan' means a written plan under which—

"(A) all participants are employees, and

"(B) the participants may choose among 2 or more benefits consisting of cash and statutory nontaxable benefits."

(2) DEFINITION OF STATUTORY NONTAXABLE BENEFIT.—

(A) IN GENERAL.—Subsection (f) of section 125 is amended to read as follows:

"(f) STATUTORY NONTAXABLE BENEFITS DEFINED.—For purposes of this section, the term 'statutory nontaxable benefit' means any benefit which, with the application of subsection (a) is not includible in the gross income of the employee by reason of an express provision of this chapter (other than section 117, 124, 127, or 132). Such term includes any group term life insurance which is includible in gross income only because it exceeds the dollar limitation of section 79."

(B) CONFORMING AMENDMENT.—Subsection (c) of section 125 is amended by striking out "nontaxable benefits" each place it appears and inserting in lieu thereof "statutory nontaxable benefits".

(3) EXCEPTION FOR KEY EMPLOYEES.—Subsection (b) of section 125 (relating to exception for highly compensated participants) is amended to read as follows:

(b) EXCEPTION FOR HIGHLY COMPENSATED PARTICIPANTS AND KEY EMPLOYEES.—

(1) HIGHLY COMPENSATED PARTICIPANTS.—In the case of a highly compensated participant, subsection (a) shall not apply to any benefit attributable to a plan year for which the plan discriminates in favor of—

(A) highly compensated individuals as to eligibility to participate, or

(B) highly compensated participants as to contributions and benefits.

(2) KEY EMPLOYEES.—In the case of a key employee (within the meaning of section 416(i)(1)), subsection (a) shall not apply to any benefit attributable to a plan for which the statutory nontaxable benefits provided to key employees exceed 25 percent of the aggregate of such benefits provided for all employees under the plan. For purposes of the preceding sentence, statutory nontaxable benefits shall be determined without regard to the last sentence of subsection (f).

(3) YEAR OF INCLUSION.—For purposes of determining the taxable year of inclusion, any benefit described in paragraph (1) or (2) shall be treated as received or accrued in the taxable year of the participant or key employee in which the plan year ends.

(4) REPORTING REQUIREMENTS.—

(A) Section 125 (relating to cafeteria plans) is amended by redesignating subsection (h) as subsection (i) and by inserting after subsection (g) the following new subsection:

"(h) REPORTING REQUIREMENTS.—

"(1) IN GENERAL.—Each employer maintaining a cafeteria plan during any taxable year which begins after December 31, 1984, and to which this section applies shall file a return (at such time and in such manner as the Secretary shall by regulations prescribe) with respect to such plan showing for such year—

"(A) the number of employees of the employer,

"(B) the number of employees participating under the plan,

"(C) the total cost of the plan during the taxable year, and

"(D) the name, address, and taxpayer identification number of the employer and the type of business in which the employer is engaged.

"(2) RECORDKEEPING REQUIREMENT.—Each employer maintaining a cafeteria plan during any year shall keep such records as may be necessary for purposes of determining whether the requirements of this section are met.

"(3) ADDITIONAL INFORMATION WHEN REQUIRED BY THE SECRETARY.—Any employer—

"(A) who maintains a cafeteria plan during any year for which a return is required under paragraph (1), and

"(B) who is required by the Secretary to file an additional return for such year,

shall file such additional return. Such additional return shall be filed at such time and in such manner as the Secretary shall prescribe and shall contain such information as the Secretary shall prescribe.".

(B) Subsection (f) of section 6652 is amended—

(i) by striking out "or 6047 (relating to information relating to certain trusts and annuity and bond purchase plans)" and inserting in lieu thereof ", 6047 (relating to information relating to certain trusts and annuity and bond purchase plans), or 125(h) (relating to information with respect to cafeteria plans)", and

(ii) by striking out "DEFERRED COMPENSATION.—" in the subsection heading and inserting in lieu thereof "DEFERRED COMPENSATION; ETC.—".

(5) EXCEPTION FOR CERTAIN CAFETERIA PLANS AND BENEFITS.—

(A) GENERAL TRANSITIONAL RULE.—Any cafeteria plan in existence on February 10, 1984, which failed as of such date and continued to fail thereafter to satisfy the rules relating to section 125 under proposed Treasury regulations, and any benefit offered under such a cafeteria plan which failed as of such date and continued to fail thereafter to satisfy the rules of section 105, 106, 120, or 129 under proposed Treasury regulations, will not fail to be a cafeteria plan under section 125 or a nontaxable benefit under section 105, 106, 120, or 129 solely because of such failures. The preceding sentence shall apply only with respect to cafeteria plans and benefits provided under cafeteria plans before the earlier of—

(i) January 1, 1985, or

(ii) the effective date of any modification to provide additional benefits after February 10, 1984.

(B) SPECIAL TRANSITION RULE FOR ADVANCE ELECTION BENEFIT BANKS.—Any benefit offered under a cafeteria plan in existence on February 10, 1984, which failed as of such date and continued to fail thereafter to satisfy the rules of section 105, 106, 120, or 129 under proposed Treasury regulations because an employee was assured of receiving (in cash or any other benefit) amounts available but unused for covered reimbursement during the year without regard to whether he incurred covered expenses, will not fail to be a nontaxable benefit under such applicable section solely because of such failure. The preceding sentence shall apply only with respect to benefits provided under cafeteria plans before the earlier of—

(i) July 1, 1985, or

(ii) the effective date of any modification to provide additional benefits after February 10, 1984.

Except as provided in Treasury regulations, the special transition rule is available only for benefits with respect to which, after December 31, 1984, contributions are fixed before the period of coverage and taxable cash is not available until the end of such period of coverage.

(C) PLANS FOR WHICH SUBSTANTIAL IMPLEMENTATION COSTS WERE INCURRED.—For purposes of this paragraph, any plan with respect to which substantial implementation costs had been incurred before February 10, 1984, shall be treated as in existence on February 10, 1984.

(6) STUDY OF EFFECTS OF CAFETERIA PLANS ON HEALTH CARE COSTS.—

(A) STUDY.—The Secretary of Health and Human Services, in cooperation with the Secretary of the Treasury, shall conduct a study of the effects of cafeteria plans (within the meaning of section 125 of the Internal Revenue Code of 1954) on the containment of health care costs.

(B) REPORT.—The Secretary of Health and Human Services, in cooperation with the Secretary of the Treasury, shall submit a report on the study conducted under subparagraph (A) to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate by no later than April 1, 1985.

(c) CLARIFICATION THAT FRINGE BENEFITS NOT COVERED BY STATUTORY EXCLUSION INCLUDED IN GROSS INCOME.—Paragraph (1) of section 61(a) (defining gross income) is amended by striking out "commissions, and similar items" and inserting in lieu thereof "commissions, fringe benefits, and similar items".

(d) CONFORMING AMENDMENTS TO EMPLOYMENT TAXES.—

(1) SOCIAL SECURITY TAXES.—

(A) Subsection (a) of section 3121 (defining wages) is amended—

(i) by striking out "all remuneration paid in any medium" in the material preceding paragraph (1) and inserting in lieu thereof "all remuneration (including benefits) paid in any medium", and

(ii) by striking out "or" at the end of paragraph (18), by striking out the period at the end of paragraph (19) and inserting in lieu thereof "; or", and by inserting after paragraph (19) the following new paragraph:

"(20) any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 117 or 132."

(B) Section 209 of the Social Security Act is amended—

(i) by striking out "all remuneration paid in any medium" in the material preceding subsection (a) and inserting in lieu thereof "all remuneration (including benefits) paid in any medium", and

(ii) by striking out "or" at the end of subsection (q), by striking out the period at the end of subsection (r) and inserting in lieu thereof "; or", and by inserting after subsection (r) the following new subsection:

"(s) Any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 117 or 132 of the Internal Revenue Code of 1954."

(2) RAILROAD RETIREMENT TAX.—Subsection (e) of section 3231 (defining compensation) is amended by adding at the end thereof the following new paragraph:

"(5) The term 'compensation' shall not include any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 117 or 132."

(3) UNEMPLOYMENT TAX.—Subsection (b) of section 3306 (defining wages) is amended—

(A) by striking out "all remuneration paid in any medium" in the material preceding paragraph (1) and inserting in lieu thereof "all remuneration (including benefits) paid in any medium", and

(B) by striking out "or" at the end of paragraph (14), by striking out the period at the end of paragraph (15) and inserting in lieu thereof "; or", and by inserting after paragraph (15) the following new paragraph:

"(16) any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 117 or 132."

(4) WITHHOLDING.—Subsection (a) of section 3401 (defining wages) is amended—

(A) by striking out "all remuneration paid in any medium" in the material preceding paragraph (1) and inserting in lieu thereof "all remuneration (including benefits) paid in any medium", and

(B) by striking out "or" at the end of paragraph (18), by striking out the period at the end of paragraph (19) and inserting in lieu thereof "; or", and by adding at the end thereof the following new paragraph:

"(20) any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 117 or 132."

(5) METHOD OF COLLECTING TAX FROM NON-CASH FRINGE BENEFITS.—Section 3501 (relating to collection and payment of taxes) is amended—

(A) by striking out "The taxes" and inserting in lieu thereof the following:

"(a) GENERAL RULE.—The taxes", and

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

"(b) TAXES WITH RESPECT TO NON-CASH FRINGE BENEFITS.—The taxes imposed by this subtitle with respect to non-cash fringe benefits shall be collected (or paid) by the employer at the time and in the manner prescribed by the Secretary by regulations."

(e) ELECTION WITH RESPECT TO CERTAIN EXISTING LINES OF BUSINESS.—

(1) IN GENERAL.—Chapter 43 (relating to qualified pension, etc., plans), as amended by this Act, is amended by adding at the end thereof the following new section:

"SEC. 4977. TAX ON CERTAIN FRINGE BENEFITS PROVIDED BY AN EMPLOYER.

"(a) IMPOSITION OF TAX.—In the case of an employer to whom an election under this section applies for any calendar year, there is hereby imposed a tax for such calendar year equal to 30 percent of the excess fringe benefits.

"(b) EXCESS FRINGE BENEFITS.—For purposes of subsection (a), the term 'excess fringe benefits' means, with respect to any calendar year—

"(1) the aggregate value of the fringe benefits provided by the employer during the calendar year which were not includible in gross income under paragraphs (1) and (2) of section 132(a), over

"(2) 1 percent of the aggregate amount of compensation—

"(A) which was paid by the employer during such calendar year to employees, and

"(B) was includible in gross income for purposes of chapter 1.

"(c) EFFECT OF ELECTION ON SECTION 132(a).—If—

"(1) an election under this section is in effect with respect to an employer for any calendar year, and

"(2) as of January 1, 1984, substantially all of the employees of the employer were entitled to employee discounts or services provided by the employer in 1 line of business,

for purposes of paragraphs (1) and (2) of section 132(a) (but not for purposes of section 132(g)(2)), all employees of any line of business of the employer which was in existence on January 1, 1984, shall be treated as employees of the line of business referred to in paragraph (2).

"(d) PERIOD OF ELECTION.—An election under this section shall apply to the calendar year for which made and all subsequent calendar years unless revoked by the employer.

"(e) TREATMENT OF AFFILIATED GROUPS.—For purposes of this section, all members of the same affiliated group of corporations (as defined in section 1504) shall be treated as 1 corporation."

(2) CLERICAL AMENDMENT.—The table of sections for chapter 43 is amended by adding at the end thereof the following new item:

"Sec. 4977. Tax on certain fringe benefits provided by an employer."

(f) DETERMINATION OF LINE OF BUSINESS IN CASE OF AFFILIATED GROUP OPERATING RETAIL DEPARTMENT STORES.—If—

(1) as of October 5, 1983, the employees of one member of an affiliated group (as defined in section 1504 of the Internal Revenue Code of 1954 without regard to subsections (b)(2) and (b)(4) thereof) were entitled to employee discounts at the retail department stores operated by another member of such affiliated group, and

(2) the primary business of the affiliated group is the operation of retail department stores,

then, for purpose of applying section 132(a)(2) of the Internal Revenue Code of 1954, with respect to discounts provided for such employees at the retail department stores operated by such other member, the employer shall be treated as engaged in the same line of business as such other member.

(g) MORATORIUM ON ISSUANCE OF REGULATIONS RELATING TO FACULTY HOUSING.—

(1) IN GENERAL.—Any regulation providing for the inclusion in gross income under section 61 of the Internal Revenue Code of 1954 of the excess (if any) of the fair market value of qualified campus lodging over the greater of—

(A) the operating costs paid or incurred in furnishing such lodging, or

(B) the rent received for such lodging,

shall not be issued before January 1, 1986.

(2) QUALIFIED CAMPUS LODGING.—For purposes of this subsection, the term "qualified campus lodging" means lodging which is—

(A) located on (or in close proximity to) a campus of an educational institution (described in section 170(b)(1)(A)(ii) of the Internal Revenue Code of 1954), and

(B) provide by such institution to an employee of such institution, or to a spouse or dependent (within the meaning of section 152 of such Code) of such employee.

(3) APPLICATION OF SUBSECTION.—This subsection shall apply with respect to lodging furnished after December 31, 1983, and before January 1, 1986.

(h) EFFECTIVE DATE.—The amendments made by this section shall take effect on January 1, 1985.

SEC. 532. EXCLUSION OF CERTAIN REDUCTIONS IN TUITION FROM GROSS INCOME.

(a) IN GENERAL.—Section 117 (relating to scholarships and fellowship grants) is amended by adding at the end thereof the following new subsection:

"(d) QUALIFIED TUITION REDUCTIONS.—

"(1) IN GENERAL.—Gross income shall not include any qualified tuition reduction.

"(2) QUALIFIED TUITION REDUCTION.—For purposes of this subsection, the term 'qualified tuition reduction' means the amount of any reduction in tuition provided to an employee of an organization described in section 170(b)(1)(A)(ii) for the education (below the graduate level) at such organization (or another organization described in section 170(b)(1)(A)(ii)) of—

"(A) such employee, or

"(B) any person treated as an employee (or whose use is treated as an employee use) under the rules of section 132(f).

"(3) REDUCTION MUST NOT DISCRIMINATE IN FAVOR OF HIGHLY COMPENSATED, ETC.—Paragraph (1) shall apply with respect to any qualified tuition reduction provided with respect to any officer, owner, or highly compensated employee only if such reduction is available on substantially the same terms to each member of a group of employees which is defined under a reasonable classification set up by the employer which does not discriminate in favor of officers, owners, or highly compensated employees."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to qualified tuition reductions (as defined in section 117(d)(2)

of the Internal Revenue Code of 1954) for education furnished after June 30, 1985, in taxable years ending after such date.

Subtitle D—Employee Stock Ownership Plans

SEC. 541. NONRECOGNITION OF GAIN ON STOCK SOLD TO EMPLOYEE STOCK OWNERSHIP PLANS OR CERTAIN COOPERATIVES IF QUALIFIED REPLACEMENTS PROPERTY ACQUIRED.

(a) IN GENERAL.—Part III of subchapter 0 of chapter 1 (relating to nontaxable exchanges), as amended by this Act, is amended by adding at the end thereof the following new section:

"SEC. 1042. SALES OF STOCK TO STOCK OWNERSHIP PLANS OR CERTAIN COOPERATIVES.

"(a) NONRECOGNITION OF GAIN.—If—

"(1) the taxpayer elects the application of this section with respect to any sale of qualified securities,

"(2) the taxpayer purchases qualified replacement property within the replacement period, and

"(3) the requirements of subsection (b) are met with respect to such sale,

then the gain (if any) on such sale shall be recognized only to the extent that the amount realized on such sale exceeds the cost to the taxpayer of such qualified replacement property.

"(b) REQUIREMENTS TO QUALIFY FOR NONRECOGNITION.—A sale of qualified securities meets the requirements of this subsection if—

"(1) SALE TO EMPLOYEE ORGANIZATIONS.—The qualified securities are sold to—

"(A) an employee stock ownership plan (as defined in section 4975(e)(7)), or

"(B) an eligible worker-owned cooperative.

"(2) EMPLOYEES MUST OWN 30 PERCENT OF STOCK AFTER SALE.—The plan or cooperative referred to in paragraph (1) owns, immediately after the sale, at least 30 percent of the total value of the qualified securities outstanding as of such time.

"(3) PLAN MAINTAINED FOR BENEFIT OF EMPLOYEES.—No portion of the assets of the plan or cooperative attributable to qualified securities acquired by the plan or cooperative described in paragraph (1) accure under such plan, or are allocated by such cooperative, for the benefit of—

"(A) the taxpayer,

"(B) any person who is a member of the family of the taxpayer (within the meaning of section 267(c)(4)), or

"(C) any other person who owns (after application of section 318(a)) more than 25 percent in value of any class of outstanding qualified securities.

"(4) WRITTEN STATEMENT REQUIRED.—

"(A) IN GENERAL.—The taxpayer files with the Secretary the written statement described in subparagraph (B).

"(B) STATEMENT.—A statement is described in this subparagraph if it is a verified written statement of—

"(i) the employer whose employees are covered by the plan described in paragraph (1), or

"(ii) any authorized officer of the cooperative described in paragraph (1),

consenting to the application of section 4978(a) with respect to such employer or cooperative.

"(c) DEFINITIONS; SPECIAL RULES.—For purposes of this section.—

"(1) QUALIFIED SECURITIES.—The term 'qualified securities' means employer securities (as defined in section 409A(l)) which—

"(A) are issued by a domestic corporation that has no securities outstanding that are readily tradable on an established securities market,

"(B) at the time of the sale described in subsection (a)(1), have been held by the taxpayer for more than 1 year, and

"(C) were not received by the taxpayer in—

"(i) a distribution from a plan described in section 401(a), or

"(ii) a transfer pursuant to an option or other right to acquire stock to which section 83, 422, 422A, 423, or 424 applies.

"(2) ELIGIBLE WORKER-OWNED COOPERATIVE.—The term 'eligible worker-owned cooperative' means any organization—

"(A) to which part I of subchapter T applies,

"(B) a majority of the membership of which is composed of employees of such organization,

"(C) a majority of the voting stock of which is owned by members,

"(D) a majority of the board of directors of which is elected by the members on the basis of 1 person 1 vote, and

"(E) a majority of the allocated earnings and losses of which are allocated to members on the basis of—

"(i) patronage,

"(ii) capital contributions, or

"(iii) some combination of clauses (i) and (ii).

"(3) REPLACEMENT PERIOD.—The term 'replacement period' means the period which begins 3 months before the date on which the sale of qualified securities occurs and which ends 12 months after the date of such sale.

"(4) QUALIFIED REPLACEMENT PROPERTY.—The term 'qualified replacement property' means any securities (as defined in section 165(g)(2)) issued by a domestic corporation which does not, for the taxable year in which such stock is issued, have passive investment income (as defined in section 1362(d)(3)(D)) that exceeds 25 percent of the gross receipts of such corporation for such taxable year.

"(5) SECURITIES ACQUIRED BY UNDERWRITER.—No acquisition of securities by an underwriter in the ordinary course of his trade or business as an underwriter, whether or not guaranteed, shall be treated as a sale for purposes of subsection (a).

"(6) TIME FOR FILING ELECTION.—An election under subsection (a) shall be filed not later than the last day prescribed by law (including extensions thereof) for filing the return of tax imposed by this chapter for the taxable year in which the sale occurs.

"(d) BASIS OF QUALIFIED REPLACEMENT PROPERTY.—The basis of the taxpayer in qualified replacement property purchased by the taxpayer during the replacement period shall be reduced by the amount of gain not recognized by reason of such purchase and the application of subsection (a). If more than one item of qualified replacement property is purchased, the basis of each of such items shall be reduced by an amount determined by multiplying the total gain not recognized by reason of such purchase and the application of subsection (a) by a fraction—

"(1) the numerator of which is the cost of such item of property, and

"(2) the denominator of which is the total cost of all such items of property.

"(e) STATUTE OF LIMITATIONS.—If any gain is realized by the taxpayer on the sale or exchange of any qualified securities and there is in effect an election under subsection (a) with respect to such gain, then—

"(1) the statutory period for the assessment of any deficiency with respect to such gain shall not expire before the expiration of 3 years from the date the Secretary is notified by the taxpayer (in such manner as the Secretary may by regulations prescribe) of—

"(A) the taxpayer's cost of purchasing qualified replacement property which the taxpayer claims results in nonrecognition of any part of such gain,

"(B) the taxpayer's intention not to purchase qualified replacement property within the replacement period, or

"(C) a failure to make such purchase within the replacement period, and

"(2) such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment."

(b) CONFORMING AMENDMENTS.—

(1) Section 1223 (relating to holding period of property) is amended by redesignating paragraph (13) as paragraph (14) and by inserting after paragraph (12) the following:

"(13) In determining the period for which the taxpayer has held qualified replacement property (within the meaning of section 1042(b)) the acquisition of which resulted under section 1042 in the nonrecognition of any part of the gain realized on the sale of qualified securities (within the meaning of section 1042(b)), there shall be included the period for which such qualified securities had been held by the taxpayer."

(2) Subsection (a) of section 1016 (relating to adjustments to basis), as amended by this Act, is amended—

(A) by striking out "and" at the end of paragraph (25),

(B) by striking out the period at the end of paragraph (26) and inserting in lieu thereof ", and", and

(C) by adding at the end thereof the following new paragraph:

"(27) in the case of qualified replacement property, the acquisition of which resulted under section 1042 in the nonrecogni-

tion of any part of the gain realized on the sale or exchange of any property, to the extent provided in section 1042(c)."

(3) The table of sections for part III of subchapter O of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 1042. Sales of stock to employees."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to sales of securities in taxable years beginning after the date of enactment of this Act.

SEC. 542. DEDUCTIBILITY OF CERTAIN DIVIDEND DISTRIBUTIONS FROM EMPLOYEE STOCK OWNERSHIP PLANS.

(a) DEDUCTION.—Section 404 (relating to deductions for employer contributions to an employees' trust) is amended by adding at the end thereof the following new subsection:

"(k) DIVIDENDS PAID DEDUCTIONS.—In addition to the deductions provided under subsection (a), there shall be allowed as a deduction to a corporation the amount of any dividend paid in cash by such corporation during the taxable year with respect to the stock of such corporation if—

"(1) such stock is held on the record date for the dividend by a tax credit employee stock ownership plan (as defined in section 409A) or an employee stock ownership plan (as defined in section 4975(e)(7)) which is maintained by such corporation or by any other corporation that is a member of a controlled group of corporations (within the meaning of section 409A(1)(4)) that includes such corporation, and

"(2) in accordance with the plan provisions—

"(A) the dividend is paid in cash to the participants in the plan, or

"(B) the dividend is paid to the plan and is distributed in cash to participants in the plan not later than 90 days after the close of the plan year in which paid."

(b) DENIAL OF PARTIAL EXCLUSION.—Section 116 (relating to partial exclusion of dividends) is amended by adding at the end thereof the following new subsection:

"(e) DIVIDENDS FROM EMPLOYEE STOCK OWNERSHIP PLANS.—Subsection (a) shall not apply to any dividend described in section 404(k)."

(c) NO WITHHOLDING ON DIVIDEND DISTRIBUTION.—Subparagraph (B) of section 3405(d)(1) (relating to designated distributions) is amended—

(1) by striking out "and" at the end of clause (i),

(2) by striking out the period at the end of clause (ii) and inserting in lieu thereof ", or", and

(3) by adding at the end thereof the following new clause:

"(iii) any distribution described in section 404(k)(2)."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after the date of enactment of this Act.

SEC. 543. EXCLUSION OF INTEREST ON LOANS USED TO FINANCE ACQUISITION OF EMPLOYER SECURITIES BY AN ESOP.

(a) IN GENERAL.—Part III of subchapter B of chapter 1 (relating to items excluded from gross income), as amended by this Act, is

amended by redesignating section 133 as section 134 and by inserting after section 131 the following new section:

"SEC. 133. INTEREST ON CERTAIN LOANS USED TO ACQUIRE EMPLOYER SECURITIES.

"(a) IN GENERAL.—Gross income does not include 50 percent of the interest received by—

"(1) a bank (within the meaning of section 581),

"(2) an insurance company to which subchapter L applies, or

"(3) a corporation actively engaged in the business of lending money,

with respect to a securities acquisition loan.

"(b) SECURITIES ACQUISITION LOAN.—

"(1) IN GENERAL.—For purposes of this section, the term 'securities acquisition loan' means any loan to a corporation, or to an employee stock ownership plan, to the extent that the proceeds are used to acquire employer securities (within the meaning of section 409A(1)) for the plan.

"(2) LOANS BETWEEN RELATED PERSONS.—The term 'securities acquisition loan' shall not include—

"(A) any loan made between corporations which are members of the same controlled group of corporations, or

"(B) any loan made between an employee stock ownership plan and any person that is—

"(i) the employer of any employees who are covered by the plan; or

"(ii) a member of a controlled group of corporations which includes such employer.

"(3) CONTROLLED GROUP OF CORPORATIONS.—For purposes of this paragraph, the term 'controlled group of corporations' has the meaning given such term by section 409A(l)(4).

"(c) EMPLOYEE STOCK OWNERSHIP PLAN.—For purposes of this section, the term 'employee stock ownership plan' has the meaning given to such term by section 4975(e)(7)."

(b) CONFORMING AMENDMENT.—The table of sections for part III of subchapter B of chapter 1 is amended by striking out the item relating to section 133 and inserting in lieu thereof the following:

"Sec. 133. Interest on certain loans used to acquire employer securities.
"Sec. 134. Cross references to other Act."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to loans used to acquire employer securities after the date of the enactment of this Act.

SEC. 544. ASSUMPTION OF ESTATE TAX LIABILITY BY EMPLOYER STOCK OWNERSHIP PLAN OR COOPERATIVE RECEIVING EMPLOYER SECURITIES

(a) IN GENERAL.—Subchapter C of chapter 11 (relating to miscellaneous estate tax provisions) is amended by adding at the end thereof the following new section:

"SEC. 2210. LIABILITY FOR PAYMENT IN CASE OF TRANSFER OF EMPLOYER SECURITIES TO AN EMPLOYEE STOCK OWNERSHIP PLAN OR A WORKER-OWNED COOPERATIVE.

"(a) IN GENERAL.—If—

"(1) employer securities—

"(A) are acquired from the decedent by an employee stock ownership plan or by an eligible worker-owned cooperative from any decedent,

"(B) pass from the decedent to such a plan or cooperative, or

"(C) are transferred by the executor to such a plan or cooperative, and

"(2) the executor elects the application of this section and files the agreements described in subsection (e) before the due date (including extensions) for filing the return of tax imposed by section 2001,

then the executor is relieved of liability for payment of that portion of the tax imposed by section 2001 which such employee stock ownership plan or cooperative is required to pay under subsection (b).

"(b) PAYMENT OF TAX BY EMPLOYEE STOCK OWNERSHIP PLAN OR COOPERATIVE.—

"(1) IN GENERAL.—An employee stock ownership plan or eligible worker-owned cooperative—

"(A) which has acquired employer securities from the decedent, or to which such securities have passed from the decedent or been transferred by the executor, and

"(B) with respect to which an agreement described in subsection (e)(1) is in effect,

shall pay that portion of the tax imposed by section 2001 with respect to the taxable estate of the decedent which is described in paragraph (2).

"(2) AMOUNT OF TAX TO BE PAID.—The portion of the tax imposed by section 2001 with respect to the taxable estate of the decedent that is referred to in paragraph (1) is equal to the lesser of—

"(A) the value of the employer securities described in subsection (a)(1) which is included in the gross estate of the decedent, or

"(B) the tax imposed by section 2001 with respect to such taxable estate reduced by the sum of the credits allowable against such tax.

"(c) INSTALLMENT PAYMENTS.—

"(1) IN GENERAL.—If—

"(A) the executor of the estate of the decedent (without regard to this section) elects to have the provisions of section 6166 (relating to extensions of time for payment of estate tax where estate consists largely of interest in closely held business) apply to payment of that portion of the tax imposed by section 2001 with respect to such estate which is attributable to employer securities, and

"(B) the plan administrator or the cooperative provides to the executor the agreement described in subsection (e)(1),

then the plan administrator or the cooperative may elect, before the due date (including extensions) for filing the return of such tax, to pay all or part of the tax described in subsection (b)(2) in installments under the provisions of section 6166.

"(2) INTEREST ON INSTALLMENTS.—In determining the 4-percent portion for purposes of section 6601(j)—

"(A) the portion of the tax imposed by section 2001 with respect to an estate for which the executor is liable, and

"(B) the portion of such tax for which an employee stock ownership plan or an eligible worker-owned cooperative is liable,

shall be aggregated.

"(d) GUARANTEE OF PAYMENTS.—Any employer—

"(1) whose employees are covered by an employee stock ownership plan, and

"(2) who has entered into an agreement described in subsection (e)(2) which is in effect,

shall guarantee (in such manner as the Secretary may prescibe) the payment of any amount such plan is required to pay under subsection (b), including any interest payable under section 6601 which is attributable to such amount.

"(e) AGREEMENTS.—The agreements described in this subsection are as follows:

"(1) A written agreement signed by the plan administrator, or by any authorized officer of the eligible worker-owned cooperative, consenting to the application of subsection (b) to such plan or cooperative.

"(2) A written agreement signed by the employer whose employees are covered by the plan described in subsection (b) consenting to the application of subsection (d).

"(f) EXEMPTION FROM TAX ON PROHIBITED TRANSACTIONS.—The assumption under this section by an employee stock ownership plan of any portion of the liability for the tax imposed by section 2001 shall be treated as a loan described in section 4975(d)(3).

"(g) DEFINITIONS.—For purposes of this section—

"(1) EMPLOYER SECURITIES.—The term 'employer securities' has the meaning given such term by section 409A(1).

"(2) EMPLOYEE STOCK OWNERSHIP PLAN.—The term 'employee stock ownership plan' has the meaning given such term by section 4975(e)(7).

"(3) ELIGIBLE WORKER-OWNED COOPERATIVE.—The term 'eligible worker-owned cooperative' has the meaning given to such term by section 1041(b)(2).

"(4) PLAN ADMINISTRATOR.—The term 'plan administrator' has the meaning given such term by section 414(g)."

(b) CONFORMING AMENDMENTS.—

(1) Section 2002 (relating to liability for payment of estate tax) is amended to read as follows:

"SEC. 2002. LIABILITY FOR PAYMENT.

"Except as provided in section 2210, the tax imposed by this chapter shall be paid by the executor."

(2) The table of sections for subchapter C of chapter 11 is amended by adding at the end thereof the following:

"Sec. 2210. Liability for payment in case of transfer of employer securities to an employee stock ownership plan or a worker-owned cooperative."

(3) Section 6018 (relating to estate tax returns) is amended by adding at the end thereof the following new subsection:

"(c) Election Under Section 2210.—In all cases in which subsection (a) requires the filing of a return, if an executor elects the applications of section 2210—

"(1) Return by executor.—The return which the executor is required to file under the provisions of subsection (a) shall be made with respect to that portion of estate tax imposed by subtitle B which the executor is required to pay.

"(2) Return by plan administrator.—The plan administrator of an employee stock ownership plan or the eligible worker-owned cooperative, as the case may be, shall make a return with respect to that portion of the tax imposed by section 2001 which such plan or cooperative is required to pay under section 2210(b)."

(4) Subsection (j) of section 6166 (relating to cross references) is amended by adding at the end thereof the following new paragraph:

"(6) Payment of estate tax by employee stock ownership plan or eligible worker-owned cooperative.—For provision allowing plan administrator or eligible worker-owned cooperative to elect to pay a certain portion of the estate tax in installments under the provisions of this section, see section 2210(c)."

(d) Effective Date.—The amendments made by this section shall apply to those estates of decedents which are required to file returns on a date (including any extensions) after the date of enactment of this Act.

SEC. 545. EXCISE TAX ON CERTAIN DISPOSITIONS OF EMPLOYER SECURITIES BY EMPLOYEE STOCK OWNERSHIP PLANS AND CERTAIN COOPERATIVES.

(a) In General.—Chapter 43 (relating to excise taxes on qualified pension plans), as amended by this Act, is amended by adding at the end thereof the following new section:

"SEC. 4978. TAX ON CERTAIN DISPOSITIONS BY EMPLOYEE STOCK OWNERSHIP PLANS AND CERTAIN COOPERATIVES.

"(a) Tax on Dispositions of Securities To Which Section 1042 Applies Before Close of Minimum Holding Period.—If, during the 3-year period after the date on which the employee stock ownership plan or eligible worker-owned cooperative acquired any qualified securities in a sale to which section 1042 applied, such plan or cooperative disposes of any qualified securities and—

"(1) the total number of shares held by such plan or cooperative after such disposition is less then the total number of qualified securities held immediately after such sale, or

"(2) except to the extent provided in regulations, the value of qualified securities held by such plan or cooperative after such disposition is less than 30 percent of the total value of all qualified securities as of such disposition,

there is hereby imposed a tax on the disposition equal to the amount determined under subsection (b).

"(b) Amount of Tax.—

"(1) In general.—The amount of the tax imposed by paragraph (1) shall be equal to 10 percent of the amount realized on the disposition.

"(2) LIMITATION.—The amount realized taken into account under paragraph (1) shall not exceed that portion allocable to qualified securities acquired in the sale to which section 1042 applied (determined as if such securities were disposed of before any other securities).

"(3) DISTRIBUTIONS TO EMPLOYEES.—The amount realized on any distribution to an employee for less than fair market value shall be determined as if the qualified security had been sold to the employee at fair market value.

"(c) LIABILITY FOR PAYMENT OF TAXES.—The tax imposed by this subsection shall be paid by—

"(1) the employer, or

"(2) the eligible worker-owned cooperative,

that made the written statement described in section 1042(a)(2)(B).

"(d) SECTION NOT TO APPLY TO CERTAIN DISPOSITIONS.—

"(1) CERTAIN DISTRIBUTIONS TO EMPLOYEES.—This section shall not apply with respect to any distribution of qualified securities (or sale of such securities) which is made by reason of—

"(A) the death of the employee,

"(B) the retirement of the employee after the employee has attained 59½ years of age,

"(C) the disability of the employee (within the meaning of section 72(m)(5)), or

"(D) the separation of the employee from service for any period which results in a 1-year break in service (within the meaning of section 411(a)(6)(A)).

"(2) CERTAIN REORGANIZATIONS.—In the case of any exchange of qualified securities in any reorganization described in section 368(a)(1) for stock of another corporation, such exchange shall not be treated as a disposition for purposes of this section.

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

"(1) EMPLOYEE STOCK OWNERSHIP PLAN.—

"(A) IN GENERAL.—The term 'employee stock ownership plan' has the meaning given to such term by section 4975(e)(7).

"(B) TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLANS.—The term 'employee stock ownership plan' includes any tax credit employee stock ownership plan (within the meaning of section 409A).

"(2) QUALIFIED SECURITIES.—The term 'qualified securities' has the meaning given to such term by section 1042(b)(1).

"(3) ELIGIBLE WORKER-OWNED COOPERATIVE.—The term 'eligible worker-owned cooperative' has the meaning given to such term by section 1042(b)(1).

"(4) DISPOSITION.—The term 'disposition' includes any distribution."

(b) CONFORMING AMENDMENT.—The table of sections for chapter 43 is amended by adding at the end thereof the following new item:

"Sec. 4978. Tax on certain dispositions and allocations by employee stock ownership plans and certain cooperatives."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after the date of enactment of this Act.

Subtitle E—Miscellaneous

SEC. 551. TREATMENT OF CERTAIN DISTRIBUTIONS FROM A QUALIFIED TERMINATED PLAN.

(a) In General.—For purposes of the Internal Revenue Code 1954, if—

(1) a distribution was made from a qualified terminated plan to an employee on December 16, 1976, and on January 6, 1977, such employee transferred all of the property received in such distribution to an individual retirement account (within the meaning of section 408(a) of such Code) established for the benefit of such employee, and

(2) the remaining balance to the credit of such employee in such qualified terminated plan was distributed to such employee on January 21, 1977, and all the property received by such employee in such distribution was transferred by such employee to such individual retirement account on January 21, 1977,

then such distributions shall be treated as qualifying rollover distributions (within the meaning of section 402(a)(5) of such Code) and shall not be includible in the gross income of such employee for the taxable year in which paid.

(b) Qualified Terminated Plan.—For purposes of this section, the term "qualified terminated plan" means a pension plan—

(1) with respect to which a notice of sufficiency was issued by the Pension Benefit Guaranty Corporation on December 2, 1976, and

(2) which was terminated by corporate action on February 20, 1976.

(c) Refund or Credit of Overpayment Barred by Statute of Limitations.—Notwithstanding section 6613(a) of the Internal Revenue Code of 1954 or any other period of limitation or lapse of time, a claim for credit or refund of overpayment of the tax imposed by such Code which arises by reason of this section may be filed by any person at any time within the 1-year period beginning on the date of enactment of this Act. Sections 6613(b) and 6514 of such Code shall not apply to any claim for credit or refund filed under this subsection within such 1-year period.

SEC. 552. PARTIAL TERMINATION FOR CERTAIN PENSION PLANS.

For purposes of section 411(d)(3) of the Internal Revenue Code of 1954 (relating to minimum vesting standards in the case of partial terminations), a partial termination shall not be treated as occurring if—

(1) the partial termination is a result of a decline in plan participation which—

(A) occurs by reason of the completion of the Trans-Alaska Oil Pipeline construction project, and

(B) occurred after December 31, 1975, and before January 1, 1980, with respect to participants employed in Alaska,

(2) no discrimination prohibited by section 401(a)(4) of such Code occurred with respect to such partial termination, and

(3) the plan administrator establishes to the satisfaction of the Secretary of the Treasury or his delegate that the benefits of this section will not accrue to the employers under the plan.

SEC. 553. DISTRIBUTION REQUIREMENTS FOR ACCOUNTS AND ANNUITIES OF AN INSURER IN A REHABILITATION PROCEEDING.

(a) IN GENERAL.—For purposes of sections 401(a)(9), 408(a) (6) and (7), and 408(b) (3) and (4) of the Internal Revenue Code of 1954—

(1) a trust, custodial account, or annuity or other contract forming part of a pension or profit-sharing plan, or a retirement annuity, or

(2) a grantor of an individual retirement account or an individual retirement annuity,

shall not be treated as failing to meet the requirements of such sections if such account, annuity, or contract was issued by an insurance company which, on March 15, 1984, was a party to a rehabilitation proceeding under the applicable State insurance law.

(b) LIMITATION.—Subsection (a) shall apply only during the period during which—

(1) the insurance company continues to be a party to the proceeding described in subsection (a), and

(2) distributions under the trust, custodial account, or annuity or other contract may not be made by reason of such proceeding.

SEC. 554. EXTENSION OF TIME FOR REPAYMENT OF QUALIFIED REFUNDING LOANS.

Paragraph (2) of section 236(c) of the Tax Equity and Fiscal Responsibility Act of 1982 is amended by adding at the end thereof the following new subparagraph:

"(D) SPECIAL RULE FOR NON-KEY EMPLOYEES.—In the case of a non-key employee (within the meaning of section 416(i)(2) of the Internal Revenue Code of 1954), this paragraph shall be applied by substituting 'January 1, 1985' for 'August 14, 1983' each place it appears."

SEC. 555. TECHNICAL AMENDMENTS TO THE INCENTIVE STOCK OPTION PROVISIONS.

(a) DETERMINATION OF FAIR MARKET VALUE.—

(1) IN GENERAL.—Subsection (c) of section 422A (relating to special rules) is amended by adding at the end thereof of the following new paragraph:

"(10) FAIR MARKET VALUE.—For purposes of this section, the fair market value of stock shall be determined without regard to any restriction other than a restriction which, by its terms, will never lapse.".

(2) INCENTIVE STOCK OPTION AS AN ITEM OF TAX PREFERENCE.—Paragraph (10) of section 57(a) (relating to items of tax preference) is amended by adding at the end thereof the following new sentence: "For purposes of this paragraph, the fair market value of a share of stock shall be determined without regard to any restriction other than a restriction which, by its terms, will never lapse."

(b) MODIFICATION OF INCENTIVE STOCK OPTIONS.—Subparagraph (B) of section 425(h)(3) (relating to modifications) is amended by striking out "422A(b)(5),".

(c) EFFECTIVE DATES.—

(1) FAIR MARKET VALUE.—The amendment made by subsection (a) shall apply to options granted after March 20, 1984,

except that such subsection shall not apply to any incentive stock option granted before September 20, 1984, pursuant to a plan adopted or corporate action taken by the board of directors of the grantor corporation before May 15, 1984.

(2) ITEMS OF TAX PREFERENCE.—The amendment made by subsection (b) shall apply to options exercised after March 20, 1984. In the case of an option issued after March 20, 1984, pursuant to a plan adopted or corporate action taken by the board of directors of the grantor corporation before May 15, 1984, the preceding sentence shall be applied by substituting "December 31, 1984" for "March 20, 1984".

(3) MODIFICATIONS.—The amendment made by subsection (c) shall apply with respect to modifications of options after March 20, 1984.

SEC. 556. TIME FOR MAKING CERTAIN SECTION 83(b) ELECTIONS.

In the case of any transfer of property in connection with the performance of services after June 30, 1976, and on or before November 18, 1982, the election permitted by section 83(b) of the Internal Revenue Code of 1954 may be made, notwithstanding paragraph (2) of such section 83(b), with the income tax return for the first taxable year ending after the date of the enactment of this Act, if—

(1) the amount paid for such property was not less than its fair market value at the time of transfer (determined without regard to any restriction other than a restriction which by its terms will never lapse), and

(2) the election is consented to by the person transferring such property.

The election shall contain that information required by the Secretary of the Treasury or his delegate for elections permitted by such section 83(b). The period for assessing any tax attributable to a transfer of property which is the subject of an election made pursuant to this section shall not expire before the date which is 3 years after the date such election was made.

SEC. 557. EMPLOYER AND EMPLOYEE BENEFIT ASSOCIATION TREATED AS RELATED PERSONS UNDER SECTION 1239.

(a) GENERAL RULE.—Section 1239 (relating to gain from sale of depreciable property between certain related taxpayers) is amended by adding at the end thereof the following new subsection:

"(d) EMPLOYER AND RELATED EMPLOYEE ASSOCIATION.—For purposes of subsection (a), the term 'related person' also includes—

"(1) an employer and any person related to the employer (within the meaning of subsection (b)), and

"(2) a welfare benefit fund (within the meaning of section 419(e)) which is controlled directly or indirectly by persons referred to in paragraph (1)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to sales or exchanges after the date of the enactment of this Act in taxable years ending after such date.

SEC. 558. ELIMINATION OF RETROACTIVE APPLICATION OF AMENDMENTS MADE BY MULTIEMPLOYER PENSION PLAN AMENDMENTS ACT OF 1980.

(a) IN GENERAL.—

(1) LIABILITY.—Any withdrawal liability incurred by an employer pursuant to part 1 of subtitle E of title IV of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1381 et seq.) as a result of the complete or partial withdrawal of such employer from a multiemployer plan before September 26, 1980, shall be void.

(2) REFUNDS.—Any amounts paid by an employer to a plan sponsor as a result of such withdrawal liability shall be refunded by the plan sponsor to the employer with interest (in accordance with section 401(a)(2)), less a reasonable amount for administrative expenses incurred by the plan sponsor (other than legal expenses incurred with respect to the plan) in calculating, assessing, and refunding such amounts.

(b) CONFORMING AMENDMENTS.—

(1) EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974.—

(A) Sections 4211 (b) and (c), 4217(a), and 4235(a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1391 (b) and (c), 1397(a), and 1415(a)) are amended by striking out "April 28, 1980" each place it appears and inserting in lieu thereof "September 25, 1980".

(B) Sections 4211 (b) and (c), 4217(a), 4219(c)(1)(C)(iii), and 4402(e) of such Act (29 U.S.C. 1391 (b) and (c), 1397(a), 1399(c)(1)(C)(iii), and 1461(e)) are amended by striking out "April 29, 1980" each place it appears and inserting in lieu thereof "September 26, 1980".

"(C) Section 4402(f)(1) of such Act (29 U.S.C. 1461(f)(1)) is amended by striking out "April 29, 1985" and inserting in lieu thereof "September 26, 1985".

(2) MULTIEMPLOYER PENSION PLAN AMENDMENTS ACT OF 1980.—Section 108(d) of the Multiemployer Pension Plan Amendments Act of 1980 (29 U.S.C. 1385 note) is amended—

(A) by striking out "April 29, 1982" in paragraph (1) and inserting in lieu thereof "September 26, 1982"; and

(B) by striking out "April 29, 1980" each place it appears in paragraphs (2) and (3) and inserting in lieu thereof "September 26, 1980".

(c) NO INCREASE IN LIABILITY.—The amendments made by this section shall not be construed to increase the liability incurred by any employer pursuant to part 1 of subtitle E of title IV of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1381 et seq.), as in effect immediately before the amendments made by subsection (b), as a result of the complete or partial withdrawal of such employer from a multiemployer plan prior to September 26, 1980.

(d) SPECIAL RULE FOR CERTAIN BINDING AGREEMENTS.—In the case of an employer who, on September 26, 1980, has a binding agreement to withdraw from a multiemployer plan, subsection (a)(1) shall be applied by substituting "December 31, 1980" for "September 26, 1980".

SEC. 559. TELECOMMUNICATION EMPLOYEES.

(a) EMPLOYEE PROTECTION.—Notwithstanding any provisions of the divestiture interchange agreement to the contrary, in the case of any change in employment on or after January 1, 1985, by a covered employee, the recognition of service credit, and enforcement of such

recognition, shall be governed in the same manner and to same extent as provided under the divestiture interchange agreement for a change in employment by a covered employee during calendar year 1984.

(b) Employees Covered.—For purposes of this section, a covered employee is an individual—

(1) who is an employee of an entity subject to the modified final judgment,

(2) who is serving in an eligible position, and

(3) who—

(A) on December 31, 1983, was an employee of any such entity serving in an eligible position, or

(B) was a former employee with rehire or recall rights on such date and is rehired during the period of the employee's rehire or recall rights.

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

(1) The term "service credit" means service credit for benefit accrual, vesting, and eligibility for benefits under any pension plan, or any other employee benefits, including the interchange and treatment of associated benefit obligations and assets.

(2) The term "change in employment" means the commencement of employment of a covered employee by an entity subject to the modified final judgment after the termination of employment (with or without break in service) of such individual from an eligible position within another entity subject to the modified final judgment.

(3) The term "eligible position" means any position (A) which is not a supervisory position, within the meaning of section 2(11) of the National Labor Relations Act (29 U.S.C. 152(11)) or (B) the annual base pay rate for which is not more than $50,000, adjusted by the percentage increase in the consumer price index since December 31, 1983.

(4) The term "modified final judgment" means the judgment of the United States District Court for the District of Columbia in the case, United States against Western Electric, et alia, No. 82–0192, as modified.

(5) The term "entity subject to the modified final judgment" means—

(A) any carrier divested as a result of the modified final judgment,

(B) the corporation owning such carrier before divestiture,

(C) any other communications common carrier owned, in whole or in part, by such corporation on December 31, 1983, or

(D) any Interchange Company (as defined in the divestiture interchange agreement) excluding any subsidiary of such company other than any such subsidiary—

(i) which was established as of December 31, 1983, and

(ii) which participates in a defined benefit pension plan maintained by such Interchange Company.

(6) The term "divestiture interchange agreement" refers to the agreement between entities subject to the modified final judg-

ment which was executed as of November 1, 1983, and which provides for mutual reciprocal recognition of service credit.

(7) The term "consumer price index" means the Consumer Price Index (all items—United States city average) published monthly by the Bureau of Labor Statistics.

(d) COORDINATION WITH OTHER BENEFIT-RELATED PROVISIONS.—Nothing in this section shall be construed to limit benefits which would otherwise be available to any individual, whether provided under the modified final judgment, under applicable law, or otherwise.

SEC. 560. STUDY OF EMPLOYEE WELFARE BENEFIT PLANS.

(a) IN GENERAL.—The Secretary of the Treasury shall make a study of the problems relating to the use of employee welfare benefit plans for the provision of benefits to current and retired employees. Such study shall include a study of the need for participation, vesting, and funding standards.

(b) REPORT.—A report of the study conducted under subsection (a), together with such recommendations for legislation as the Secretary deems appropriate, shall be made to the Congress by not later than February 1, 1985.

TITLE VI—TAX-EXEMPT BOND PROVISIONS

Subtitle A—Mortgage Subsidy Bonds

SEC. 611. 4-YEAR EXTENSION OF MORTGAGE SUBSIDY BOND AUTHORITY.

(a) GENERAL RULE.—Subparagraph (B) of section 103A(c)(1) (defining qualified mortgage bond) is amended by striking out "December 31, 1983" each place it appears and inserting in lieu thereof "December 31, 1987".

(b) REPORTING, ETC., REQUIREMENTS FOR MORTGAGE SUBSIDY BONDS.—

(1) IN GENERAL.—Subsection (j) of section 103A (relating to other requirements) is amended by adding at the end thereof the following new paragraphs:

"(3) INFORMATION REPORTING REQUIREMENT.—

"(A) IN GENERAL.—An issue meets the requirements of this subsection only if the issuer submits to the Secretary, not later than the 15th day of the 2nd calendar month after the close of the calendar quarter in which the issue is issued, a statement concerning the issue which contains—

"(i) the name and address of the issuer,

"(ii) the date of the issue, the amount of the lendable proceeds of the issue, and the stated interest rate, term, and face amount of each obligation which is part of the issue,

"(iii) such information as the Secretary may require in order to determine whether such issue meets the requirements of this section and the extent to which proceeds of such issue have been made available to low-income individuals, and

"(iv) such other information as the Secretary may require.

"(B) EXTENSION OF TIME.—The Secretary may grant an extension of time for the filing of any statement under subparagraph (A) if there is reasonable cause for the failure to file such statement in a timely fashion.

"(4) STATE CERTIFICATION REQUIREMENTS.—

"(A) IN GENERAL.—An issue meets the requirements of this subsection only if, before the issue, a State official designated by State law (or, where there is no such State official, the Governor) certifies that the issue meets the requirements of subsection (g).

"(B) CERTIFICATION FURNISHED TO SECRETARY.—Any certification under subparagraph (A) shall be submitted to the Secretary at the same time as the statement with respect to such issue is submitted under paragraph (3).

"(C) SPECIAL RULE FOR CONSTITUTIONAL HOME RULE CITIES.—In the case of constitutional home rule cities (as defined in subsection (g)(5)(C)), the certification under subparagraph (A) shall be made by the chief executive officer of such city.

"(5) POLICY STATEMENT.—

"(A) IN GENERAL.—An issue meets the requirements of this subsection only if the applicable elected representative of the governmental unit—

"(i) which is the issuer, or

"(ii) on whose behalf such issue was issued,

has published (after a public hearing following reasonable public notice) a report described in subparagraph (B) by the last day of the year preceding the year in which such issue is issued and a copy of such report has been submitted to the Secretary on or before such last day.

"(B) REPORT.—The report referred to in subparagraph (A) which is published by the applicable elected representative of the governmental unit shall include—

"(i) a statement of the housing, development, and income distribution policies which such governmental unit is to follow in issuing mortgage subsidy bonds and mortgage credit certificates, and

"(ii) an assessment of the compliance of such governmental unit during the preceding 1-year period preceding the date of the report with—

"(I) the statement of policy on qualified mortgage bonds and mortgage credit certificates that was set forth in the previous report, if any, of an applicable elected representative of such governmental unit, and

"(II) the intent of Congress that State and local governments are expected to use their authority to issue qualified mortgage bonds and mortgage credit certificates to the great extent feasible (taking into account prevailing interest rates and conditions in the housing market) to assist lower

income families to afford home ownership before assisting higher income families."

(c) TREATMENT OF QUALIFIED VETERANS' MORTGAGE BONDS.—

(1) Subparagraph (C) of section 103A(c)(3) (defining qualified veterans' mortgage bond) is amended by striking out "subsection (j)(1)" and inserting in lieu thereof "subsection (d), paragraphs (1) and (3) of subsection (j), and subsection (o)".

(2) Section 103A is amended by adding at the end thereof the following new subsection:

"(o) ADDITIONAL REQUIREMENTS FOR QUALIFIED VETERANS' MORTGAGE BONDS.—

"(1) VETERANS TO WHOM FINANCING MAY BE PROVIDED.—An obligation meets the requirements of this subsection only if each mortgagor to whom financing is provided under the issue is a qualified veteran.

"(2) REQUIREMENT THAT STATE PROGRAM BE IN EFFECT BEFORE JUNE 22, 1984.—An issue meets the requirements of this subsection only if it is a general obligation of a State which issued qualified veterans' mortgage bonds before June 22, 1984.

"(3) VOLUME LIMITATION.—

"(A) IN GENERAL.—An issue meets the requirements of this subsection only if the aggregate amount of bonds issued pursuant thereto (when added to the aggregate amount of qualified veterans' mortgage bonds previously issued by the state during the calendar year) does not exceed the State veterans limit for such calendar year.

"(B) STATE VETERANS LIMIT.—A State's veterans limit for any calendar year is one-fifth of the aggregate amount of qualified veterans' bonds issued by such State during the period beginning on January 1, 1979, and ending on June 22, 1984.

"(4) QUALIFIED VETERAN.—For purposes of this subsection, the term 'qualified veteran' means any veteran—

(A) who served on active duty at some time before January 1, 1977, and

"(B) who applied for the financing before the later of—

"(i) the date 30 years after the last date on which such veteran left active service, or

"(ii) January 1, 1985.

"(5) GOOD FAITH EFFORT RULES MADE APPLICABLE.—Rules similar to the rules of subparagraphs (B) and (C) of subsection (c)(2) shall apply to the requirements of this subsection.

"(6) SPECIAL RULE FOR CERTAIN SHORT-TERM OBLIGATIONS.—In the case of any obligation which has a term of 1 year or less and which was issued to provide financing for property taxes, the amount taken into account under this subsection with respect to such obligation shall be $\frac{1}{15}$ of its principal amount."

(d) EFFECTIVE DATES.—

(1) SUBSECTION (a).—The amendment made by subsection (a) shall apply with respect to obligations issued after December 31, 1983.

(2) SUBSECTION (b).—The amendments made by subsection (b) shall apply to obligations issued after December 31, 1984.

(3) SUBSECTION (c).—

(A) In general.—Except as provided in subparagraph (B), the amendment made by subsection (c) shall apply to obligations issued after the date of the enactment of this Act.

(B) Volume limitation.—The requirements of paragraph (3) of section 103A(o) of the Internal Revenue Code of 1954 (as added by this section) shall apply to obligations issued after June 22, 1984. In applying such requirements to obligations issued after such date, obligations issued on or before such date shall not be taken into account under such paragraph (3).

(C) Qualified veterans' mortgage bonds authorized before October 18, 1983, not taken into account.—The requirements of section 103(o)(3) of the Internal Revenue Code of 1954 shall not apply to any qualified veterans' mortgage bond if—

(i) the issuance of such bond was authorized by a State referendum before October 18, 1983, or

(ii) the issuance of such bond is authorized pursuant to a State referendum before December 1, 1983, where such referendum was authorized by action of the State legislature before October 18, 1983.

(4) Transitional rule where State formula for allocating State ceiling expires.—

(A) In general.—If a State law which provided a formula for allocating the State ceiling under section 103A(g) of the Internal Revenue Code of 1954 for calendar year 1983 expires as of the close of calendar year 1983, for purposes of section 103A(g) of such Code, such State law shall be treated as remaining in effect after 1983. In any case to which the preceding sentence applies, where the State's expiring allocation formula requires action by a State official to allocate the State ceiling among issuers, actions of such State official in allocating such ceiling shall be effective.

(B) Termination.—Subparagraph (A) shall not apply on or after the effective date of any State legislation enacted after the date of the enactment of this Act with respect to the allocation of the State ceiling.

(C) Special rule for Texas.—In the case of Texas, the Governor of such State may take the actions described in subparagraph (A) pursuant to procedures established by the Governor consistent with the State laws of Texas.

(5) Special rule for determinations of statistical area.—For purposes of applying section 103A of the Internal Revenue Code of 1954 and any other provision of Federal law—

(A) Rescission.—The Director of the Office of Management and Budget shall rescind the designation of the Kansas City, Missouri primary metropolitan statistical area (KCMO PMSA) and the designation of the Kansas City, Kansas primary metropolitan statistical area (Kansas City, KS PMSA), and shall not take any action to designate such two primary metropolitan statistical areas as a consolidated metropolitan statistical area.

(B) DESIGNATION.—The Director of the Office of Management and Budget shall designate a single metropolitan statistical area which includes the following:

(i) Kansas City, Kansas.

(ii) Kansas City, Missouri.

(iii) The counties of Johnson, Wyandotte, Leavenworth, and Miami in Kansas.

(iv) The counties of Cass, Clay, Jackson, Platte, Ray, and Lafayette in Missouri.

The metropolitan statistical area designation pursuant to this subsection shall be known as the "Kansas City Missouri-Kansas Metropolitan Statistical Area".

(6) TRANSITIONAL RULE FOR KENTUCKY AND NEVADA.—For purposes of section 103A(g) of the Internal Revenue Code of 1954, in the case of Kentucky and Nevada, subclause (I) of section 103A(g)(6)(B)(ii) of such Code shall be applied as if the first day referred to in such subclause were January 1, 1987.

(7) ANNUAL REPORT TO CONGRESS.—The Secretary of the Treasury, in consultation with the Secretary of Housing and Urban Development, shall submit an annual report to the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives regarding the performance of issuers of qualified mortgage bonds and mortgage credit certificates relative to the intent of Congress described in section 103A(j) of the Internal Code of 1954.

SEC. 612. MORTGAGE CREDIT CERTIFICATES.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 (relating to credits against tax) is amended by redesignating section 25 as section 26 and by inserting after section 24 the following new section:

"SEC 25. INTEREST ON CERTAIN HOME MORTGAGES.

"(a) ALLOWANCE OF CREDIT.—

"(1) IN GENERAL.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the product of—

"(A) the certificate credit rate, and

"(B) the interest paid or incurred by the taxpayer during the taxable year on the remaining principal of the certificated indebtedness amount.

"(2) LIMITATION WHERE CREDIT RATE EXCEEDS 20 PERCENT.—

"(A) IN GENERAL.—If the certificate credit rate exceeds 20 percent, the amount of the credit allowed to the taxpayer under paragraph (1) for any taxable year shall not exceed $2,000.

"(B) SPECIAL RULE WHERE 2 OR MORE PERSONS HOLD INTERESTS IN RESIDENCE.—If 2 or more persons hold interests in any residence, the limitation of subparagraph (A) shall be allocated among such persons in proportion to their respective interests in the residence.

"(b) CERTIFICATE CREDIT RATE; CERTIFIED INDEBTEDNESS AMOUNT.—For purposes of this section—

"(1) CERTIFICATE CREDIT RATE.—The term 'certificate credit rate' means the rate of the credit allowable by this section which is specified in the mortgage credit certificate.

"(2) CERTIFIED INDEBTEDNESS AMOUNT.—The term 'certified indebtedness amount' means the amount of indebtedness which is—

"(A) incurred by the taxpayer—

"(i) to acquire the principal residence of the taxpayer,

"(ii) as a qualified home improvement loan (as defined in section 103A(l)(6)) with respect to such residence, or

"(iii) as a qualified rehabilitation loan (as defined in section 103A(l)(7)) with respect to such residence, and

"(B) specified in the mortgage credit certificate.

"(c) MORTGAGE CREDIT CERTIFICATE; QUALIFIED MORTGAGE CREDIT CERTIFICATE PROGRAM.—For purposes of this section—

"(1) MORTGAGE CREDIT CERTIFICATE.—The term 'mortgage credit certificate' means any certificate which—

"(A) is issued under a qualified mortgage credit certificate program by the State or political subdivision having the authority to issue a qualified mortgage bond to provide financing on the principal residence of the taxpayer,

"(B) is issued to the taxpayer in connection with the acquisition, qualified rehabilitation, or qualified home improvement of the taxpayer's principal residence,

"(C) specifies—

"(i) the certificate credit rate, and

"(ii) the certified indebtedness amount, and

"(D) is in such form as the Secretary may prescribe.

"(2) QUALIFIED MORTGAGE CREDIT CERTIFICATE PROGRAM.—

"(A) IN GENERAL.—The term 'qualified mortgage credit certificate program' means any program—

"(i) which is established by a State or political subdivision thereof for any calendar year for which it is authorized to issue qualified mortgage bonds,

"(ii) under which the issuing authority elects (in such manner and form as the Secretary may prescribe) not to issue an amount of qualified mortgage bonds which it may otherwise issue during such calendar year under section 103A,

"(iii) under which the indebtedness certified by mortgage credit certificates meets the requirements of the following subsections of section 103A (as modified by subparagraph (B) of this paragraph):

"(I) subsection (d) (relating to residence requirements),

"(II) subsection (e) (relating to 3-year requirement),

"(III) subsection (f) (relating to purchase price requirement),

"(IV) subsection (h) (relating to portion of loans required to be placed in targeted areas), and

"(V) paragraph (1) of subsection (j) (relating to other requirements),

"(iv) under which no mortgage credit certificate may be issued with respect to any residence any of the financing of which is provided from the proceeds of a qualified mortgage bond or a qualified veterans' mortgage bond,

"(v) except to the extent provided in regulations, which is not limited to indebtedness incurred from particular lenders,

"(vi) except to the extent provided in regulations, which provides that a mortgage credit certificate is not transferrable, and

"(vii) if the issuing authority allocates a block of mortgage credit certificates for use in connection with a particular development, which requires the developer to furnish to the issuing authority and the homebuyer a certificate that the price for the residence is no higher than it would be without the use of a mortgage credit certificate.

"(B) MODIFICATIONS OF SECTION 103A.—Under regulations prescribed by the Secretary, in applying section 103A for purposes of subclauses (II) and (IV) of subparagraph (A)(iii)—

"(i) each qualified mortgage certificate credit program shall be treated as a separate issue,

"(ii) the product determined by multiplying—

"(I) the certified indebtedness amount of each mortgage credit certificate issued under such program, by

"(II) the certificate credit rate specified in such certificate,

shall be treated as proceeds of such issue and the sum of such products shall be treated as the total proceeds of such issue, and

"(iii) paragraph (1) of section 103A(e) shall be applied by substituting '100 percent' for '90 percent or more'.

Clause (iii) shall not apply if the issuing authority submits a plan to the Secretary for administering the 90-percent requirement of section 103A(e)(1) and the Secretary is satisfied that such requirement will be met under such plan.

"(d) DETERMINATION OF CERTIFICATE CREDIT RATE.—For purposes of this section—

"(1) IN GENERAL.—The certificate credit rate specified in any mortgage credit certificate shall not be less than 10 percent or more than 50 percent.

"(2) AGGREGATE LIMIT ON CERTIFICATE CREDIT RATES.—

"(A) IN GENERAL.—In the case of each qualified mortgage credit certificate program, the sum of the products determined by multiplying—

"(i) the certified indebtedness amount of each mortgage credit certificate issued under such program, by

"(ii) the certificate credit rate with respect to such certificate,

shall not exceed 20 percent of the nonissued bond amount or, if lesser, the aggregate amount of certified indebtedness referred to in clause (i).

"(B) NONISSUED BOND AMOUNT.—For purposes of subparagraph (A), the term 'nonissued bond amount' means, with respect to any qualified mortgage credit certificate program, the amount of qualified mortgage bonds which the issuing authority is otherwise authorized to issue and elects not to issue under subsection (c)(2)(A)(ii).

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

"(1) CARRYFORWARD OF UNUSED CREDIT.—

"(A) IN GENERAL.—If the credit allowable under subsection (a) for any taxable year exceeds the applicable tax limit for such taxable year, such excess shall be a carryover to each of the 3 succeeding taxable years and, subject to the limitations of subparagraph (B), shall be added to the credit allowable by subsection (a) for such succeeding taxable year.

"(B) LIMITATION.—The amount of the unused credit which may be taken into account under subparagraph (A) for any taxable year shall not exceed the amount by which the applicable tax limit for such taxable year exceeds the sum of the amounts which, by reason of this paragraph, are carried to such taxable year and are attributable to taxable years before the unused credit year.

"(C) APPLICABLE TAX LIMIT.—For purposes of this paragraph, the term 'applicable tax limit' means the limitation imposed by section 26(a) for the taxable year reduced by the sum of the credits allowable under this subpart (other than this section).

"(2) INDEBTEDNESS NOT TREATED AS CERTIFIED WHERE CERTAIN REQUIREMENTS NOT IN FACT MET.—Subsection (a) shall not apply to any indebtedness if all the requirements of subsection (d)(1), (e), (f), (g), and (j) of section 103A were not in fact met with respect to such indebtedness. Except to the extent provided in regulations, the requirements described in the preceding sentence shall be treated as met if there is a certification, under penalty of perjury, that such requirements are met.

"(3) PERIOD FOR WHICH CERTIFICATE IN EFFECT.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), a mortgage credit certificate shall be treated as in effect with respect to interest attributable to the period—

"(i) beginning on the date such certificate is issued, and

"(ii) ending on the earlier of the date on which—

"(I) the certificate is revoked by the issuing authority, or

"(II) the residence to which such certificate relates ceases to be the principal residence of the individual to whom the certificate relates.

"(B) CERTIFICATE INVALID UNLESS INDEBTEDNESS INCURRED WITHIN CERTAIN PERIOD.—A certificate shall not apply to any indebtedness which is incurred after the close

of the second calendar year following the calendar year for which the issuing authority made the applicable election under subsection (c)(2)(A)(ii).

"(C) NOTICE TO SECRETARY WHEN CERTIFICATE REVOKED.—An issuing authority which revokes any mortgage credit certificate shall notify the Secretary of such revocation at such time and in such manner as the Secretary shall prescribe by regulations.

(4) CERTAIN REFINANCING PERMITTED.—In applying subsection (c)(2)(A)(iii), under regulations, the requirements of section 103A(j)(1) may treated as met if a mortgage credit certificate is issued with respect to a mortgage which is used to replace an existing mortgage for which such a certificate has already been issued if such replacement mortgage does not extend the term, alter the amortization schedule, or increase the principal amount, of the original mortgage.

"(5) PUBLIC NOTICE THAT CERTIFICATES WILL BE ISSUED.—At least 90 days before any mortgage credit certificate is to be issued after a qualified mortgage credit certificate program, the issuing authority shall provide reasonable public notice of—

"(A) the eligibility requirements for such certificate,

"(B) the methods by which such certificates are to be issued, and

"(C) such other information as the Secretary may require.

"(6) INTEREST PAID OR ACCRUED TO RELATED PERSONS.—No credit shall be allowed under subsection (a) for any interest paid or accrued to a person who is a related person to the taxpayer (within the meaning of section 103(b)(6)(C)(i)).

(7) PRINCIPAL RESIDENCE.—The term 'principal residence' has the same meaning as when used in section 1034.

"(8) QUALIFIED REHABILITATION AND HOME IMPROVEMENT.—

"(A) QUALIFIED REHABILITATION.—The term 'qualified rehabilitation' has the meaning given such term by section 103A(l)(7)(B).

"(B) QUALIFIED HOME IMPROVEMENT.—The term 'qualified home improvement' means an alteration, repair, or improvement described in section 103A(l)(6).

"(9) QUALIFIED MORTGAGE BOND.—The term 'qualified mortgage bond' has the meaning given such term by section 103A(c)(1).

"(10) MANUFACTURED HOUSING.—For purposes of this section, the term 'single family residence' includes any manufactured home which has a minimum of 400 square feet of living space and a minimum width in excess of 102 inches and which is of a kind customarily used at a fixed location. Nothing in the preceding sentence shall be construed as providing that such a home will be taken into account in making determinations under section 103A.

"(f) REDUCTION IN AGGREGATE AMOUNT OF QUALIFIED MORTGAGE BONDS WHICH MAY BE ISSUED WHERE CERTAIN REQUIREMENTS NOT MET.—

"(1) IN GENERAL.—If for any calendar year any mortgage credit certificate program fails to meet the requirements of—

"(A) clause (iv), (v), or (vi) of subsection (c)(2)(A), or

"(B) paragraph (2) of subsection (d),
the applicable State ceiling under paragraph (4) of section 103A(g) for the State in which such program operates shall be reduced by 1.25 times the correction amount with respect to such failure. Such reduction shall be applied to such State ceiling for the calendar year following the calendar year in which the Secretary determines the correction amount with respect to such failure.

"(2) CORRECTION AMOUNT.—

"(A) IN GENERAL.—For purposes of paragraph (1), the term 'correction amount' means, in the case of a failure to meet a requirement referred to in—

"(i) paragraph (1)(A), the amount of indebtedness involved, or

"(ii) paragraph (1)(B), the amount equal to the excess credit amount divided by 0.20.

"(B) EXCESS CREDIT AMOUNT.—

"(i) IN GENERAL.—For purposes of subparagraph (A)(ii), the term 'excess credit amount' means the excess of—

"(I) the credit amount for any mortgage credit certificate program, over

"(II) the amount which would have been the credit amount for such program had such program met the requirements of paragraph (2) of subsection (d).

"(ii) CREDIT AMOUNT.—For purposes of clause (i), the term 'credit amount' means the sum of the products determined under clauses (i) and (ii) of subsection (d)(2)(A).

"(3) SPECIAL RULE FOR STATES HAVING CONSTITUTIONAL HOME RULE CITIES.—In the case of a State having one or more constitutional home rule cities (within the meaning of section 103A(g)(5)(C)), the reduction in the State ceiling by reason of paragraph (1) shall be allocated to the constitutional home rule city, or to the portion of the State not within such city, whichever caused the reduction.

"(4) EXCEPTION WHERE CERTIFICATION PROGRAM.—The provisions of this subsection shall not apply in any case in which there is a certification program which is designed to insure that the requirements of this section are met and which meets such requirements as the Secretary may by regulations prescribe.

"(5) WAIVER.—The Secretary may waive the application of paragraph (1) in any case in which he determines that the failure is due to reasonable cause.

"(g) REPORTING REQUIREMENTS.—Each person who makes a loan which is a certified indebtedness amount under any mortgage credit certificate shall file a report with the Secretary containing—

"(1) the name, address, and social security account number of the individual to which the certificate was issued,

"(2) the certificate's issuer, date of issue, certified indebtedness amount, and certificate credit rate, and

"(3) such other information as the Secretary may require by regulations.

Each person who issues a mortgage credit certificate shall file a report showing such information as the Secretary shall by regulations prescribe. Any such report shall be filed at such time and in such manner as the Secretary may require by regulations.

"(h) TERMINATION.—No election may be made under subsection (c)(2)(A)(ii) for any calendar year after 1987.

"(i) REGULATIONS; CONTRACTS.—

"(1) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section, including regulations which may require recipients of mortgage credit certificates to pay a reasonable processing fee to defray the expenses incurred in administering the program.

"(2) CONTRACTS.—The Secretary is authorized to enter into contracts with any person to provide services in connection with the administration of this section."

(b) APPLICATION WITH SECTION 103A.—Subsection (g) of section 103A (relating to limitation on aggregate amount of qualified mortgage bonds issued during any calendar year) is amended by adding at the end thereof the following new paragraph:

"(8) REDUCTION FOR MORTGAGE CREDIT CERTIFICATES.—The applicable limit of any issuing authority for any calendar year shall be reduced by the sum of—

"(A) the amount of qualified mortgage bonds which such authority elects not to issue under section 25(c)(2)(A)(ii) during such year, plus

"(B) the amount of any reduction in such ceiling under section 25(f) applicable to such authority for such year."

(c) DISALLOWANCE OF PORTION OF DEDUCTION FOR INTEREST WHERE CREDIT TAKEN.—Section 163 (relating to deduction for interest) is amended by redesignating subsection (g) as subsection (h) and by inserting after subsection (f) the following new subsection:

"(g) REDUCTION OF DEDUCTION WHERE SECTION 25 CREDIT TAKEN.—The amount of the deduction under this section for interest paid or accrued during any taxable year on indebtedness with respect to which a mortgage credit certificate has been issued under section 25 shall be reduced by the amount of the credit allowable with respect to such interest under section 25 (determined without regard to section 26)."

(d) CIVIL PENALTIES.—

(1) Subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end thereof the following new section:

"SEC. 6708. PENALTIES WITH RESPECT TO MORTGAGE CREDIT CERTIFICATES.

"(a) NEGLIGENCE.—If—

"(1) any person makes a misstatement in any verified written statement made under penalties of perjury with respect to the issuance of a mortgage credit certificate, and

"(2) such misstatement is due to the negligence of such person,

such person shall pay a penalty of $1,000 for each mortgage credit certificate with respect to which such a misstatement was made.

"(b) FRAUD.—If a misstatement described in subsection (a)(1) is due to fraud on the part of the person making such misstatement, in addition to any criminal penalty, such person shall pay a penalty of $10,000 for each mortgage credit certificate with respect to which such a misstatement is made.

"(c) REPORTS.—Any person required by section 25(g) to file a report with the Secretary who fails to file the report with respect to any mortgage credit certificate at the time and in the manner required by the Secretary shall pay a penalty of $200 for such failure unless it is shown that such failure is due to reasonable cause and not to willful neglect.

"(d) MORTGAGE CREDIT CERTIFICATE.—The term 'mortgage credit certificate' has the meaning given to such term by section 25(c)."

(2) The table of sections for subchapter B of chapter 68 is amended by adding at the end thereof the following new item:

"Sec. 6708. Penalties with respect to mortgage credit certificates."

(e) TECHNICAL AMENDMENTS.—

(1) Sections 28(d)(2), 29(b)(5), 30(g)(1)(A), 38(c)(2), and 901(a), as amended by this Act, are each amended by striking out "section 25(b)" and inserting in lieu thereof "section 26(b)".

(2) Section 23(b)(5), as amended by this Act, is amended by striking out "section 25(a)" and inserting in lieu thereof "section 26(a)" and by striking out "(other than this section)" and inserting in lieu thereof "(other than this section and section 25)".

(3) Paragraph (3) of section 55(c) is amended—

(A) by striking out "25" each place it appears and inserting in lieu thereof "26", and

(B) by striking out "section 23, 30, or 38" and inserting in lieu thereof "section 23, 25, 30, or 38".

(4) Clause (iii) of section 168(i)(1)(D), as added by section 208(a) of the Tax Equity and Fiscal Responsibility Act of 1982 and amended by this Act, is amended by striking out "section 25(b)(2)" and inserting in lieu thereof "section 26(b)(2)".

(5) Clause (iii) of section 168(i)(1)(D), as added by section 209(b) of the Tax Equity and Fiscal Responsibility Act of 1982 and amended by this Act, is amended by striking out "section 25(b)(2)" and inserting in lieu thereof "section 26(b)(2)".

(g) CONFORMING AMENDMENT.—The table of sections for subpart A of part IV of subchapter A of chapter 1 is amended by striking out the item relating to section 25 and inserting in lieu thereof the following:

"Sec. 25. Interest on certain home mortgages.
"Sec. 26. Limitation based on tax liability; definition of tax liability."

(h) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to interest paid or accrued after December 31, 1984, on indebtedness incurred after December 31, 1984.

(2) ELECTIONS.—The amendments made by this section shall apply to elections under section 25(c)(2)(A)(ii) of the Internal Revenue Code of 1954 (as added by this section) for calendar years after 1983.

SEC. 613. AUTHORITY TO BORROW FROM FEDERAL FINANCING BANK.

(a) GENERAL RULE.—Upon application by the appropriate State Housing Agency of Oregon, the Federal Financing Bank shall make qualified cash flow loans to such Agency. Such loans shall bear interest at a rate equal to the average rate on the applicable mortgage bonds with respect to which such loans were made.

(b) QUALIFIED CASH FLOW LOANS.—For purposes of this section, the term "qualified cash flow loan" means any loan with respect to an applicable mortgage bond reasonably necessary to cover any excess determined under subsection (c)(2) on the basis of actual payments. The aggregate amount of such loans which may be outstanding at any 1 time shall not exceed $300,000,000.

(c) APPLICABLE MORTGAGE BONDS.—For purposes of this section, the term "applicable mortgage bond" means any qualified veterans' mortgage bond issued as part of an issue—

(1) which was outstanding on December 5, 1980,

(2) with respect to which the excess of—

(A) the projected aggregate payments of principal on the applicable mortgage bonds during the 15-fiscal year period beginning with fiscal year 1984, over

(B) the projected aggregate payments during such period of principal on mortgages financed by the applicable mortgage bonds,

exceeds 12 percent of the aggregate principal amount of such bonds outstanding on July 1, 1983,

(3) with respect to which the amount of the average annual prepayments during fiscal years 1981, 1982, and 1983 was less than 2 percent of the average of the loan balances as of the beginning of each of such fiscal years, and

(4) which, for fiscal year 1983, had a prepayment experience rate that did not exceed 20 percent of the prepayment experience rate of the Federal Housing Administration in the State or region in which the issuer is located.

(d) DEFINITIONS.—

(1) ASSUMPTIONS USED IN MAKING PROJECTION.—The computation under subsection (c)(2) shall be made by using the following percentage of the prepayment experience of the Federal Housing Administration in the State or region in which the issuer of the applicable mortgage bonds is located:

Fiscal Year:	*Percentage:*
1984	*15*
1985	*20*
1986	*25*
1987 and thereafter	*30.*

(2) QUALIFIED VETERANS' MORTGAGE BONDS.—The term "qualified veterans' mortgage bonds" has the meaning given to such term by section 103A(c)(3) of the Internal Revenue Code of 1954.

SEC. 614. ELIMINATION OF CERTAIN EXCEPTIONS TO THE APPLICATION OF THE MORTGAGE SUBSIDY BOND TAX ACT OF 1980.

Section 1104 of the Mortgage Subsidy Bond Tax Act of 1980 is amended by adding at the end thereof the following new subsections:

"(p) MOST EXCEPTIONS NOT TO APPLY TO BONDS ISSUED AFTER DECEMBER 31, 1984.—In addition to any obligations to which the amendments made by section 1102 apply by reason of the provisions of this section, the amendments made by section 1102 shall apply, notwithstanding any other provision of this section (other than subsection (n)), to obligations issued after December 31, 1984, all or a major portion of the proceeds of which are used to finance new mortgages on single-family residences that are owner occupied.

"(q) REDUCTION OF STATE CEILING BY AMOUNT OF SPECIAL MORTGAGE BONDS ISSUED BEFORE 1985.—

"(1) IN GENERAL.—Notwithstanding any other provision of this section (other than subsections (n) and (r)), any obligation—

"(A) which is part of an issue all or a major portion of the proceeds of which are used to finance new mortgages in single-family residences that are owner occupied.

"(B) which were issued by issuing authorities in such State after June 15, 1984, and before January 1, 1985, and

"(C) to which the amendments made by section 1102 do not apply by reason of any provision of this section other than subsection (n),

shall, for purposes of applying the Internal Revenue Code of 1954, be treated as an obligation which is not described in section 103(a) of such Code if the aggregate face amount of such issue exceeds the portion of the State ceiling that is allocated by the State to such issue prior to the date of issuance of such issue.

"(2) APPLICATION OF SECTION 103A(g).—For purposes of applying section 103A(g) of such Code, the State ceiling for calendar year 1984 shall be reduced by the aggregate amount allocated by the State to any issues described in paragraph (1).

"(3) STATE CEILING.—For purposes of this subsection, the term 'State ceiling' has the meaning given to such term by section 103A(g)(4) of the Internal Revenue Code of 1954.

"(r) EXCEPTIONS TO SUBSECTION (q).—Subsection (q) shall not apply with respect to—

"(1) obligations—

"(A) the proceeds of which are used to finance the River Place Project located in Minneapolis, Minnesota, and

"(B) the aggregate face amount of which does not exceed $55,000,000, or

"(2) obligations—

"(A) the proceeds of which are used to finance the Waseca, Minnesota project, and

"(B) the aggregate face amount of which does not exceed $7,800,000.".

Subtitle B—Private Activity Bonds

PART I—GENERAL RESTRICTIONS

SEC. 621. LIMITATION ON AGGREGATE AMOUNT OF PRIVATE ACTIVITY BONDS.

Section 103 (relating to interest on certain governmental obligations) is amended by redesignating subsection (n) as subsection (o) and by inserting after subsection (m) the following new subsection:

"(n) LIMITATION ON AGGREGATE AMOUNT OF PRIVATE ACTIVITY BONDS ISSUED DURING ANY CALENDAR YEAR.—

"(1) IN GENERAL.—A private activity bond issued as part of an issue shall be treated as an obligation not described in subsection (a) if the aggregate amount of private activity bonds issued pursuant to such issue, when added to the aggregate amount of private activity bonds previously issued by the issuing authority during the calendar year, exceeds such authority's private activity bond limit for such calendar year.

"(2) PRIVATE ACTIVITY BOND LIMIT FOR STATE AGENCIES.—For purposes of this subsection—

"(A) IN GENERAL.—The private activity bond limit for any agency of the State authorized to issue private activity bonds for any calendar year shall be 50 percent of the State ceiling for such calendar year.

"(B) SPECIAL RULE WHERE STATE HAS MORE THAN 1 AGENCY.—If more than 1 agency of the State is authorized to issue private activity bonds, all such agencies shall be treated as a single agency.

"(3) PRIVATE ACTIVITY BOND LIMIT FOR OTHER ISSUERS.—For purposes of this subsection—

"(A) IN GENERAL.—The private activity bond limit for any issuing authority (other than a State agency) for any calendar year shall be an amount which bears the same ratio to 50 percent of the State ceiling for such calendar year as—

"(i) the population of the jurisdiction of such issuing authority, bears to

"(ii) the population for the entire State.

"(B) OVERLAPPING JURISDICTIONS.—For purposes of subparagraph (A)(i), the rules of section 103A(g)(3)(B) shall apply.

"(4) STATE CEILING.—For purposes of this subsection—

"(A) IN GENERAL.—The State ceiling applicable to any State for any calendar year shall be the greater of

"(i) an amount equal to $150 multiplied by the State's population, or

"(ii) $200,000,000.

"(B) PHASEIN OF LIMITATION WHERE AMOUNT OF 1983 PRIVATE ACTIVITY BONDS EXCEEDS THE CEILING.—

"(i) IN GENERAL.—In the case of any State which has an excess bond amount for 1983, the State ceiling for calendar year 1984 shall be the sum of the State ceiling

determined under subparagraph (A) plus 50 percent of the excess bond amount for 1983.

"(ii) EXCESS BOND AMOUNT FOR 1983.—For purposes of clause (i), the excess bond amount for 1983 in any State is the excess (if any) of—

"(I) the aggregate amount of private activity bonds issued by issuing authorities in such State during the first 9 months of calendar year 1983 multiplied by 4/3, over

"(II) the State ceiling determined under subparagraph (A) for calendar year 1984.

"(C) ADJUSTMENT OF CEILING TO REFLECT TERMINATION OF SMALL ISSUE EXEMPTION.—In the case of calendar years after 1986, subparagraph (A) shall be applied by substituting '$100' for '$150'.

"(5) SPECIAL RULE FOR STATES WITH CONSTITUTIONAL HOME RULE CITIES.—In the case of any State with 1 or more constitutional home rule cities (as defined in section 103A(g)(5)(C)), the rules of paragraph (5) of section 103A(g) shall apply for purposes of this subsection.

"(6) STATE MAY PROVIDE FOR DIFFERENT ALLOCATION.—

"(A) IN GENERAL.—A State may, by law provide a different formula for allocating the State ceiling among the governmental units in such State having authority to issue private activity bonds.

"(B) INTERIM AUTHORITY FOR GOVERNOR.—

"(i) IN GENERAL.—The Governor of any State may proclaim a different formula for allocating the State ceiling among the governmental units in such State having authority to issue private activity bonds.

"(ii) TERMINATION OF AUTHORITY.—The authority provided in clause (i) shall not apply after the earlier of—

"(I) the first day of the first calendar year beginning after the legislature has met in regular session for more than 60 days after the date of the enactment of this paragraph, or

"(II) the effective date of any State legislation with respect to the allocation of the State ceiling.

"(C) STATE MAY NOT ALTER ALLOCATION TO CONSTITUTIONAL HOME RULE CITIES.—The rules of paragraph (6)(C) of section 103A(g) shall apply for purposes of this paragraph.

"(7) PRIVATE ACTIVITY BOND.—For purposes of this subsection—

"(A) IN GENERAL.—Except as otherwise provided in the paragraph, the term 'private activity bond' means any obligation the interest on which is exempt from tax under subsection (a) and which is—

"(i) an industrial development bond, or

"(ii) a student loan bond.

"(B) EXCEPTION FOR MULTIFAMILY HOUSING.—The term 'private activity bond' shall not include any obligation described in subsection (b)(4)(A) nor any housing program ob-

ligation under section 11(b) of the United States Housing Act of 1937.

"(C) EXCEPTION FOR CERTAIN FACILITIES DESCRIBED IN SECTION 103(b)(4) (C) OR (D).—

"(i) IN GENERAL.—The term 'private activity bond' shall not include any obligation described in subparagraph (C) or (D) of section 103(b)(4), but only if the property described in such subparagraph is owned by or on behalf of a governmental unit.

"(ii) EXCEPTION NOT TO APPLY TO CERTAIN PARKING FACILITIES.—This subparagraph shall not apply to any obligation described in subparagraph (D) of section 103(b)(4) (determined by not taking into account any parking facilities unless such facilities are related to another facility described in such subparagraph (D)).

"(iii) DETERMINATION OF WHETHER PROPERTY OWNED BY GOVERNMENTAL UNIT.—For purposes of clause (i), property shall not be treated as not owned by a governmental unit solely by reason of the length of the lease to which it is subject if the lessee makes an irrevocable election (binding on the lessee and all successors in interest under the lease) not to claim depreciation or an investment credit with respect to such property.

"(iv) Restriction where significant front end loading.—Under regulations prescribed by the Secretary, clause (i) shall not apply in any case where the property is leased under a lease which has significant front end loading of rental accruals or payments.

"(D) REFUNDING ISSUES.—The term 'private activity bond' shall not include any obligation which is issued to refund another obligation to the extent that the amount of such obligation does not exceed the amount of the refunded obligation. In the case of any student loan bond, the preceding sentence shall apply only if the maturity date of the refunding obligation is not later than the later of—

"(i) the maturity of the obligation to be refunded, or

"(ii) the date 17 years after the date on which the refunded obligation was issued (or in the case of a series of refundings, the date on which the original obligation was issued).

"(8) STUDENT LOAN BONDS.—For purposes of this subsection, the term 'student loan bond' means an obligation which is issued as part of an issue all or a major portion of the proceeds of which are to be used directly or indirectly to finance loans to individuals for educational expenses.

"(9) POPULATION.—For purposes of this subsection, determinations of the population of any State (or issuing authority) shall be made with respect to any calendar year on the basis of the most recent census estimate of the resident population of such State (or issuing authority) published by the Bureau of the Census before the beginning of such calendar year.

"(10) ELECTIVE CARRYFORWARD OF UNUSED LIMITATION FOR SPECIFIED PROJECT.—

"(A) IN GENERAL.—If—

"(i) an issuing authority's private activity bond limit for any calendar year after 1983, exceeds

"(ii) the aggregate amount of private activity bonds issued during such calendar year by such authority,

such authority may elect to treat all (or any portion) of such excess as a carryforward for 1 or more carryforward projects.

"(B) ELECTION MUST SPECIFY PROJECT.—In any election under subparagraph (A), the issuing authority shall—

"(i) specify the project (or projects) for which the carryforward is elected, and

"(ii) specify the portion of the excess described in subparagraph (A) which is to be a carryforward for each such project.

"(C) USE OF CARRYFORWARD.—

"(i) IN GENERAL.—If any issuing authority elects a carryforward under subparagraph (A) with respect to any carryforward project, any private activity bonds issued by such authority with respect to such project during the 3 calendar years (or, in the case of a project described in subsection (b)(4)(F), 6 calendar years) following the calendar year in which the carryforward arose shall not be taken into account under paragraph (1) to the extent the amount of such bonds do not exceed the amount of the carryforward elected for such project.

"(ii) ORDER IN WHICH CARRYFORWARD USED.—Carryforwards elected with respect to any project shall be used in the order of the calendar years in which they arose.

"(D) ELECTION.—Any election made under this paragraph shall be made at such time and in such manner as the Secretary shall by regulations prescribe. Any such election (and any specification contained therein), once made, shall be irrevocable.

"(E) CARRYFORWARD PROJECT.—For purposes of this paragraph, the term 'carryforward project' means—

"(i) any project described in paragraph (4) or (5) of subsection (b), and

"(ii) the purpose of issuing student loan bonds.

"(11) TREATMENT OF QUALIFIED SCHOLARSHIP FUNDING BONDS.—In the case of a qualified scholarship funding bond (as defined in subsection (e)), such bond shall be treated for purposes of this subsection as issued by a State or local issuing authority (whichever is appropriate).

"(12) Certification of no consideration for allocation.

"(A) IN GENERAL.—Any private activity bond allocated any portion of the State limit shall not be exempt from tax under subsection (a) unless the public official if any responsible for such allocation certifies under penalty of perjury that the allocation was not made in consideration of any bribe, gift, gratuity, or direct or indirect contribution to any political campaign.

"(B) Any criminal penalty made applicable.—Any person willfully making an allocation described in subparagraph (A) in consideration of any bribe, gift, gratuity, or direct or indirect contribution to any political campaign shall be subject to criminal penalty to the same extent as if such allocation were a willful attempt to evade tax imposed by this title."

SEC. 622. TAX EXEMPTION DENIED WHERE OBLIGATION DIRECTLY OR INDIRECTLY GUARANTEED BY FEDERAL GOVERNMENT.

Subsection (h) of section 103 (relating to certain obligations must not be guaranteed or subsidized under a energy program) is amended to read as follows:

"(h) OBLIGATION MUST NOT BE GUARANTEED, ETC.—

"(1) IN GENERAL.—An obligation shall not be treated as an obligation described in subsection (a) if such obligation is federally guaranteed.

"(2) FEDERALLY GUARANTEED DEFINED.—For purposes of paragraph (1), an obligation is federally guaranteed if—

"(A) the payment of principal or interest with respect to such obligation is guaranteed (in whole or in part) by the United States (or any agency or instrumentality thereof),

"(B) such obligation is issued as part of an issue and a significant portion of the proceeds of such issue are to be—

"(i) used in making loans the payment of principal or interest with respect to which are to be guaranteed (in whole or in part) by the United States (or any agency or instrumentality thereof), or

"(ii) invested (directly or indirectly) in federally insured deposits or accounts, or

"(C) the payment of principal or interest on such obligation is otherwise indirectly guaranteed (in whole or in part) by the United States (or an agency or instrumentality thereof).

"(3) EXCEPTIONS.—

"(A) CERTAIN INSURANCE PROGRAMS.—An obligation shall not be treated as federally guaranteed by reason of—

"(i) any guarantee by the Federal Housing Administration, the Veterans' Administration, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, or the Government National Mortgage Association,

"(ii) any guarantee of student loans and any guarantee by the Student Loan Marketing Association to finance student loans,

"(iii) any guarantee by the Small Business Administration with respect to qualified contracts for pollution control facilities (within the meaning of section 404(a) of the Small Business Investment Act of 1958, as in effect on the date of the enactment of the Tax Reform Act of 1984) if—

"(I) the Administrator of the Small Business Administration charges a fee for making such guarantee, and

"(II) the amount of such fee equals or exceeds 1 percent of the amount guaranteed, or

"(iv) any guarantee by the Bonneville Power Authority pursuant to the Northwest Power Act (16 U.S.C. 839d) as in effect on the date of the enactment of the Tax Reform Act of 1984.

"(B) DEBT SERVICE, ETC.—Paragraph (1) shall not apply to—

"(i) proceeds of the issue invested for an initial temporary period until such proceeds are needed for the purpose for which such issue was issued,

"(ii) investments of a bona fide debt service fund,

"(iii) investments of a reserve which meet the requirements of subsection (c)(4)(B),

"(iv) investments in obligations issued by the United States Treasury, or

"(v) other investments permitted under regulations.

"(C) EXCEPTION FOR HOUSING PROGRAMS.—

"(i) IN GENERAL.—Except as provided in clause (ii), paragraph (1) shall not apply to—

"(I) an obligation described in subsection (b)(4)(A) or a housing program obligation under section 11(b) of the United States Housing Act of 1937,

"(II) a qualified mortgage bond (as defined in section 103A(c)(1)), or

"(III) a qualified veterans' mortgage bond (as defined in section 103A(c)(3)).

"(ii) EXCEPTION NOT TO APPLY WHERE OBLIGATION INVESTED IN FEDERALLY INSURED DEPOSITS OR ACCOUNTS.—Clause (i) shall not apply to any obligation which is federally guaranteed within the meaning of paragraph (2)(B)(ii).

"(D) LOANS TO, OR GUARANTEES BY, FINANCIAL INSTITUTIONS.—Except as provided in paragraph (2)(B)(ii), an obligation which is issued as part of an issue shall not be treated as federally guaranteed merely by reason of the fact that the proceeds of such issue are used in making loans to a financial institution or there is a guarantee by a financial institution.

"(4) DEFINITIONS.—For purposes of this subsection—

"(A) TREATMENT OF CERTAIN ENTITIES WITH AUTHORITY TO BORROW FROM UNITED STATES.—To the extent provided in regulations prescribed by the Secretary, any entity with statutory authority to borrow from the United States shall be treated as an instrumentality of the United States. Except in the case of a private activity bond (as defined in subsection (n)(7)), nothing in the preceding sentence shall be construed as treating the District of Columbia or any possession of the United States as an instrumentality of the United States.

"(B) FEDERALLY INSURED DEPOSIT OR ACCOUNT.—The term 'federally insured deposit or account' means any deposit or account in a financial institution to the extent

such deposit or account is insured under Federal law by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, the National Credit Union Administration, or any similar federally chartered corporation.

"(5) CERTAIN OBLIGATIONS SUBSIDIZED UNDER ENERGY PROGRAM.—

"(A) IN GENERAL.—An obligation to which this paragraph applies shall be treated as an obligation not described in subsection (a) if the payment of the principal or interest with respect to such obligation is to be made (in whole or in part) under a program of the United States, a State, or a political subdivision of a State the principal purpose of which is to encourage the production or conservation of energy.

"(B) OBLIGATIONS TO WHICH PARAGRAPH APPLIES.—This paragraph shall apply to any obligations to which paragraph (1) of subsection (b) does not apply by reason of—

"(i) subsection (b)(4)(H) (relating to qualified hydroelectric generating facilities), or

"(ii) subsection (g) (relating to qualified steam-generating or alcohol-producing facilities)."

SEC. 623. AGGREGATE LIMIT PER TAXPAYER FOR SMALL ISSUE EXCEPTION.

Subsection (b) of section 103 (relating to industrial development bonds) is amended by adding at the end thereof the following new paragraph:

"(15) AGGREGATE LIMIT PER TAXPAYER FOR SMALL ISSUE EXCEPTION.—

"(A) IN GENERAL.—Paragraph (6) of this subsection shall not apply to any issue if the aggregate authorized face amount of such issue allocated to any test-period beneficiary (when increased by the outstanding tax-exempt IDB's of such beneficiary) exceeds $40,000,000.

"(B) OUTSTANDING TAX-EXEMPT IDB'S OF ANY PERSON.—For purposes of applying subparagraph (A) with respect to any issue, the outstanding tax-exempt IDB's of any person who is a test-period beneficiary with respect to such issue is the aggregate face amount of all industrial development bonds the interest on which is exempt from tax under subsection (a)—

"(i) which are allocated to such beneficiary, and

"(ii) which are outstanding at the time of such later issue (not including as outstanding any obligation which is to be redeemed from the proceeds for the later issue).

"(C) ALLOCATIONS.—The amount of any issue shall be allocated—

"(i) in the case of any test-period beneficiary who is the owner of any facilities being financed, on the basis of ownership, and

"(ii) in the case of any test-period beneficiary who is a principal user of the facilities, on the basis of the use.

"(D) TEST-PERIOD BENEFICIARY.—For purposes of this paragraph, except as provided in regulations, the term 'test-period beneficiary' means any person who was an owner or principal user of facilities being financed by the issue at any time during the 3-year period beginning on the later of—

"(i) the date such facilities were placed in service, or

"(ii) the date of the issue.

"(E) TREATMENT OF RELATED PERSONS.—For purposes of this paragraph, all persons who are related (within the meaning of paragraph (6)(C)) to each other shall be treated as one person."

PART II—ARBITRAGE LIMITATIONS

SEC. 624. ARBITRAGE ON NONPURPOSE OBLIGATIONS.

(a) IN GENERAL.—Subsection (c) of section 103 (relating to arbitrage bonds) is amended by redesignating paragraph (6) as paragraph (7) and inserting after paragraph (5) the following new paragraph:

"(6) INVESTMENTS IN NONPURPOSE OBLIGATIONS.—

"(A) IN GENERAL.—For purposes of this title, any obligation which is part of an issue of industrial development bonds which does not meet the requirements of subparagraphs (C) and (D) shall be treated as an obligation which is not described in subsection (a).

"(B) EXCEPTIONS.—Subparagraph (A) shall not apply to any obligation described in subsection (b)(4)(A) or to any housing program obligation under section 11(b) of the Housing Act of 1937.

"(C) LIMITATION ON INVESTMENT IN NONPURPOSE OBLIGATIONS.—

"(i) IN GENERAL.—An issue meets the requirements of this subparagraph only if—

"(I) at no time during any bond year, the amount invested in nonpurpose obligations with a yield higher than the yield on the issue exceeds 150 percent of the debt service on the issue for the bond year, and

"(II) the aggregate amount invested as provided in subclause (I) is promptly and appropriately reduced as the amount of outstanding obligations of the issue is reduced.

"(ii) EXCEPTION FOR TEMPORARY PERIODS.—Clause (i) shall not apply to—

"(I) proceeds of the issue invested for an initial temporary period until such proceeds are needed for the governmental purpose of the issue, and

"(II) temporary investment periods related to debt service.

"(iii) DEBT SERVICE DEFINED.—For purposes of this subparagraph, the debt service on the issue for any bond year is the scheduled amount of interest and amortization of principal payable for such year with re-

spect to such issue. For purposes of the preceding sentence, there shall not be taken into account amounts scheduled with respect to any bond which has been retired before the beginning of the bond year.

"(iv) NO DISPOSITION IN CASE OF LOSS.—This subparagraph shall not require the sale or disposition of any investment if such sale or disposition would result in a loss which exceeds the amount which would be paid to the United States (but for such sale or disposition) at the time of such sale or disposition.

"(D) REBATE TO UNITED STATES.—An issue shall be treated as meeting the requirements of this subparagraph only if an amount equal to the sum of—

"(i) the excess of—

"(I) the aggregate amount earned on all nonpurpose obligations (other than investments attributable to an excess described in this clause), over

"(II) the amount which would have been earned if all nonpurpose obligations were invested at a rate equal to the yield on the issue, plus

"(ii) any income attributable to the excess described in clause (i),

is paid to the United States by the issuer in accordance with the requirements of subparagraph (E).

"(E) DUE DATE OF PAYMENTS UNDER SUBPARAGRAPH (D).—The amount which is required to be paid to the United States by the issuer shall be paid in installments which are made at least once every 5 years. Each installment shall be in an amount which insures that 90 percent of the amount described in subparagraph (D) with respect to the issue at the time payment of such installment is required will have been paid to the United States. The last installment shall be made no later than 30 days after the day on which the last obligation of the issue is redeemed and shall be in an amount sufficient to pay the remaining balance of the amount described in subparagraph (D) with respect to such issue.

"(F) SPECIAL RULES FOR APPLYING SUBPARAGRAPH (D).—

"(i) IN GENERAL.—In determining the aggregate amount earned on nonpurpose obligations for purposes of subparagraph (D)—

"(I) any gain or loss on the disposition of a nonpurpose obligation shall be taken into account, and

"(II) unless the issuer otherwise elects, any amount earned on a bona fide debt service fund shall not be taken into account if the gross earnings on such fund for the bond year is less than $100,000.

"(ii) TEMPORARY INVESTMENTS.—Notwithstanding subparagraph (D), an issue shall, for purposes of this paragraph, be treated as meeting the requirements of subparagraph (D) if the gross proceeds of such issue are expended for the governmental purpose for which the bond was issued by no later than the day which is 6

months after the date of issuance of such issue. Gross proceeds which are held in a bona fide debt service fund shall not be considered gross proceeds for purposes of this paragraph only.

"(G) EXEMPTION FROM GROSS INCOME OF SUM REBATED.—Gross income does not include the sum described in subparagraph (D). Notwithstanding any other provision of this title, no deduction shall be allowed for any amount paid to the United States under subparagraph (D).

"(H) DEFINITIONS.—For purposes of this paragraph—

"(i) NONPURPOSE OBLIGATIONS.—The term 'nonpurpose obligation' means any security (within the meaning of subparagraph (A) or (B) of section 165(g)(2)) or any obligation not described in subsection (a) which—

"(I) is acquired with the gross proceeds of an issue, and

"(II) is not acquired in order to carry out the governmental purpose of the issue.

"(ii) GROSS PROCEEDS.—The gross proceeds of an issue include—

"(I) amounts received (including repayments of principal) as a result of investing the original proceeds of the issue, and

"(II) amounts used to pay debt service on the issue.

"(iii) YIELD.—The yield on the issue shall be determined on the basis of the issue price (within the meaning of section 1273 or 1274)".

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 103A(i) (relating to arbitrage) is amended by striking out "section 103(c)" and inserting in lieu thereof "section 103(c) (other than section 103(c)(6))".

(2) Subsection (c) of section 103 is amended by striking out "Bonds" in the heading.

(3) Paragraph (1) of section 103(c) is amended by inserting "to arbitrage bonds" in the heading.

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply with respect to bonds issued after December 31, 1984.

(2) EXCEPTION.—The amendments made by this section shall not apply to obligations issued by the Essex County Port Authority of New York and New Jersey as part of an issue approved by Essex County, New Jersey, on July 7, 1981, and approved by the State of New Jersey on December 31, 1981. The aggregate face amount of bonds to which this paragraph applies shall not exceed $350,000,000.

SEC. 625. STUDENT LOAN BOND.

(a) ARBITRAGE REGULATIONS.—

(1) IN GENERAL.—The Secretary shall prescribe regulations which specify the circumstances under which a qualified student loan bond shall be treated as an arbitrage bond for pur-

poses of section 103 of the Internal Revenue Code of 1954. Such regulations may provide that—

(A) paragraphs (4) and (5) of section 103(c) of such Code shall not apply, and

(B) rules similar to section 103(c)(6) shall apply,

to qualified student loan bonds.

(2) DEFINITIONS.—For purposes of this subsection—

(A) QUALIFIED STUDENT LOAN BOND.—The term 'qualified student loan bond' has the meaning given to such term by section 103(o)(3) of the Internal Revenue Code of 1954 (as amended by this Act).

(B) ARBITRAGE BOND.—The term "arbitrage bond" has the meaning given to such term by section 103(c)(2).

(3) EFFECTIVE DATE.—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, any regulations prescribed by the Secretary under paragraph (1) shall apply to obligations issued after the qualified date.

(B) QUALIFIED DATE.—

(i) IN GENERAL.—For purposes of this paragraph, the term "qualified date" means the earlier of—

(I) the date on which the Higher Education Act of 1965 expires, or

(II) the date, after the date of enactment of this Act, on which the Higher Education Act of 1965 is reauthorized.

(ii) PUBLICATION OF REGULATIONS.—Notwithstanding clause (i), the qualified date shall not be a date which is prior to the date that is 6 months after the date on which the regulations prescribed under paragraph (1) are published in the Federal Register.

(C) REFUNDING OBLIGATIONS.—Regulations prescribed by the Secretary under paragraph (1) shall not apply to any obligation issued exclusively to refund any qualified student loan bond which was issued before the qualified date, except that the requirements of subparagraphs (A) and (B) of section 625(c)(5) of this Act must be met with respect to such refunding.

(D) FULFILLMENT OF COMMITMENTS.—Regulations prescribed by the Secretary under paragraph (1) shall not apply to any obligations which are needed to fulfill written commitments to acquire or finance student loans which are originated after June 30, 1984, and before the qualified date, but only if—

(i) such commitments are binding on the qualified date, and

(ii) the amount of such commitments is consistent with practices of the issuer which were in effect on March 15, 1984, with respect to establishing secondary markets for student loans.

(b) ARBITRAGE LIMITATION ON STUDENT LOAN BONDS WHICH ARE NOT QUALIFIED STUDENT LOAN BONDS.—Under regulations prescribed by the Secretary of the Treasury or his delegate, any student loan bond (other than a qualified student loan bond) issued after

December 31, 1985, shall be treated as an obligation not described in subsection (a) (1) or (2) of section 103 of the Internal Revenue Code of 1954 unless the issue of which such obligation is a part meets requirements similar to those of sections 103(c)(6) and 103A(i) of such Code.

(c) ISSUANCE OF STUDENT LOAN BONDS WHICH ARE NOT TAX-EXEMPT.—Any issuer who may issue obligations described in section 103(a) of the Internal Revenue Code of 1954 may elect to issue student loan bonds which are not described in such section 103(a) of such Code without prejudice to—

(1) the status of any other obligations issued, or to be issued, by such issuer as obligations described in section 103(a) of such Code, or

(2) the status of the issuer as an organization exempt from taxation under such Code.

(d) FEDERAL EXECUTIVE BRANCH JURISDICTION OVER TAX-EXEMPT STATUS.—For purposes of Federal law, any determination by the executive branch of the Federal Government of whether interest on any obligation is exempt from taxation under the Internal Revenue Code of 1954 shall be exclusively within the jurisdiction of the Department of the Treasury.

(e) STUDY ON TAX EXEMPT STUDENT LOAN BONDS.—

(1) IN GENERAL.—The Comptroller General of the United States and the Director of the Congressional Budget Office, shall conduct studies of—

(A) the appropriate role of tax-exempt bonds which are issued in connection with the guaranteed student loan program and the PLUS program established under the Higher Education Act of 1965, and

(B) the appropriate arbitrage rules for such bonds.

(2) REPORT.—The Comptroller General of the United States and the Director of the Congressional Budget Office, shall submit to the Committee on Finance and the Committee on Labor and Human Resources of the Senate and the Committee on Ways and Means and the Committee on Education and Labor of the House of Representatives reports on the studies conducted under paragraph (1) by no later than 9 months after the date of enactment of this Act.

PART III—OTHER RESTRICTIONS

SEC. 626. DENIAL OF TAX EXEMPTION TO CONSUMER LOAN BONDS.

(a) IN GENERAL.—Section 103 (relating to interest on certain governmental obligations) is amended by adding at the end thereof the following new subsection:

"(o) CONSUMER LOAN BONDS.—

"(1) DENIAL OF TAX EXEMPTION.—For purposes of this title, any consumer loan bond shall be treated as an obligation which is not described in subsection (a).

"(2) CONSUMER LOAN BONDS.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'consumer loan bond' means any obligation which is issued as part of an issue all or a significant portion of the proceeds of which are reasonably

expected to be used directly or indirectly to make or finance loans (other than loans described in subparagraph (C)) to persons who are not exempt persons (within the meaning of subsection (b)(3)).

"(B) EXCLUDED OBLIGATIONS.—The term 'consumer loan bond' shall not include any—

"(i) qualified student loan bond,

"(ii) industrial development bond, or

"(iii) qualified mortgage bond or qualified veterans' mortgage bond.

"(C) EXCLUDED LOANS.—A loan is described in this subparagraph if the loan—

"(i) enables the borrower to finance any governmental tax or assessment of general application for an essential governmental function, or

"(ii) is used to acquire or carry nonpurpose obligations (within the meaning of subsection (c)(6)(G)(i)).

"(3) QUALIFIED STUDENT LOANS.—For purposes of this subsection, the term 'qualified student loan bond' means any obligation which is issued as part of an issue all or a major portion of the proceeds of which are reasonably expected to be used directly or indirectly to make or finance student loans under a program of general application to which the Higher Education Act of 1965 applies if—

"(A) limitations are imposed under the program on—

"(i) the maximum amount of loans outstanding to any student, and

"(ii) the maximum rate of interest payable on any loan,

"(B) the loans are directly or indirectly guaranteed by the Federal Government,

"(C) the financing of loans under the program is not limited by Federal law to the proceeds of obligations the interest on which is exempt from taxation under this title, and

"(D) special allowance payments under section 438 of the Higher Education Act of 1965—

"(i) are authorized to be paid with respect to loans made under the program, or

"(ii) would be authorized to be made with respect to loans under the program if such loans were not financed with the proceeds of obligations the interest on which is exempt from taxation under this title.

Such term shall not include any obligation issued under a State program which discriminates on the basis of the location (in the United States) at which the educational institution is located.

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection the amendment made by subsection (a) shall apply to obligations issued after the date of enactment of this Act.

(2) EXCEPTIONS FOR CERTAIN STUDENT LOAN PROGRAMS.—

(A) IN GENERAL.—The amendments made by this section shall not apply to obligations issued by a program described in the following table to the extent the aggregate

face amount of such obligations does not exceed the amount of allowable obligations specified in the following table with respect to such program:

Program	*Amount of Allowable Obligations*
Colorado Student Obligation Bond Authority	*$60 million*
Connecticut Higher Education Supplementary Loan Authority	*$15.5 million*
District of Columbia	*$50 million*
Illinois Higher Education Authority	*$11 million*
State of Iowa	*$16 million*
Louisiana Public Facilities Authority	*$75 million*
Maine Health and Higher Education Facilities Authority	*$5 million*
Maryland Higher Education Supplemental Loan Program	*$24 million*
Massachusetts College Student Loan Authority	*$90 million*
Minnesota Higher Education Coordinating Board	*$60 million*
New Hampshire Higher Education and Health Facilities Authority	*$39 million*
New York Dormitory Authority	*$120 million*
Pennsylvania Higher Education Assistance Agency	*$300 million*
Georgia Private Colleges and University Authority	*$31 million*
Wisconsin State Building Commission	*$60 million*
South Dakota Health and Educational Facilities Authority	*$6 million*

(B) PENNSYLVANIA HIGHER EDUCATION ASSISTANCE AGENCY.—Subparagraph (A) shall apply to obligations issued by the Pennsylvania Higher Education Assistance Agency only if such obligations are issued solely for the purpose of refunding student loan bonds outstanding on March 15, 1984.

(4) CERTAIN TAX-EXEMPT MORTGAGE SUBSIDY BONDS.—For purposes of applying section 103(o) of the Internal Revenue Code of 1954, the term "consumer loan bond" shall not include any mortgage subsidy bond (within the meaning of section 103A(b) of such Code) to which the amendments made by section 1102 of the Mortgage Subsidy Bond Tax Act of 1980 do not apply.

(5) REFUNDING EXCEPTION.—The amendments made by this section shall not apply to any obligation or series of obligations the proceeds of which are used exclusively to refund obligations issued before March 15, 1984, except that—

(A) the amount of the refunding obligations may not exceed 101 percent of the aggregate face amount of the refunded obligations, and

(B) the maturity date of any refunding obligation may not be later than the date which is 17 years after the date on which the refunded obligation was issued (or, in the case of a series of refundings, the date on which the original obligation was issued).

(6) EXCEPTION FOR CERTAIN ESTABLISHED PROGRAMS.—The amounts made by this section shall not apply to any obligation substantially all of the proceeds of which are used to carry out a program established under State law which has been in effect in substantially the same form during the 30-year period ending on the date of enactment of this Act, but only if such proceeds are used to make loans or to fund similar obligations—

(A) in the same manner in which,

(B) in the same (or lesser) amount per participant, and

(C) for the same purposes for which,

such program was operated on March 15, 1984. This subparagraph shall not apply to obligations issued on or after March 15, 1987.

(7) CERTAIN BONDS FOR RENEWABLE ENERGY PROPERTY.—The amendments made by this section shall not apply to any obligations described in section 243 of the Crude Oil Windfall Profit Tax Act of 1980.

SEC. 627. LIMITATIONS ON ACQUISITIONS OF LAND, EXISTING FACILITIES, ETC.

(a) LIMITATION ON USE FOR LAND ACQUISITION.—Subsection (b) of section 103 is amended by adding at the end thereof the following new paragraph:

"(16) LIMITATION ON USE FOR LAND ACQUISITION.—

"(A) IN GENERAL.—Paragraphs (4), (5), and (6) shall not apply with respect to any obligation issued as part of an issue if—

"(i) any portion of the proceeds of such issue are to be used (directly or indirectly) for the acquisition of land (or an interest therein) to be used for farming purposes, or

"(ii) 25 percent or more of the proceeds of such issue are to be used (directly or indirectly) for the acquisition of land not described in clause (i) (or an interest therein).

In the case of an obligation described in paragraph (5) (relating to industrial parks), clause (i) shall be applied by substituting '50 percent' for '25 percent'.

"(B) EXCEPTION FOR FIRST-TIME FARMERS.—

"(i) IN GENERAL.—If the requirements of clause (ii) are met with respect to any land, subparagraph (A) shall not apply to such land, and paragraph (17) shall not apply to property located thereon or to property to be acquired within 1 year to be used in farming, but only to the extent of expenditures (financed with the proceeds of the issue) not in excess of $250,000.

"(ii) ACQUISITION BY FIRST-TIME FARMERS.—The requirements of this clause are met with respect to any land if—

"(I) such land is to be used for farming purposes, and

"(II) such land is to be acquired by an individual who is a first-time farmer, who will be the principal user of such land, and who will materially and substantially participate on the farm of which such land is a part in the operation of such farm.

"(iii) FIRST-TIME FARMER.—For purposes of this subparagraph, the term 'first-time farmer' means any individual if such individual has not at any time had any direct or indirect ownership interest in substantial farmland in the operation of which such individual

materially participated. For purposes of this subparagraph, any ownership or material participation by an individual's spouse or minor child shall be treated as ownership and material participation by the individual.

"(iv) FARM.—For purposes of this subparagraph, the term 'farm' has the meaning given such term by section 6420(c)(2).

"(v) SUBSTANTIAL FARMLAND.—The term 'substantial farmland' means any parcel of land unless—

"(I) such parcel is smaller than 15 percent of the median size of a farm in the county in which such parcel is located, and

"(II) the fair market value of the land does not at any time while held by the individual exceed $125,000.

"(C) EXCEPTION FOR CERTAIN LAND ACQUIRED FOR ENVIRONMENTAL PURPOSES.—Any land acquired by a public agency in connection with an airport, mass transit, or port development project shall not be taken into account under subparagraph (A) if—

"(i) such land is acquired for a noise abatement, wetland preservation, future use, or other public purpose, and

"(ii) there is not other significant use of such land."

(b) ACQUISITION OF EXISTING PROPERTY NOT PERMITTED.—Subsection (b) of section 103 (relating to industrial development bonds) is amended by adding at the end thereof the following new paragraph:

"(17) ACQUISITION OF EXISTING PROPERTY NOT PERMITTED.—

"(A) IN GENERAL.—Paragraphs (4), (5), (6), and (7) shall not apply to any obligation issued as part of an issue if any portion of the proceeds of such issue is to be used for the acquisition of any property (or an interest therein) unless the first use of such property is pursuant to such acquisition.

"(B) EXCEPTION FOR CERTAIN REHABILITATIONS.—Subparagraphs (A) shall not apply with respect to any building (and the equipment therefor) if—

"(i) the rehabilitation expenditures with respect to such building equals or exceeds

"(ii) 15 percent of the portion of the cost of acquiring such building (and equipment) financed with the proceeds of the issue.

A rule similar to the rule of the preceding sentence shall apply in the case of facilities other than a building except that clause (ii) shall be applied by substituting '100 percent' for '15 percent'.

"(C) REHABILITATION EXPENDITURES.—

For purposes of this paragraph—

"(i) IN GENERAL.—Except as provided in this subparagraph, the term 'rehabilitation expenditures' means any amount properly chargeable to capital account which is incurred by the person acquiring the building for property (or additions or improvements to

property) in connection with the rehabilitation of a building. In the case of an integrated operation contained in a building before its acquisition, such term includes rehabilitating existing equipment in such building or replacing it with equipment having substantially the same function. For purposes of this clause, any amount incurred by a successor to the person acquiring the building or by the seller under a sales contract with such person shall be treated as incurred by such person.

"(ii) CERTAIN EXPENDITURES NOT INCLUDED.—The term 'rehabilitation expenditures' does not include any expenditure described in section 48(g)(2)(B) (other than clause (i) thereof).

"(iii) PERIOD DURING WHICH EXPENDITURES MUST BE INCURRED.—The term 'rehabilitation expenditures' shall not include any amount which is incurred after the date 2 years after the later of—

"(I) the date on which the building was acquired, or

"(II) the date on which the obligation was issued."

(c) USE OF TAX-EXEMPT BONDS PROHIBITED FOR SKYBOXES, AIRPLANES, GAMBLING ESTABLISHMENTS, ETC.—Subsection (b) of section 103 (relating to industrial development bonds) is amended by adding at the end thereof the following new paragraph:

"(18) NO PORTION OF BONDS MAY BE ISSUED FOR SKYBOXES, AIRPLANES, GAMBLING ESTABLISHMENTS, ETC.—Paragraphs (4), (5), and (6) shall not apply to any obligation issued as part of an issue if any portion of the proceeds of such issue is to be used to provide any airplane, skybox, or other private luxury box, any health club facility, any facility primarily used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises."

SEC. 628. MISCELLANEOUS INDUSTRIAL DEVELOPMENT BOND PROVISIONS.

(a) CERTAIN RESTRICTIONS APPLY TO EXEMPTIONS NOT CONTAINED IN INTERNAL REVENUE CODE OF 1954.—

(1) Paragraph (1) of section 103(m) (relating to obligations exempt other than under this title) is amended by adding at the end thereof the following new sentence: "In the case of an obligation issued after December 31, 1983, such obligation shall not be treated as described in this paragraph unless the appropriate requirements of subsections (b), (c), (h), (k), (l), and (n) of this section and section 103A are met with respect to such obligation. For purposes of applying such requirements, a possession of the United States shall be treated as a State; except that clause (ii) of subsection (o)(4)(A) shall not apply."

(2) Subparagraph (B) of section 103(m)(2) is amended to read as follows:

"(B) is exempt from tax under this title without regard to any provision of law not contained in this title."

(3) Subsection (m) of section 103 is amended by adding at the end thereof the following new paragraph:

"(3) EXCEPTIONS.—The following obligations shall be treated as obligations described in paragraph (1) (without regard to the second sentence thereof):

"(A) Any obligation issued pursuant to the Northwest Power Act.

"(B) Any obligation issued pursuant to section 608(6)(A) of Public Law 97-468.

"(C) Any obligation described in section 243 of the Crude Oil Windfall Profits Tax Act of 1980.

(b) EXPANSION OF TAX-EXEMPT BOND FINANCED PROPERTY REQUIRED TO BE DEPRECIATED ON STRAIGHT-LINE BASIS.—

(1) IN GENERAL.—Subparagraph (C) of section 168(f)(12) (relating to limitations on property financed with tax-exempt bonds) is amended to read as follows:

"(C) EXCEPTION FOR PROJECTS FOR RESIDENTIAL RENTAL PROPERTY.—Subparagraph (A) shall not apply to any recovery property which is placed in service in connection with projects for residential rental property financed by the proceeds of obligations described in section 103(b)(4)(A)."

(2) CONFORMING AMENDMENT.—Paragraph (12) of section 168(f) is amended by striking out subparagraph (D) and by redesignating subparagraph (E) as subparagraph (D).

(c) AGGREGATION OF ISSUES FOR SINGLE PROJECT.—Paragraph (6) of section 103(b) (relating to exemption for small issues) is amended by adding at the end thereof the following new subparagraph:

"(P) AGGREGATION OF ISSUES WITH RESPECT TO SINGLE PROJECT.—For purposes of this paragraph, 2 or more issues part or all of which are to be used with respect to a single building, an enclosed shopping mall, or a strip of offices, stores, or warehouses using substantial common facilities shall be treated as 1 issue (and any person who is a principal user with respect to any of such issues shall be treated as a principal user with respect to the aggregated issue)."

(d) DEFINITION OF RELATED PERSONS IN THE CASE OF PARTNERSHIPS.—Paragraph (13) of section 103(b) (relating to exception where bond held by substantial user) is amended by adding at the end thereof the following new sentences: "For purposes of this paragraph—

"(A) a partnership and each of its partners (and their spouses and minor children) shall be treated as related persons, and

"(B) an S corporation and each of its shareholders (and their spouses and minor children) shall be treated as related persons.".

(e) RESIDENTIAL RENTAL PROPERTY MAY BE IN MIXED USE STRUCTURE.—Paragraph (4) of section 103(b) (relating to certain exempt activities) is amended by adding at the end thereof the following new sentence: "For purposes of subparagraph (A), any property shall not be treated as failing to be residential rental property merely because part of the building in which such property is located is used for purposes other than residential rental purposes."

(f) PUBLIC APPROVAL REQUIREMENT IN THE CASE OF PUBLIC AIRPORT.—If—

(1) the proceeds of any issue are to be used to finance a facility or facilities located on a public airport, and

(2) the governmental unit issuing such obligations is the owner or operator of such airport,

such governmental unit shall be deemed to be the only governmental unit having jurisdiction over such airport for purposes of subsection (k) of section 103 of the Internal Revenue Code of 1954 (relating to public approval for industrial development bonds).

(g) REPEAL OF ADVANCE REFUNDING OF QUALIFIED PUBLIC FACILITIES.—Paragraph (7) of section 103(b) (relating to advance refunding of qualified public facilities) is hereby repealed.

SEC. 629. CERTAIN PUBLIC UTILITIES TREATED AS EXEMPTED PERSONS UNDER SECTION 103(b); SPECIAL RULES FOR CERTAIN RAILROADS.

(a) CERTAIN PUBLIC UTILITIES.—For purposes of applying section 103(b)(3) of the Internal Revenue Code with respect to—

(1) any obligations issued after the date of enactment of this Act, and

(2) any obligations issued after December 31, 1969, which were treated as obligations described in section 103(a) of such Code on the day on which such obligations were issued,

the term "exempt person" shall include a regulated public utility having any customer service area within a State served by a public power authority which was required as a condition of a Federal Power Commission license specified by an Act of Congress enacted prior to the enactment of section 107 of the Revenue and Expenditure Control Act of 1968 (Public Law 90–364) to contract to sell power to one such utility and which is authorized by State law to sell power to other such utilities, but only with respect to the purchase by any such utility and resale to its customers of any output of any electrical generation facility or any portion thereof or any use of any electrical transmission facility or any portion thereof financed by such power authority and owned by it or by such State, and provided that by agreement between such power authority and any such utility there shall be no markup in the resale price charged by such utility of that component of the resale price which represents the price paid by such utility for such output or use.

(b) CERTAIN RAILROADS.—Section 103(b)(1) of the Internal Revenue Code of 1954 shall not apply to any obligation which is described in section 103(b)(6)(A) of such Code if—

(1) substantially all of the proceeds of such obligation are used to acquire railroad track and right-of-way from a railroad involved in a title 11 or similar proceeding (within the meaning of section 368(a)(3)(A) of such Code), and

(2) the Federal Railroad Administration provides joint financing for such acquisitions.

(c) SPECIAL RULES FOR SUBSECTION (A).—

(1) OBLIGATIONS SUBJECT TO CAP.—Any obligation described in subsection (a) shall be treated as a private activity bond for purposes of section 103(n) of the Internal Revenue Code of 1954.

(2) LIMITATION ON AMOUNT OF OBLIGATIONS TO WHICH SUBSECTION (A)(1) APPLIES.—The aggregate amount of obligations to which subsection (a)(1) applies shall not exceed $625,000,000.

(3) LIMITATION ON PURPOSES.—Subsection (a)(1) shall only apply to obligations issued as part of an issue substantially all the proceeds of which are used to provide 1 or more of the following:

(A) Cable facilities.

(B) Small hydroelectric facilities.

(C) The acquisition of an interest in an electrical generating facility.

SEC. 630. EXTENSION OF SMALL ISSUE INDUSTRIAL DEVELOPMENT BOND EXCEPTION.

Subparagraph (N) of section 103(D)(6) (relating to termination date) is amended to read as follows:

"(N) TERMINATION DATES.—

"(i) IN GENERAL.—This paragraph shall not apply to any obligation issued after December 31, 1986 (including any obligations issued to refund an obligation issued on or before such date).

"(ii) OBLIGATIONS USED TO FINANCE MANUFACTURING FACILITIES.—In the case of an obligation which is part of an issue substantially all of the proceeds of which are to be used to provide a manufacturing facility, clause (i) shall be applied by substituting '1988' for '1986'.

"(iii) MANUFACTURING FACILITY.—For purposes of this subparagraph, the term 'manufacturing facility' means any facility which is used in the manufacturing or production of tangible personal property (including the processing resulting in a change in the condition of such property).

SEC. 631. EFFECTIVE DATES.

(a) PRIVATE ACTIVITY BOND CAP.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendment made by section 621 shall apply to obligations issued after December 31, 1983.

(2) INDUCEMENT RESOLUTION BEFORE JUNE 19, 1984.—The amendment made by section 621 shall not apply to any issue of obligations if—

(A) there was an inducement resolution (or other comparable preliminary approval) for the issue before June 19, 1984, and

(B) the issue is issued before January 1, 1985.

(3) CERTAIN PROJECTS PRELIMINARILY APPROVED BEFORE OCTOBER 19, 1983, GIVEN APPROVAL.—If—

(A) there was an inducement resolution (or other comparable preliminary approval) for a project before October 19, 1983, by any issuing authority,

(B) a substantial user of such project notifies the issuing authority within 30 days after the date of the enactment of this Act that it intends to claim its rights under this paragraph, and

(C) construction of such project began before October 19, 1983, or the substantial user was under a binding contract

on such date to incur significant expenditures with respect to such project,

such issuing authority shall allocate its share of the limitation under section 103(n) of such Code for the calendar year during which the obligations were to be issued pursuant to such resolution (or other approval) first to such project. If the amount of obligations required by all projects which meet the requirements of the preceding sentence exeeds the issuing authority's share of the limitation under section 103(n) of such Code, priority under the preceding sentence shall be provided first to those projects for which substantial expenditures were incurred before October 19, 1983. If any issuing authority fails to meet the requirements of this paragraph, the limitation under section 103(n) of such Code for the issuing authority for the calendar year following such failure shall be reduced by the amount of obligations with respect to which such failure occurred.

(3) EXCEPTION FOR CERTAIN BONDS FOR A CONVENTION CENTER AND RESOURCE RECOVERY PROJECT.—In the case of any city, if—

(A) the city council of such city authorized a feasibility study for a convention center on June 10, 1982, and

(B) on November 4, 1983, a municipal authority acting for such city accepted a proposal for the construction of a facility that is capable of generating steam and electricity through the combustion of municipal waste,

the amendment made by section 621 shall not apply to any issue, issued during 1984, 1985, 1986, or 1987 and substantially all of the proceeds of which are to be used to finance the convention center (or access ramps and parking facilities therefor) described in subparagraph (A) or the facility described in subparagraph (B).

(b) PROPERTY FINANCED WITH TAX-EXEMPT BONDS REQUIRED TO BE DEPRECIATED ON STRAIGHT-LINE BASIS.—

(1) IN GENERAL.—Except as otherwise provided in this section, the amendments made by section 628(b) shall apply to property placed in service after December 31, 1983, to the extent such property is financed by the proceeds of an obligation (including a refunding obligation) issued after October 18, 1983.

(2) EXCEPTIONS.—

(A) CONSTRUCTION OR BINDING AGREEMENT.—The amendments made by section 628(b) shall not apply with respect to facilities—

(i) the original use of which commences with the taxpayer and the construction, reconstruction, or rehabilitation of which began before October 19, 1983, or

(ii) with respect to which a binding contract to incur significant expenditures was entered into before October 19, 1983.

(B) REFUNDING.—

(i) IN GENERAL.—Except as provided in clause (ii), in the case of property placed in service after December 31, 1983, which is financed by the proceeds of an obligation which is issued solely to refund another obligation which was issued before October 19, 1983, the amendments made by section 628(b) shall apply only with re-

spect to an amount equal to the basis in such property which has not been recovered before the date such refunded obligation is issued.

(ii) SIGNIFICANT EXPENDITURES.—*In the case of facilities the original use of which commences with the taxpayer and with respect to which significant expenditures are made before January 1, 1984, the amendments made by section 628(b) shall not apply with respect to such facilities to the extent such facilities are financed by the proceeds of an obligation issued solely to refund another obligation which was issued before October 19, 1983.*

(C) FACILITIES.—*In the case of an inducement resolution or other comparable preliminary approval adopted by an issuing authority before October 19, 1983, for purposes of applying subparagraphs (A)(i) and (B)(ii) with respect to obligations described in such resolution, the term "facilities" means the facilities described in such resolution.*

(c) OTHER PROVISIONS RELATING TO TAX-EXEMPT BONDS.—

(1) IN GENERAL.—*Except as otherwise provided in this section, the amendments made by this subtitle shall apply to obligations issued after December 31, 1983.*

(2) OBLIGATIONS INVESTED IN FEDERALLY INSURED DEPOSITS.—*Notwithstanding any other provision of this section, clause (ii) of section 103(h)(2)(B) of the Internal Revenue Code of 1954 (as amended by this subtitle) shall apply to obligations issued after April 14, 1983; except that such clause shall not apply to any obligation issued pursuant to a binding contract in effect on March 4, 1983.*

(3) EXCEPTIONS.—

(A) CONSTRUCTION OR BINDING AGREEMENT.—*The amendments made by this subtitle (other than section 621) shall not apply to obligations with respect to facilities—*

(i) the original use of which commences with the taxpayer and the construction, reconstruction, or rehabilitation of which began before October 19, 1983, or

(ii) with respect to which a binding contract to incur significant expenditures was entered into before October 19, 1983.

(B) FACILITIES.—*Subparagraph (C) of subsection (b)(2)(A) shall apply for purposes of subparagraph (A) of this paragraph.*

(4) REPEAL OF ADVANCE REFUNDING OF QUALIFIED PUBLIC FACILITIES.—*The amendment made by section 628(j) shall apply to refunding obligations issued after the date of the enactment of this Act; except that if substantially all the proceeds of the refunded issue were used to provide airports or docks, such amendment shall only apply to refunding obligations issued after December 31, 1984. In the case of any refunding obligation with respect to the Alabama State Docks Department or the Dade County Florida Airport, the preceding sentence shall be applied by substituting "December 31, 1985" for "December 31, 1984".*

(d) PROVISIONS OF THIS SUBTITLE NOT TO APPLY TO CERTAIN PROPERTY.—The amendments made by this subtitle shall not apply to any property (and shall not apply to obligations issued to finance such property) if such property is described in any of the following paragraphs:

(1) Any property described in paragraph (5), (6), or (7) of section 32(g) of this Act.

(2) Any property described in paragraph (4) of section 32(g) of such Act but only if the obligation is issued before January 1, 1985.

(3) Any property described in paragraph (3) of section 216(b) of the Tax Equity and Fiscal Responsibility Act of 1982.

(4) Any solid waste disposal facility described in section 103(b)(4)(E) of the Internal Revenue Code of 1954 if—

(A) a State public authority created pursuant to State legislation which took effect on June 18, 1973, took formal action before October 19, 1983, to commit development funds for such facility,

(B) such authority issues obligations for any such facility before January 1, 1987, and

(C) expenditures have been made for the development of any such facility before October 19, 1983.

(e) DETERMINATION OF SIGNIFICANT EXPENDITURE.—

(1) IN GENERAL.—For purposes of this section, the term "significant expenditures" means expenditures which equal or exceed the lesser of—

(A) $15,000,000, or

(B) 20 percent of the estimated cost of the facilities.

(2) CERTAIN GRANTS TREATED AS EXPENDITURES.—For purposes of paragraph (1), the amount of any UDAG grant preliminarily approved on May 5, 1981, or April 4, 1983, shall be treated as an expenditure with respect to the facility for which such grant was so approved.

(f) EXCEPTIONS FOR CERTAIN OTHER AMENDMENTS.—If—

(1) there was an inducement resolution (or other comparable preliminary approval) for an issue before June 1, 1984, by any issuing authority, and

(2) such issue is issued before January 1, 1985, the following amendments shall not apply:

(A) the amendments made by section 623,

(B) the amendments made by subsections (a) and (b) of section 627 (except to the extent such amendments relate to farm land),

(C) in the case of a race track, the amendment made by section 627(c), and

(D) the amendments made by section 628(c).

SEC. 632. MISCELLANEOUS EXCEPTIONS AND SPECIAL RULES.

(a) EXCEPTION FROM PROVISIONS OTHER THAN ARBITRAGE AND FEDERAL GUARANTEES.—Notwithstanding any other provision of this tilte, the amendments made by this title (other than by section 622 (relating to Federal guarantees) and section 623 (relating to arbitrage)) shall not apply to the following obligations:

(1) Obligations issued with respect to any waste-to-energy facility authorized by official action on April 10, 1980 and with respect to which a subsequent agreement was signed between a city government and the Department of the Army on December 27, 1982, to jointly pursue construction and operation of such facility.

(2) Obligations issued to finance a redevelopment program on 9 city blocks adjacent to a transit station but only if such program was approved on October 25, 1983.

(3) Obligations issued pursuant to an inducement resolution adopted on August 8, 1978, for a redevelopment plan for which a redevelopment trust fund was established on September 7, 1977.

(4) Obligations issued to finance a UDAG project which was preliminarily approved on December 29, 1982, and which received final approval on May 3, 1984.

(5) Obligations issued to finance a parking garage pursuant to an inducement resolution adopted on March 9, 1984, in connection with a project for which a UDAG grant application was made on January 31, 1984.

(6) Obligations which—

(A) are issued to finance a downtown development project with respect to which an urban development action grant is made but only if such grant—

(i) was preliminarily approved on November 23, 1983, and

(ii) received final approval before June 1, 1984, and

(B) are issued pursuant to inducement resolutions that were adopted on December 21, 1982, July 5, 1983, and March 1, 1983,

but only to the extent the aggregate face amount of such obligations does not exceed $34,000,000.

(7) Obligations with respect to which an inducement resolution was adopted on March 5, 1984, for the purpose of acquiring existing airport facilities at more than 12 locations in 1 State but—

(A) only if the Civil Aeronautics Board certifies that such transaction would reduce the amount of Federal subsidies provided under section 419 of the Airline Deregulation Act of 1978, and

(B) only to the extent the aggregate face amount of such obligations does not exceed $25,000,000.

(8) Obligations described in subsection (b).

(b) CERTAIN PARKING FACILITY BONDS.—For purposes of the Internal Revenue Code of 1954, any obligation issued with respect to a parking facility approved by an agency of a county government on December 1, 1982, as part of an urban revitalization plan shall be treated as an obligation described in section 103(b)(4)(D) of such Code.

(c) EXCEPTION TO CERTAIN BOND LIMITATIONS.—The amendments made by section 621 (relating to the limitations on amount of private activity bonds) and section 626(a) (relating to the prohibition on acquiring existing facilities) shall not apply to obligations issued before January 1, 1987, in connection with the Claymont, Delaware

regeneration plant of the Delaware Economic Development Authority, but only to the extent the aggregate face amount of such obligation does not exceed $30,000,000.

(d) CERTAIN OBLIGATIONS TREATED AS NOT FEDERALLY GUARANTEED.—For purposes of section 103(h) of the Internal Revenue Code of 1954, obligations (including refunding obligations) shall not be treated as federally guaranteed if—

(A) such obligations were issued with respect to any facility, and

(B) any obligation was issued on June 3, 1982 in the principal amount of $11,312,125 for the purpose of financing the development, study, or related costs incurred with respect to such facility or any facility related to such facility.

(e) CERTAIN EXPENDITURES TREATED AS SIGNIFICANT EXPENDITURES.—For purposes of this title, expenditures of $850,000 incurred with respect to any project involving $15,000,000 shall be treated as significant expenditures if such expenditures were incurred pursuant to an agreement entered into on July 13, 1982, relating to the discharge of industrial waste after January 1, 1986.

(f) CERTAIN ORDINANCES TREATED AS INDUCEMENT RESOLUTIONS.—For purposes of this title, any ordinance passed on May 3, 1982, with respect to a planned development district shall be treated as an inducement resolution with respect to obligations issued in 1984 in connection with a mall project for such district.

(g) DELAYED EFFECTIVE DATE WITH RESPECT TO CERTAIN IDBS.—

(1) FERC PROJECTS.—Notwithstanding any other provision of this title, any amendments made by this title (other than the amendments to section 103(c) of the Internal Revenue Code of 1954) which, but for this paragraph, would apply to industrial development bonds issued after December 31, 1984, shall not apply to any of the following obligations issued before January 1, 1986:

(A) obligations issued with respect to Federal Energy Regulatory Commission project 4657, but only to the extent the aggregate face amount of such obligations does not exceed $12,900,000;

(B) obligations issued with respect to Federal Energy Regulatory Commission project 2853, but only to the extent the aggregate face amount of such obligations does not exceed $28,600,000; or

(C) obligations issued with respect to Federal Energy Regulatory Commission project 4700, but only to the extent the aggregate face amount of such obligations does not exceed $3,850,000.

(2) PARK CENTRAL NEW TOWN IN TOWN PROJECT.—Notwithstanding any other provision of this title, any amendments made by this title (other than the amendments to section 103(c) of the Internal Revenue Code of 1954) which, but for this paragraph, would apply to industrial development bonds issued after December 31, 1984, shall not apply to any obligation issued before January 1, 1988, with respect to Park Central New Town In Town Project located in Port Arthur, Texas, but only to the extent the aggregate face amount of such obligations does not exceed $80,000,000.

Subtitle C—Miscellaneous Provisions

SEC. 641. CLARIFICATION OF TREATMENT OF CERTAIN EXEMPTIONS FOR PURPOSES OF THE FEDERAL ESTATE AND GIFT TAXES.

(a) GENERAL RULE.—Nothing in any provision of law exempting any property (or interest therein) from taxation shall exempt the transfer of such property (or interest therein) from Federal estate, gift, and generation-skipping transfer taxes. In the case of any provision of law enacted after the date of the enactment of this Act, such provision shall not be treated as exempting the transfer of property from Federal estate, gift, and generation-skipping transfer taxes unless it refers to the appropriate provisions of the Internal Revenue Code of 1954.

(b) EFFECTIVE DATE.—

"(1) IN GENERAL.—The provisions of subsection (a) shall apply to the estates of decedents dying, gifts made, and transfers made on or after June 19, 1984.

"(2) TREATMENT OF CERTAIN TRANSFERS TREATED AS TAXABLE.—The provisions of subsection (a) shall also apply in the case of any transfer of property (or interest therein) if at any time there was filed an estate or gift tax return showing such transfer as subject to Federal estate or gift tax.

"(3) NO INFERENCE.—No inference shall arise from paragraphs (1) and (2) that any transfer of property (or interest therein) before June 19, 1984, is exempt from Federal estate and gift taxes.

SEC. 642. REPORTS WITH TRANSFERS OF PUBLIC HOUSING BONDS.

(a) GENERAL RULE.—With respect to transfers of public housing bonds occurring after December 31, 1983, and before June 19, 1984, the taxpayer shall report the date and amount of such transfer and such other information as the Secretary of the Treasury or his delegate shall prescribe by regulations to allow the determination of the tax and interest due if it is ultimately determined that such transfers are subject to estate, gift, or generation-skipping tax.

(b) PENALTY FOR FAILURE TO REPORT.—Any taxpayer failing to provide the information required by subsection (a) shall be liable for a penalty equal to 25 percent of the excess of (1) the estate, gift, or generation-skipping tax that is payable assuming that such transfers are subject to tax, over (2) the tax payable assuming such transfers are not so subject.

SEC. 643. TAX-EXEMPT STATUS OF OBLIGATIONS OF CERTAIN EDUCATIONAL ORGANIZATIONS.

(a) IN GENERAL.—For purposes of section 103 of the Internal Revenue Code of 1954, a qualified educational organization shall be treated as a State governmental unit, but only with respect to a trade or business carried on by such organization which is not an unrelated trade or business (determined by applying section 513(a) of such Code to such organization).

(b) QUALIFIED EDUCATIONAL ORGANIZATION.—For purposes of subsection (a), the term "qualified educational organization" means a college or university created on February 22, 1855, by specific act of the legislature of the State within which such college or university is located.

(c) EFFECTIVE DATE.—This section shall apply to obligations issued after December 31, 1953.

SEC. 644. LOCAL FURNISHING OF ELECTRICITY OR GAS.

(a) GENERAL RULE.—For the purposes of section 103(b)(4)(E), facilities for the local furnishing of electric energy also shall include a facility that is part of a system providing service to the general populace (i) if at least 97 percent (measured both by total number of metered customers and by their annual consumption on a kilowatt hour basis) of the retail customers of such system are located in two contiguous counties, and (ii) if the remainder of such customers are located in a portion of a third contiguous county which portion is located on a peninsula not directly connected by land to the rest of the county of which it is a part.

(b) ELECTION TO ALLOCATE TO 1984 ONE-HALF OF STATE LIMIT FOR 1985, 1986, AND 1987.—Solely for purposes of issuing obligations described in subsection (a), the issuing authorities of a State may elect (at such time and in such manner as the Secretary of the Treasury shall by regulations prescribe) to take into account in 1984 one-half of the amount which would have been the State limit for the calendar years 1985, 1986, and 1987.

SEC. 645. LOCAL FURNISHING WHERE FACILITY INITIALLY AUTHORIZED BY FEDERAL GOVERNMENT.

For the purpose of section 103(b)(4)(E), facilities for the local furnishing of electric energy also shall include a facility that is part of a system providing service to the general populace—

(i) if the facility was initially authorized by the Federal Government in 1962;

(ii) if the facility receives financing of at least 25 percent by an exempt person;

(iii) if the electric energy generated by the facility is purchased by an electric cooperative qualified as a rural electric borrower under 7 U.S.C. section 901 et seq. and if;

(iv) the facility is located in a noncontiguous State.

SEC. 646. TREASURY DEPARTMENT DECISIONS AFFECTING TAX-EXEMPT BONDS.

(a) The Secretary of Education and the Secretary of the Treasury shall within 90 days of the date of enactment of this provision, establish procedures under which issuers affected by any decision of the Secretary of Education or his delegate under section 7 of the Student Loan Consolidation and Technical Amendments Act of 1983 may request and obtain a hearing and a review of such decision by the Secretary of the Treasury or his delegate followed by a written report to the Secretary of Education and to such person with respect to such review to be filed no later than 60 days of the request for review (unless the person requesting such review consents to an extension of time).

(b) Nothing in this section shall affect the exemption from income taxation of interest on any student loan bond or any issuer of such bonds.

SEC. 647. SPECIAL RULE FOR POSSESSIONS AND DISTRICT OF COLUMBIA.

Notwithstanding any other provision of law—

(1) the Virgin Islands and American Samoa shall have authority to issue industrial development bonds (within the meaning of section 103(b)(2) of the Internal Revenue Code of 1954), and

(2) the District of Columbia housing finance agency shall have the authority to issue obligations described in section 103(b)(4)(A) of such Code and to issue mortgage subsidy bonds (as defined in section 103A of such Code).

SEC. 648. SPECIAL ARBITRAGE RULE.

Securities or obligations are not described in section 103(c)(2)(A) or (B) of the Internal Revenue Code of 1954 and are not subject to yield restrictions to the extent that on the date of issue of a bond issue which is payable from the investment earnings on such securities or obligations—

(1) such securities or obligations are held in a fund which, except to the extent of the investment earnings on such securities or obligations, cannot be used, under State constitutional or statutory restrictions continuously in effect since October 9, 1969, to pay debt service on the bond issue or to finance the facilities that are to be financed with the proceeds of the bonds,

(2) the fund has received no substantial discretionary contributions after October 9, 1969,

(3) the issuer (A) had a practice of issuing bonds secured by the investment earnings of the fund during the period commencing January 1, 1960, and ending on October 9, 1969, and (B) has had a continuous practice of issuing bonds secured by the investment earnings of the fund at least once during each 5-year period beginning on October 9, 1969, and

(4) the amount of securities or obligations benefitting from this rule cannot exceed the principal amount of bonds (to which such securities or other obligations would, but for this rule, be allocated) which could be issued under applicable laws restricting the amount of bonds that can be issued (but not restrictions on the purposes for which bonds can be issued) in effect on October 9, 1969, as applied to the facts on the day of issue.

TITLE VII—TECHNICAL CORRECTIONS

SEC. 701. COORDINATION WITH OTHER TITLES.

For purposes of applying the amendments made by any title of this Act other than this title, the provisions of this title shall be treated as having been enacted immediately before the provisions of such other titles.

Subtitle A—Amendments Related to the Tax Equity and Fiscal Responsibility Act of 1982

SEC. 711. TECHNICAL CORRECTIONS OF PROVISIONS RELATING TO INDIVIDUALS.

(a) AMENDMENTS RELATED TO SECTION 201.—

(1) DEFINITION OF REGULAR TAX.—Paragraph (2) of section 55(f) (defining regular tax) is amended by striking out "sections

72(m)(5)(B)" and inserting in lieu thereof "sections 47(a), 72(m)(5)(B)".

(2) SPECIAL ELECTION FOR INTANGIBLE DRILLING AND DEVELOPMENT COSTS LIMITED TO WELLS LOCATED IN THE UNITED STATES.—Subparagraph (A) of section 58(i)(4) (relating to special election for intangible drilling and development cost not allocable to interest as limited partner) is amended by inserting "(with respect to wells located in the United States)" after "intangible drilling costs".

(3) 3-YEAR AMORTIZATION FOR CIRCULATION EXPENSES.—

(A) Subparagraph (B) of section 57(a)(6) (relating to circulation and research and experimental expenditures) is amended to read as follows:

"(B) the amount which would have been allowable for the taxable year with respect to expenditures paid or incurred during such taxable year if—

"(i) the circulation expenditures described in section 173 had been capitalized and amortized ratably over the 3-year period beginning with the taxable year in which such expenditures were made, or

"(ii) the research and experimental expenditures described in section 174 had been capitalized and amortized ratably over the 10-year period beginning with the taxable year in which such expenditures were made."

(B) Paragraph (1) of section 58(i) (relating to optional 10-year writeoff of certain tax preferences) is amended by striking out "10-year period" and inserting in lieu thereof "10-year period (3-year period in the case of circulation expenditures described in section 173)".

(C) Subsection (b) of section 173 is amended by striking out "10-year" and inserting in lieu thereof "3-year".

(4) LOSSES TREATED AS INVESTMENT LOSSES.—Subparagraph (B) of section 55(e)(8) is amended to read as follows:

"(B) INCOME AND LOSSES TAKEN INTO ACCOUNT IN COMPUTING QUALIFIED NET INVESTMENT INCOME.—Any income or loss derived from a limited business interest shall be taken into account in computing qualified net investment income."

(5) TREATMENT OF ALCOHOL FUELS CREDIT.—Subparagraph (c) of section 55(b)(1) (defining alternative minimum taxable income) is amended by striking out "section 667" and inserting in lieu thereof "section 87 or 667".

(b) AMENDMENT RELATED TO SECTION 202.—Paragraph (5) of section 213(d) (relating to definitions) is amended by striking out "paragraph (2)" and inserting in lieu thereof "paragraph (4)".

(c) AMENDMENTS RELATED TO SECTION 203.—

(1) CLARIFICATION OF ADJUSTED GROSS INCOME IN THE CASE OF ESTATES AND TRUSTS.—Paragraph (2) of section 165(h) (relating to casualty and theft losses) is amended by redesignating subparagraph (B) as subparagraph (C) and by inserting after subparagraph (A) the following new subparagraph:

"(B) DETERMINATION OF ADJUSTED GROSS INCOME IN CASE OF ESTATES AND TRUSTS.—For purposes of paragraph (1), the adjusted gross income of an estate or trust shall be com-

puted in the same manner as in the case of an individual, except that the deductions for costs paid or incurred in connection with the administration of the estate or trust shall be treated as allowable in arriving at adjusted gross income."

(2) COORDINATION OF SECTION 165(h) WITH SECTION 1231.—

(A) COORDINATION FOR 1984 AND SUBSEQUENT YEARS.—

(i) CLARIFICATION OF LOSSES TO WHICH SECTION 165(c)(3) APPLIES.—Paragraph (3) of section 165(c) (relating to limitation on loss of individuals) is amended by striking out "trade or business" and inserting in lieu thereof "trade or business or a transaction entered into for profit".

(ii) AMENDMENT OF SECTION 165(h).—Subsection (h) of section 165 (relating to casualty and theft losses) is amended to read as follows:

"(h) TREATMENT OF CASUALTY GAINS AND LOSSES.—

"(1) $100 LIMITATION PER CASUALTY.—Any loss of an individual described in subsection (c)(3) shall be allowed only to the extent that the amount of the loss to such individual arising from each casualty, or from each theft, exceeds $100.

"(2) NET CASUALTY LOSS ALLOWED ONLY TO THE EXTENT IT EXCEEDS 10 PERCENT OF ADJUSTED GROSS INCOME.—

"(A) IN GENERAL.—If the personal casualty losses for any taxable year exceed the personal casualty gains for such taxable year, such losses shall be allowed for the taxable year only to the extent of the sum of—

"(i) the amount of the personal casualty gains for the taxable year, plus

"(ii) so much of such excess as exceeds 10 percent of the adjusted gross income of the individual.

"(B) SPECIAL RULE WHERE PERSONAL CASUALTY GAINS EXCEED PERSONAL CASUALTY LOSSES.—If the personal casualty gains for any taxable year exceed the personal casualty losses for such taxable year—

"(i) all such gains shall be treated as gains from sales or exchanges of capital assets, and

"(ii) all such losses shall be treated as losses from sales or exchanges of capital assets.

"(3) DEFINITIONS OF PERSONAL CASUALTY GAIN AND PERSONAL CASUALTY LOSS.—For purposes of this subsection—

"(A) PERSONAL CASUALTY GAIN.—The term 'personal casualty gain' means the recognized gain from any involuntary conversion of property which is described in subsection (c)(3) arising from fire, storm, shipwreck, or other casualty, or from theft.

"(B) PERSONAL CASUALTY LOSS.—The term 'personal casualty loss' means any loss described in subsection (c)(3). For purposes of paragraph (2), the amount of any personal casualty loss shall be determined after the application of paragraph (1).

"(4) SPECIAL RULES.—

"(A) PERSONAL CASUALTY LOSSES ALLOWABLE IN COMPUTING ADJUSTED GROSS INCOME TO THE EXTENT OF PERSONAL

CASUALTY GAINS.—In any case to which paragraph (2)(A) applies, the deduction for personal casualty losses for any taxable year shall be treated as a deduction allowable in computing adjusted gross income to the extent such losses do not exceed the personal casualty gains for the taxable year.

"(B) JOINT RETURNS.—For purposes of this subsection, a husband and wife making a joint return for the taxable year shall be treated as 1 individual.

"(C) DETERMINATION OF ADJUSTED GROSS INCOME IN CASE OF ESTATES AND TRUSTS.—For purposes of paragraph (2), the adjusted gross income of an estate or trust shall be computed in the same manner as in the case of an individual, except that the deductions for costs paid or incurred in connection with the administration of the estate or trust shall be treated as allowable in arriving at adjusted gross income.

"(D) COORDINATION WITH ESTATE TAX.—No loss described in subsection (c)(3) shall be allowed if, at the time of filing the return, such loss has been claimed for estate tax purposes in the estate tax return."

(iii) SECTION 1231 NOT TO APPLY TO PERSONAL CASUALTY GAINS OR LOSSES.—Subsection (a) of section 1231 (relating to property used in the trade or business and involuntary conversions) is amended to read as follows:

"(a) GENERAL RULE.—

"(1) GAINS EXCEED LOSSES.—If—

"(A) the section 1231 gains for any taxable year, exceed

"(B) the section 1231 losses for such taxable year,

such gains and losses shall be treated as long-term capital gains or long-term capital losses, as the case may be.

"(2) GAINS DO NOT EXCEED LOSSES.—If—

"(A) the section 1231 gains for any taxable year, do not exceed

"(B) the section 1231 losses for such taxable year,

such gains and losses shall not not be treated as gains and losses from sales or exchanges of capital assets.

"(3) SECTION 1231 GAINS AND LOSSES.—For purposes of this subsection—

"(A) SECTION 1231 GAIN.—The term 'section 1231 gain' means—

"(i) any recognized gain on the sale or exchange of property used in the trade or business, and

"(ii) any recognized gain from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) into other property or money of—

"(I) property used in the trade or business, or

"(II) any capital asset which is held for more than 1 year and is held in connection with a trade or business or a transaction entered into for profit.

"(B) SECTION 1231 LOSS.—The term 'section 1231 loss' means any recognized loss from a sale or exchange or conversion described in subparagraph (A).

"(4) SPECIAL RULES.—For purposes of this subsection—

"(A) In determining under this subsection whether gains exceed losses—

"(i) the section 1231 gains shall be included only if and to the extent taken into account in computing gross income, and

"(ii) the section 1231 losses shall be included only if and to the extent taken into account in computing taxable income, except that section 1211 shall not apply.

"(B) Losses (including losses not compensated for by insurance or otherwise) on the destruction, in whole or in part, theft or seizure, or requisition or condemnation of—

"(i) property used in the trade or business, or

"(ii) capital assets which are held for more than 1 year and are held in connection with a trade or business or a transaction entered into for profit,

shall be treated as losses from a compulsory or involuntary conversion.

"(C) In the case of any involuntary conversion (subject to the provisions of this subsection but for this sentence) arising from fire, storm, shipwreck, or other casualty, or from theft, of any—

"(i) property used in the trade or business, or

"(ii) any capital asset which is held for more than 1 year and is held in connection with a trade or business or a transaction entered into for profit,

this subsection shall not apply to such conversion (whether resulting in gain or loss) if during the taxable year the recognized losses from such conversions exceed the recognized gains from such conversions."

(iv) Sections 873(b)(1) and 931(d)(2)(B) are each amended by striking out ", for losses of property not connected with the trade or business if arising from certain casualties or theft," and inserting in lieu thereof "for losses".

(v) EFFECTIVE DATE.—The amendments made by this subparagraph shall apply to taxable years beginning after December 31, 1983.

(B) TRANSITIONAL RULE.—In the case of taxable years beginning before January 1, 1984—

(i) For purposes of paragraph (1)(B) of section 165(h) of the Internal Revenue Code of 1954, adjusted gross income shall be determined without regard to the application of section 1231 of such Code to any gain or loss from an involuntary conversion of property described in subsection (c)(3) of section 165 of such Code arising from fire, storm, shipwreck, or other casualty or from theft.

(ii) Section 1231 of such Code shall be applied after the application of paragraph (1) of section 165(h) of such Code.

(3) CLERICAL AMENDMENT.—Subsection (d) of section 6405 (relating to refunds attributable to certain disaster losses) is amended by striking out "section 165(h)" and inserting in lieu thereof "section 165(i)".

SEC. 712. TECHNICAL CORRECTIONS OF PROVISIONS PRIMARILY RELATING TO BUSINESSES.

(a) AMENDMENTS RELATED TO SECTION 204.—

(1) CLARIFICATION OF ADDITIONAL AMOUNT TREATED AS ORDINARY INCOME UNDER SECTION 1250.—

(A) Paragraph (1) of section 291(a) (relating to section 1250 capital gain treatment) is amended—

(i) by striking out "under section 1250" in subparagraph (B) and inserting in lieu thereof "under section 1250 (determined without regard to this paragraph)", and

(ii) by striking out "which is ordinary income" and inserting in lieu thereof "which is ordinary income under section 1250".

(B) Subsection (a) of section 1250 is amended by adding at the end thereof the following new paragraph:

"(4) CROSS REFERENCE.—

"For reduction in the case of corporations on capital gain treatment under this section, see section 291(a)(1)."

(2) INVESTMENT TAX CREDIT ALLOWED ONLY FOR MINERAL EXPLORATION AND DEVELOPMENT COSTS FOR DEPOSITS LOCATED IN THE UNITED STATES.—Clause (ii) of section 291(b)(2)(B) is amended by inserting "in the case of a deposit located in the United States," after "(ii)".

(3) CLARIFICATION OF COORDINATION WITH COST DEPLETION.—Paragraph (6) of section 291(b) (relating to coordination with cost depletion) is amended to read as follows:

"(6) COORDINATION WITH COST DEPLETION.—The portion of the adjusted basis of any property which is attributable to amounts to which paragraph (1) applied shall not be taken into account for purposes of determining depletion under section 611."

(4) CLARIFICATION OF DEFINITION OF INTEREST.—Subparagraph (B) of section 291(e)(1) (relating to interest on debt to carry tax-exempt obligations acquired after December 31, 1982) is amended by adding at the end thereof the following new clause:

"(iii) INTEREST.—For purposes of this subparagraph, the term 'interest' includes amounts (whether or not designated as interest) paid in respect of deposits, investment certificates, or withdrawable or repurchasable shares."

(b) AMENDMENT RELATED TO SECTION 205.—Subsection (q) of section 48 (relating to basis adjustment to section 38 property) is amended by adding at the end thereof the following new paragraph:

"(6) ADJUSTMENT IN BASIS OF INTEREST IN PARTNERSHIP OR S CORPORATION.—The adjusted basis of—

"(A) a partner's interest in a partnership, and

"(B) stock in an S corporation,

shall be appropriately adjusted to take into account adjustments made under this subsection in the basis of property held by the partnership or S corporation (as the case may be).''

(c) AMENDMENT RELATED TO SECTION 207.—Paragraph (4) of section 189(e) (defining residential real property) is amended by striking out "or" at the end of subparagraph (A), by striking out the period at the end of subparagraph (B) and inserting in lieu thereof ", or", and by adding at the end thereof the following new subparagraph:

"(C) real property held by a cooperative housing corporation (as defined in section 216(b)) and used for dwelling purposes."

(d) AMENDMENTS RELATED TO SECTION 210.—

(1) SPECIAL RULE WHERE DEALER-LESSEE REQUIRED TO PURCHASE VEHICLE.—Paragraph (2) of section 210(b) of the Tax Equity and Fiscal Responsibility Act of 1982 (defining terminal rental adjustment clause) is amended by adding at the end thereof the following new sentence: "Such term also includes a provision of an agreement which requires a lessee who is a dealer in motor vehicles to purchase the motor vehicle for a predetermined price and then resell such vehicle where such provision achieves substantially the same results as a provision described in the preceding sentence."

(2) EXCEPTION WHERE LESSEE TOOK POSITION ON RETURN THAT HE WAS OWNER.—Section 210 of the Tax Equity and Fiscal Responsibility Act of 1982 is amended by adding at the end thereof the following new subsection:

"(c) EXCEPTION WHERE LESSEE TOOK POSITION ON RETURN.—Subsection (a) shall not apply to deny a deduction for interest paid or accrued claimed by a lessee with respect to a qualified motor vehicle agreement on a return of tax imposed by chapter 1 of the Internal Revenue Code of 1954 which was filed before the date of the enactment of this Act or to deny a credit for investment in depreciable property claimed by the lessee on such a return pursuant to an agreement with the lessor that the lessor would not claim the credit."

(e) AMENDMENT RELATED TO SECTION 211.—Subparagraph (A) of section 211(e)(2) of the Tax Equity and Fiscal Responsibility Act of 1982 (relating to retention of old sections 907(b) and 904(f)(4) where taxpayer had separate basket foreign loss) is amended by striking out "the 8-year period" and inserting in lieu thereof "the 8-year period (or such shorter period as the taxpayer may select)".

(f) AMENDMENT RELATED TO SECTION 212.—Paragraph (1) of section 954(h) (defining foreign base company oil-related income) is amended by striking out "section 907(c)(2)" and inserting in lieu thereof "paragraphs (2) and (3) of section 907(c)".

(g) AMENDMENT RELATED TO SECTION 213.—The table contained in subparagraph (C) of section 936(a)(2) is amended by striking out "The percentage tax is:" and inserting in lieu thereof "The percentage is:".

(h) AMENDMENT RELATED TO SECTION 217.—Subsection (e) of section 217 of the Tax Equity and Fiscal Responsibility Act of 1982 (relating to effective date) is amended by adding at the end thereof the following new sentence: "For purposes of applying section

168(f)(8)(D)(v) of the Internal Revenue Code of 1954, the amendments made by subsection (c) shall apply to agreements entered into after the date of the enactment of this Act."

(i) AMENDMENTS RELATED TO SECTION 222.—

(1) Sections 301(e)(2) and 302(f)(3) are each amended by striking out "partial or complete liquidation" and inserting in lieu thereof "complete liquidation".

(2) The paragraph heading of paragraph (1) of section 306(b) (relating to exceptions) is amended by striking out "INTEREST." and inserting in lieu thereof "INTEREST, ETC.".

(3) Paragraph (1) of section 543(a) (defining personal holding company income) is amended by striking out subparagraph (C), by adding "and" at the end of subparagraph (A), and by striking out ", and" at the end of subparagraph (B) and inserting in lieu thereof a period.

(j) AMENDMENT RELATED TO SECTION 223.—Paragraph (1) of section 311(e) (defining qualified stock) is amended by adding at the end thereof the following new subparagraph:

"(C) RULES FOR PASSTHRU ENTITIES.—In the case of an S corporation, partnership, trust, or estate—

"(i) the determination of whether subparagraph (A) is satisfied shall be made at the shareholder, partner, or beneficiary level (rather than at the entity level), and

"(ii) the distribution shall be treated as made directly to the shareholders, partners, or beneficiaries in proportion to their respective interests in the entity."

(k) AMENDMENTS RELATED TO SECTION 224.—

(1) ASSETS TREATED AS SOLD AT FAIR MARKET VALUE.—

(A) IN GENERAL.—Paragraph (1) of section 338(a) (relating to general rule) is amended by inserting "at fair market value" after "acquisition date".

(B) BASIS OF ASSETS AFTER DEEMED PURCHASE.—Subsection (b) of section 338 (relating to price at which deemed sale made) is amended to read as follows:

"(b) BASIS OF ASSETS AFTER DEEMED PURCHASE.—

"(1) IN GENERAL.—For purposes of subsection (a), the assets of the target corporation shall be treated as purchased for an amount equal to the sum of—

"(A) the grossed-up basis of the purchasing corporation's recently purchased stock, and

"(B) the basis of the purchasing corporation's nonrecently purchased stock.

"(2) ADJUSTMENT FOR LIABILITIES AND OTHER RELEVANT ITEMS.—The amount described in paragraph (1) shall be adjusted under regulations prescribed by the Secretary for liabilities of the target corporation and other relevant items.

"(3) ELECTION TO STEP-UP THE BASIS OF CERTAIN TARGET STOCK.—

"(A) IN GENERAL.—Under regulations prescribed by the Secretary, the basis of the purchasing corporation's nonrecently purchased stock shall be the basis amount determined under subparagraph (B) of this paragraph if the purchasing corporation makes an election to recognize gain as

if such stock were sold on the acquisition date for an amount equal to the basis amount determined under subparagraph (B).

"(B) DETERMINATION OF BASIS AMOUNT.—For purposes of subparagraph (A), the basis amount determined under this subparagraph shall be an amount equal to the grossed-up basis determined under subparagraph (A) of paragraph (1) multiplied by a fraction—

"(i) the numerator of which is the percentage of stock (by value) in the target corporation attributable to the purchasing corporation's nonrecently purchased stock, and

"(ii) the denominator of which is 100 percent minus the percentage referred to in clause (i).

"(4) GROSSED-UP BASIS.—For purposes of paragraph (1), the grossed-up basis shall be an amount equal to the basis of the corporation's recently purchased stock, multiplied by a fraction—

"(A) the numerator of which is 100 percent, minus the percentage of stock (by value) in the target corporation attributable to the purchasing corporation's nonrecently purchased stock, and

"(B) the denominator of which is the percentage of stock (by value) in the target corporation attributable to the purchasing corporation's recently purchased stock.

"(5) ALLOCATION AMONG ASSETS.—The amount determined under paragraphs (1) and (2) shall be allocated among the assets of the target corporation under regulations prescribed by the Secretary.

"(6) DEFINITIONS OF RECENTLY PURCHASED STOCK AND NONRECENTLY PURCHASED STOCK.—For purposes of this subsection—

"(A) RECENTLY PURCHASED STOCK.—The term 'recently purchased stock' means any stock in the target corporation which is held by the purchasing corporation on the acquisition date and which was purchased by such corporation during the 12-month acquisition period.

"(B) NONRECENTLY PURCHASED STOCK.—The term 'nonrecently purchased stock' means any stock in the target corporation which is held by the purchasing corporation on the acquisition date and which is not recently purchased stock."

(2) COORDINATION WITH SECTION 333.—The last sentence of paragraph (1) of section 338(c) (relating to coordination with section 337 where purchasing corporation holds less than 100 percent of stock) is amended by striking out "such 1-year period" and inserting in lieu thereof "such 1-year period and section 333 does not apply to such liquidation".

(3) EXCEPTIONS TO DEEMED ELECTION RULE.—Paragraph (2) of section 338(e) (relating to exceptions) is amended—

(A) by striking out "(in whole or in part)" in subparagraph (B) and inserting in lieu thereof "wholly",

(B) by inserting "and" at the end of subparagraph (C), and

(C) by striking out subparagraphs (D) and (E) and inserting in lieu thereof the following:

"(D) such acquisition is described in regulations prescribed by the Secretary and meets such conditions as such regulations may provide."

(4) TIME FOR MAKING ELECTION.—Paragraph (1) of section 338(g) (relating to election) is amended to read as follows:

"(1) WHEN MADE.—Except as otherwise provided in regulations, an election under this section shall be made not later than the 15th day of the 9th month beginning after the month in which the acquisition date occurs."

(5) DEFINITION OF PURCHASE.—

(A) Subparagraph (B) of section 338(h)(3) (defining purchase) is amended to read as follows:

"(B) DEEMED PURCHASE UNDER SUBSECTION (a).—The term 'purchase' includes any deemed purchase under subsection (a)(2). The acquisition date for a corporation which is deemed purchased under subsection (a)(2) shall be determined under regulations prescribed by the Secretary."

(B) Paragraph (3) of section 338(h) is amended by adding at the end thereof the following new subparagraph:

"(C) CERTAIN STOCK ACQUISITIONS FROM RELATED CORPORATIONS.—

"(i) IN GENERAL.—Clause (iii) of subparagraph (A) shall not apply to an acquisition of stock from a related corporation if at least 50 percent in value of the stock of such related corporation was acquired by purchase (within the meaning of subparagraph (A) and (B)).

"(ii) CERTAIN DISTRIBUTIONS.—Clause (i) of subparagraph (A) shall not apply to an acquisition of stock described in clause (i) of this subparagraph if the corporation acquiring such stock—

"(I) made a qualified stock purchase of stock of the related corporation, and

"(II) made an election under this section (or is treated under subsection (e) as having made such an election) with respect to such qualified stock purchase.

"(iii) RELATED CORPORATION DEFINED.—For purposes of this subparagraph, a corporation is a related corporation if stock owned by such corporation is treated (under section 318(a) other than paragraph (4) thereof) as owned by the corporation acquiring the stock."

(C) Paragraph (1) of section 338(h) (defining 12-month acquisition period) is amended by inserting before the period at the end thereof the following: "(or, if any of such stock was acquired in an acquisition which is a purchase by reason of subparagraph (C) of paragraph (3), the date on which the acquiring corporation is first considered under section 318(a) (other than paragraph (4) thereof) as owning stock owned by the corporation from which such acquisition was made)."

(D) clause (ii) of section 338(h)(3)(A) (defining purchase) is amended to read as follows:

"(ii) the stock is not acquired in an exchange to which section 351, 354, 355, or 356 applies and is not acquired in any other transaction described in regulations in which the transferor does not recognize the entire amount of the gain or loss realized on the transaction, and".

(E) Paragraph (4) of section 318(b) (relating to cross references) is amended to read as follows: "(4) section 338(h)(3) (defining purchase);".

(6) SPECIAL RULES FOR APPLYING SECTION 338.—

(A) Subsection (h) of section 338 (relating to definitions and special rules) is amended by striking out paragraph (7), by redesignating paragraphs (8) and (9) as paragraphs (9) and (10), respectively, and by inserting after paragraph (6) the following new paragraphs:

"(7) ADDITIONAL PERCENTAGE MUST BE ATTRIBUTABLE TO PURCHASE, ETC.—For purposes of subsection (c)(1), any increase in the maximum percentage of stock taken into account over the percentage of stock (by value) of the target corporation held by the purchasing corporation on the acquisition date shall be taken into account only to the extent such increase is attributable to—

"(A) purchase, or

"(B) a redemption of stock of the target corporation—

"(i) to which section 302(a) applies, or

"(ii) in the case of a shareholder who is not a corporation, to which section 301 applies.

"(8) ACQUISITIONS BY AFFILIATED GROUP TREATED AS MADE BY 1 CORPORATION.—Except as provided in regulations prescribed by the Secretary, stock and asset acquisitions made by members of the same affiliated group shall be treated as made by 1 corporation."

(B) Paragraph (9) of section 338(h), as redesignated by subparagraph (A), is amended by striking out "paragraph (9)" and inserting in lieu thereof "paragraph (10)".

(C) Subsection (h) of section 338 is amended by adding at the end thereof the following new paragraphs:

"(11) ELECTIVE FORMULA FOR DETERMINING FAIR MARKET VALUE.—For purposes of subsection (a)(1), fair market value may be determined on the basis of a formula provided in regulations prescribed by the Secretary which takes into account liabilities and other relevant items.

"(12) SECTION 337 TO APPLY WHERE TARGET HAD ADOPTED PLAN FOR COMPLETE LIQUIDATION.—If—

"(A) during the 12-month period ending on the acquisition date the target corporation adopted a plan of complete liquidation,

"(B) such plan was not rescinded before the close of the acquisition date, and

"(C) the purchasing corporation makes an election under this section (or is treated under subsection (e) as having

35-426 O 84 - 31

made such an election) with respect to the target corporation,

then, subject to rules similar to the rules of subsection (c)(1), for purposes of section 337 (and other provisions which relate to section 337), the target corporation shall be treated as having distributed all of its assets as of the close of the acquisition date.

"(13) TAX ON DEEMED SALE NOT TAKEN INTO ACCOUNT FOR ESTIMATED TAX PURPOSES.—For purposes of section 6655, tax attributable to the sale described in subsection (a)(1) shall not be taken into account.

"(14) COORDINATION WITH SECTION 341.—For purposes of determining whether section 341 applies to a disposition within 1 year after the acquisition date of stock by a shareholder (other than the acquiring corporation) who held stock in the target corporation on the acquisition date, section 341 shall be applied without regard to this section.

"(15) COMBINED DEEMED SALE RETURN.—Under regulations prescribed by the Secretary, a combined deemed sale return may be filed by all target corporations acquired by a purchasing corporation on the same acquisition date if such target corporations were members of the same selling consolidated group (as defined in subparagraph (B) of paragraph (10))."

(7) Subsection (i) of section 338 (relating to regulations) is amended to read as follows:

"(i) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including—

"(1) regulations to ensure that the purpose of this section to require consistency of treatment of stock and asset sales and purchases may not be circumvented through the use of any provision of law or regulations (including the consolidated return regulations) and

"(2) regulations providing for the coordination of the provisions of this section with the provision of this title relating to foreign corporations and their shareholders."

(8) TREATMENT OF CERTAIN LIQUIDATIONS.—

(A) IN GENERAL.— Section 269 (relating to acquisitions made to evade or avoid income tax) is amended by redesignating subsection (b) as subsection (c) and by inserting after subsection (a) the following new subsection:

"(b) CERTAIN LIQUIDATIONS AFTER QUALIFIED STOCK PURCHASES.—

"(1) IN GENERAL.—If—

"(A) there is a qualified stock purchase by a corporation of another corporation,

"(B) an election is not made under section 338 with respect to such purchase,

"(C) the acquired corporation is liquidated pursuant to a plan of liquidation adopted not more than 2 years after the acquisition date, and

"(D) the principal purpose for such liquidation is the evasion or avoidance of Federal income tax by securing the

benefit of a deduction, credit, or other allowance which the acquiring corporation would not otherwise enjoy,

then the Secretary may disallow such deduction, credit, or other allowance.

"(2) MEANING OF TERMS.—For purposes of paragraph (1), the terms 'qualified stock purchase' and 'acquisition date' have the same respective meanings as when used in section 338."

(B) CONFORMING AMENDMENT.—Subsection (c) of section 269 (as redesignated by subparagraph (A)) is amended by striking out "subsection (a)" and inserting in lieu thereof "subsection (a) or (b)".

(C) EFFECTIVE DATE.—The amendments made by this paragraph shall apply to liquidations after October 20, 1983, in taxable years ending after such date.

(9) AMENDMENTS NOT TO APPLY TO ACQUISITIONS BEFORE SEPTEMBER 1, 1982.—

(A) IN GENERAL.—The amendments made by this subsection shall not apply to any qualified stock purchase (as defined in section 338(d)(3) of the Internal Revenue Code of 1954) where the acquisition date (as defined in section 338(h)(2) of such Code) is before September 1, 1982.

(B) EXTENSION OF TIME FOR MAKING ELECTION.—In the case of any qualified stock purchase described in subparagraph (A), the time for making an election under section 338 of such Code shall not expire before the close of the 60th day after the date of the enactment of this Act.

(10) SPECIAL RULES FOR DEEMED PURCHASES UNDER PRIOR LAW.—If, before October 20, 1983, a corporation was treated as making a qualified stock purchase (as defined in section 338(d)(3) of the Internal Revenue Code of 1954), but would not be so treated under the amendments made by paragraphs (5) and (6) of this subsection, the amendments made by such paragraphs shall not apply to such purchase unless such corporation elects (at such time and in such manner as the Secretary of the Treasury or his delegate may by regulations prescribe) to have the amendments made by such paragraphs apply.

(l) AMENDMENTS RELATED TO SECTION 226.—

(1) AMOUNT CONSTITUTING DIVIDEND.—Paragraph (2) of section 304(b) (relating to amount constituting dividend) is amended to read as follows:

"(2) AMOUNT CONSTITUTING DIVIDEND.—In the case of any acquisition of stock to which subsection (a) applies, the determination of the amount which is a dividend (and the source thereof) shall be made as if the property were distributed—

"(A) by the acquiring corporation to the extent of its earnings and profits, and

"(B) then by the issuing corporation to the extent of its earnings and profits."

(2) COORDINATION WITH SECTION 351.—Subparagraph (A) of section 304(b)(3) (relating to coordination with section 351) is amended by striking out "(and not part III)" and inserting in lieu thereof "(and not section 351 and not so much of sections 357 and 358 as relates to section 351)".

(3) CERTAIN ASSUMPTIONS OF LIABILITY.—

(A) The first sentence of clause (i) of section 304(b)(3)(B) (relating to certain assumptions of liability, etc.) is amended by striking out "Subsection (a)" and inserting in lieu thereof "In the case of an acquisition described in section 351, subsection (a)".

(B) Subparagraph (B) of section 304(b)(3) (relating to coordination with section 351) is amended by adding at the end thereof the following new clause:

"(iii) CLAUSE (i) DOES NOT APPLY TO STOCK ACQUIRED FROM RELATED PERSON EXCEPT WHERE COMPLETE TERMINATION.—Clause (i) shall apply only to stock acquired by the transferor from a person—

"(I) none of whose stock is attributable to the transferor under section 318(a) (other than paragraph (4) thereof), or

"(II) who satisfies rules similar to the rules of section 302(c)(2) with respect to both the acquiring and the issuing corporations (determined as if such person were a distributee of each such corporation)."

(4) DISTRIBUTIONS INCIDENT TO FORMATION OF BANK HOLDING COMPANIES.—Subparagraph (C) of section 304(b)(3) (relating to distributions incident to formation of bank holding companies) is amended by adding at the end thereof the following new sentence: "For purposes of this subparagraph, any assumption of (or acquisition of stock subject to) a liability under subparagraph (B) shall not be treated as a distribution of property."

(5) CONSTRUCTIVE OWNERSHIP.—

(A) Paragraph (3) of section 304(c) (relating to constructive ownership) is amended to read as follows:

"(3) CONSTRUCTIVE OWNERSHIP.—

"(A) IN GENERAL.—Section 318(a) (relating to constructive ownership of stock) shall apply for purposes of determining control under this section.

"(B) MODIFICATION OF 50-PERCENT LIMITATIONS IN SECTION 318.—For purposes of subparagraph (A)—

"(i) paragraph (2)(C) of section 318(a) shall be applied by substituting '5 percent' for '50 percent', and

"(ii) paragraph (3)(C) of section 318(a) shall be applied—

"(I) by substituting '5 percent' for '50 percent', and

"(II) in any case where such paragraph would not apply but for subclause (I), by considering a corporation as owning the stock (other than stock in such corporation) owned by or for any shareholder of such corporation in that proportion which the value of the stock which such shareholder owned in such corporation bears to the value of all stock in such corporation."

(B) Paragraph (4) of section 306(c) is amended by striking out the last sentence and inserting in lieu thereof the following: "For purposes of applying the preceding sentence to paragraph (3), the rules of section 304(c)(3)(B) shall apply."

(6) CERTAIN STOCK ACQUIRED IN SECTION 351 EXCHANGE.—Paragraph (3) of section 306(c) (relating to certain stock acquired in section 351 exchange) is amended by striking out the last sentence and inserting in lieu thereof the following: "Rules similar to the rules of section 304(b)(2) shall apply—

"(A) for purposes of the preceding sentence, and

"(B) for purposes of determining the application of this section to any subsequent disposition of stock which is section 306 stock by reason of an exchange described in the preceding sentence."

(7) EFFECTIVE DATES FOR AMENDMENTS MADE BY PARAGRAPHS (1) AND (3).—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, the amendments made by paragraphs (1) and (3) shall apply to stock acquired after June 18, 1984, in taxable years ending after such date.

(B) ELECTION BY TAXPAYER TO HAVE AMENDMENTS APPLY EARLIER.—Any taxpayer may elect, at such time and in such manner as the Secretary of the Treasury or his delegate may prescribe, to have the amendments made by paragraphs (1) and (3) apply as if included in section 226 of the Tax Equity and Fiscal Responsibility Act of 1982.

(C) SPECIAL RULE FOR CERTAIN TRANSFERS TO FORM BANK HOLDING COMPANY.—Except as provided in subparagraph (D), the amendments made by paragraphs (1) and (3) shall not apply to transfers pursuant to an application to form a BHC (as defined in section 304(b)(3)(D)(ii) of the Internal Revenue Code of 1954) filed with the Federal Reserve Board before June 18, 1984, if—

(i) such BHC was formed not later than the 90th day after the date of the last required approval of any regulatory authority to form such BHC, and

(ii) such BHC did not elect (at such time and in such manner as the Secretary of the Treasury or his delegate shall prescribe) not to have the provisions of this subparagraph apply.

(D) AMENDMENTS TO APPLY TO CERTAIN LIABILITIES INCURRED BEFORE OCTOBER 20, 1983.—The amendment made by paragraph (3)(A) shall apply to the acquisition of any stock to the extent the liability assumed, or to which such stock is subject, was incurred by the transferor after October 20, 1983.

(m) AMENDMENT RELATED TO SECTION 229.—Subsection (c) of section 229 of the Tax Equity and Fiscal Responsibility Act of 1982 (relating to modification of regulations on the completed contract method of accounting) is amended by adding at the end thereof the following new paragraph:

"(4) UNDERPAYMENTS OF ESTIMATED TAX FOR 1982.—To the extent provided in regulations, no addition to tax shall be made under section 6654 or 6655 of the Internal Revenue Code of 1954 for the taxpayer's first taxable year ending after December 31, 1982, by reason of a long-term contract, but only with respect to installments required to be paid before April 13, 1983."

(n) AMENDMENT RELATED TO SECTION 233.—Paragraph (11) of section 51(d) (defining members of economically disadvantaged families) is amended by adding at the end thereof the following new sentence: "Any such determination with respect to an individual who is a qualified summer youth employee or youth participating in a qualified cooperative education program with respect to any employer shall also apply for purposes of determining whether such individual is a member of another targeted group with respect to such employer."

SEC. 713. TECHNICAL CORRECTIONS OF PENSION PROVISIONS.

(a) AMENDMENTS RELATED TO SECTION 235.—

(1) ACTUARIAL ADJUSTMENTS MADE TO BENEFIT LIMIT RATHER THAN TO BENEFIT.—

(A) Subparagraph (C) of section 415(b)(2) (relating to adjustment to $90,000 limit where benefit begins before age 62) is amended by striking out the first sentence and inserting in lieu thereof the following: "If the retirement income benefit under the plan begins before age 62, the determination as to whether the $90,000 limitation set forth in paragraph (1)(A) has been satisfied shall be made, in accordance with regulations prescribed by the Secretary, by reducing the limitation of paragraph (1)(A) so that such limitation (as so reduced) equals an annual benefit (beginning when such retirement income benefit begins) which is equivalent to a $90,000 annual benefit beginning at age 62."

(B) Subparagraph (D) of section 415(b)(2) (relating to adjustment to $90,000 limitation where benefit begins after age 65) is amended to read as follows:

"(D) ADJUSTMENT TO $90,000 LIMIT WHERE BENEFIT BEGINS AFTER AGE 65.—If the retirement income benefit under the plan begins after age 65, the determination as to whether the $90,000 limitation set forth in paragraph (1)(A) has been satisfied shall be made, in accordance with regulations prescribed by the Secretary, by increasing the limitation of paragraph (1)(A) so that such limitation (as so increased) equals an annual benefit (beginning when such retirement income benefit begins) which is equivalent to a $90,000 annual benefit beginning at age 65."

(C)(i) Clauses (i) and (iii) of section 415(b)(2)(E) are each amended by striking out "any benefit" and inserting in lieu thereof "any benefit or limitation".

(ii) Clause (ii) of section 415(b)(2)(E) is amended by striking out "any benefit" and inserting in lieu thereof "any limitation".

(2) DEFINITION OF CURRENT ACCRUED BENEFIT IN THE CASE OF COLLECTIVELY BARGAINED PLANS.—Clause (i) of section 235(g)(4)(B) of the Tax Equity and Fiscal Responsibility Act of 1982 (defining current accrued benefit) is amended by adding at the end thereof the following new sentence: "In the case of any plan described in the first sentence of paragraph (5), the preceding sentence shall be applied by substituting for 'January 1, 1983' the applicable date determined under paragraph (5)."

(3) TRANSITION FRACTION ONLY APPLIES TO PLANS IN EXISTENCE BEFORE JULY 1, 1982.—Paragraph (6) of section 415(e) (relating to special transition rule for defined contribution fraction for years ending after December 31, 1982) is amended by adding at the end thereof the following new subparagraph:

"(C) PLAN MUST HAVE BEEN IN EXISTENCE ON OR BEFORE JULY 1, 1982.—This paragraph shall apply only to plans which were in existence on or before July 1, 1982."

(4) TREATMENT OF CERTAIN COLLECTIVE BARGAINING AGREEMENTS ENTERED INTO BEFORE JULY 1, 1982.—Clause (ii) of section 235(g)(4)(B) of the Tax Equity and Fiscal Responsibility Act of 1982 (defining current accrued benefit) is amended by adding at the end thereof the following new sentence: "For purposes of subclause (I), any change in the terms and conditions of the plan pursuant to a collective bargaining agreement entered into before July 1, 1982, and ratified before September 3, 1982, shall be treated as a change made before July 1, 1982."

(b) AMENDMENTS RELATED TO SECTION 236.—

(1) EXCEPTION FOR CERTAIN LOANS NOT TO APPLY TO LOANS FROM DEDUCTIBLE EMPLOYEE CONTRIBUTIONS.—

(A) Subparagraph (A) of section 72(o)(3) (relating to amounts constructively received) is amended by striking out "subsection (p)" and inserting in lieu thereof "subsection (p) (other than the exception contained in paragraph (2) thereof)".

(B) Subparagraph (A) of section 72(p)(2) (relating to exception for certain loans) is amended by adding at the end thereof the following new sentence:

"For purposes of clause (ii), the present value of the nonforfeitable accrued benefit shall be determined without regard to any accumulated deductible employee contributions (as defined in subsection (o)(5)(B))."

(2) DEFINITION OF REQUIRED PRINCIPAL PAYMENT.—Subparagraph (C) of section 236(c)(2) of the Tax Equity and Fiscal Responsibility Act of 1982 is amended by inserting before the period at the end thereof the following: "or if such loan was payable on demand".

(3) REPEAL OF PROVISION TREATING CERTAIN LOAN REPAYMENTS AS CONTRIBUTIONS.—Subsection (f) of section 404 (relating to certain loan repayments considered as contributions) is hereby repealed.

(4) CLARIFICATION OF EXCEPTION FOR SMALL LOANS.—Clause (ii) of section 72(p)(2)(A) (relating to exception for certain loans) is amended to read as follows:

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

(c) AMENDMENTS RELATED TO SECTION 237.—

(1) AMENDMENTS CONFORMING TO LIMITING TO KEY EMPLOYEES THE PENALTY FOR PREMATURE DISTRIBUTIONS.—

(A) Clause (i) of section 72(m)(5)(A) is amended by striking out "as an owner-employee" and inserting in lieu thereof "as a key employee".

(B) The paragraph heading of section 72(m)(5) is amended by striking out "OWNER-EMPLOYEES" and inserting in lieu thereof "KEY EMPLOYEES".

(C) Sections 46(a)(4), 53(a), and 901(a) are each amended by striking out "tax on premature distributions to owner-employees" and inserting in lieu thereof "tax on premature distributions to key employees".

(2) CORRECTION OF CROSS REFERENCE TO DEFINITION OF BANK.—

(A) Subsection (f) of section 401 is amended by striking out "(as defined in subsection (d)(1))" and inserting in lieu thereof "(as defined in section 408(n))".

(B) Subsection (h) of section 408 is amended by striking out "(as defined in section 401(d)(1))" and inserting in lieu thereof "(as defined in subsection (n))".

(3) LIMITATION ON ROLLOVERS TO APPLY ONLY TO KEY EMPLOYEES.—Clause (ii) of section 402(a)(5)(E) (relating to self-employed individuals and owner-employees) is amended to read as follows:

"(ii) KEY EMPLOYEES.—An eligible retirement plan described in subclause (IV) or (V) of subparagraph (D)(iv) shall not be treated as an eligible retirement plan for the transfer of a distribution if any part of the distribution is attributable to contributions made on behalf of the employee while he was a key employee in a top-heavy plan. For purposes of the preceding sentence, the terms 'key employee' and 'top-heavy plan' have the same respective meanings as when used in section 416."

(d) AMENDMENTS RELATED TO SECTION 238.—

(1) REPEAL OF SECTION 72(m)(9).—Paragraph (9) of section 72(m) (relating to return of excess contributions before due date of return) is hereby repealed.

(2) INCREASE IN AMOUNT OF DEDUCTION FOR SIMPLIFIED EMPLOYEE PENSIONS.—Clause (ii) of section 219(b)(2)(A) (relating to special rules for employer contributions under simplified employee pensions) is amended by striking out "but not in excess of $15,000" and inserting in lieu thereof "but not in excess of the limitation in effect under section 415(c)(1)(A)".

(3) REPEAL OF SECTION 401(e).—Subsection (e) of section 401 (relating to contributions for premiums on annuity, etc., contracts) is hereby repealed.

(4) REPEAL OF SECTION 404(a)(9).—

(A) Subsection (a) of section 404 is amended by striking out paragraph (9) and by redesignating paragraph (10) as paragraph (9).

(B) Subparagraph (C) of section 415(c)(6) is amended—

(i) by striking out "paragraph (10) of section 404(a)" and inserting in lieu thereof "paragraph (9) of section 404(a)",

(ii) by striking out "section 404(a)(10)(A)" and inserting in lieu thereof "section 404(a)(9)(A)", and

(iii) by striking out "section 404(a)(10)(B)" and inserting in lieu thereof "section 404(a)(9)(B)".

(5) Repeal of section 404(h)(4).—Paragraph (4) of section 404(h) (relating to effect on self-employed individuals or shareholder employees) is hereby repealed.

(6) Determination of earned income of self-employed for purposes of section 404(a)(8)(D).—Subparagraph (D) of section 404(a)(8) is amended by striking out "the earned income of such individual" and inserting in lieu thereof "the earned income of such individual (determined without regard to the deductions allowed by this section and section 405(c))".

(7) Repeal of section 415(c)(7).—

(A) Subsection (c) of section 415 is amended by striking out paragraph (7) and by redesignating paragraph (8) as paragraph (7).

(B) Subclause (II) of section 415(e)(3)(B)(ii) is amended by striking out "subsection (c)(7) or (8)" and inserting in lieu thereof "subsection (c)(7)".

(8) Coordination of repeals of certain sections.—Sections 404(e) and 1379(b) of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of the Tax Equity and Fiscal Responsibility Act of 1982) shall not apply to any plan to which section 401(j) of such Code applies (or would apply but for its repeal).

(9) Amendment of section 404(e).—Subsection (e) of section 404 is amended by striking out "under this section" and inserting in lieu thereof "under paragraph (1), (2), or (3) of subsection (a)".

(e) Amendment Related to Section 239.—Subparagraph (B) of section 101(b)(3) (relating to treatment of self-employed individuals for exclusion of employees' death benefits) is amended to read as follows:

"(B) Special rule for certain distributions.—In the case of any amount paid or distributed—

"(i) by a trust described in section 401(a) which is exempt from tax under section 501(a), or

"(ii) under a plan described in section 403(a),

the term 'employee' includes a self-employed individual described in section 401(c)(1)."

(f) Amendments Related to Section 240.—

(1) Definition of key employee.—

(A) Subparagraph (A) of section 416(i)(1) (defining key employee) is amended by striking out "any participant in an employer plan" and inserting in lieu thereof "an employee".

(B) Clause (ii) of section 416(i)(1)(A) is amended to read as follows:

"(ii) 1 of the 10 employees having annual compensation from the employer of more than the limitation in effect under section 415(c)(1)(A) and owning (or considered as owning within the meaning of section 318) the largest interests in the employer,".

(C) Subparagraph (A) of section 416(i)(1) (defining key employee) is amended by adding at the end thereof the following new sentence: "For purposes of clause (ii), if 2 employees have the same interest in the employer, the employee

having greater annual compensation from the employer shall be treated as having a larger interest."

(D) Subparagraph (C) of section 416(i)(1) is amended by striking out "DETERMINING 5-PERCENT OR 1-PERCENT OWNERS" in the subparagraph heading and inserting in lieu thereof "DETERMINING OWNERSHIP IN THE EMPLOYER".

(2) TREATMENT OF SIMPLIFIED EMPLOYEE PENSIONS.—Paragraph (1) of section 408(k) (defining simplified employee pension) is amended to read as follows:

"(1) IN GENERAL.—For purposes of this title, the term 'simplified employee pension' means an individual retirement account or individual retirement annuity—

"(A) with respect to which the requirements of paragraphs (2), (3), (4), and (5) of this subsection are met, and

"(B) if such account or annuity is part of a top-heavy plan (as defined in section 416), with respect to which the requirements of section 416(c)(2) are met."

(3) CLARIFICATION OF TRANSITIONAL RULE.—Paragraph (3) of section 235(g) of the Tax Equity and Fiscal Responsibility Act of 1982 is amended by adding at the end thereof the following new sentence: "A similar rule shall apply with respect to the last plan year beginning before January 1, 1984, for purposes of applying section 416(h) of the Internal Revenue Code of 1954."

(4) TREATMENT OF DISTRIBUTIONS FROM TERMINATED PLANS.—Paragraph (3) of section 416(g) (relating to distributions during last 5 years taken into account) is amended by adding at the end thereof the following new sentence: "The preceding sentence shall also apply to distributions under a terminated plan which if it had not been terminated would have been required to be included in an aggregation group."

(5) CLARIFICATION OF COST-OF-LIVING ADJUSTMENTS.—

(A) IN GENERAL.—Paragraph (2) of section 416(d) (relating to cost-of-living adjustments) is amended by striking out "in the same manner" and inserting in lieu thereof "at the same time and in the same manner".

(B) SIMPLIFIED EMPLOYEE PENSIONS.—Subparagraph (C) of section 408(k)(3) (relating to contributions must bear uniform relationship to total compensation) is amended by adding at the end thereof the following new sentence: "The Secretary shall annually adjust the $200,000 amount contained in the preceding sentence at the same time and in the same manner as he adjusts the dollar amount contained in section 415(c)(1)(A)."

(6) CLERICAL AMENDMENTS.—

(A) Subsection (f) of section 416 is amended by striking out "require" and inserting in lieu thereof "required".

(B) Clause (iii) of section 416(i)(1)(B) is amended by striking out "subparagraph (A)(ii)(II)" and inserting in lieu thereof "subparagraph (A)(ii)".

(g) AMENDMENTS RELATED TO SECTION 243.—

(1) EFFECTIVE DATE FOR PROVISIONS RELATED TO INHERITED INDIVIDUAL RETIREMENT PLANS.—Subsection (c) of section 243 of the Tax Equity and Fiscal Responsibility Act of 1982 is amended to read as follows:

"(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to individuals dying after December 31, 1983."

(2) CLERICAL AMENDMENT.—The subparagraph (C) of section 408(d)(3) which was added by section 335(a)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 is redesignated as subparagraph (D).

(h) AMENDMENT RELATED TO SECTION 247.—Subsection (a) of section 247 of the Tax Equity and Fiscal Responsibility Act of 1982 (relating to existing personal service corporations may liquidate under section 333 during 1983 and 1984) is amended by inserting "which is in existence on September 3, 1982," after "section 535(c)(2)(B) of the Internal Revenue Code of 1954)".

(i) AMENDMENT RELATED TO SECTION 248.—Paragraph (2) of section 414(n) (defining leased employee) is amended by striking out "any person" in the material preceding subparagraph (A) and inserting in lieu thereof "any person who is not an employee of the recipient and".

(j) AMENDMENT RELATED TO SECTION 249.—Subparagraph (D) of section 408(k)(3) (relating to treatment of certain contributions and taxes) is amended by striking out the second and third sentences and inserting in lieu thereof the following: "If the employer does not maintain an integrated plan at any time during the taxable year, OASDI contributions (as defined in section 401(l)(2)) may, for purposes of this paragraph, be taken into account as contributions by the employer to the employee's simplified employee pension, but only if such contributions are so taken into account with respect to each employee maintaining a simplified employee pension."

(k) AMENDMENTS RELATED TO SECTION 253.—

(1) LIMITATION OF PROFIT-SHARING AND STOCK BONUS PLANS.—Subparagraph (C) of section 415(c)(3) is amended by striking out "In the case of a participant" and inserting in lieu thereof "In the case of a participant in a profit-sharing or stock bonus plan".

(2) CLARIFICATION OF RULE THAT CONTRIBUTIONS BE NONFORFEITABLE.—Subparagraph (C) of section 415(c)(3) (relating to special rules for permanent and total disability) is amended by striking out the last sentence and inserting in lieu thereof the following: "This subparagraph shall apply only if contributions made with respect to amounts treated as compensation under this subparagraph are nonforfeitable when made."

SEC. 714. MISCELLANEOUS PROVISIONS.

(a) AMENDMENT RELATED TO SECTION 255.—Subsection (c) of section 811 (relating to special rule for dividends to policyholders under reinsurance contracts) is amended by striking out "conventional coinsurance contract" and inserting in lieu thereof "reinsurance contract".

(b) AMENDMENT RELATED TO SECTION 281A.—Paragraph (2) of section 281A(b) of the Tax Equity and Fiscal Responsibility Act of 1982 is amended by striking out "subsection (a)" and inserting in lieu thereof "paragraph (1)".

(c) AMENDMENT RELATED TO SECTION 292.—Paragraph (2) of section 7430(a) (relating to awarding of court costs and certain fees) is

amended by striking out "including the Tax Court" and inserting in lieu thereof "including the Tax Court and the United States Claims Court".

(d) AMENDMENT RELATED TO SECTION 309.—Paragraph (2) of section 6042(b) (relating to exceptions from dividend reporting requirements) is amended to read as follows:

"(2) EXCEPTIONS.—For purposes of this section, the term 'dividend' does not include any distribution or payment—

"(A) to the extent provided in regulations prescribed by the Secretary—

"(i) by a foreign corporation, or

"(ii) to a foreign corporation, a nonresident alien, or a partnership not engaged in a trade or business in the United States and composed in whole or in part of nonresident aliens, or

"(B) except to the extent otherwise provided in regulations prescribed by the Secretary, to any person described in section 6049(b)(4)."

(e) AMENDMENTS RELATED TO SECTION 311.—

(1) IN GENERAL.—Section 6045(c) (relating to returns of brokers) is amended by adding at the end thereof the following new paragraph:

"(4) PERSON.—The term 'person' includes any governmental unit and any agency or instrumentality thereof."

(2) NO PENALTY FOR PAYMENTS BEFORE JANUARY 1, 1985.—No penalty shall be imposed under the Internal Revenue Code of 1954 with respect to any person required (by reason of the amendment made by paragraph (1)) to file a return under section 6045 of such Code with respect to any payment before January 1, 1985.

(f) AMENDMENT RELATED TO SECTION 314.—Subparagraph (E) of section 6678(a)(3) is amended by striking out "section 6053(c)" and inserting in lieu thereof "section 6053".

(g) AMENDMENTS RELATED TO SECTION 320.—

(1) PERMITTING THE JOINDER OF REFUND AND INJUNCTIVE ACTIONS WITH RESPECT TO CERTAIN PENALTIES.—Section 7422 (relating to civil actions for refund) is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) SPECIAL RULE FOR ACTIONS WITH RESPECT TO TAX SHELTER PROMOTER AND UNDERSTATEMENT PENALTIES.—No action or proceeding may be brought in the United States Claims Court for any refund or credit of a penalty imposed by section 6700 (relating to penalty for promoting abusive tax shelters, etc.) or section 6701 (relating to penalties for aiding and abetting understatement of tax liability)."

(2) AMENDMENT TO TITLE 28.—Chapter 91 of title 28, United States Code, is amended by adding at the end thereof the following new section:

"§ 1509. No jurisdiction in cases involving refunds of tax shelter promoter and understatement penalties

"The United States Claims Court shall not have jurisdiction to hear any action or proceeding for any refund or credit of any penal-

ty imposed under section 6700 of the Internal Revenue Code of 1954 (relating to penalty for promoting abusive tax shelters, etc.) or section 6701 of such Code (relating to penalties for aiding and abetting understatement of tax liability).''

(3) CONFORMING AMENDMENT.—The table of sections for chapter 91 of title 28, United States Code, is amended by adding at the end thereof the following new item:

''1509. No jurisdiction in cases involving refunds of tax shelter promoter and understatement penalties.''

(4) EFFECTIVE DATE.—The amendments made by this subsection shall apply to any claim for refund or credit filed after the date of the enactment of this Act.

(h) AMENDMENTS RELATED TO SECTION 323.—

(1) Subsection (b) of section 5684 is amended—

(A) by striking out ''SECTION 6660'' in the heading and inserting in lieu thereof ''SECTION 6662'', and

(B) by striking out ''section 6660(a)'' in the text and inserting in lieu thereof ''section 6662(a)''.

(2) Subsection (c) of section 5761 is amended—

(A) by striking out ''SECTION 6660'' in the heading and inserting in lieu thereof ''SECTION 6662'', and

(B) by striking out ''section 6660(a)'' in the text and inserting in lieu thereof ''section 6662(a)''.

(3) Clause (ii) of section 6661(b)(2)(A) (defining understatement) is amended by inserting '', reduced by any rebate (within the meaning of section 6211(b)(2))'' after ''return''.

(i) AMENDMENT RELATED TO SECTION 333.—Section 7609(c)(1) (relating to summons to which section applies) is amended by striking out ''section 7602'' and inserting in lieu thereof ''section 7602(a)''.

(j) AMENDMENTS RELATED TO SECTION 334.—

(1) CLARIFICATION THAT DEATH BENEFIT EXCLUSION APPLIES TO DISTRIBUTIONS UNDER SECTION 403(b).—Subparagraph (C) of section 3405(b)(2) (relating to special rule for distributions by reason of death) is amended to read as follows:

''(C) SPECIAL RULE FOR DISTRIBUTIONS BY REASON OF DEATH.—In the case of any nonperiodic distribution from or under any plan or contract described in section 401(a), 403(a), or 403(b)—

''(i) which is made by reason of a participant's death, and

''(ii) with respect to which the requirements of clauses (ii) and (iv) of subsection (d)(4)(A) are met,

subparagraph (A) or (B) (as the case may be) shall be applied by taking into account the exclusion from gross income provided by section 101(b) (whether or not allowable).''

(2) CLARIFICATION OF CREDIT FOR WITHHELD AMOUNTS.—Paragraph (1) of section 31(a) is amended by striking out ''under section 3402 as tax on the wages of any individual'' and inserting in lieu thereof ''as tax under chapter 24''.

(3) PENALTY FOR FAILURE TO GIVE NOTICE.—Section 6652 (relating to penalty for failure to file certain information returns, registration statements, etc.) is amended by redesignating sub-

section (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) FAILURE TO GIVE NOTICE TO RECIPIENTS OF CERTAIN PENSION, ETC., DISTRIBUTIONS.—In the case of each failure to provide notice as required by section 3405(d)(10)(B), at the time prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid, on notice and demand of the Secretary and in the same manner as tax, by the person failing to provide such notice, an amount equal to $10 for each such failure, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $5,000."

(4) EXCEPTION FOR AMOUNTS PAID TO NONRESIDENT ALIENS.—Subparagraph (B) of section 3405(d)(1) (relating to exceptions) is amended by striking out "and" at the end of clause (i), by striking out the period at the end of clause (ii) and inserting in lieu thereof ", and", and by adding at the end thereof the following new clause:

"(iii) any amount which is subject to withholding under subchapter A of chapter 3 (relating to withholding of tax on nonresident aliens and foreign corporations) by the person paying such amount or which would be so subject but for a tax treaty."

(5) CLARIFICATION OF AMOUNT WITHHELD WHERE EMPLOYER SECURITY DISTRIBUTED.—Paragraph (8) of section 3405(d) (relating to maximum amount withheld) is amended by adding at the end thereof the following new sentence: "No amount shall be required to be withheld under this section in the case of any designated distribution which consists only of employer securities of the employer corporation (within the meaning of section 402(a)(3)) and cash (not in excess of $200) in lieu of fractional shares."

(k) AMENDMENT RELATED TO SECTION 337.—Subsection (d) of section 982 (relating to admissibility of documentation maintained in foreign countries) is amended by striking out paragraph (3) and by redesignating paragraph (4) as paragraph (3).

(l) AMENDMENT RELATED TO SECTION 339.—Paragraph (1) of section 6038A(c) (defining control) is amended by striking out "section 6038(d)(1)" and inserting in lieu thereof "section 6038(e)(1)".

(m) AMENDMENT RELATED TO SECTION 345.—Subsection (b) of section 345 of the Tax Equity and Fiscal Responsibility Act of 1982 (relating to effective date) is amended by striking out "taking effect on" and inserting in lieu thereof "taking effect on or after".

(n) AMENDMENTS RELATED TO SECTION 346.—

(1) CLERICAL AMENDMENT.—Subparagraph (B) of section 346(c)(2) of the Tax Equity and Fiscal Responsibility Act of 1982 is amended to read as follows:

"(B) Subparagraph (A) of section 6601(d)(2) is amended by striking out 'the last day of' each place it appears and inserting in lieu thereof 'the filing date for'."

(2) INTEREST ON REFUNDS CAUSED BY CARRYBACKS.—

(A) Paragraph (3) of section 6611(f) (relating to refund of tax caused by carryback, etc.) is amended by adding at the end thereof the following new subparagraph:

"(C) APPLICATION OF SUBPARAGRAPH (B) WHERE SECTION 6411(a) CLAIM FILED.—For purposes of subparagraph (B)(i)(II), if a taxpayer—

"(i) files a claim for refund of any overpayment described in paragraph (1) or (2) with respect to the taxable year to which a loss or credit is carried back, and

"(ii) subsequently files an application under section 6411(a) with respect to such overpayment,

then the claim for overpayment shall be treated as having been filed on the date the application under section 6411(a) was filed."

(B) The last sentence of section 6411(a) is amended by striking out "An" and inserting in lieu thereof "Except for purposes of applying section 6611(f)(3)(B), an".

(o) AMENDMENT RELATED TO SECTION 349.—Subsection (b) of section 6331 is amended by striking out "subsection (d)(3)" and inserting in lieu thereof "subsection (e)".

(p) AMENDMENTS RELATED TO TITLE IV.—

(1) EXTENSION OF PARTNERSHIP AUDIT PROVISIONS TO ENTITIES FILING PARTNERSHIP RETURNS, ETC.—Subchapter C of chapter 63 (relating to tax treatment of partnership items) is amended by adding at the end thereof the following new section:

"SEC. 6233. EXTENSION TO ENTITIES FILING PARTNERSHIP RETURNS, ETC.

"(a) GENERAL RULE.—If a partnership return is filed by an entity for a taxable year but it is determined that the entity is not a partnership for such year, then, to the extent provided in regulations, the provisions of this subchapter are hereby extended in respect of such year to such entity and its items and to persons holding an interest in such entity.

"(b) SIMILAR RULES IN CERTAIN CASES.—If for any taxable year—

"(1) an entity files a return as an S corporation but it is determined that the entity was not an S corporation for such year, or

"(2) a partnership return or S corporation return is filed but it is determined that there is no entity for such taxable year,

then, to the extent provided in regulations, rules similar to the rules of subsection (a) shall apply."

(2) TECHNICAL AND CLERICAL AMENDMENTS.—

(A) Subparagraph (B) of section 6230(c)(1) is amended by striking out "(or erroneously computed the amount of any such credit or refund)".

(B) Paragraph (9) of section 6231(a) is amended by striking out "electing small business corporation" and inserting in lieu thereof "S corporation".

(C) Subparagraph (A) of section 6231(d)(1) is amended to read as follows:

"(A) in the case of a partner whose entire interest in the partnership is disposed of during such partnership taxable year, as of the moment immediately before such disposition, or".

(D) Subsection (f) of section 6231 is amended by striking out "such deduction or credit" and inserting in lieu thereof "such loss or credit".

(E) The table of sections for subpart C of chapter 63 is amended by adding at the end thereof the following new item:

"Sec. 6233. Extension to entities filing partnership returns, etc."

(F) Paragraph (3) of section 6603(q) is amended to read as follows:

"(3) CROSS REFERENCE.—

"For extension of period for windfall profit tax items of partnerships, see section 6229 as made applicable by section 6232."

(G) Paragraph (3) of section 6613(h) is amended to read as follows:

"(3) CROSS REFERENCE.—

"For period of limitation for windfall profit tax items of partnerships, see section 6227(a) and subsections (c) and (d) of section 6230 as made applicable by section 6232."

(H) Subsection (h) of section 7422 is amended by striking out "section 6131(a)(3)" and inserting in lieu thereof "section 6231(a)(3)".

(I) Subparagraph (B) of section 6231(b)(2) (relating to items cease to be partnership items in certain cases) is amended by striking out "section 6227(b)" and inserting in lieu thereof "section 6227(c)".

(q) ESTATES AND TRUSTS AND S CORPORATIONS REQUIRED TO PROVIDE INFORMATION TO CERTAIN BENEFICIARIES AND SHAREHOLDERS.—

(1) ESTATES AND TRUSTS.—Subpart A of part III of subchapter A of chapter 61 (relating to information concerning persons subject to special provisions) is amended by adding after section 6034 the following new section:

"SEC. 6034A. INFORMATION TO BENEFICIARIES OF ESTATES AND TRUSTS.

"The fiduciary of any estate or trust making the return required to be filed under section 6012(a) for any taxable year shall, on or before the date on which such return was filed, furnish to each beneficiary—

"(1) who receives a distribution from such estate or trust with respect to such taxable year, or

"(2) to whom any item with respect to such taxable year is allocated,

a statement containing such information shown on such return as the Secretary may prescribe."

(2) S CORPORATIONS.—Section 6037 (relating to return of S corporation) is amended—

(A) by striking out "Every" and inserting in lieu thereof "(a) In General.—Every", and

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

"(b) COPIES TO SHAREHOLDERS.—Each S corporation required to file a return under subsection (a) for any taxable year shall (on or before the day on which the return for such taxable year was filed) furnish to each person who is a shareholder at any time during such taxable year a copy of such information shown on such return as may be required by regulations."

(3) PENALTY FOR FAILURE TO PROVIDE INFORMATION.—Section 6678(a)(3) (relating to failure to furnish certain statements) is

amended by striking out "or" at the end of subparagraph (D), by inserting "or" at the end of subparagraph (E), and by adding after subparagraph (E) the following new subparagraph:

"(F) section 6031(b), 6034A, or 6037(b) (relating to statements furnished by certain pass-thru entities),".

(4) CONFORMING AMENDMENT.—The table of sections for subpart A of III of subchapter A of chapter 61 is amended by adding after the item relating to section 6034 the following new item:

"Sec. 6034A. Information to beneficiaries of estates and trusts."

(5) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years beginning after December 31, 1984.

SEC. 715. EFFECTIVE DATE.

Any amendment made by this subtitle shall take effect as if included in the provision of the Tax Equity and Fiscal Responsibility Act of 1982 to which such amendment relates.

Subtitle B—Amendments Related to Subchapter S Revision Act of 1982; Etc.

SEC. 721. TECHNICAL CORRECTIONS OF SUBCHAPTER S REVISION ACT OF 1982.

(a) LIMITATION ON RECOGNITION OF GAIN IN THE CASE OF CERTAIN DISTRIBUTIONS.—

(1) Section 1363 (relating to effect of election on corporation) is amended by adding at the end thereof the following new subsection:

"(e) SUBSECTION (d) NOT TO APPLY TO COMPLETE LIQUIDATIONS AND REORGANIZATIONS.—Subsection (d) shall not apply to any distribution—

"(1) of property in complete liquidation of the corporation, or

"(2) to the extent it consists of property permitted by section 354, 355, or 356 to be received without the recognition of gain."

(2) Subsection (d) of section 1363 is amended by striking out "If" and inserting in lieu thereof "Except as provided in subsection (e), if".

(b) COORDINATION WITH RULES RELATING TO INCOME FROM DISCHARGE OF INDEBTEDNESS.—

(1) Paragraph (2) of section 1363(c) (relating to elections of the S corporation) is amended by striking out subparagraph (A) and by redesignating subparagraphs (B), (C), and (D) as subparagraphs (A), (B), and (C), respectively.

(2) Subsection (d) of section 108 (relating to income from discharge of indebtedness) is amended by redesignating paragraphs (7), (8), and (9) as paragraphs (8), (9), and (10), respectively, by striking out paragraph (6), and by inserting after paragraph (5) the following new paragraphs:

"(6) SUBSECTIONS (a), (b), AND (c) TO BE APPLIED AT PARTNER LEVEL.—In the case of a partnership, subsections (a), (b), and (c) shall be applied at the partner level.

"(7) SPECIAL RULES FOR S CORPORATION.—

"(A) SUBSECTIONS (a), (b), AND (c) TO BE APPLIED AT CORPORATE LEVEL.—In the case of an S corporation, subsections (a), (b), and (c) shall be applied at the corporate level.

"(B) REDUCTION IN CARRYOVER OF DISALLOWED LOSSES AND DEDUCTIONS.—In the case of an S corporation, for purposes of subparagraph (A) of subsection (b)(2), any loss or deduction which is disallowed for the taxable year of the discharge under section 1366(d)(1) shall be treated as a net operating loss for such taxable year. The preceding sentence shall not apply to any discharge to the extent that subsection (a)(1)(C) applies to such discharge.

"(C) COORDINATION WITH BASIS ADJUSTMENTS UNDER SECTION 1367(b)(2).—For purposes of subsection (e)(6), a shareholder's adjusted basis in indebtedness of an S corporation shall be determined without regard to any adjustments made under section 1367(b)(2)."

(c) TREATMENT OF INACTIVE SUBSIDIARIES.—Paragraph (6) of section 1361(c) (relating to ownership of stock in certain inactive corporations) is amended to read as follows:

"(6) OWNERSHIP OF STOCK IN CERTAIN INACTIVE CORPORATIONS.—For purposes of subsection (b)(2)(A), a corporation shall not be treated as a member of an affiliated group during any period within a taxable year by reason of the ownership of stock in another corporation if such other corporation—

"(A) has not begun business at any time on or before the close of such period, and

"(B) does not have gross income for such period."

(d) TREATMENT OF WORTHLESS DEBT.—Paragraph (3) of section 1367(b) (relating to coordination with section 165(g)) is amended to read as follows:

"(3) COORDINATION WITH SECTIONS 165(g) AND 166(d).—This section and section 1366 shall be applied before the application of sections 165(g) and 166(d) to any taxable year of the shareholder or the corporation in which the security or debt becomes worthless."

(e) ADJUSTMENT TO EARNINGS AND PROFITS FOR RECAPTURE UNDER SECTION 47.—

(1) Subsection (d) of section 1371 (relating to coordination with investment credit recapture) is amended by adding at the end thereof the following new paragraph:

"(3) ADJUSTMENT TO EARNINGS AND PROFITS FOR AMOUNT OF RECAPTURE.—Paragraph (1) of subsection (c) shall not apply to any increase in tax under section 47 for which the S corporation is liable."

(2) Paragraph (1) of section 1371(c) is amended by striking out "paragraphs (2) and (3)" and inserting in lieu thereof "paragraphs (2) and (3) and subsection (d)(3)".

(f) QUALIFIED SUBCHAPTER S TRUSTS.—

(1) GRACE PERIOD.—Subparagraph (D) of section 1361(d)(2) (relating to grade period) is amended by striking out "60 days" and inserting in lieu thereof "15 days and 2 months".

(2) DEFINITION OF QUALIFIED SUBCHAPTER S TRUST.—Subsection (d) of section 1361 (relating to special rule for qualified

subchapter S trust) is amended by striking out paragraphs (3) and (4) and inserting in lieu thereof the following:

"(3) QUALIFIED SUBCHAPTER S TRUST.—For purposes of this subsection, the term 'qualified subchapter S trust' means a trust—

"(A) the terms of which require that—

"(i) during the life of the current income beneficiary, there shall be only 1 income beneficiary of the trust,

"(ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary,

"(iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust, and

"(iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary, and

"(B) all of the income (within the meaning of section 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

"(4) TRUST CEASING TO BE QUALIFIED.—

"(A) FAILURE TO MEET REQUIREMENTS OF PARAGRAPH (3)(A).—If a qualified subchapter S trust ceases to meet any requirement of paragraph (3)(A), the provisions of this subsection shall not apply to such trust as of the date it ceases to meet such requirement.

"(B) FAILURE TO MEET REQUIREMENTS OF PARAGRAPH (3)(B).—If any qualified subchapter S trust ceases to meet any requirement of paragraph (3)(B) but continues to meet the requirements of paragraph (3)(A), the provisions of this subsection shall not apply to such trust as of the first day of the first taxable year beginning after the first taxable year for which it failed to meet the requirements of paragraph (3)(B)."

(3) TECHNICAL AMENDMENT.—Clause (i) of section 1361(d)(2)(B) (relating to separate election with respect to each S corporation) is amended by striking out "S corporation" each place it appears and inserting in lieu thereof "corporation".

(g) COORDINATION WITH SECTION 338.—

(1) Paragraph (6) of section 1362(e) (relating to treatment of S termination year) is amended by adding at the end thereof the following new subparagraph:

"(C) PARAGRAPH (2) NOT TO APPLY TO ITEMS RESULTING FROM SECTION 338.—Paragraph (2) shall not apply with respect to any item resulting from the application of section 338."

(2) Paragraph (2) of section 1362(e) is amended by striking out "as provided in paragraph (3)" and inserting in lieu thereof "as provided in paragraphs (3) and (6)(C)".

(h) ELECTION TO HAVE ITEMS ASSIGNED TO SHORT TAXABLE YEAR UNDER NORMAL ACCOUNTING RULES.—Subparagraph (B) of section 1362(e)(3) (relating to election to have items assigned to each short

taxable year under normal accounting rules) is amended to read as follows:

"(B) SHAREHOLDERS MUST CONSENT TO ELECTION.—An election under this subsection shall be valid only if all persons who are shareholders in the corporation at any time during the S short year and all persons who are shareholders in the corporation on the first day of the C short year consent to such election."

(i) ELECTION TO HAVE NEW PASSIVE INCOME RULES NOT APPLY DURING 1982.—Paragraph (3) of section 6(b) of the Subchapter S Revision Act of 1982 (relating to new passive income rules apply to taxable years beginning during 1982) is amended by adding at the end thereof the following new sentences: "The preceding sentence shall not apply in the case of any corporation which elects (at such time and in such manner as the Secretary of the Treasury or his delegate shall prescribe) to have such sentence not apply. Subsection (e) shall not apply to any termination resulting from an election under the preceding sentence."

(j) S CORPORATION TREATED AS PARTNERSHIP FOR PURPOSES OF SECTION 318.—Paragraph (5) of section 318(a) (relating to constructive ownership of stock) is amended by adding at the end thereof the following new subparagraphs:

"(E) S CORPORATION TREATED AS PARTNERSHIP.—For purposes of this subsection—

"(i) an S corporation shall be treated as a partnership, and

"(ii) any shareholder of the S corporation shall be treated as a partner of such partnership.

The preceding sentence shall not apply for purposes of determining whether stock in the S corporation is constructively owned by any person."

(k) CLARIFICATION OF TREATMENT OF CERTAIN ELECTIONS UNDER PRIOR LAW.—Subsection (e) of section 6 of the Subchapter S Revision Act of 1982 (relating to treatment of certain elections under prior law) is amended by striking out "any termination" and inserting in lieu thereof "any termination or revocation".

(l) ELECTION FOR CERTAIN SHORT TAXABLE YEARS.—

(1) Subsection (b) of section 1362 (relating to when subchapter S election made) is amended by adding at the end thereof the following new paragraph:

"(4) TAXABLE YEARS OF 2½ MONTHS OR LESS.—For purposes of this subsection, an election for a taxable year made not later than 2 months and 15 days after the first day of the taxable year shall be treated as timely made during such year."

(2) Paragraph (3) of section 1362(b) is amended by striking out "on or before the last day of such taxable year" and inserting in lieu thereof "on or before the 15th day of the 3rd month of the following taxable year".

(m) TAXABLE YEAR OF EXISTING S CORPORATIONS.—Paragraph (1) of section 1378(c) (relating to existing S corporations required to use permitted year after 50-percent shift in ownership) is amended by striking out "which includes December 31, 1982" and inserting in lieu thereof "which includes December 31, 1982 (or which is an S

corporation for a taxable year beginning during 1983 by reason of an election made on or before October 19, 1982)".

(n) REFERENCES TO PRIOR LAW.—Subsection (b) of section 1379 (relating to references to prior law included) is amended to read as follows:

"(b) REFERENCES TO PRIOR LAW INCLUDED.—Any references in this title to a provision of this subchapter shall, to the extent not inconsistent with the purposes of this subchapter, include a reference to the corresponding provision as in effect before the enactment of the Subchapter S Revision Act of 1982."

(o) ELECTION TO TREAT DISTRIBUTIONS AS DIVIDENDS DURING CERTAIN POST-TERMINATION TRANSITION PERIODS.—Subsection (e) of section 1371 (relating to coordination with subchapter C) is amended to read as follows:

"(e) CASH DISTRIBUTIONS DURING POST-TERMINATION TRANSITION PERIOD.—

"(1) IN GENERAL.—Any distribution of money by a corporation with respect to its stock during a post-termination transition period shall be applied against and reduce the adjusted basis of the stock, to the extent that the amount of the distribution does not exceed the accumulated adjustments account.

"(2) ELECTION TO DISTRIBUTE EARNINGS FIRST.—An S corporation may elect to have paragraph (1) not apply to all distributions made during a post-termination transition period described in section 1377(b)(1)(A). Such election shall not be effective unless all shareholders of the S corporation to whom distributions are made by the S corporation during such post-termination transition period consent to such election."

(p) CORPORATE PREFERENCE RULES APPLIED TO S CORPORATIONS WHICH WERE RECENT C CORPORATIONS.—Subsection (b) of section 1363 (relating to computation of corporation's taxable income) is amended by striking out "and" at the end of paragraph (2), by striking out the period at the end of paragraph (3) and inserting in lieu thereof ", and", and by adding at the end thereof the following new paragraph:

"(4) section 291 shall apply if the S corporation (or any predecessor) was a C corporation for any of the 3 immediately preceding taxable years."

(q) TREATMENT OF STOCK HELD BY ESTATE OF QUALIFIED TRANSFEROR.—Clause (i) of section 1378(c)(3)(B) (relating to existing S corporations required to use permitted year after 50-percent shift in ownership) is amended by striking out "who held" and inserting in lieu thereof "who (or whose estate) held".

(r) AMENDMENTS RELATED TO ACCUMULATED ADJUSTMENTS ACCOUNT.—

(1) Subparagraph (A) of section 1368(e)(1) (defining accumulated adjustments account) is amended by striking out "(except that" and all that follows through the end thereof and inserting in lieu thereof the following: "(except that no adjustment shall be made for income (and related expenses) which is exempt from tax under this title and the phrase '(but not below zero)' shall be disregarded in section 1367(b)(2)(A))".

(2) Subsection (c) of section 1368 (relating to S corporation having earning and profits) is amended by adding at the end

thereof the following new sentence: "Except to the extent provided in regulations, if the distributions during the taxable year exceed the amount in the accumulated adjustments account at the close of the taxable year, for purposes of this subsection, the balance of such account shall be allocated among such distributions in proportion to their respective sizes."

(s) SPECIAL RULES FOR CERTAIN EXPENSES OF S CORPORATIONS.—Paragraph (1) of section 267(f) (as in effect on the day before the date of the enactment of this Act) is amended by striking out all that follows subparagraph (B) and inserting in lieu thereof the following: "then any deduction allowable under such sections in respect of such amount shall be allowable as of the day as of which such amount is includible in the gross income of the person to whom the payment is made (or, if later, as of the day on which it would be so allowable but for this paragraph)."

(t) PRO RATA ALLOCATION FOR S TERMINATION YEAR NOT TO APPLY IF 50-PERCENT CHANGE IN OWNERSHIP.—Paragraph (6) of section 1362(e) (relating to special rules) is amended by adding at the end thereof the following new subparagraph:

"(D) PRO RATA ALLOCATION FOR S TERMINATION YEAR NOT TO APPLY IF 50-PERCENT CHANGE IN OWNERSHIP.—Paragraph (2) shall not apply to an S termination year if there is a sale or exchange of 50 percent or more of the stock in such corporation during such year."

(u) TREATMENT OF PREDECESSOR CORPORATION UNDER SECTION 1374.—Paragraph (2) of section 1374(c) (relating to exception for new corporations) is amended—

(1) by striking out "(and any predecessor corporation)" in subparagraph (A), and

(2) by adding at the end thereof the following new sentence: "To the extent provided in regulations, an S corporation and any predecessor corporation shall be treated as 1 corporation for purposes of this paragraph and paragraph (1)."

(v) AUTHORITY TO WAIVE TAX ON PASSIVE INVESTMENT INCOME.—Section 1375 (relating to tax imposed when passive investment income of corporation having subchapter C earnings and profits exceeds 25 percent of gross receipts) is amended by adding at the end thereof the following new subsection:

"(d) WAIVER OF TAX IN CERTAIN CASES.—If the S corporation establishes to the satisfaction of the Secretary that—

"(1) it determined in good faith that it had no subchapter C earnings and profits at the close of a taxable year, and

"(2) during a reasonable period of time after it was determined that it did have subchapter C earnings and profits at the close of such taxable year such earnings and profits were distributed,

the Secretary may waive the tax imposed by subsection (a) for such taxable year."

(w) APPLICATION OF DEBT RESTORATION RULES.—Subparagraph (B) of section 1367(b)(2) (relating to adjustments in basis of indebtedness) is amended by striking out "for any taxable year there is" and inserting in lieu thereof "for any taxable year beginning after December 31, 1982, there is".

(x) CLERICAL AMENDMENTS.—

(1) Clause (i) of section 48(k)(5)(D) is amended by striking out "electing small business corporation" and inserting in lieu thereof "S corporation".

(2) Subparagraph (B) of section 465(a)(1) (relating to limitation to amount at risk) is amended by striking out "a corporation" and inserting in lieu thereof "a C corporation".

(3) Subsection (e) of section 1371 (relating to cash distributions during post-termination transition period) is amended by inserting before the period at the end thereof the following: "(within the meaning of section 1368(e))".

(4) Paragraph (2) of section 6659(f) is amended by striking out "section 465(a)(1)(C)" and inserting in lieu thereof "section 465(a)(1)(B)".

(5) Subparagraph (C) of section 6362(d)(2) is amended by striking out "electing small business corporation (within the meaning of section 1371(a))" and inserting in lieu thereof "an S corporation".

(y) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, any amendment made by this section shall take effect as if included in the Subchapter S Revision Act of 1982.

(2) AMENDMENT MADE BY SUBSECTION (b)(2).—Subparagraph (C) of section 108(d)(7) of the Internal Revenue Code of 1954 (as amended by subsection (b)(2)) shall apply to contributions to capital after December 31, 1980, in taxable years ending after such date.

(3) AMENDMENT MADE BY SUBSECTION (g)(1).—If—

(A) any portion of a qualified stock purchase is pursuant to a binding contract entered into on or after October 19, 1982, and before the date of the enactment of this Act, and

(B) the purchasing corporation establishes by clear and convincing evidence that such contract was negotiated on the contemplation that, with respect to the deemed sale under section 338 of the Internal Revenue Code of 1954, paragraph (2) of section 1362(e) of such Code would apply,

then the amendment made by paragraph (1) of subsection (g) shall not apply to such qualified stock purchase.

(4) AMENDMENTS MADE BY SUBSECTION (l).—The amendments made by subsection (l) shall apply to any election under section 1362 of the Internal Revenue Code of 1954 (or any corresponding provision of prior law) made after October 19, 1982.

(5) AMENDMENT MADE BY SUBSECTION (t).—If—

(A) on or before the date of the enactment of this Act 50 percent or more of the stock of an S corporation has been sold or exchanged in 1 or more transactions, and

(B) the person (or persons) acquiring such stock establish by clear and convincing evidence that such acquisitions were negotiated on the contemplation that paragraph (2) of section 1362(e) of the Internal Revenue Code of 1954 would apply to the S termination year in which such sales or exchanges occur,

then the amendment made by subsection (t) shall not apply to such S termination year.

SEC. 722. MISCELLANEOUS PROVISIONS.

(a) AMENDMENTS RELATED TO TECHNICAL CORRECTIONS ACT OF 1982.—

(1) Paragraph (12) of section 57(a) (relating to accelerated cost recovery deduction) is amended—

(A) by striking out "(or, in the case of property described in section 167(k), under section 167)" in subparagraph (A), and

(B) by inserting "(or, in the case of property described in section 167(k), under section 167)" after "section 168(a)" in subparagraph (B).

(2) Subparagraph (A) of section 1256(g)(1) (defining foreign currency contract) is amended by inserting after "delivery of" the following: ", or the settlement of which depends on the value of,".

(3) Subclause (I) of section 306(a)(8)(A)(ii) of the Technical Corrections Act of 1982 is amended by striking out "the date of the enactment of the Tax Equity and Fiscal Responsibility Act of 1982" and inserting in lieu thereof "September 1, 1982".

(4)(A) Subparagraph (A) of section 172(b)(2) (relating to amount of carrybacks and carryovers) is amended by striking out "and (6)" and inserting in lieu thereof "and (5)".

(B) Subsection (d) of section 172 (relating to modifications) is amended by redesignating paragraphs (7) and (8) as paragraphs (6) and (7), respectively.

(5) Subsection (b) of section 5684 is amended by striking out "subsections (a) and (b)" and inserting in lieu thereof "subsection (a)".

(6) Any amendment made by this subsection shall take effect as if included in the provisions of the Technical Corrections Act of 1982 to which such amendment relates.

(7)(A) If—

(i) there is an overpayment of tax imposed by section 4986 of the Internal Revenue Code of 1954 for any period before January 1, 1983, by reason of section 201(h)(1)(E) of the Technical Corrections Act of 1982,

(ii) refund of such overpayment is payable to the partners of a partnership, and

(iii) such partners are obligated to pay over any such refund to 1 or more organizations referred to in such section 201(h)(1)(E),

such partnership shall be treated as authorized to act for each person who was a partner at any time in such partnership in claiming and paying over such refund.

(B) Notwithstanding section 6613 of the Internal Revenue Code of 1954, the time for filing a claim for credit or refund of the overpayment referred to in subparagraph (A)(i) shall not expire before the date 1 year after the date of the enactment of this Act.

(b) COORDINATION OF CERTAIN AMENDMENTS MADE BY HIGHWAY REVENUE ACT OF 1982 AND PUBLIC LAW 97-473.—For purposes of applying the amendments made by section 547 of the Highway Revenue Act of 1982 and the amendment made by section 202(b)(2) of

Public Law 97-473, Public Law 97-473 shall be deemed to have been enacted immediately before the Highway Revenue Act of 1982.

(c) NO DESIGNATION OF PRINCIPAL CAMPAIGN COMMITTEE REQUIRED WHERE ONLY ONE POLITICAL COMMITTEE.—Effective for taxable years beginning after December 31, 1981, subparagraph (B) of section 527(h)(2) (relating to special rule for principal campaign committees) is amended by adding at the end thereof the following new sentence: "Nothing in this subsection shall be construed to require any designation where there is only one political committee with respect to a candidate."

(d) AMOUNT OF CREDIT FOR PRODUCING FUEL FROM A NONCONVENTIONAL SOURCE IN CASE OF FISCAL YEAR TAXPAYER.—

(1) Subparagraph (A) of section 44D(b)(1) (relating to credit for producing fuel from a nonconventional source) is amended by striking out "in which the taxable year begins" and inserting in lieu thereof "in which the sale occurs".

(2) Paragraph (2) of section 44D(b) is amended by striking out "in which a taxable year begins" and inserting in lieu thereof "in which the sale occurs".

(3) The amendments made by this subsection shall apply to taxable years ending after December 31, 1979.

(e) BASIS ADJUSTMENTS IN PARTNERSHIP INTERESTS AND SUBCHAPTER S STOCK FOR PERCENTAGE DEPLETION.—

(1) PARTNERSHIP INTERESTS.—Paragraph (3) of section 705(a) (relating to determination of basis of partner's interest) is amended to read as follows:

"(3) decreased (but not below zero) by the amount of the partner's deduction for depletion for any partnership oil and gas property to the extent such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to such partner under section 613A(c)(7)(D)."

(2) SUBCHAPTER S STOCK.—Subparagraph (E) of section 1367(a)(2) (relating to adjustments to basis of stock of shareholders, etc.) is amended to read as follows:

"(E) the amount of the shareholder's deduction for depletion for any oil and gas property held by the S corporation to the extent such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to such shareholder under section 613A(c)(13)(B)."

(3) EFFECTIVE DATE.—

(A) The amendment made by paragraph (1) shall take effect on January 1, 1975.

(B) The amendment made by paragraph (2) shall apply to taxable years beginning after December 31, 1982.

(f) CLARIFICATION OF INCREASE IN BASIS FOR GAIN RECOGNIZED ON TRANSFER TO PARTNERSHIP.—

(1) IN GENERAL.—Sections 722 and 723 are each amended by striking out "gain recognized" and inserting in lieu thereof "gain recognized under section 721(b)".

(2) EFFECTIVE DATE.—The amendments made by paragraph (1) shall take effect as if included in the amendments made by section 2131 of the Tax Reform Act of 1976.

(g) AMENDMENTS RELATED TO INCOME TAXES OF CERTAIN MILITARY AND CIVILIAN EMPLOYEES OF THE UNITED STATES DYING AS A RESULT OF INJURIES SUSTAINED OVERSEAS.—

(1) EFFECTIVE DATE.—Paragraph (1) of section 1(b) of Public Law 98-259 is amended by striking out "December 31, 1979" and inserting in lieu thereof "November 17, 1978".

(2) REQUIREMENT THAT EMPLOYMENT RELATIONSHIP EXIST AT TIME OF INJURY.—Paragraph (1) of section 692 (relating to certain military and civilian employees of the United States dying as a result of injuries sustained overseas) is amended by striking out "as a result of wounds or injury incurred" and inserting in lieu thereof "as a result of wounds or injury which was incurred while the individual was a military or civilian employee of the United States and which was incurred".

(3) CLARIFICATION OF DEFINITION OF TERRORISTIC ACTIVITY AGAINST THE UNITED STATES.—Subparagraph (A) of section 692(c)(2) (defining terroristic or military action) is amended to read as follows:

"(A) any terroristic activity which a preponderance of the evidence indicates was directed against the United States or any of its allies, and".

(4) TREATMENT OF DIRECTOR GENERAL OF MULTINATIONAL FORCE IN SINAI.—For purposes of section 692(c) of the Internal Revenue Code of 1954, the Director General of the Multinational Force and Observers in the Sinai who died on February 15, 1984, shall be treated as if he were a civilian employee of the United States while he served as such Director General.

(5) EFFECTIVE DATE.—

(A) IN GENERAL.—The amendments made by this subsection shall take effect as if they were included in the amendments made by section 1 of Public Law 98-259.

(B) STATUTE OF LIMITATIONS WAIVED.—Notwithstanding section 6613 of the Internal Revenue Code of 1954, the time for filing a claim for credit or refund of any overpayment of tax resulting from the amendments made by this subsection shall not expire before the date 1 year after the date of the enactment of this Act.

(h) AMENDMENTS TO THE INTEREST AND DIVIDEND TAX COMPLIANCE ACT OF 1983.—

(1) BROKER NOTIFICATION OF PAYOR.—

(A) Subparagraph (A) of section 3406(d)(2) (relating to special rules for readily tradable instruments) is amended—

(i) by inserting "the payor was notified by a broker under subparagraph (B) or" after "if (and only if)", and

(ii) by striking out clause (i) and redesignating clauses (ii) and (iii) as clauses (i) and (ii).

(B) Subparagraph (B) of section 3406(d)(2) is amended to read as follows:

"(B) BROKER NOTIFIES PAYOR.—If—

"(i) a payee acquires any readily tradable instrument through a broker, and

"(ii) with respect to such acquisition—

"(I) the payee fails to furnish his TIN to the broker in the manner required under subsection (a)(1)(A),

"(II) the Secretary notifies such broker before such acquisition that the TIN furnished by the payee is incorrect,

"(III) the Secretary notifies such broker before such acquisition that such payee is subject to withholding under subsection (a)(1)(C), or

"(IV) the payee does not provide a certification to such broker under subparagraph (C),

such broker shall, within such period as the Secretary may prescribe by regulations (but not later than 15 days after such acquisition), notify the payor that such payee is subject to withholding under subparagraph (A), (B), (C), or (D) of subsection (a)(1), respectively."

(2) NOTIFIED PAYEE UNDERREPORTING.—Paragraph (1) of section 3406(c) (relating to notified payee underreporting) is amended by striking out "(but not the reasons therefor)" and inserting in lieu thereof "(but not the reasons for the withholding under subsection (a)(1)(C))".

(3) APPLICATION WITH TRUSTS.—Section 643 (relating to definitions applicable to trusts) is amended by adding at the end thereof the following new subsection:

"(d) COORDINATION WITH BACK-UP WITHHOLDING.—Except to the extent otherwise provided in regulations, this subchapter shall be applied with respect to payments subject to withholding under section 3406—

"(1) by allocating between the estate or trust and its beneficiaries any credit allowable under section 31(c) (on the basis of their respective shares of any such payment taken into account under this subchapter),

"(2) by treating each beneficiary to whom such credit is allocated as if an amount equal to such credit has been paid to him by the estate or trust, and

"(3) by allowing the estate or trust a deduction in an amount equal to the credit so allocated to beneficiaries."

(4) COORDINATION OF PENSION AND BACK-UP WITHHOLDING.—

(A) Section 3405(d) (relating to definitions and special rules) is amended by adding at the end thereof the following new paragraph:

"(12) FAILURE TO PROVIDE CORRECT TIN.—If—

"(A) a payee fails to furnish his TIN to the payor in the manner required by the Secretary, or

"(B) the Secretary notifies the payor before any payment or distribution that the TIN furnished by the payee is incorrect,

no election under subsection (a)(2) or (b)(3) shall be treated as in effect and subsection (a)(4) shall not apply to such payee."

(B) Section 6041(a) (relating to information at source) is amended by inserting "6047(e)," after "6044(a)(1),".

(5) EFFECTIVE DATES.—

(A) Except as provided in this paragraph, the amendments made by this subsection shall apply as if included in

the amendments made by the Interest and Dividend Tax Compliance Act of 1983.

(B) The amendments made by paragraph (4) shall apply to payments or distributions after December 31, 1984, unless the payor elects to have such amendments apply to payments or distributions before January 1, 1985.

Subtitle C—Amendments Relating to Highway Revenue Act of 1982

SEC. 731. VALUE OF USED COMPONENTS FURNISHED BY FIRST USER NOT TAKEN INTO ACCOUNT IN DETERMINING PRICE.

Subparagraph (B) of section 4052(b)(1) (relating to determination of price) is amended by striking out "and" at the end of clause (ii) and by inserting after clause (iii) the following new clause:

"(iv) the value of any component of such article if—

"(I) such component is furnished by the first user of such article, and

"(II) such component has been used before such furnishing, and".

SEC. 732. CLARIFICATION OF APPLICATION OF GASOLINE EXCISE TAX TO GASOHOL, ETC.

(a) GASOLINE EXCISE TAX TO APPLY TO GALLON OF GASOHOL.—

(1) IN GENERAL.—Paragraph (1) of section 4081(c) (relating to gasoline mixed with alcohol) is amended to read as follows:

"(1) IN GENERAL.—Under regulations prescribed by the Secretary, subsection (a) shall be applied—

"(A) by substituting '4 cents' for '9 cents' in the case of the sale of any gasohol (the gasoline in which was not taxed under subparagraph (B)), and

"(B) by substituting '4⁴⁄₉ cents' for '9 cents' in the case of the sale of any gasoline for use in producing gasohol.

For purposes of this paragraph, the term 'gasohol' means any mixture of gasoline if at least 10 percent of such mixture is alcohol."

(2) LATER SEPARATION OF GASOLINE.—Paragraph (2) of section 4081(c) is amended—

(A) by striking out "at the rate of 4 cents a gallon" and inserting in lieu thereof "at a rate equivalent to 4 cents a gallon", and

(B) by striking out "5 cents a gallon" and inserting in lieu thereof "4⁵⁄₉ cents a gallon".

(3) CREDIT OR REFUND.—Paragraph (1) of section 6427(f) (relating to gasoline used to produce certain alcohol fuels) is amended by striking out "5 cents" and inserting in lieu thereof "4⁵⁄₉ cents".

(b) LOWER FLOOR STOCKS TAX ON GASOHOL.—Subsection (a) of section 521 of the Highway Revenue Act of 1982 is amended by inserting "(4 cents a gallon in the case of a gallon of gasohol, as defined in section 4081(c))" after "5 cents a gallon".

SEC. 733. CERTAIN CHAIN OPERATORS OF RETAIL GASOLINE STATIONS TREATED AS PRODUCERS.

(a) IN GENERAL.—Subsection (d) of section 4082 (defining wholesale distributor) is amended to read as follows:

"(d) WHOLESALE DISTRIBUTOR.—As used in subsection (a), the term 'wholesale distributor' includes—

"(1) any person who—

"(A) sells gasoline to producers, retailers, or to users who purchase in bulk quantities and deliver into bulk storage tanks, or

"(B) purchases gasoline from a producer and distributes such gasoline to 10 or more retail gasoline stations under common management with such person,

"(2) but only if such person elects to register with respect to the tax imposed by section 4081.

Such term does not include any person who (excluding the term 'wholesale distributor' from subsection (a)) is a producer or importer."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the first day of the first calendar quarter beginning after the date of the enactment of this Act.

SEC. 734. OTHER TECHNICAL AMENDMENTS.

(a) FLOOR STOCKS REFUNDS FOR TIRES TAXED AT LOWER RATE AFTER JANUARY 1, 1984.—

(1) IN GENERAL.—Paragraph (1) of section 523(b) of the Highway Revenue Act of 1982 (relating to floor stocks refunds for tires) is amended by inserting "(or will be subject to a lower rate of tax under such section)" after "and which will not be subject to tax under such section".

(2) AMOUNT OF REFUND LIMITED TO REDUCTION IN TAX, ETC.—

(A) IN GENERAL.—Subsection (b) of section 523 of the Highway Revenue Act of 1982 (relating to floor stocks refunds for tires) is amended by adding at the end thereof the following new paragraph:

"(3) SPECIAL RULES FOR TIRES TAXED AT LOWER RATE AFTER JANUARY 1, 1984.—In the case of any tire which is a tax-repealed article solely by reason of the parenthetical matter in paragraph (1)—

"(A) the amount of the credit or refund under subsection (a) shall not exceed the excess of—

"(i) the tax imposed with respect to such tire by section 4071(a) as in effect on December 31, 1983, over

"(ii) the tax which would have been imposed with respect to such tire by section 4071(a) on January 1, 1984, and

"(B) paragraph (1) of section 522(a) shall be applied—

"(i) by substituting 'January 1, 1985' for 'July 1, 1983', and

"(ii) by substituting 'April 1, 1985' for 'October 1, 1983' each place it appears."

(B) CONFORMING AMENDMENT.—Paragraph (2) of section 523(b) of such Act is amended by striking out "In the case

of" and inserting in lieu thereof "Except as provided in paragraph (3), in the case of".

(b) OVERPAYMENTS OF TAX ON TRUCKS, ETC., AND TIRES.—

(1) TRUCKS, ETC.—

(A) IN GENERAL.—Subsection (b) of section 6416 (relating to special cases in which tax payments considered overpayments) is amended by inserting after paragraph (5) the following new paragraph:

"(6) TRUCK CHASSIS, BODIES, AND SEMITRAILERS USED FOR FURTHER MANUFACTURE.—If—

"(A) the tax imposed by section 4051 has been paid with respect to the sale of any article, and

"(B) before any other use, such article is by any person used as a component part of another article taxable under section 4051 manufactured or produced by him,

such tax shall be deemed to be an overpayment by such person. For purposes of the preceding sentence, an article shall be treated as having been used as a component part of another article if, had it not been broken or rendered useless in the manufacture or production of such other article, it would have been so used."

(B) TECHNICAL AMENDMENT.—Subparagraph (B) of section 6416(a)(2) is amended by striking out "or (5)" and inserting in lieu thereof "(5), or (6)".

(2) TIRES.—

(A) IN GENERAL.—Paragraph (4) of section 6416(b) (relating to tires) is amended to read as follows:

"(4) TIRES.—If—

"(A) the tax imposed by section 4071 has been paid with respect to the sale of any tire by the manufacturer, producer, or importer thereof, and

"(B) such tire is sold by any person on or in connection with, or with the sale of, any other article, such tax shall be deemed to be an overpayment by such person if such other article is—

"(i) an automobile bus chassis or an automobile bus body, or

"(ii) by such person exported, sold to a State or local government for the exclusive use of a State or local government, sold to a nonprofit educational organization for its exclusive use, or used or sold for use as supplies for vessels or aircraft."

(B) TECHNICAL AMENDMENTS.—

(i) Paragraph (2) of section 6416(b) is amended by striking out subparagraph (E).

(ii) Paragraph (3) of section 6416(b) (relating to taxpaid articles used for further manufacture, etc.) is amended by striking out subparagraph (C).

(iii) Subparagraph (C) of section 6416(a)(1) is amended by striking out ", (b)(3) (C) or (D), or (b)(4)".

(iv) Subparagraph (B) of section 6416(a)(2), as amended by paragraph (1)(B), is amended by inserting "(4)," before "(5)".

(v) Paragraph (3) of section 6416(a) is amended to read as follows:

"(3) SPECIAL RULE.—For purposes of this subsection, in any case in which the Secretary determines that an article is not taxable, the term 'ultimate purchaser' (when used in paragraph (1)(B) of this subsection) includes a wholesaler, jobber, distributor, or retailer who, on the 15th day after the date of such determination, holds such article for sale; but only if claim for credit or refund by reason of this paragraph is filed on or before the date for filing the return with respect to the taxes imposed under chapter 32 for the first period which begins more than 60 days after the date on such determination."

(c) ALLOWANCE OF TAX-FREE SALES OF GASOLINE FOR USE IN NONCOMMERCIAL AVIATION.—

(1) IN GENERAL.—Section 4082 (relating to definitions with respect to the tax on gasoline) is amended by adding at the end thereof the following new subsection:

"(e) CERTAIN SELLERS OF GASOLINE FOR USE IN NONCOMMERCIAL AVIATION TREATED AS PRODUCERS.—For purposes of this subpart, the term 'producer' includes any person who regularly sells gasoline to owners, lessees, or operators of aircraft for use as fuel in such aircraft in noncommercial aviation (as defined in section 4041(c)(4))."

(2) REFUNDS.—Section 6427 (relating to fuels not used for taxable purposes) is amended by redesignating subsections (j), (k), and (l) as subsections (k), (l), and (m), respectively, and by inserting after subsection (i) the following new subsection:

"(j) SPECIAL RULES WITH RESPECT TO NONCOMMERCIAL AVIATION.—For purposes of subsection (a), in the case of gasoline—

"(1) on which tax was imposed under section 4041(c)(2),

"(2) on which tax was not imposed under section 4081, and

"(3) which was not used as an off-highway business use (within the meaning of section 6421(d)(2)),

the amount of the payment under subsection (a) shall be an amount equal to the amount of gasoline used as described in subsection (a) or resold multiplied by the rate equal to the excess of the rate of tax imposed by section 4041(c)(2) over the rate of tax imposed by section 4081."

(3) EFFECTIVE DATE.—The amendments made by this subsection shall take effect on the first day of the first calendar quarter beginning after the date of the enactment of this Act.

(d) FLOOR STOCKS REFUNDS FOR TREAD RUBBER.—Paragraph (1) of section 523(b) of the Highway Revenue Act of 1982 (relating to floor stocks refunds for tires) is amended by adding at the end thereof the following new sentence: "Any tread rubber which was subject to tax under section 4071(a)(4) as in effect on December 31, 1983, and which on January 1, 1984, is part of a retread tire which is held by a dealer and has not been used and is intended for sale shall be treated as a tax-repealed article for purposes of subsection (a) of section 522."

(e) PENALTIES, ETC., TO APPLY TO FLOOR STOCKS TAXES.—Subsection (c) of section 521 of the Highway Revenue Act of 1982 is amended by adding at the end thereof the following: "All other provisions of law, including penalties, applicable with respect to the taxes im-

posed by section 4081 or 4071(a) (whichever is appropriate) shall apply to the floor stocks taxes imposed by this section."

(f) NO 1984 SHORT TAXABLE PERIOD FOR OWNER-OPERATORS.—Subsection (a) of section 4481 (relating to tax on use of certain vehicles), as in effect before the amendments made by the Highway Revenue Act of 1982, is amended by striking out the last sentence.

(g) CLARIFICATION OF SECONDARY LIABILITY OF INSTALLERS OF PARTS AND ACCESSORIES PURCHASED SEPARATELY.—The text of section 4051(b)(3) is amended to read as follows: "The owners of the trade or business installing the parts or accessories shall be secondarily liable for the tax imposed by paragraph (1)."

(h) NO INFERENCE FOR PAST PERIODS TO BE DRAWN FROM AMENDMENT RELATING TO CUSTOMARY USE OF TRAILERS.—The subsection heading of subsection (c) of section 513 of the Highway Revenue Act of 1982 is amended by striking out "Clarification of".

(i) WIRE TRANSFER TO FEDERAL RESERVE BANK REQUIRED WHERE EXTENSION OF PAYMENT DUE DATE FOR CERTAIN FUEL TAXES.—Subsection (a) of section 518 of the Highway Revenue Act of 1982 (relating to extension of payment due date for certain fuel taxes) is amended by striking out "any government depository authorized under section 6302 of such Code" and inserting in lieu thereof "any Federal Reserve Bank".

(j) CREDIT OR REFUND OF RETAIL TAX ON TRUCKS AND TRAILERS WHERE PRICE READJUSTMENTS.—Subparagraph (A) of section 6416(b)(1) (relating to price readjustments) is amended by inserting "or by section 4051" after "by chapter 32".

SEC. 735. REPEAL OF CERTAIN PROVISIONS MADE OBSOLETE BY HIGHWAY REVENUE ACT OF 1982.

(a) DELETION OF TERMINATED MANUFACTURERS EXCISE TAX ON MOTOR VEHICLES.—

(1) Part I of subchapter A of chapter 32 is amended by striking out sections 4061, 4062, and 4063.

(2) The part heading and the table of sections for such part I are amended to read as follows:

"PART I—GAS GUZZLERS

"Sec. 4064. Gas guzzlers tax."

(3) The table of parts for subchapter A of chapter 32 is amended by striking out the item relating to part I and inserting in lieu thereof the following:

"Part I. Gas guzzlers."

(b) CROSS-REFERENCES TO TERMINATED MANUFACTURERS EXCISE TAX ON MOTOR VEHICLES STATED AS PART OF RETAIL TAX.—

(1) EXEMPTIONS.—Section 4053 (relating to exemptions from retail tax on heavy trucks, etc.) is amended to read as follows:

"SEC. 4053. EXEMPTIONS.

"No tax shall be imposed by section 4051 on any of the following articles:

"(1) CAMPER COACHES BODIES FOR SELF-PROPELLED MOBILE HOMES.—Any article designed—

"(A) to be mounted or placed on automobile trucks, automobile truck chassis, or automobile chassis, and

"(B) to be used primarily as living quarters or camping accommodations.

"(2) FEED, SEED, AND FERTILIZER EQUIPMENT.—Any body primarily designed—

"(A) to process or prepare seed, feed, or fertilizer for use on farms,

"(B) to haul feed, seed, or fertilizer to and on farms,

"(C) to spread feed, seed, or fertilizer on farms,

"(D) to load or unload feed, seed, or fertilizer on farms, or

"(E) for any combination of the foregoing.

"(3) HOUSE TRAILERS.—Any house trailer.

"(4) AMBULANCES, HEARSES, ETC.—Any ambulance, hearse, or combination ambulance-hearse.

"(5) CONCRETE MIXERS.—Any article designed—

"(A) to be placed or mounted on an automobile truck chassis or truck trailer or semitrailer chassis, and

"(B) to be used to process or prepare concrete.

"(6) TRASH CONTAINERS, ETC.—Any box, container, receptacle, bin or other similar article—

"(A) which is designed to be used as a trash container and is not designed for the transportation of freight other than trash, and

"(B) which is not designed to be permanently mounted on or permanently affixed to an automobile truck chassis or body.

"(7) RAIL TRAILERS AND RAIL VANS.—Any chassis or body of a trailer or semitrailer which is designed for use both as a highway vehicle and a railroad car. For purposes of the preceding sentence, piggy-back trailer or semitrailer shall not be treated as designed for use as a railroad car."

(2) CERTAIN COMBINATIONS NOT TREATED AS MANUFACTURE.—Subsection (c) of section 4052 (relating to definitions and special rules) is amended to read as follows:

"(c) CERTAIN COMBINATIONS NOT TREATED AS MANUFACTURE.—

"(1) IN GENERAL.—For purposes of this subchapter (other than subsection (a)(3)(B)), a person shall not be treated as engaged in the manufacture of any article by reason of merely combining such article with any item listed in paragraph (2).

"(2) ITEMS.—The items listed in this paragraph are any coupling device (including any fifth wheel), wrecker crane, loading and unloading equipment (including any crane, hoist, winch, or power liftgate), aerial ladder or tower, snow and ice control equipment, earthmoving, excavation and construction equipment, spreader, sleeper cab, cab shield, or wood or metal floor."

(c) OTHER TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Clause (i) of section 48(l)(16)(B) (defining qualified intercity bus) is amended to read as follows:

"(i) the chassis of which is an automobile bus chassis and the body of which is an automobile bus body,".

(2)(A) The first sentence of section 4071(b) is amended by striking out "or inner tube" and by striking out "or tube" each place it appears.

(B) The first sentence of section 4071(c) is amended by striking out "on total weight," and all that follows and inserting in lieu thereof "on total weight exclusive of metal rims or rim bases."

(C) Subsection (e) of section 4071 is amended—

(i) by striking out "or inner tubes (other than bicycle tires and inner tubes)",

(ii) by striking out "and inner tubes" in paragraphs (1) and (2), and

(iii) by striking out the last sentence and inserting in lieu thereof the following: "This subsection shall not apply with respect to the sale of an automobile bus chassis or an automobile bus body."

(D) Subsection (f) of section 4071 (relating to imported recapped or retreaded United States tires) is hereby repealed.

(3) Section 4072 (relating to definitions) is amended by striking out subsection (b) and by redesignating subsection (c) as subsection (b).

(4) Section 4073 (relating to exemptions) is amended to read as follows:

"SEC. 4073. EXEMPTION FOR TIRES WITH INTERNAL WIRE FASTENING.

"The tax imposed by section 4071 shall not apply to tires of extruded tiring with an internal wire fastening agent."

*(5)(A) The heading for part II of subchapter A of chapter 32 is amended by striking out "**AND TUBES**".*

(B) The table of parts for subchapter A of chapter 32 is amended by striking out "and tubes" in the item relating to part II.

(C) The item relating to section 4073 in the table of sections for part II of subchapter A of chapter 32 is amended to read as follows:

"Sec. 4073. Exemption for tires with internal wire fastening."

(6)(A) Paragraph (1) of section 4216(b) (defining constructive sale price) is amended—

(i) by striking out "(other than an article the sale of which is taxable under section 4061(a))" in the second sentence, and

(ii) by striking out the third sentence.

(B) Paragraph (2) of section 4216(b) is amended by striking out subparagraph (C), by adding "and" at the end of subparagraph (B), and by redesignating subparagraph (D) as subparagraph (C).

(C) Subsection (b) of section 4216 is amended by striking out paragraph (5).

(D) Paragraph (3) of section 4216(b) is amended by striking out "paragraphs (4) and (5)" and inserting in lieu thereof "paragraph (4)".

(E) Paragraph (6) of section 4216(b) is redesignated as paragraph (5) and is amended by striking out "(1), (3), and (5)" and inserting in lieu thereof "(1) and (3)".

(F) Subsection (f) of section 4216 (relating to certain trucks incorporating used components) is hereby repealed.

(7)(A) Subsection (b) of section 4218 (relating to use by manufacturer or importer considered as sale) is amended—

(i) by striking out "or inner tube", and

(ii) by striking out "Except as provided in subsection (d), if" and inserting in lieu thereof "If".

(B) The heading for subsection (b) of section 4218 is amended by striking out "and Tubes".

(C) Section 4218 is amended by striking out subsections (c) and (d) and by redesignating subsection (e) as subsection (c).

(D) Subsection (a) of section 4218 is amended by striking out "(other than an article specified in subsection (b), (c), or (d))" and inserting in lieu thereof "(other than a tire taxable under section 4071)".

(8)(A) Subsection (a) of section 4221 (relating to tax-free sales) is amended by inserting "(or under section 4051 on the first retail sale)" after "manufacturer".

(B) Subsection (c) of section 4221 is amended by striking out "section 4063(a) (6) or (7), 4063(b), 4063(e)," and inserting in lieu thereof "section 4053(a)(6)".

(C) Paragraph (1) of section 4221(d) (defining manufacturer) is amended by inserting before the period ", and, in the case of the tax imposed by section 4051, includes the retailer with respect to the first retail sale".

(D) Paragraph (6) of section 4221(d) (relating to use in further manufacture) is amended—

(i) by striking out subparagraph (B) and the last sentence,

(ii) by striking out "(other than an article referred to in subparagraph (B))" in subparagraph (A),

(iii) by redesignating subparagraph (C) as subparagraph (B), and

(iv) by adding "or" at the end of subparagraph (A).

(E) Paragraph (2) of section 4221(e) is amended—

(i) by striking out "or inner tube" each place it appears; and

(ii) by striking out "or tube" each place it appears.

(F) The heading for paragraph (2) of section 4221(e) is amended by striking out "AND TUBES".

(G) Subsection (e) of section 4221 is amended by striking out paragraphs (4), (5), and (6) and inserting in lieu thereof the following:

"(3) TIRES USED ON INTERCITY, LOCAL, AND SCHOOL BUSES.—Under regulations prescribed by the Secretary, the tax imposed by section 4071 shall not apply in the case of tires sold for use by the purchaser on or in connection with a qualified bus."

(9) Subsection (d) of section 4222 is amended by striking out "4063(a)(7), 4063(b), 4063(e)," and inserting in lieu thereof "4053(a)(6),".

(10) Paragraph (1) of section 4223(b) is amended by striking out "section 4218(e)" and inserting in lieu thereof "4218(c)".

(11) Paragraph (2) of section 4227 is amended by striking out "and tubes".

(12)(A) So much of paragraph (1) of section 6412(a) (relating to floor stock refunds) as precedes "there shall be credited or refunded" is amended to read as follows:

"(1) TIRES AND GASOLINE.—Where before October 1, 1988, any article subject to the tax imposed by section 4071 or 4081 has

been sold by the manufacturer, producer, or importer and on such date is held by a dealer and has not been used and is intended for sale,".

(B) Paragraph (1) of section 6412(a) is amended by striking out the last sentence.

(C) Subparagraph (A) of section 6412(a)(2) is amended to read as follows:

"(A) The term 'dealer' includes a wholesaler, jobber, distributor, or retailer."

(D) Subsection (c) of section 6412 is amended by striking out "4061, 4071," and inserting in lieu thereof "4071".

(13)(A) Subparagraph (C) of section 6416(b)(1) (relating to adjustment of tire price) is amended by striking out "section 4071(a) (1) or (2) or section 4071(b)" and inserting in lieu thereof "subsection (a) or (b) of section 4071".

(B) Paragraph (2) of section 6416(b) is amended by striking out subparagraph (F) and all that follows to the end thereof and inserting in lieu thereof the following:

"(E) in the case of any tire taxable under section 4071(a), sold to any person for use as described in section 4221(e)(3); or

"(F) in the case of gasoline, used or sold for use in the production of special fuels referred to in section 4041.

Subparagraphs (C) and (D) shall not apply in the case of any tax paid under section 4064."

(C) Paragraph (3) of section 6416(b) is amended by striking out all subparagraphs and the last sentence thereof and inserting in lieu thereof the following:

"(A) in the case of any article other than gasoline taxable under section 4081, such article is used by the subsequent manufacturer or producer as material in the manufacture or production of, or as a component part of—

"(i) another article taxable under chapter 32, or

"(ii) an automobile bus chassis or an automobile bus body,

manufactured or produced by him; or

"(B) in the case of gasoline taxable under section 4081, such gasoline is used by the subsequent manufacturer or producer, for nonfuel purposes, as a material in the manufacture or production of any other article manufactured or produced by him."

(D) Subparagraph (B) of section 6416(a)(2) is amended by striking out "or (B)".

(E) Section 6416 is amended by striking out subsections (c) and (g) and by redesignating subsections (e), (f), (h), and (i) as subsections (c), (d), (e), and (f), respectively.

(F) Subparagraph (A) of section 6416(b)(2) is amended by striking out "(except in any case to which subsection (g) applies)".

(14) Section 6613 is amended by striking out subsection (i) and by redesignating subsection (j) as subsection (i).

(15) Paragraph (3) of section 9502(b) is amended by striking out "under paragraphs (2) and (3) of section 4071(a), with respect to tires and tubes of types used on aircraft" and inserting

in lieu thereof "under section 4071 with respect to tires of the types used on aircraft".

(16) Sections 1366(f)(1) and 6401(b) are each amended by striking out ", special fuels, and lubricating oil" and inserting in lieu thereof "and special fuels".

SEC. 736. EFFECTIVE DATE.

Except as otherwise provided in this subtitle, any amendment made by this subtitle shall take effect as if included in the provisions of the Highway Revenue Act of 1982 to which such amendment relates.

TITLE VIII—FOREIGN SALES CORPORATIONS

SEC. 801. FOREIGN SALES CORPORATIONS.

(a) IN GENERAL.—Part III of subchapter N of chapter 1 (relating to income from sources outside the United States) is amended by inserting after subpart B the following new subpart:

"Subpart C—Taxation of Foreign Sales Corporations

"SEC. 921. EXEMPT FOREIGN TRADE INCOME EXCLUDED FROM GROSS INCOME.

"(a) EXCLUSION.—Exempt foreign trade income of a FSC shall be treated as foreign source income which is not effectively connected with the conduct of a trade or business within the United States.

"(b) PROPORTIONATE ALLOCATION OF DEDUCTIONS TO EXEMPT FOREIGN TRADE INCOME.—Any deductions of the FSC properly apportioned and allocated to the foreign trade income derived by a FSC from any transaction shall be allocated between—

"(1) the exempt foreign trade income derived from such transaction, and

"(2) the foreign trade income (other than exempt foreign trade income) derived from such transaction, on a proportionate basis.

"(c) DENIAL OF CREDITS.—Notwithstanding any other provision of this chapter, no credit (other than a credit allowable under section 27(a), 33, or 34) shall be allowed under this chapter to any FSC.

"(d) FOREIGN TRADE INCOME, INVESTMENT INCOME, AND CARRYING CHARGES TREATED AS EFFECTIVELY CONNECTED WITH UNITED STATES BUSINESS.—For purposes of this chapter—

"(1) all foreign trade income of a FSC other than—

"(A) exempt foreign trade income, and

"(B) section 923(a)(2) non-exempt income,

"(2) all interest, dividends, royalties, and other investment income received by a FSC, and

"(3) all carrying charges received by a FSC,
shall be treated as income effectively connected with the conduct of a trade or business conducted through a permanent establishment of such corporation within the United States. Income described in paragraph (1) shall be treated as derived from sources within the United States.

"SEC. 922. FSC DEFINED.

"(a) FSC DEFINED.—For purposes of this title, the term 'FSC' means any corporation—

"(1) which—

"(A) was created or organized—

"(i) under the laws of any foreign country which meets the requirements of section 927(e)(3), or

"(ii) under the laws applicable to any possession of the United States,

"(B) has no more than 25 shareholders at any time during the taxable year,

"(C) does not have any preferred stock outstanding at any time during the taxable year,

"(D) during the taxable year—

"(i) maintains an office located outside the United States in a foreign country which meets the requirements of section 927(e)(3),

"(ii) maintains a set of the permanent books of account (including invoices) of such corporation at such office, and

"(iii) maintains at a location within the United States the records which such corporation is required to keep under section 6001,

"(E) at all times during the taxable year, has a board of directors which includes at least one individual who is not a resident of the United States, and

"(F) is not a member, at any time during the taxable year, of any controlled group of corporations of which a DISC is a member, and

"(2) which has made an election (at the time and in the manner provided in section 927(f)(1)) which is in effect for the taxable year to be treated as a FSC.

"(b) SMALL FSC DEFINED.—For purposes of this title, a FSC is a small FSC with respect to any taxable year if—

"(1) such corporation has made an election (at the time and in the manner provided in section 927(f)(1)) which is in effect for the taxable year to be treated as a small FSC, and

"(2) such corporation is not a member, at any time during the taxable year, of a controlled group of corporations which includes a FSC unless such other FSC has also made an election under paragraph (1) which is in effect for such year.

"SEC. 923. EXEMPT FOREIGN TRADE INCOME.

"(a) EXEMPT FOREIGN TRADE INCOME.—For purposes of this subpart—

"(1) IN GENERAL.—The term 'exempt foreign trade income' means the aggregate amount of all foreign trade income of a

FSC for the taxable year which is described in paragraph (2) or (3).

"(2) INCOME DETERMINED WITHOUT REGARD TO ADMINISTRATIVE PRICING RULES.—In the case of any transaction to which paragraph (3) does not apply, 32 percent of the foreign trade income derived from such transaction shall be treated as described in this paragraph. For purposes of the preceding sentence, foreign trade income shall not include any income properly allocable to excluded property described in subparagraph (B) of section 927(a)(2) (relating to intangibles).

"(3) INCOME DETERMINED WITH REGARD TO ADMINISTRATIVE PRICING RULES.—In the case of any transaction with respect to which paragraph (1) or (2) of section 925(a) (or the corresponding provisions of the regulations prescribed under section 925(b)) applies, 16/23 of the foreign trade income derived from such transaction shall be treated as described in this paragraph.

"(4) SPECIAL RULE FOR FOREIGN TRADE INCOME ALLOCABLE TO A COOPERATIVE.—

"(A) IN GENERAL.—In any case in which a qualified cooperative is a shareholder of a FSC, paragraph (3) shall be applied with respect to that portion of the foreign trade income of such FSC for any taxable year which is properly allocable to the marketing of agricultural or horticultural products (or the providing of related services) by such cooperative by substituting '100 percent' for '16/23'.

"(B) PARAGRAPH ONLY TO APPLY TO AMOUNTS FSC DISTRIBUTES.—Subparagraph (A) shall not apply for any taxable year unless the FSC distributes to the qualified cooperative the amount which (but for such subparagraph) would not be treated as exempt foreign trade income. Any distribution under this subparagraph for any taxable year—

"(i) shall be made before the due date for filing the return of tax for such taxable year, but

"(ii) shall be treated as made on the last day of such taxable year.

"(5) SPECIAL RULE FOR MILITARY PROPERTY.—Under regulations prescribed by the Secretary, that portion of the foreign trading gross receipts of the FSC for the taxable year attributable to the disposition of, or services relating to, military property (within the meaning of section 995(b)(3)(B)) which may be treated as exempt foreign trade income shall equal 50 percent of the amount which (but for this paragraph) would be treated as exempt foreign trade income.

"(b) Foreign Trade Income Defined.—For purposes of this subpart, the term 'foreign trade income' means the gross income of a FSC attributable to foreign trading gross receipts.

"SEC. 924. FOREIGN TRADING GROSS RECEIPTS.

"(a) IN GENERAL.—Except as otherwise provided in this section, for purposes of this subpart, the term 'foreign trading gross receipts' means the gross receipts of any FSC which are—

"(1) from the sale, exchange, or other disposition of export property,

"(2) from the lease or rental of export property for use by the lessee outside the United States,

"(3) for services which are related and subsidiary to—

"(A) any sale, exchange, or other disposition of export property by such corporation, or

"(B) any lease or rental of export property described in paragraph (2) by such corporation,

"(4) for engineering or architectural services for construction projects located (or proposed for location) outside the United States, or

"(5) for the performance of managerial services for an unrelated FSC or DISC in furtherance of the production of foreign trading gross receipts described in paragraph (1), (2), or (3).

Paragraph (5) shall not apply to a FSC for any taxable year unless at least 50 percent of its gross receipts for such taxable year is from activities described in paragraph (1), (2), or (3).

"(b) FOREIGN MANAGEMENT AND FOREIGN ECONOMIC PROCESS REQUIREMENTS.—

"(1) IN GENERAL.—Except as provided in paragraph (2)—

"(A) a FSC shall be treated as having foreign trading gross receipts for the taxable year only if the management of such corporation during such taxable year takes place outside the United States as required by subsection (c), and

"(B) a FSC has foreign trading gross receipts from any transaction only if economic processes with respect to such transaction take place outside the United States as required by subsection (d).

"(2) EXCEPTION FOR SMALL FSC.—

"(A) IN GENERAL.—Paragraph (1) shall not apply with respect to any small FSC.

"(B) LIMITATION ON AMOUNT OF FOREIGN TRADING GROSS RECEIPTS OF SMALL FSC TAKEN INTO ACCOUNT.—

"(i) IN GENERAL.—Any foreign trading gross receipts of a small FSC for the taxable year which exceed $5,000,000 shall not be taken into account in determining the exempt foreign trade income of such corporation and shall not be taken into account under any other provision of this subpart.

"(ii) ALLOCATION OF LIMITATION.—If the foreign trading gross receipts of a small FSC exceed the limitation of clause (i), the corporation may allocate such limitation among such gross receipts in such manner as it may select (at such time and in such manner as may be prescribed in regulations).

"(iii) RECEIPTS OF CONTROLLED GROUP AGGREGATED.—For purposes of applying clauses (i) and (ii), all small FSC's which are members of the same controlled group of corporations shall be treated as a single corporation.

"(iv) ALLOCATION OF LIMITATION AMONG MEMBERS OF CONTROLLED GROUP.—The limitation under clause (i) shall be allocated among the foreign trading gross receipts of small FSC's which are members of the same

controlled group of corporations in a manner provided in regulations prescribed by the Secretary.

"(c) REQUIREMENT THAT FSC BE MANAGED OUTSIDE THE UNITED STATES.—The management of a FSC meets the requirements of this subsection for the taxable year if—

"(1) all meetings of the board of directors of the corporation, and all meetings of the shareholders of the corporation, are outside the United States,

"(2) the principal bank account of the corporation is maintained outside the United States at all times during the taxable year, and

"(3) all dividends, legal and accounting fees, and salaries of officers and members of the board of directors of the corporation disbursed during the taxable year are disbursed out of bank accounts of the corporation maintained outside the United States.

"(d) REQUIREMENT THAT ECONOMIC PROCESSES TAKE PLACE OUTSIDE THE UNITED STATES.—

"(1) IN GENERAL.—The requirements of this subsection are met with respect to the gross receipts of a FSC derived from any transaction if—

"(A) such corporation (or any person acting under a contract with such corporation) has participated outside the United States in the solicitation (other than advertising), the negotiation, or the making of the contract relating to such transaction, and

"(B) the foreign direct costs incurred by the FSC attributable to the transaction equal or exceed 50 percent of the total direct costs attributable to the transaction.

"(2) ALTERNATIVE 85-PERCENT TEST.—A corporation shall be treated as satisfying the requirements of paragraph (1)(B) with respect to any transaction if, with respect to each of at least 2 paragraphs of subsection (e), the foreign direct costs incurred by such corporation attributable to activities described in such paragraph equal or exceed 85 percent of the total direct costs attributable to activities described in such paragraph.

"(3) DEFINITIONS.—For purpose of this subsection—

"(A) TOTAL DIRECT COSTS.—The term 'total direct costs' means, with respect to any transaction, the total direct costs incurred by the FSC attributable to activities described in subsection (e) performed at any location by the FSC or any person acting under a contract with such FSC.

"(B) FOREIGN DIRECT COSTS.—The term 'foreign direct costs' means with respect to any transaction, the portion of the total direct costs which are attributable to activities performed outside the United States.

"(4) RULES FOR COMMISSIONS, ETC.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection and subsection (e) in the case of commissions, rentals, and furnishing of services.

"(e) ACTIVITIES RELATING TO DISPOSITION OF EXPORT PROPERTY.—The activities referred to in subsection (d) are—

"(1) advertising and sales promotion,

"(2) the processing of customer orders and the arranging for delivery of the export property,

"(3) transportation from the time of acquisition by the FSC (or, in the case of a commission relationship, from the beginning of such relationship for such transaction) to the delivery to the customer,

"(4) the determination and transmittal of a final invoice or statement of account and the receipt of payment, and

"(5) the assumption of credit risk.

"(f) CERTAIN RECEIPTS NOT INCLUDED IN FOREIGN TRADING GROSS RECEIPTS.—

"(1) CERTAIN RECEIPTS EXCLUDED ON BASIS OF USE; SUBSIDIZED RECEIPTS AND RECEIPTS FROM RELATED PARTIES EXCLUDED.—The term 'foreign trading gross receipts' shall not include receipts of a FSC from a transaction if—

"(A) the export property or services—

"(i) are for ultimate use in the United States, or

"(ii) are for use by the United States or any instrumentality thereof and such use of export property or services is required by law or regulation,

"(B) such transaction is accomplished by a subsidy granted by the United States or any instrumentality thereof, or

"(C) such receipts are from another FSC which is a member of the same controlled group of corporations of which such corporation is a member.

"(2) INVESTMENT INCOME; CARRYING CHARGES.—The term 'foreign trading gross receipts' shall not include any investment income or carrying charges.

"SEC. 925. TRANSFER PRICING RULES.

"(a) IN GENERAL.—In the case of a sale of export property to a FSC by a person described in section 482, the taxable income of such FSC and such person shall be based upon a transfer price which would allow such FSC to derive taxable income attributable to such sale (regardless of the sales price actually charged) in an amount which does not exceed the greatest of—

"(1) 1.83 percent of the foreign trading gross receipts derived from the sale of such property by such FSC,

"(2) 23 percent of the combined taxable income of such FSC and such person which is attributable to the foreign trading gross receipts derived from the sale of such property by such FSC, or

"(3) taxable income based upon the sale price actually charged (but subject to the rules provided in section 482).

Paragraphs (1) and (2) shall apply only if the FSC meets the requirements of subsection (c) with respect to the sale.

"(b) RULES FOR COMMISSIONS, RENTALS, AND MARGINAL COSTING.—The Secretary shall prescribe regulations setting forth—

"(1) rules which are consistent with the rules set forth in subsection (a) for the application of this section in the case of commissions, rentals, and other income, and

"(2) rules for the allocation of expenditures in computing combined taxable income under subsection (a)(2) in those cases

where a FSC is seeking to establish or maintain a market for export property.

"(c) REQUIREMENTS FOR USE OF ADMINISTRATIVE PRICING RULES.—A sale by a FSC meets the requirements of this subsection if—

"(1) all of the activities described in section 924(e) attributable to such sale, and

"(2) all of the activities relating to the solicitation (other than advertising), negotiation, and making of the contract for such sale,

have been performed by such FSC (or by another person acting under a contract with such FSC).

"(d) LIMITATION ON GROSS RECEIPTS PRICING RULE.—The amount determined under subsection (a)(1) with respect to any transaction shall not exceed 2 times the amount which would be determined under subsection (a)(2) with respect to such transaction.

"(e) TAXABLE INCOME.—For purposes of this section, the taxable income of a FSC shall be determined without regard to section 921.

"(f) SPECIAL RULE FOR COOPERATIVES.—In any case in which a qualified cooperative sells export property to a FSC, in computing the combined taxable income of such FSC and such organization for purposes of subsection (a)(2), there shall not be taken into account any deduction allowable under subsection (b) or (c) of section 1382 (relating to patronage dividends, per-unit retain allocations, and nonpatronage distributions).

"SEC. 926. DISTRIBUTIONS TO SHAREHOLDERS.

"(a) DISTRIBUTIONS MADE FIRST OUT OF FOREIGN TRADE INCOME.—For purposes of this title, any distribution to a shareholder of a FSC by such FSC which is made out of earnings and profits shall be treated as made—

"(1) first, out of earnings and profits attributable to foreign trade income, to the extent thereof, and

"(2) then, out of any other earnings and profits.

"(b) DISTRIBUTIONS BY FSC TO NONRESIDENT ALIENS AND FOREIGN CORPORATIONS TREATED AS UNITED STATES CONNECTED.—For purposes of this title, any distribution by a FSC which is made out of earnings and profits attributable to foreign trade income to any shareholder of such corporation which is a foreign corporation or a nonresident alien individual shall be treated as a distribution—

"(1) which is effectively connected with the conduct of a trade or business conducted through a permanent establishment of such shareholder within the United States, and

"(2) of income which is derived from sources within the United States.

"(c) FSC INCLUDES FORMER FSC.—For purposes of this section, the term 'FSC' includes a former FSC.

"SEC. 927. OTHER DEFINITIONS AND SPECIAL RULES.

"(a) EXPORT PROPERTY.—For purposes of this subpart—

"(1) IN GENERAL.—The term 'export property' means property—

"(A) manufactured, produced, grown, or extracted in the United States by a person other than a FSC,

"(B) held primarily for sale, lease, or rental, in the ordinary course of trade or business, by, or to, a FSC, for direct use, consumption, or disposition outside the United States, and

"(C) not more than 50 percent of the fair market value of which is attributable to articles imported into the United States.

For purposes of subparagraph (C), the fair market value of any article imported into the United States shall be its appraised value, as determined by the Secretary under section 402 of the Tariff Act of 1930 (19 U.S.C. 1401a) in connection with its importation.

"(2) EXCLUDED PROPERTY.—The term 'export property' shall not include—

"(A) property leased or rented by a FSC for use by any member of a controlled group of corporations of which such FSC is a member,

"(B) patents, inventions, models, designs, formulas, or processes whether or not patented, copyrights (other than films, tapes, records, or similar reproductions, for commercial or home use), good will, trademarks, trade brands, franchises, or other like property,

"(C) oil or gas (or any primary product thereof), or

"(D) products the export of which is prohibited or curtailed to effectuate the policy set forth in paragraph (2)(C) of section 3 of the Export Administration Act of 1979 (relating to the protection of the domestic economy).

"(3) PROPERTY IN SHORT SUPPLY.—If the President determines that the supply of any property described in paragraph (1) is insufficient to meet the requirements of the domestic economy, he may by Executive order designate the property as in short supply. Any property so designated shall not be treated as export property during the period beginning with the date specified in the Executive order and ending with the date specified in an Executive order setting forth the President's determination that the property is no longer in short supply.

"(4) QUALIFIED COOPERATIVE.—The term 'qualified cooperative' means any organization to which part I of subchapter T applies which is engaged in the marketing of agricultural or horticultural products.

"(b) GROSS RECEIPTS.—

"(1) IN GENERAL.—For purposes of this subpart, the term 'gross receipts' means—

"(A) the total receipts from the sale, lease, or rental of property held primarily for sale, lease, or rental in the ordinary course of trade or business, and

"(B) gross income from all other sources.

"(2) GROSS RECEIPTS TAKEN INTO ACCOUNT IN CASE OF COMMISSION.—In the case of commissions on the sale, lease, or rental of property, the amount taken into account for purposes of this subpart as gross receipts shall be the gross receipts on the sale, lease, or rental of the property on which such commissions arose.

"(c) INVESTMENT INCOME.—For purposes of this subpart, the term 'investment income' means—

"(1) dividends,

"(2) interest,

"(3) royalties,

"(4) annuities,

"(5) rents (other than rents from the lease or rental of export property for use by the lessee outside of the United States),

"(6) gains from the sale or exchange of stock or securities,

"(7) gains from futures transactions in any commodity on, or subject to the rules of, a board of trade or commodity exchange (other than gains which arise out of a bona fide hedging transaction reasonably necessary to conduct business of the FSC in the manner in which such business is customarily conducted by others),

"(8) amounts includible in computing the taxable income of the corporation under part I of subchapter J, and

"(9) gains from the sale or other disposition of any interest in an estate or trust.

"(d) OTHER DEFINITIONS.—For purposes of this subpart—

"(1) CARRYING CHARGES.—The term 'carrying charges' means—

"(A) carrying charges, and

"(B) under regulations prescribed by the Secretary, any amount in excess of the price for an immediate cash sale and any other unstated interest.

"(2) TRANSACTION.—

"(A) IN GENERAL.—The term 'transaction' means—

"(i) any sale, exchange, or other disposition,

"(ii) any lease or rental, and

"(iii) any furnishing of services.

"(B) GROUPING OF TRANSACTIONS.—To the extent provided in regulations, any provision of this subpart which, but for this subparagraph, would be applied on a transaction-by-transaction basis may be applied by the taxpayer on the basis of groups of transactions based on product lines or recognized industry or trade usage. Such regulations may permit different groupings for different purposes.

"(3) UNITED STATES DEFINED.—The term 'United States' includes the Commonwealth of Puerto Rico.

"(4) CONTROLLED GROUP OF CORPORATIONS.—The term 'controlled group of corporations' has the meaning given to such term by section 1563(a), except that—

"(A) 'more than 50 percent' shall be substituted for 'at least 80 percent' each place it appears therein, and

"(B) section 1563(b) shall not apply.

"(5) POSSESSIONS.—The term 'possession of the United States' means Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the Virgin Islands of the United States.

"(6) SECTION 923(a)(2) NON-EXEMPT INCOME.—The term 'section 923(a)(2) non-exempt income' means any foreign trade income from a transaction with respect to which paragraph (1)

or (2) of section 925(a) does not apply and which is not exempt foreign trade income.

"(e) SPECIAL RULES.—

"(1) SOURCE RULES FOR RELATED PERSONS.—Under regulations, the income of a person described in section 482 from a transaction giving rise to foreign trading gross receipts of a FSC which is treated as from sources outside the United States shall not exceed the amount which would be treated as foreign source income earned by such person if the pricing rule under section 994 which corresponds to the rule used under section 925 with respect to such transaction applied to such transaction.

"(2) PARTICIPATION IN INTERNATIONAL BOYCOTTS, ETC.—Under regulations prescribed by the Secretary, the exempt foreign trade income of a FSC for any taxable year shall be limited under rules similar to the rules of clauses (i) and (ii) of section 995(b)(1)(F).

"(3) EXCHANGE OF INFORMATION REQUIREMENTS.—For purposes of this title, the term 'FSC' shall not include any corporation which was created or organized under the laws of any foreign country unless, at the time such corporation was created or organized, there was in effect between such country and the United States—

"(A) a bilateral or multilateral agreement described in section 274(h)(6)(C), or

"(B) an income tax treaty with respect to which the Secretary certifies that the exchange of information program with such country under such treaty carries out the purposes of this paragraph.

"(4) DISALLOWANCE OF TREATY BENEFITS.—Any corporation electing to be treated as a FSC under subsection (f)(1) may not claim any benefits under any income tax treaty between the United States and any foreign country.

"(5) EXEMPTION FROM CERTAIN OTHER TAXES.—

"(A) IN GENERAL.—No tax shall be imposed on any foreign trade income derived before January 1, 1987, by any jurisdiction described in subsection (d)(5).

"(B) EXCEPTION FOR TAX LIABILITY INCURRED TO POSSESSION.—Subparagraph (A) shall not apply with respect to any income tax liability which is incurred to any jurisdiction described in subsection (d)(5).

"(f) ELECTION OF STATUS AS FSC (AND AS SMALL FSC).—

"(1) ELECTION.—

"(A) TIME FOR MAKING.—An election by a corporation under section 922(a)(2) to be treated as a FSC, and an election under section 922(b)(1) to be a small FSC, shall be made by such corporation for a taxable year at any time during the 90-day period immediately preceding the beginning of the taxable year, except that the Secretary may give his consent to the making of an election at such other times as he may designate.

"(B) MANNER OF ELECTION.—An election under subparagraph (A) shall be made in such manner as the Secretary shall prescribe and shall be valid only if all persons who are shareholders in such corporation on the first day of the

first taxable year for which such election is effective consent to such election.

"(2) Effect of election.—If a corporation makes an election under paragraph (1), then the provisions of this subpart shall apply to such corporation for the taxable year of the corporation for which made and for all succeeding taxable years.

"(3) Termination of election.—

"(A) Revocation.—An election under this subsection made by any corporation may be terminated by revocation of such election for any taxable year of the corporation after the first taxable year of the corporation for which the election is effective. A termination under this paragraph shall be effective with respect to such election—

"(i) for the taxable year in which made, if made at any time during the first 90 days of such taxable year, or

"(ii) for the taxable year following the taxable year in which made, if made after the close of such 90 days, and

for all succeeding taxable years of the corporation. Such termination shall be made in such manner as the Secretary shall prescribe by regulations.

"(B) Continued failure to be a FSC.—If a corporation is not a FSC for each of any 5 consecutive taxable years of the corporation for which an election under this subsection is effective, the election to be a FSC shall be terminated and not be in effect for any taxable year of the corporation after such 5th year.".

(b) Dividend Received Deduction for Domestic Corporations.—

(1) In general.—Section 245 (relating to dividends received from certain foreign corporations) is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) Certain Dividends Received From FSC.—

"(1) In general.—In the case of a domestic corporation, there shall be allowed as a deduction an amount equal to 100 percent of any dividend received by such corporation from another corporation which is distributed out of earnings and profits attributable to foreign trade income for a period during which such other corporation was a FSC. The deduction allowable under the preceding sentence with respect to any dividend shall be in lieu of any deduction allowable under subsection (a) or (b) with respect to such dividend.

"(2) Exception for certain dividends.—Paragraph (1) shall not apply to any dividend which is distributed out of earnings and profits attributable to foreign trade income which—

"(A) is section 923(a)(2) non-exempt income (within the meaning of section 927(d)(6)), or

"(B) would not, but for section 923(a)(4), be treated as exempt foreign trade income.

"(3) Definitions.—For purposes of this subsection, the terms 'foreign trade income' and 'exempt foreign trade income' have the meaning given such terms by section 923.".

"(2) CONFORMING AMENDMENTS.—

(A) Paragraph (1) of section 246(b) (relating to limitation on aggregate amount of deduction) is amended by striking out "245" each place it appears and inserting in lieu thereof "subsection (a) or (b) of section 245".

(B) Subsection (d) of section 245 (relating to property distributions), as redesignated by paragraph (1), is amended by striking out "subsections (a) and (b)" and inserting in lieu thereof "this section".

(c) CLARIFICATION OF INFORMATION EXCHANGE AGREEMENTS.— Subparagraph (D) of section 274(h)(6) (relating to coordination with section 6103) is amended—

(1) by adding at the end thereof the following new sentence: "The Secretary may exercise his authority under subchapter A of chapter 78 to carry out any obligation of the United States under an agreement referred to in subparagraph (C).", and

(2) by striking out the heading thereof and inserting in lieu thereof "COORDINATION WITH OTHER PROVISIONS.—".

(d) CONFORMING AMENDMENTS.—

(1) Section 901 (relating to foreign tax credit) is amended by redesignating subsection (h) as subsection (i) and inserting after subsection (g) the following new subsection:

"(h) TAXES PAID WITH RESPECT TO FOREIGN TRADE INCOME.—No credit shall be allowed under this section for any income, war profits, and excess profits taxes paid or accrued with respect to the foreign trade income (within the meaning of section 923(b)) of a FSC, other than section 923(a)(2) non-exempt income (within the meaning of section 927(d)(6).".

(2) Paragraph (1) of section 904(d) (relating to application of section in case of certain interest income and dividends from a DISC) as amended—

(A) by striking out "and" at the end of subparagraph (B),

(B) by striking out subparagraph (C) and inserting in lieu thereof the following:

"(C) taxable income attributable to foreign trade income (within the meaning of section 923(b)),

"(D) distributions from a FSC (or former FSC) out of earnings and profits attributable to foreign trade income (within the meaning of section 923(b)), and

"(E) income other than income described in subparagraph (A), (B), (C), or (D).", and

(C) by striking out the heading and inserting in lieu thereof:

"(d) SEPARATE APPLICATION OF SECTION WITH RESPECT TO CERTAIN INTEREST INCOME AND INCOME FROM DISC, FORMER DISC, FSC, OR FORMER FSC.—".

(3) Subsection (b) of section 906 (relating to special rules) is amended by adding at the end thereof the following new paragraph:

"(5) No credit shall be allowed under this section for any income, war profits, and excess profits taxes paid or accrued with respect to the foreign trade income (within the meaning of section 923(b)) of a FSC.".

(4) Section 951 (relating to amounts included in gross income of shareholders) is amended by adding at the end thereof the following new subsection:

"(e) Foreign Trade Income Not Taken Into Account.—

"(1) In general.—The foreign trade income of a FSC and any deductions which are apportioned or allocated to such income shall not be taken into account under this subpart. For purposes of the preceding sentence, income described in paragraph (2) or (3) of section 921(d) shall be treated as derived from sources within the United States.

"(2) Foreign trade income.—For purposes of this subsection, the term 'foreign trade income' has the meaning given such term by section 923(b), but does not include section 923(a)(2) non-exempt income (within the meaning of section 927(d)(6)).".

(5) Paragraph (4) of section 275(a) (relating to disallowance of deduction for certain taxes) is amended to read as follows:

"(4) Income, was profits, and excess profits taxes imposed by the authority of any foreign country or possession of the United States if—

"(A) the taxpayer chooses to take to any extent the benefits of section 901, or

"(B) such taxes are paid or accrued with respect to foreign trade income (within the meaning of section 923(b)) of a FSC.".

(6) Subsection (d) of section 1248 (relating to exclusions from earnings and profits) is amended by adding at the end thereof the following new paragraph:

"(6) Foreign trade income.—Earnings and profits of the foreign corporation attributable to foreign trade income (within the meaning of section 923(b)) of a FSC.".

(7) Section 934 (relating to limitation on reduction in income tax liability incurred to the Virgin Islands) is amended by adding at the end thereof the following new subsection:

"(f) FSC.—Subsection (a) shall not apply in the case of a Virgin Islands corporation which is a FSC.".

(8) Paragraph (2) of section 956(b) (defining United States property) is amended by striking out "and" at the end of subparagraph (G), by striking out the period at the end of subparagraph (H) and inserting in lieu thereof a semicolon and "and", and by adding at the end thereof the following new subparagraph:

"(I) to the extent provided in regulations prescribed by the Secretary, property which is otherwise United States property which is held by a FSC and which is related to the export activities of such FSC.".

(9) Subparagraph (B) of section 7651(5), as amended by this Act, is amended by inserting "or subpart C of part III of subchapter N of chapter 1" after "881(b)(1)".

(10) Section 996(g) (relating to effectively connected income) is amended by inserting "and which are derived from sources within the United States" after "United States".

SEC. 802. INTEREST CHARGE DISC.

(a) INTEREST CHARGE ON DEFERRED TAX.—Section 995 (relating to taxation of DISC income to shareholders) is amended—

(1) by striking out subsections (e) and (f),

(2) by redesignating subsection (g) as subsection (e), and

(3) by adding at the end thereof the following new subsection:

"(f) INTEREST ON DISC-RELATED DEFERRED TAX LIABILITY.—

"(1) IN GENERAL.—A shareholder of a DISC shall pay for each taxable year interest in an amount equal to the product of—

"(A) the shareholder's DISC-related deferred tax liability for such year, and

"(B) the base period T-bill rate.

"(2) SHAREHOLDER'S DISC-RELATED DEFERRED TAX LIABILITY.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'shareholder's DISC-related deferred tax liability' means, with respect to any taxable year of a shareholder of a DISC, the excess of—

"(i) the amount which would be the tax liability of the shareholder for the taxable year if the deferred DISC income of such shareholder for such taxable year were included in gross income as ordinary income, over

"(ii) the actual amount of the tax liability of such shareholder for such taxable year.

Determinations under the preceding sentence shall be made without regard to carrybacks to such taxable year.

"(B) ADJUSTMENTS FOR LOSSES, CREDITS, AND OTHER ITEMS.—The Secretary shall prescribe regulations which provide such adjustments—

"(i) to the accounts of the DISC, and

"(ii) to the amount of any carryover or carryback of the shareholder,

as may be necessary or appropriate in the case of net operating losses, credits, and carryovers and carrybacks of losses and credits.

"(C) TAX LIABILITY.—The term 'tax liability' means the amount of the tax imposed by this chapter for the taxable year reduced by credits allowable against such tax (other than credits allowable under sections 31, 32, and 34).

"(3) DEFERRED DISC INCOME.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'deferred DISC income' means, with respect to any taxable year of a shareholder, the excess of—

"(i) the shareholder's pro rata share of accumulated DISC income (for periods after 1984) of the DISC as of the close of the computation year, over

"(ii) the amount of the distributions-in-excess-of-income for the taxable year of the DISC following the computation year.

"(B) COMPUTATION YEAR.—For purposes of applying subparagraph (A) with respect to any taxable year of a shareholder, the computation year is the taxable year of the DISC which ends with (or within) the taxable year of the

shareholder which precedes the taxable year of the shareholder for which the amount of deferred DISC income is being determined.

"(C) DISTRIBUTIONS-IN-EXCESS-OF-INCOME.—For purposes of subparagraph (A), the term 'distributions-in-excess-of-income' means, with respect to any taxable year of a DISC, the excess (if any) of—

"(i) the amount of actual distributions to the shareholder out of accumulated DISC income, over

"(ii) the shareholder's pro rata share of the DISC income for such taxable year.

"(3) BASE PERIOD T-BILL RATE.—For purposes of this subsection, the term 'base period T-bill rate' means the annual rate of interest determined by the Secretary to be equivalent to the average investment yield of United States Treasury bills with maturities of 52 weeks which were auctioned during the 1-year period ending on September 30 of the calendar year ending with (or of the most recent calendar year ending before) the close of the taxable year of the shareholder.

"(4) SHORT YEARS.—The Secretary shall prescribe such regulations as may be necessary for the application of this subsection to short years of the DISC, the shareholder, or both.

"(5) PAYMENT AND ASSESSMENT AND COLLECTION OF INTEREST.—The interest accrued during any taxable year which a shareholder is required to pay under paragraph (1) shall be treated, for purposes of this title, as interest payable under section 6601 and shall be paid by the shareholder at the time the tax imposed by this chapter for such taxable year is required to be paid.".

(b) TAXABLE INCOME IN EXCESS OF $10,000,000 DEEMED DISTRIBUTED.—

(1) IN GENERAL.—Subparagraph (E) of section 995(b)(1) (relating to based period export gross receipts) is amended to read as follows:

"(E) the taxable income of the DISC attributable to qualified export receipts of the DISC for the taxable year which exceed $10,000,000,".

(2) AGGREGATION OF RECEIPTS.—Subsection (b) of section 995 (relating to deemed distributions) is amended by adding at the end thereof the following new paragraph:

"(4) AGGREGATION OF QUALIFIED EXPORT RECEIPTS.—

"(A) IN GENERAL.—For purposes of applying paragraph (1)(E), all DISC's which are members of the same controlled group shall be treated as a single corporation.

"(B) ALLOCATION.—The dollar amount under paragraph (1)(E) shall be allocated among the DISC's which are members of the same controlled group in a manner provided in regulations prescribed by the Secretary.".

(c) CONFORMING AMENDMENTS.—

(1) Subsection (a)(1) of section 992 (relating to definition of DISC) is amended—

(A) by striking out "and" at the end of subparagraph (C),

(B) by striking out the period at the end of subparagraph (D) and inserting in lieu thereof ", and", and

(C) by adding at the end thereof the following new subparagraph:

"(E) such corporation is not a member of any controlled group of which a FSC is a member.".

(2) Paragraph (3) of section 993(a) (relating to controlled groups) is amended by striking out "such term by" and inserting in lieu thereof "the term 'controlled group of corporations' by".

(3) Subsection (c) of section 999 (relating to international boycott factor) is amended by striking out "995(b)(1)(F)(ii)" each place it appears and inserting in lieu thereof "995(b)(1)(F)(i)".

(4) The table of subparts of part III of subchapter N of chapter 1 is amended by inserting after the item relating to subpart B the following new item:

"Subpart C. Taxation of foreign sales corporations."

SEC. 803. TAXABLE YEAR OF DISC AND FSC REQUIRED TO CONFORM TO TAXABLE YEAR OF MAJORITY SHAREHOLDER.

(a) IN GENERAL.—Subsection (b) of section 441 (relating to period for computation of taxable income) is amended—

(1) by striking out "or" at the end of paragraph (2),

(2) by striking out the period at the end of paragraph (3) and inserting in lieu thereof "; or", and

(3) by adding at the end thereof the following new paragraph:

"(4) in the case of a FSC or DISC filing a return for a period of at least 12 months, the period determined under subsection (h).".

(b) DETERMINATION OF TAXABLE YEAR.—Section 441 is amended by adding at the end thereof the following new subsection:

"(h) TAXABLE YEAR OF FSC's AND DISC's.—

"(1) IN GENERAL.—For purposes of this subtitle, the taxable year of any FSC or DISC shall be the taxable year of that shareholder (or group of shareholders with the same 12-month taxable year) who has the highest percentage of voting power.

"(2) SPECIAL RULE WHERE MORE THAN ONE SHAREHOLDER (OR GROUP) HAS HIGHEST PERCENTAGE.—If 2 or more shareholders (or groups) have the highest percentage of voting power under paragraph (1), the taxable year of the FSC or DISC shall be the same 12-month period as that of any such shareholder (or group).

"(3) SUBSEQUENT CHANGES OF OWNERSHIP.—The Secretary shall prescribe regulations under which paragraphs (1) and (2) shall apply to a change of ownership of a corporation after the taxable year of the corporation has been determined under paragraph (1) or (2) only if such change is a substantial change of ownership.

"(4) VOTING POWER DETERMINED.—For purposes of this subsection, voting power shall be determined on the basis of total combined voting power of all classes of stock of the corporation entitled to vote.".

SEC. 804. REPORTING REQUIREMENTS.

(a) IN GENERAL.—The Secretary of the Treasury shall, for calendar year 1985 and each second calendar year thereafter, submit a

report to the Congress within 27½ months following the close of such calendar year setting forth an analysis of the operation and effect of the provisions of this title.

(b) REPEAL OF DISC REPORTING REQUIREMENTS.—

(1) IN GENERAL.—Section 806 of the Revenue Act of 1971 (relating to submission of annual reports to Congress) is hereby repealed.

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to reports for calendar years after 1984.

SEC. 805. EFFECTIVE DATE; TRANSITION RULES.

(a) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in this subsection, the amendments made by this title shall apply to transactions after December 31, 1984, in taxable years ending after such date.

(2) SPECIAL RULE FOR CERTAIN CONTRACTS.—To the extent provided in regulations prescribed by the Secretary, subsections (c) and (d) of section 924 of the Internal Revenue Code of 1954 (as added by this title) shall not apply to—

(A) any contract with respect to which the taxpayer uses the completed contract method of accounting and which—

(i) was entered into before March 16, 1984, or

(ii) was entered into after March 15, 1984, and before January 1, 1985, pursuant to a written plan to enter into such contract which was in effect on March 15, 1984,

(B) any contract which was entered into before March 16, 1984, except that this subparagraph shall only apply to the first 2 taxable years of the FSC ending after January 1, 1985, or such later taxable years as the Secretary of the Treasury may designate, or

(C) any contract which was entered into after March 15, 1984, and before January 1, 1985, except that this subparagraph shall only apply to the first taxable year of the FSC ending after January 1, 1985, or such later taxable years as the Secretary of the Treasury may designate.

(3) SECTION 801(d)(10).—The amendment made by section 801(d)(10) shall apply to distributions on or after June 22, 1984.

(4) SECTION 803.—The amendments made by section 803 shall apply to any DISC established after March 21, 1984.

(b) TRANSITION RULES FOR DISC'S.—

(1) CLOSE OF 1984 TAXABLE YEARS OF DISC'S.—

(A) IN GENERAL.—For purposes of applying the Internal Revenue Code of 1954, the taxable year of each DISC which begins before January 1, 1985, and which (but for this paragraph) would include January 1, 1985, shall close on December 31, 1984. For purposes of such Code, the requirements of section 992(a)(1)(B) of such Code (relating to percentage of qualified export assets on last day of the taxable year) shall not apply to any taxable year ending on December 31, 1984.

(B) UNDERPAYMENTS OF ESTIMATED TAX.—To the extent provided in regulations prescribed by the Secretary of the Treasury or his delegate, no addition to tax shall be made

under section 6654 or 6655 of such Code with respect to any underpayment of any installment required to be paid before April 13, 1985, to the extent the underpayment was created or increased by reason of subparagraph (A).

(2) EXEMPTION OF ACCUMULATED DISC INCOME FROM TAX.—

(A) IN GENERAL.—For purposes of applying the Internal Revenue Code of 1954 with respect to actual distributions made after December 31, 1984, by a DISC or former DISC which was a DISC on December 31, 1984, any accumulated DISC income of a DISC or former DISC (within the meaning of section 996(f)(1) of such Code) which is derived before January 1, 1985, shall be treated as previously taxed income (within the meaning of section 996(f)(2) of such Code).

(B) EXCEPTION FOR DISTRIBUTION OF AMOUNTS PREVIOUSLY DISQUALIFIED.—Subparagraph (A) shall not apply to the distribution of any accumulated DISC income of a DISC or former DISC to which section 995(b)(2) of such Code applied by reason of any revocation or disqualification (other than a revocation which under regulations prescribed by the Secretary results solely from the provisions of this title.

(3) INSTALLMENT TREATMENT OF CERTAIN DEEMED DISTRIBUTIONS OF SHAREHOLDERS.—

(A) IN GENERAL.—Notwithstanding section 995(b) of such Code, if a shareholder of a DISC elects the application of this paragraph, any qualified distribution shall be treated, for purposes of such Code, as received by such shareholder in 10 equal installments on the last day of each of the 10 taxable years of such shareholder which begins after the first taxable year of such shareholder beginning in 1984. The preceding sentence shall apply without regard to whether the DISC exists after December 31, 1984.

(B) QUALIFIED DISTRIBUTION.—The term 'qualified distribution' means any distribution which a shareholder is deemed to have received by reason of section 995(b) of such Code with respect to income derived by the DISC in the first taxable year of the DISC beginning—

(i) in 1984, and

(ii) after the date in 1984 on which the taxable year of such shareholder begins.

(C) SHORTER PERIOD FOR INSTALLMENTS.—The Secretary of the Treasury or his delegate may by regulations provide for the election by any shareholder to be treated as receiving a qualified distribution over such shorter period as the taxpayer may elect.

(D) ELECTIONS.—Any election under this paragraph shall be made at such time and in such manner as the Secretary of the Treasury or his delegate may prescribe.

(4) TREATMENT OF TRANSFERS FROM DISC TO FSC.—Except to the extent provided in regulations, section 367 of such Code shall not apply to transfers made before January 1, 1986 (or, if later, the date 1 year after the date on which the corporation ceases to be a DISC), to a FSC of qualified export assets (as defined in section 993(b) of such Code) held on August 4, 1983, by

a DISC in a transaction described in section 351 or 368(a)(1) of such Code.

(5) DEEMED TERMINATION OF A DISC.—Under regulations prescribed by the Secretary, if any controlled group of corporations of which a DISC is a member establishes a FSC, then any DISC which is a member of such group shall be treated as having terminated its DISC status.

(6) DEFINITIONS.—For purposes of this subsection, the terms "DISC" and "former DISC" have the respective meanings given to such terms by section 992 of such Code.

(c) SPECIAL RULE FOR EXPORT TRADE CORPORATIONS.—

(1) IN GENERAL.—If, before January 1, 1985, any export trade corporation—

(A) makes an election under section 927(f)(1) of the Internal Revenue Code of 1954 to be treated as a FSC, or

(B) elects not to be treated as an export trade corporation with respect to taxable years beginning after December 31, 1984,

rules similar to the rules of paragraphs (2) and (4) of subsection (b) shall apply to such export trade corporation.

(2) TREATMENT OF TRANSFERS TO FSC.—In the case of any export trade corporation which—

(A) makes an election described in paragraph (1), and

(B) transfers before January 1, 1986, any portion of its property to a FSC in a transaction described in section 351 or 368(a)(1),

then, subject to such rules as the Secretary of the Treasury or his delegate may prescribe based on principles similar to the principles of section 505 (a) and (b) of the Revenue Act of 1971, no income, gain, or loss shall be recognized on such transfer or on the distribution of any stock of the FSC received (or treated as received) in connection with such transfer.

(3) EXPORT TRADE CORPORATION.—For purposes of this subsection, the term "export trade corporation" has the meaning given such term by section 971 of the Internal Revenue Code of 1954.

TITLE IX—HIGHWAY REVENUE PROVISIONS

Subtitle A— Provisions Relating to Heavy Vehicle Use Tax

SEC. 901. REDUCTION OF HEAVY VEHICLE USE TAX.

(a) GENERAL RULE.—Subsection (a) of section 4481 (as amended by section 513(a) of the Highway Revenue Act of 1982) is amended to read as follows:

"(a) IMPOSITION OF TAX.—A tax is hereby imposed on the use of any highway motor vehicle which (together with the semitrailers and trailers customarily used in connection with highway motor vehicles of the same type as such highway motor vehicle) has a taxable gross weight of at least 55,000 pounds at the rate specified in the following table:

"Taxable gross weight:	Rate of tax:
"At least 55,000 pounds, but not over 75,000 pounds	$100 per year plus $22 for each 1,000 pounds (or fraction thereof) in excess of 55,000 pounds.
Over 75,000 pounds	$550."

(b) SPECIAL RULES IN THE CASE OF CERTAIN OWNER-OPERATORS.—

(1) SPECIAL RULE FOR TAXABLE PERIOD BEGINNING ON JULY 1, 1984.—In the case of a small owner-operator, the amount of the tax imposed by section 4481 of the Internal Revenue Code of 1954 on the use of any highway motor vehicle subject to tax under section 4481(a) of such Code (as amended by subsection (a)) for the taxable period which begins on July 1, 1984, shall be the lesser of—

(A) $3 for each 1,000 pounds of taxable gross weight (or fraction thereof), or

(B) the amount of the tax which would be imposed under such section 4481(a) without regard to this paragraph.

(2) EXEMPTION FOR VEHICLES USED FOR LESS THAN 5,000 MILES (AND CERTAIN OTHER AMENDMENTS) TO TAKE EFFECT ON JULY 1, 1984.—In the case of a small owner-operator, notwithstanding subsection (f)(2) of section 513 of the Highway Revenue Act of 1982, the amendments made by subsections (b), (c), and (d) of such section shall take effect on July 1, 1984.

(3) SMALL OWNER-OPERATOR DEFINED.—For purposes of this subsection, the term "small owner-operator" has the meaning given such term by section 513(f)(2) of the Highway Revenue Act of 1982.

(4) TAXABLE GROSS WEIGHT.—For purposes of this subsection, the term 'taxable gross weight' has the same meaning as when used in section 4481 of the Internal Revenue Code of 1954.

(c) EFFECTIVE DATE.—The amendment made by subsection (a) (and the provisions of subsection (b)) shall take effect on July 1, 1984.

SEC. 902. SPECIAL RULE FOR TRUCKS USED IN LOGGING.

(a) IN GENERAL.—Section 4483 (relating to exemptions from highway use tax) is amended by redesignating subsection (e) as subsection (f) and inserting after subsection (d) the following new subsection:

"(e) REDUCTION IN TAX FOR TRUCKS USED IN LOGGING.—The tax imposed by section 4481 shall be reduced by 25 percent with respect to any highway motor vehicle if—

"(1) the exclusive use of such vehicle during any taxable period is the transportation, to and from a point located on a forested site, of products harvested from such forested site, and

"(2) such vehicle is registered (under the laws of the State in which such vehicle is required to be registered) as a highway motor vehicle used in the transportation of harvested forest products.".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on July 1, 1984.

SEC. 903. SPECIAL RULE FOR CERTAIN AGRICULTURAL VEHICLES.

(a) IN GENERAL.—Subsection (d) of section 4483 (relating to exemptions from highway use tax) is amended by redesignating paragraph (5) as paragraph (6) and by inserting after paragraph (4) the following new paragraph:

"(5) 7,500-MILES EXEMPTION FOR AGRICULTURAL VEHICLES.—

"(A) IN GENERAL.—In the case of an agricultural vehicle, paragraphs (1) and (2) shall be applied by substituting '7,500' for '5,000' each place it appears.

"(B) DEFINITIONS.—For purposes of this paragraph—

"(i) AGRICULTURAL VEHICLE.—The term 'agricultural vehicle' means any highway motor vehicle—

"(I) used primarily for farming purposes, and

"(II) registered (under the laws of the State in which such vehicle is required to be registered) as a highway motor vehicle used for farming purposes.

"(ii) FARMING PURPOSES.—The term 'farming purposes' means the transporting of any farm commodity to or from a farm or the use directly in agricultural production.

"(iii) FARM COMMODITY.—The term 'farm commodity' means any agricultural or horticultural commodity, feed, seed, fertilizer, livestock, bees, poultry, fur-bearing animals, or wildlife.".

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall take effect as if included in the amendments made by section 513 of the Highway Revenue Act of 1982.

Subtitle B—Provisions Relating to Fuel Taxes

SEC. 911. INCREASE IN DIESEL FUEL TAX.

(a) GENERAL RULE.—Paragraph (1) of section 4041(a) (relating to diesel fuel) is amended by striking out "9 cents" and inserting in lieu thereof "15 cents".

(b) INCOME TAX CREDIT FOR PURCHASE OF DIESEL-POWERED AUTOMOBILE OR LIGHT TRUCK.—Section 6427 (relating to fuels not used for taxable purposes), as amended by this Act, is amended by redesignating subsections (g), (h), (i), (j), (k), (l), and (m) as subsections (h), (i), (j), (k), (l), (m), and (n), respectively, and by inserting after subsection (f) the following new subsection:

"(g) ADVANCE REPAYMENT OF INCREASED DIESEL FUEL TAX TO ORIGINAL PURCHASERS OF DIESEL-POWERED AUTOMOBILES AND LIGHT TRUCKS.—

"(1) IN GENERAL.—Except as provided in subsection (j), the Secretary shall pay (without interest) to the original purchaser of any qualified diesel-powered highway vehicle an anount equal to the diesel fuel differential amount.

"(2) QUALIFIED DIESEL-POWERED HIGHWAY VEHICLE.—For purposes of this subsection, the term 'qualified diesel-powered highway vehicle' means any diesel-powered highway vehicle which—

"(A) has at least 4 wheels,

"(B) has a gross vehicle weight rating of 10,000 pounds or less, and

"(C) is registered for highway use in the United States under the laws of any State.

"(3) DIESEL FUEL DIFFERENTIAL AMOUNT.—For purposes of this subsection, the term 'diesel fuel differential amount' means—

"(A) except as provided in subparagraph (B), $102, or

"(B) in the case of a truck or van, $198.

"(4) ORIGINAL PURCHASER.—For purposes of this subsection—

(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'original purchaser' means the first person to purchase the qualified diesel-powered vehicle for use other than resale.

"(B) EXCEPTION FOR CERTAIN PERSONS NOT SUBJECT TO FUELS TAX.—The term 'original purchaser' shall not include any State or local government (as defined in section 4221(d)(4)) or any nonprofit educational organization (as defined in section 4221(d)(5)).

"(C) TREATMENT OF DEMONSTRATION USE BY DEALER.—For purposes of subparagraph (A), use as a demonstrator by a dealer shall not be taken into account.

"(5) VEHICLES TO WHICH SUBSECTION APPLIES.—Except as provided in paragraph (6), this subsection shall only apply to qualified diesel-powered highway vehicles originally purchased after January 1, 1985, and before January 1, 1988.

"(6) SPECIAL RULE FOR CERTAIN VEHICLES HELD ON JANUARY 1, 1985.—

"(A) IN GENERAL.—In the case of any person holding a qualified diesel-powered highway vehicle on January 1, 1985—

"(i) such person shall be treated as if he originally purchased such vehicle on December 31, 1984, but

"(ii) the amount payable under paragraph (1) to such person for such vehicle shall be the applicable fraction of the diesel fuel differential amount.

"(B) APPLICABLE FRACTION.—For purposes of subparagraph (A), the applicable fraction is the fraction determined in accordance with the following table:

"If the model year of the vehicle is:	*The applicable fraction is:*
1984 or 1985	*1*
1983	$\frac{5}{6}$
1982	$\frac{4}{6}$
1981	$\frac{3}{6}$
1980	$\frac{2}{6}$
1979	$\frac{1}{6}$

In the case of a 1978 or earlier model year vehicle, the applicable fraction shall be zero.

"(7) BASIS REDUCTION.—For the purposes of subtitle A, the basis of any qualified diesel-powered highway vehicle shall be reduced by the amount payable under this subsection with respect to such vehicle."

(d) TECHNICAL AND CONFORMING ADMENDMENTS.—

(1) AMENDMENTS TO HIGHWAY TRUST FUND.—

(A) TRANSFERS TO MASS TRANSIT ACCOUNT.—Paragraph (2) of section 9503(e) (relating to transfers to Mass Transit Account) is amended to read as follows:

"(2) TRANSFERS TO MASS TRANSIT ACCOUNT.—The Secretary of the Treasury shall transfer to the Mass Transit Account the mass transit portion of the amounts appropriated to the Highway Trust Fund under subsection (b) which are attributable to taxes under sections 4041 and 4081 imposed after March 31, 1983. For purposes of the preceding sentence, the term 'mass transit portion' means an amount determined at the rate of 1 cent for each gallon with respect to which tax was imposed under section 4041 or 4081."

(B) INCOME TAX CREDITS PAYABLE OUT OF HIGHWAY TRUST FUND.—Clause (ii) of section 9503(c)(2)(A) is amended by striking out "used before October 1, 1988" and inserting in lieu thereof "used before October 1, 1988 (or with respect to qualified diesel-powered highway vehicles purchased before January 1, 1988)".

(2) CONFORMING AMENDMENTS TO INCOME TAX CREDIT.—

(A) Subsections (a)(4) and (b) of section 39 (as in effect before the enactment made by title IV of this Act) are each amended by striking out "6427(i)" and inserting in lieu thereof "6427(j)".

(B) Subsections (a), (b)(1), (c), (d), (e)(1), and (f)(1) of section 6427 are each amended by striking out "(i)" and inserting in lieu thereof "(j)".

(C) Subsection (h)(1) of section 6427 (as redesignated by subsection (c)) is amended—

(i) by striking out "or (f)" and inserting in lieu thereof "(f), or (g)", and

(ii) by striking out "fuel used" each place it appears and inserting in lieu thereof "fuel used (or a qualified diesel powered highway vehicle purchased)".

(D) Subsection (h)(2)(A) of section 6427 (as so redesignated) is amended—

(i) by striking out "and (e)" in clause (i) and inserting in lieu thereof "(e), and (g)", and

(ii) by striking out "fuel used" each place it appears and inserting in lieu thereof "fuel used (or a qualified diesel powered highway vehicle purchased)".

(E) Subsection (k)(2) of section 6427 (as so redesignated) is amended by striking out "(g)(2)" and inserting in lieu thereof "(h)(2)".

(F) Subsection (m) of section 6427 (as so redesignated) is amended by striking out "and (d)" each place it appears and inserting in lieu thereof "(d), and (g)".

(G) Sections 7210, 7603, 7604(b), 7604(c)(2), 7605(a), 7609(c)(1), and 7610(c) are each amended by striking out "6427(h)(2)" each place it appears and inserting in lieu thereof "6427(i)(2)".

(e) EFFECTIVE DATE.—The amendments made by this section shall take effect on August 1, 1984.

SEC. 912. DECREASE IN TAX IMPOSED ON GASOHOL.

(a) AMENDMENT OF SECTION 4041.—Paragraph (1) of section 4041(k) (relating to fuels containing alcohol) is amended to read as follows:

"(1) IN GENERAL.—Under regulations prescribed by the Secretary, in the case of the sale or use of any liquid at least 10 percent of which consists of alcohol (as defined in section 4081(c)(3))—

"(A) subsection (a)(1) shall be applied by substituting '9 cents' for '15 cents', and

"(B) subsection (a)(2) shall be applied by substituting '3 cents' for '9 cents', and

"(C) no tax shall be imposed by subsection (c).".

(b) AMENDMENTS OF SECTION 4081.—Subsection (c) of section 4081 (relating to imposition of tax on petroleum products), as amended by title VII of this Act, is amended—

(A) by striking out "4 cents" each place it appears and inserting in lieu thereof "3 cents",

(B) by striking out "4⁴⁄₉ cents" and inserting in lieu thereof "3⅓ cents", and

(C) by striking out "4⁵⁄₉ cents" and inserting in lieu thereof "5⅔ cents".

(c) CREDIT FOR ALCOHOL USED AS A FUEL.—Section 40 (relating to alcohol used as a fuel) (as amended by title IV of this Act) is amended

(1) by striking out "50 cents" each place it appears and inserting in lieu thereof "60 cents", and

(2) by striking out "37.5 cents" each place it appears and inserting in lieu thereof "45 cents".

(d) AMENDMENT OF SECTION 6427.—Paragraph (1) of section 6427(f) (relating to gasoline used to produce certain alcohol fuels) is amended by striking out "4⁵⁄₉ cents" and inserting in lieu thereof "5⅔ cents".

(e) TARIFF IMPORTED FOR USE AS A FUEL.—Item 901.50 of the Tariff Schedules of the United States (19 U.S.C. 1202) is amended by striking out "50 cents per gal." each place it appears and inserting in lieu thereof "60 cents per gal.".

(f) DEFINITION OF ALCOHOL.—Sections 40(d)(1)(A)(i) (as amended by title IV of this Act) and 4081 (c)(3) (defining alcohol) are each amended by striking out "coal" and inserting in lieu thereof "coal (including peat)".

(g) EFFECTIVE DATE.—The amendments made by this section shall take effect on January 1, 1985.

SEC. 913. MODIFICATION OF TAX IMPOSED ON METHANOL AND ETHANOL.

(a) IN GENERAL.—Section 4041 (relating to imposition of tax on special fuels) is amended by adding at the end thereof the following new subsection.

"(m) CERTAIN ALCOHOL FUELS.—

"(1) IN GENERAL.—In the case of the sale or use of any partially exempt methanol or ethanol fuel—

"(A) subsection (a)(2) shall be applied by substituting "4½ cents" for "9 cents", and

"(B) no tax shall be imposed by subsection (c).

"(2) PARTIALLY EXEMPT METHANOL OR ETHANOL FUEL.—The term 'partially exempt methanol or ethanol fuel' means any liquid at least 85 percent of which consists of methanol, ethanol, or other alcohol produced from natural gas.".

(b) CONFORMING AMENDMENT.—Subsection (c) of section 40 (relating to coordination of credit for alcohol used as a fuel with exemption from excise tax) (as redesignated by title IV of this Act) is amended by striking out "(b)(2) or (k)" and inserting in lieu thereof "(b)(2), (k), or (m)".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on August 1, 1984.

SEC. 914. EXTENSION OF REDUCTION IN TAX FOR FUEL USED BY TAXICABS.

Paragraph (3) of section 6427(e) (relating to termination of use in certain taxicabs) is amended by striking out "September 30, 1984" and inserting in lieu thereof "September 30, 1985".

SEC. 915. 3 CENT TAX ON DIESEL FUEL, ETC., USED IN CERTAIN BUSES.

(a) IN GENERAL.—Subsection (b) of section 6427 (relating to fuels not used for taxable purposes) is amended by redesignating paragraph (2) as paragraph (3) and inserting after paragraph (1) the following new paragraph:

"(2) 3-cent reduction in refund in certain cases.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the rate of tax taken into account under paragraph (1) shall not exceed 12 cents.

"(B) EXCEPTION.—Subparagraph (A) shall not apply to fuel used in any automobile bus while engaged in furnishing (for compensation) intracity passenger land transportation—

"(i) which is available to the general public, and

"(ii) which is scheduled and along regular routes,

but only if such bus is a qualified local bus.

"(C) QUALIFIED LOCAL BUS.—For purposes of this paragraph, the term 'qualified local bus' means any local bus—

"(i) which has a seating capacity of at least 20 adults (not including the driver), and

"(ii) which is under contract (or is receiving more than a nominal subsidy) from any State or local government (as defined in section 4221(d)) to furnish such transportation."

(b) EFFECTIVE DATE.—The amendments made by this section shall take effect on August 1, 1984.

Subtitle C—Temporary Reduction in Retail Tax on Certain Piggyback Trailers

SEC. 921. TEMPORARY REDUCTION IN TAX.

Section 4051 (relating to retail tax on heavy trucks and trailers) is amended by redesignating subsection (d) as subsection (e) and inserting after subsection (c) the following new subsection:

"(d) TEMPORARY REDUCTION IN TAX ON CERTAIN PIGGYBACK TRAILERS.—

"(1) IN GENERAL.—In the case of piggyback trailers or semitrailers sold within the 1-year period beginning on the date of the enactment of the Tax Reform Act of 1984, subsection (a) shall be applied by substituting '6 percent' for '12 percent'.

"(2) PIGGYBACK TRAILERS OR SEMITRAILERS.—For purposes of this subsection, the term 'piggyback trailers or semitrailers' means any trailer or semitrailer—

"(A) which is designed for use principally in connection with trailer-on-flatcar service by rail, and

"(B) with respect to which the seller certifies, in such manner and form and at such time as the Secretary prescribes by regulations, that such trailer or semitrailer—

"(i) will be used, or resold for use, principally in connection with such service, or

"(ii) will be incorporated into an article which will be so used or resold.

"(3) ADDITIONAL TAX WHERE NONQUALIFIED USE.—If any piggyback trailer or semitrailer was subject to tax under subsection (a) at the 6 percent rate and such trailer or semitrailer is used or resold for use other than for a use described in paragraph (2)—

"(A) such use or resale shall be treated as a sale to which subsection (a) applies,

"(B) the amount of the tax imposed under subsection (a) on such sale shall be equal to the amount of the tax which was imposed on the first retail sale, and

"(C) the person so using or reselling such trailer or semitrailer shall be liable for the tax imposed by subsection (a)."

Subtitle D—Studies

PART I—STUDIES RELATING TO HEAVY VEHICLE USE TAX

SEC. 931. WHETHER HEAVY VEHICLES BEAR FAIR SHARE OF HIGHWAY COSTS.

The Secretary of Transportation shall conduct a study of whether highway motor vehicles with taxable gross weights of 80,000 pounds or more bear their fair share of the costs of the highway system.

SEC. 932. TRANS-BORDER TRUCKING.

The Secretary of Transportation shall conduct a study to determine the significance of the tax imposed by section 4481 of the Internal Revenue Code of 1954 (relating to tax on use of certain vehicles) on trans-border trucking operations.

SEC. 933. WEIGHT-DISTANCE TAXES.

The Secretary of Transportation shall conduct a study to evaluate the feasibility and ability of weight-distance truck taxes to provide the greatest degree of equity among highway users, to ease the costs of compliance of such taxes, and to improve the efficiency by which such taxes might be administered. Such study shall also include an evaluation of the evasion potential for weight-distance taxes and an assessment of the benefits to interstate commerce of replacing all

Federal truck taxes (other than fuel taxes) with a weight-distance tax.

SEC. 934. REPORTS, ETC.

(a) CONSULTATION WITH TREASURY.—Studies conducted under this part shall be conducted in consultation with the Secretary of the Treasury.

(b) REPORT.—Not later than October 1, 1987, the Secretary of Transportation shall submit to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate a report on each study conducted under this part together with such recommendations as the Secretary may deem advisable.

PART II—OTHER STUDIES

SEC. 935. STUDY OF REDUCED FUEL TAXES FOR TAXICABS.

The Secretary of the Treasury or his delegate shall conduct a study of the reduced rate of fuel taxes provided by section 6427(e) of the Internal Revenue Code of 1954. Not later than January 1, 1985, such Secretary shall submit a report on such study to the Congress, together with such recommendations as the Secretary may deem advisable.

SEC. 936. STUDY OF PIGGYBACK TRAILERS.

(a) IN GENERAL.—The Secretary of Transportation (in consultation with the Secretary of the Treasury) shall conduct a study of the appropriate application and level of the tax imposed by section 4051 of the Internal Revenue Code of 1954 (relating to tax on trucks and trailers sold at retail) on piggyback trailers and semi-trailers.

(b) REPORT.—Not later than May 1, 1985, the Secretary of Transportation shall submit to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate a report on the study conducted under subsection (a) together with such recommendations as the Secretary may deem advisable.

TITLE X—MISCELLANEOUS REVENUE PROVISIONS

Subtitle A—Capital Gains and Losses

SEC. 1001. DECREASE IN HOLDING PERIOD REQUIRED FOR LONG-TERM CAPITAL GAIN TREATMENT.

(a) IN GENERAL.—

(1) CAPITAL GAINS.—Paragraphs (1) and (3) of section 1222 (relating to other terms relating to capital gains and losses) are each amended by striking out "1 year" and inserting in lieu thereof "6 months".

(2) CAPITAL LOSSES.—Paragraphs (2) and (4) of section 1222 are each amended by striking out "1 year" and inserting in lieu thereof "6 months".

(b) CONFORMING AMENDMENTS.—The following provisions are each amended by striking out "1 year" each place it appears and inserting in lieu thereof "6 months".

(1) Paragraph (1)(B) of section 166(d) (relating to nonbusiness debts).

(2) Subsection (a) of section 341 (relating to treatment of gain to shareholders in the case of collapsible corporations).

(3) Paragraph (2) of subsection (a) and subparagraph (L) of subsection (e)(4) of section 402 (relating to capital gains treatment for certain distributions in the case of a beneficiary of an exempt employees' trust).

(4) Subparagraph (A) of section 403(a)(2) (relating to capital gains treatment for certain distributions in the case of a beneficiary under a qualified annuity plan).

(5) Paragraph (1) of section 423(a) (relating to employee stock purchase plans).

(6) Paragraph (2) of section 582(c) (relating to capital gains of banks).

(7) Subparagraphs (A) and (B) of section 584(c)(1) (relating to inclusions in taxable income of participants in common trust funds).

(8) Paragraphs (3) and (4) of section 642(c) (relating to charitable deductions for certain trusts).

(9) Paragraphs (1) and (2) of section 702(a) (relating to income and credits of partner).

(10) Subparagraph (A) of section 817(a)(1) (relating to certain gains and losses in the case of life insurance companies).

(11) Subparagraph (B) of section 852(b)(3) (relating to taxation of shareholders of regulated investment companies).

(12) Subparagraph (A) of section 856(c)(4) (relating to definition of real estate investment trust).

(13) Paragraphs (3)(B) and (7) of section 857(b) (relating to taxation of shareholders of real estate investment trust).

(14) Paragraphs (11) and (12) of section 1223 (relating to holding period of property).

(15) Section 1231 (relating to property used in the trade or business and involuntary conversions).

(16) Paragraph (2) of section 1232(a) (relating to sale or exchange in the case of bonds and other evidences of indebtedness).

(17) Subsections (b), (d), and subparagraph (A) of subsection (e)(4) of section 1233 (relating to gains and losses from short sales).

(18) Paragraph (1) of section 1234(b) (relating to treatment of the grantor of an option in the case of stock, securities, or commodities).

(19) Subsection (a) of section 1235 (relating to sale or exchange of patents).

(20) Paragraph (4) of section 1246(a) (relating to holding period in the case of gain on foreign investment company stock).

(21) Subsection (i) of section 1247 (relating to loss on sale or exchange of certain stock in the case of foreign investment companies electing to distribute income currently).

(22) Subsections (b) and (g)(3)(C) of section 1248 (relating to gain from certain sales or exchanges of stock in certain foreign corporations).

(23) Subparagraph (A) of section 1251(e)(1) (defining farm recapture property).

(c) TECHNICAL AMENDMENT RELATING TO TIMBER, COAL, AND DOMESTIC IRON ORE.—Section 631 (relating to gain or loss in the case of timber, coal, or domestic iron ore) is amended—

(1) by striking out "for a period of more than 1 year" in the first sentence of subsection (a) and inserting in lieu thereof "on the first day of such year and for a period of more than 6 months before such cutting", and

(2) by striking out "1 year" in subsections (b) and (c) and inserting in lieu thereof "6 months".

(d) TECHNICAL AMENDMENT RELATING TO CERTAIN SHORT-TERM GOVERNMENT OBLIGATIONS.—Section 1232(a)(3)(A) (relating to certain short-term government obligations) is amended by striking out "held less than 1 year".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to property acquired after June 22, 1984, and before January 1, 1988.

SEC. 1002. REPEAL OF SPECIAL RULE FOR PRE-1970 LOSSES.

(a) IN GENERAL.—Paragraph (3) of section 1212(b) (relating to transitional rule for taxpayers other than corporations) is repealed.

(b) EFFECTIVE DATE.—The repeal made by subsection (a) shall apply to taxable years beginning after December 31, 1986.

Subtitle B—Excise Tax Provisions

PART I—BOATING SAFETY AND SPORT FISH RESTORATION

Subpart A—Boating Safety Amendments

SEC. 1010. POLICY.

It is declared to be the policy of Congress and the purpose of this part to improve recreational boating safety and to foster greater development, use, and enjoyment of all waters of the United States by encouraging and assisting participation by the States, the boating industry, and the boating public in activities related to increasing boating safety; by authorizing the establishment of national construction and performance standards for boats and associated equipment; by creating more flexible authority governing the use of boats and equipment; and by facilitating the provision of services by the United States Coast Guard on behalf of boating safety. It is further declared to be the policy of Congress to encourage greater and continuing uniformity of boating laws and regulations among the States and the Federal Government, to encourage and assist the States in exercising their authorities in boating safety, to foster greater cooperation and assistance between the Federal Government and the States in administering and enforcing Federal and State laws and regulations pertaining to boating safety, and to equitably utilize taxes paid on fuel use in motor boats in a manner which enhances boating safety.

SEC. 1011. GENERAL AMENDMENTS TO TITLE 46.

(a) Section 2102 of title 46, United States Code, is amended—

(1) by striking out "and facilities improvement" in paragraph (1);

(2) by striking out paragraphs (3) and (4); and

(3) by redesignating paragraph (5) as paragraph (3).

(b)(1) Section 13101 of such title is amended—

(A) by striking out "and facility improvement" in subsection (a); and

(B) by striking out "and facilities improvement" each place it appears.

(2) Subsection (a) of section 13101 of such title is amended by striking out "may" in the second sentence and inserting in lieu thereof "shall".

(c)(1) Section 13102 of such title is amended by striking out "and facilities improvement" each place it appears.

(2) Subsection (a) of section 13102 of such title is amended by striking out "may" and inserting in lieu thereof "shall".

(3) Paragraph (2) of section 13102(a) of such title is amended by striking out ", (d), or (f)".

(4) Subsections (d) and (f) of section 13102 of such title are repealed, and subsection (e) of such section (and any reference thereto) is redesignated as subsection (d).

(d)(1) Subsections (b), (d), and (f) of section 13103 of such title are repealed, and subsections (c) and (e) of such section (and all references thereto) are redesignated as subsections (b) and (c), respectively.

(2) Subsections (b) and (c) of section 13103 of such title (as redesignated by paragraph (1) of this subsection) are amended by striking out "and facilities improvement" each place it appears.

(e) Section 13105 of such title is amended by striking out "and facilities improvement".

(f) Subsection (c) of section 13108 of such title is amended by striking out "and facilities improvement" each place it appears.

(g) Section 13109 of such title is amended by striking out "and facilities improvement" each place it appears.

SEC. 1012. AUTHORIZATION OF FUNDS FOR BOATING SAFETY.

Section 13106 of title 46, United States Code, is amended to read as follows:

"(a) The Secretary may expend in each of the fiscal years 1985, 1986, 1987, and 1988, subject to amounts as are provided in appropriations laws for liquidation of contract authority, an amount equal to two-thirds of the amount transferred for such fiscal year to the Boat Safety Account under section 9503(c)(4) of the Internal Revenue Code of 1954 (26 U.S.C. 9503(c)(4)). The amount shall be allocated as provided under section 13103 of this title and shall be available for State recreational boating safety programs as provided under the guidelines established under subsection (b) of this section. Amounts authorized to be expended for State recreational boating safety programs shall remain available until expended and are deemed to have been expended only if an amount equal to the total amounts authorized to be expended under this section for the fiscal year in question and all prior fiscal years have been obligated. Amounts previously obligated but released by payment of a final voucher or modification of a program acceptance shall be credited to

the balance of unobligated amounts and are immediately available for expenditure.

"(b) The Secretary shall establish guidelines prescribing the purposes for which amounts available under this chapter for State recreational boating safety programs may be used. Those purposes may include—

"(1) providing facilities, equipment, and supplies for boating safety education and law enforcement, including purchase, operation, maintenance, and repair;

"(2) training personnel in skills related to boating safety and to the enforcement of boating safety laws and regulations;

"(3) providing public boating safety education, including educational programs and lectures, to the boating community and the public school system;

"(4) acquiring, constructing, or repairing public access sites used primarily by recreational boaters;

"(5) conducting boating safety inspections and marine casualty investigations;

"(6) establishing and maintaining emergency or search and rescue facilities, and providing emergency or search and rescue assistance;

"(7) establishing and maintaining waterway markers and other appropriate aids to navigation; and

"(8) providing State recreational vessel numbering or titling programs.

"(c) Ar amount equal to one-third of the amount transferred for each fiscal year to the Boat Safety Account under section 9503(c)(4) of the Internal Revenue Code of 1954 (26 U.S.C. 9503(c)(4)) is available to the Secretary for expenditures out of the operating expenses account of the Coast Guard for services provided by the Coast Guard for recreational boating safety, including services provided by the Coast Guard Auxiliary. Amounts made available by this subsection shall remain available until expended."

SEC. 1013. EFFECTIVE DATE.

The amendments made by this subpart shall take effect on October 1, 1984, and shall apply with respect to fiscal years beginning after September 30, 1984.

Subpart B—Sport Fish Restoration Program

SEC. 1014. AMENDMENTS TO THE SPORT FISH RESTORATION PROGRAM.

(a) The Act entitled "An Act to provide that the United States shall aid the States in fish restoration and management projects, and for other purposes", approved August 9, 1950 (16 U.S.C. 777 et seq.), is amended as follows:

(1) The first section is amended—

(A) by inserting "(a)" after "That"; and

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

"(b) Each coastal State, to the extent practicable, shall equitably allocate the following sums between marine fish projects and freshwater fish projects in the same proportion as the estimated number of resident marine anglers and the estimated number of resident

freshwater anglers, respectively, bear to the estimated number of all resident anglers in that State:

"(1) The additional sums apportioned to such State under this Act as a result of the taxes imposed by the amendments made by section 1015 of the Tax Reform Act of 1984 on items not taxed under section 4161(a) of the Internal Revenue Code of 1954 before October 1, 1984.

"(2) The sums apportioned to such State under this Act that are not attributable to any tax imposed by such section 4161(a).

As used in this subsection, the term 'coastal State' means any one of the States of Alabama, Alaska, California, Connecticut, Delaware, Florida, Georgia, Hawaii, Louisiana, Maine, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York, North Carolina, Oregon, Rhode Island, South Carolina, Texas, Virginia, and Washington. The term also includes the Commonwealth of Puerto Rico, the United States Virgin Islands, Guam, American Samoa, and the Commonwealth of the Northern Marianas."

(2) The first sentence of section 3 is amended to read as follows: "To carry out the provisions of this Act for fiscal years after September 30, 1984, there are authorized to be appropriated from the Sport Fish Restoration Account established by section 9504(a) of the Internal Revenue Code of 1954 the amounts paid, transferred, or otherwise credited to that Account. For purposes of the provision of the Act of August 31, 1951, which refers to this section, such amounts shall be treated as the amounts that are equal to the revenues described in this section."

(3) The first sentence of section 4 is amended to read as follows: "So much, not to exceed 6 per centum, of each annual appropriation made in accordance with the provisions of section 3 of this Act as the Secretary of the Interior may estimate to be necessary for his expenses in the conduct of necessary investigations, administration, and the execution of this Act and for aiding in the formulation, adoption, or administration of any compact between two or more States for the conservation and management of migratory fishes in marine or freshwaters shall be deducted for that purpose, and such sum is authorized to be made available therefor until the expiration of the next succeeding fiscal year."

(4) Section 5 is amended by striking all after the first sentence.

(5) Section 6 is amended by adding at the end thereof the following new subsection:

"(d) The Secretary of the Interior may enter into agreements to finance up to 75 per centum of the initial costs of the acquisition of lands or interests therein and the construction of structures or facilities for appropriations currently available for the purposes of this Act; and to agree to finance up to 75 per centum of the remaining costs over such a period of time as the Secretary may consider necessary. The liability of the United States in any such agreement is contingent upon the continued availability of funds for the purposes of this Act."

(6) Section 8 is amended by inserting "(a)" before the first sentence, and by adding at the end thereof the following new subsections:

"(b)(1) Each State shall allocate 10 per centum of the funds apportioned to it for each fiscal year under section 4 of this Act for the payment of up to 75 per centum of the costs of the acquisition, development, renovation, or improvement of facilities (and auxiliary facilities necessary to insure the safe use of such facilities) that create, or add to, public access to the waters of the United States to improve the suitability of such waters for recreational boating purposes.

"(2) So much of the funds that are allocated by a State under paragraph (1) in any fiscal year that remained unexpended or unobligated at the close of such year are authorized to be made available for the purposes described in paragraph (1) during the succeeding fiscal year, but any portion of such funds that remain unexpended or unobligated at the close of such succeeding fiscal year are authorized to be made available for expenditure by the Secretary of the Interior in carrying out the research program of the Fish and Wildlife Service in respect to fish of material value for sport or recreation.

"(c) Each State may use not to exceed 10 per centum of the funds apportioned to it under section 4 of this Act to pay up to 75 per centum of the costs of an aquatic resource education program for the purpose of increasing public understanding of the Nation's water resources and associated aquatic life forms. The non-Federal share of such costs may not be derived from other Federal grant programs. The Secretary shall issue not later than the one hundred and twentieth day after the effective date of this subsection such regulations as he deems advisable regarding the criteria for such programs."

(7) Section 12 is amended—

(A) inserting "the Mayor of the District of Columbia," immediately after "the Secretary of Agriculture of Puerto Rico,";

(B) by inserting "for the District of Columbia one-third of 1 per centum," immediately after "for Puerto Rico 1 per centum,"; and

(C) by inserting "the District of Columbia," after "Puerto Rico," each place it appears therein.

(b) The amendments made by subsection (a) shall take effect on October 1, 1984, and shall apply with respect to fiscal years beginning after September 30, 1984.

Subpart C—Taxes on Sales of Sport Fishing Equipment, Etc.

SEC. 1015. TAX ON SALE OF SPORT FISHING EQUIPMENT.

(a) GENERAL RULE.—Subsection (a) of section 4161 (relating to imposition of tax on the sale of rods, reels, etc.) is amended to read as follows:

"(a) SPORT FISHING EQUIPMENT.—

"(1) IMPOSITION OF TAX.—There is hereby imposed on the sale of any article of sport fishing equipment by the manufacturer, producer, or importer a tax equal to 10 percent of the price for which so sold.

"(2) 3 PERCENT RATE OF TAX FOR ELECTRIC OUTBOARD MOTORS AND SONAR DEVICES SUITABLE FOR FINDING FISH.—

"(A) IN GENERAL.—In the case of an electric outboard motor or a sonar device suitable for finding fish, paragraph (1) shall be applied by substituting '3 percent' for '10 percent'.

"(B) $30 LIMITATION ON TAX IMPOSED ON SONAR DEVICES SUITABLE FOR FINDING FISH.—The tax imposed by paragraph (1) on any sonar device suitable for finding fish shall not exceed $30.

"(3) PARTS OR ACCESSORIES SOLD IN CONNECTION WITH TAXABLE SALE.—In the case of any sale by the manufacturer, producer, or importer of any article of sport fishing equipment, such article shall be treated as including any parts or accessories of such article sold on or in connection therewith or with the sale thereof."

(b) DEFINITION OF SPORT FISHING EQUIPMENT, ETC.—Part I of subchapter D of chapter 32 is amended by adding at the end thereof the following new section:

"SEC. 4162. DEFINITIONS; TREATMENT OF CERTAIN RESALES.

"(a) SPORT FISHING EQUIPMENT DEFINED.—For purposes of this part, the term 'sport fishing equipment' means—

"(1) fishing rods and poles (and component parts therefor),

"(2) fishing reels,

"(3) fly fishing lines, and other fishing lines not over 130 pounds test,

"(4) fishing spears, spear guns, and spear tips,

"(5) items of terminal tackle, including—

"(A) leaders,

"(B) artificial lures,

"(C) artificial baits,

"(D) artificial flies,

"(E) fishing hooks,

"(F) bobbers,

"(G) sinkers,

"(H) snaps,

"(I) drayles, and

"(J) swivels,

but not including natural bait or any item of terminal tackle designed for use and ordinarily used on fishing lines not described in paragraph (3), and

"(6) the following items of fishing supplies and accessories—

"(A) fish stringers,

"(B) creels,

"(C) tackle boxes,

"(D) bags, baskets, and other containers designed to hold fish,

"(E) portable bait containers,

"(F) fishing vests,

"(G) landing nets,

"(H) gaff hooks,

"(I) fishing hood disgorgers, and

"(J) dressing for fishing lines and artificial flies,

"(7) fishing tip-ups and tilts,

"(8) fishing rod belts, fishing rodholders, fishing harnesses, fish fighting chairs, fishing outriggers, and fishing downriggers,

"(9) electric outboard boat motors, and

"(10) sonar devices suitable for finding fish.

"(b) SONAR DEVICE SUITABLE FOR FINDING FISH.—For purposes of this part, the term 'sonar device suitable for finding fish' shall not include any sonar device which is—

"(1) a graph recorder,

"(2) a digital type,

"(3) a meter readout, or

"(4) a combination graph recorder meter readout.

"(c) TREATMENT OF CERTAIN RESALES.—

"(1) IN GENERAL.—If—

"(A) the manufacturer, producer, or importer sells any article taxable under section 4161(a) to any person,

"(B) the constructive sale price rules of section 4216(b) do not apply to such sale, and

"(C) such person (or any other person) sells such article to a related person with respect to the manufacturer, producer, or importer,

then such related person shall be liable for tax under section 4161 in the same manner as if such related person were the manufacturer of the article.

"(2) CREDIT FOR TAX PREVIOUSLY PAID.—If—

"(A) tax is imposed on the sale of any article by reason of paragraph (1), and

"(B) the related person establishes the amount of the tax which was paid on the sale described in paragraph (1)(A),

the amount of the tax so paid shall be allowed as a credit against the tax imposed by reason of paragraph (1).

"(3) RELATED PERSON.—For purposes of this subsection, the term 'related person' has the meaning given such term by section 168(e)(4)(D).

"(4) REGULATIONS.—Except to the extent provided in regulations, rules similar to the rules of this subsection shall also apply in cases (not described in paragraph (1)) in which intermediaries or other devices are used for purposes of reducing the amount of the tax imposed by section 4161(a)."

(c) TIME FOR PAYMENT OF TAX.—Section 6302 (relating to mode or time of collecting tax) is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) TIME FOR PAYMENT OF MANUFACTURERS EXCISE TAX ON SPORT FISHING EQUIPMENT.—The tax imposed by section 4161(a) (relating to manufacturers excise tax on sport fishing equipment) shall be due and payable on the date for filing the return for such tax."

(d) CLERICAL AMENDMENT—The table of sections for part I of subchapter D of chapter 32 is amended by adding at the end thereof the following new item:

"Sec. 4162. Definitions; treatment of certain resales."

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply with respect to articles sold by the manufacturer, producer, or importer after September 30, 1984.

(2) TREATMENT OF CERTAIN RESALES.—Subsection (c) of section 4162 of the Internal Revenue Code of 1954 (relating to treatment of certain resales), as added by this section, shall apply to sales by related persons (as defined in such subsection) after the date of the enactment of this Act.

SEC. 1016. ESTABLISHMENT OF AQUATIC RESOURCES TRUST FUND.

(a) GENERAL RULE.—Subchapter A of chapter 98 (relating to Trust Fund Code) is amended by adding at the end thereof the following new section:

"SEC. 9504. AQUATIC RESOURCES TRUST FUND.

"(a) CREATION OF TRUST FUND.—

"(1) IN GENERAL.—There is hereby established in the Treasury of the United States a trust fund to be known as the 'Aquatic Resources Trust Fund'.

"(2) ACCOUNTS IN TRUST FUND.—The Aquatic Resources Trust Fund shall consist of—

"(A) a Sport Fish Restoration Account, and

"(B) a Boat Safety Account.

Each such Account shall consist of such amounts as may be appropriated, credited, or paid to it as provided in this section, section 9503(c)(4), or section 9602(b).

"(b) SPORT FISH RESTORATION ACCOUNT.—

"(1) TRANSFER OF CERTAIN TAXES TO ACCOUNT.—There is hereby appropriated to the Sport Fish Restoration Account amounts equivalent to the following amounts received in the Treasury on or after October 1, 1984—

"(A) the taxes imposed by section 4161(a) (relating to sport fishing equipment), and

"(B) the import duties imposed on fishing tackle under subpart B of part 5 of schedule 7 of the Tariff Schedules of the United States (19 U.S.C. 1202) and on yachts and pleasure craft under subpart D of part 6 of schedule 6 of such Schedules.

"(2) EXPENDITURES FROM ACCOUNT.—Amounts in the Sport Fish Restoration Account shall be available, as provided by appropriation Acts, to carry out the purposes of the Act entitled 'An Act to provide that the United States shall aid the States in fish restoration and management projects, and for other purposes', approved August 9, 1950 (as in effect on June 1, 1984).

"(c) EXPENDITURES FROM BOAT SAFETY ACCOUNT.—Amounts in the Boat Safety Account shall be available, as provided by appropriation Acts, for making expenditures before April 1, 1989, to carry out the purposes of section 13106 of title 46, United States Code (as in effect on June 1, 1984).

"(d) CROSS REFERENCE.—

"For provision transferring motorboat fuels taxes to Boat Safety Account and Sport Fish Restoration Account, see section 9503(c)(4)."

(b) TRANSFERS FROM HIGHWAY TRUST FUND.—

(1) Subparagraph (A) of section 9503(c)(4) of such Code is amended—

(A) by striking out "the National Recreational Boating Safety and Facilities Improvement Fund established by section 202 of the Recreational Boating Fund Act" in clause (i) and inserting in lieu thereof "the Boat Safety Account in the Aquatic Resources Trust Fund",

(B) by striking out "the amount in the National Recreational Boating Safety and Facilities Improvement Fund" in clause (ii) and inserting in lieu thereof "the amount in the Boat Safety Account", and

(C) by striking out "NATIONAL RECREATIONAL BOATING SAFETY AND FACILITIES IMPROVEMENT FUND" in the subparagraph heading and inserting in lieu thereof "BOAT SAFETY ACCOUNT".

(2) Paragraph (4) of section 9503(c) is amended by redesignating subparagraph (C) as subparagraph (D) and by striking out subparagraph (B) and inserting in lieu thereof the following new subparagraphs:

"(B) $1,000,000 PER YEAR OF EXCESS TRANSFERRED TO LAND AND WATER CONSERVATION FUND.—

"(i) IN GENERAL.—Any amount received in the Highway Trust Fund—

"(I) which is attributable to motorboat fuel taxes, and

"(II) which is not transferred from the Highway Trust Fund under subparagraph (A),

shall be transferred (subject to the limitation of clause (ii)) by the Secretary from the Highway Trust Fund into the land and water conservation fund provided for in title I of the Land and Water Conservation Fund Act of 1965.

"(ii) LIMITATION.—The aggregate amount transferred under this subparagraph during any fiscal year shall not exceed $1,000,000.

"(C) EXCESS FUNDS TRANSFERRED TO SPORT FISH RESTORATION ACCOUNT.—Any amount received in the Highway Trust Fund—

"(i) which is attributable to motorboat fuel taxes, and

"(ii) which is not transferred from the Highway Trust Fund under subparagraph (A) or (B),

shall be transferred by the Secretary from the Highway Trust Fund into the Sport Fish Restoration Account in the Aquatic Resources Trust Fund."

(c) CONFORMING AMENDMENTS.

(1) Section 13107 of title 46, United States Code, is hereby repealed.

(2) The table of sections for chapter 131 of title 46, United States Code, is amended by striking out the item relating to section 13107.

(d) CLERICAL AMENDMENT.—The table of sections for subchapter A of chapter 98 is amended by adding at the end thereof the following new item:

"Sec. 9504. Aquatic Resources Trust Fund."

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall take effect on October 1, 1984.

(2) BOAT SAFETY ACCOUNT TREATED AS CONTINUATION OF NATIONAL RECREATIONAL BOATING SAFETY AND FACILITIES IMPROVEMENT FUND.—The Boat Safety Account in the Aquatic Resources Trust Fund established by the amendments made by this section shall be treated for all purposes of law as the continuation of the National Recreational Boating Safety and Facilities Improvement Fund established by section 13107 of title 46, United States Code. Any reference in any law to the National Recreational Boating Safety and Facilities Improvement Fund established by such section shall be deemed to include (wherever appropriate) a reference to such Boat Safety Account.

SEC. 1017. TAX ON CERTAIN ARROWS.

(a) GENERAL RULE.—Paragraph (1) of section 4161(b) (relating to bows and arrows) is amended to read as follows:

"(1) BOWS AND ARROWS.—There is hereby imposed on the sale by the manufacturer, producer, or importer—

"(A) of any bow which has a draw weight of 10 pounds or more, and

"(B) of any arrow which—

"(i) measures 18 inches overall or more in length, or

"(ii) measures less than 18 inches overall in length but is suitable for use with a bow described in subparagraph (A).

a tax equal to 11 percent of the price for which so sold."

(b) COORDINATION WITH TAX ON SPORT FISHING EQUIPMENT.—

(1) Subsection (b) of section 4161 is amended by adding at the end thereof the following new paragraph:

"(3) COORDINATION WITH SUBSECTION (a).—No tax shall be imposed under this subsection with respect to any article taxable under subsection (a)."

(2) Paragraph (2) of section 4161(b) is amended by striking out "(other than a fishing reel)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to articles sold by the manufacturer, producer, or importer after September 30, 1984.

PART II—OTHER EXCISE TAXES

SEC. 1018. EXEMPTION FROM AVIATION EXCISE TAX FOR CERTAIN HELICOPTER OPERATIONS.

(a) EXEMPTION FROM FUEL TAX.—Paragraph (1) of section 4041(l) (relating to exemption for certain helicopter uses) is amended to read as follows:

"(1) transporting individuals, equipment, or supplies in—

"(A) the exploration for, or the development or removal of, hard minerals, or

"(B) the exploration for oil or gas, or".

(b) EXEMPTION FROM TAX ON TRANSPORTATION BY AIR.—Paragraph (1) of section 4261(e) (relating to exemption for certain helicopter uses) is amended to read as follows:

"(1) transporting individuals, equipment, or supplies in—

"(A) the exploration for, or the development or removal of, hard minerals, or

"(B) the exploration for oil or gas, or".

(c) EFFECTIVE DATE.—

(1) SUBSECTION (a).—The amendment made by subsection (a) shall take effect on April 1, 1984.

(2) SUBSECTION (b).—The amendment made by subsection (b) shall apply to transportation beginning after March 31, 1984, but shall not apply to any amount paid on or before such date.

SEC. 1019. TECHNICAL AMENDMENTS TO THE HAZARDOUS SUBSTANCE RESPONSE REVENUE ACT OF 1980.

(a) CLARIFICATION OF EXCEPTED SUBSTANCES.—

(1) IN GENERAL.—Subsection (b) of section 4662 (relating to definitions and special rules with respect to tax on certain chemicals) is amended by adding at the end thereof the following new paragraphs:

"(5) SUBSTANCES USED IN THE PRODUCTION OF MOTOR FUEL, ETC.—

"(A) IN GENERAL.—In the case of any chemical described in subparagraph (D) which is a qualified fuel substance, no tax shall be imposed under section 4661(a).

"(B) QUALIFIED FUEL SUBSTANCE.—For purposes of this section, the term 'qualified fuel substance' means any substance—

"(i) used in a qualified fuel use by the manufacturer, producer, or importer,

"(ii) sold for use by any purchaser in a qualified fuel use, or

"(iii) sold for resale by any purchaser for use, or resale for ultimate use, in a qualified fuel use.

"(C) QUALIFIED FUEL USE.—For purposes of this subsection, the term 'qualified fuel use' means—

"(i) any use in the manufacture or production of any motor fuel, diesel fuel, aviation fuel, or jet fuel, or

"(ii) any use as such a fuel.

"(D) CHEMICALS TO WHICH PARAGRAPH APPLIES.—For purposes of this subsection, the chemicals described in this subparagraph are acetylene, benzene, butylene, butadiene, ethylene, naphthalene, propylene, toluene, and xylene.

"(E) TAXATION OF NONQUALIFIED SALE OR USE.—For purposes of section 4661(a), if no tax was imposed by such section on the sale or use of any chemical by reason of subparagraph (A), the first person who sells or uses such chemical other than in a sale or use described in subparagraph (A) shall be treated as the manufacturer of such chemical.

"(6) SUBSTANCE HAVING TRANSITORY PRESENCE DURING REFINING PROCESS, ETC.—

"(A) IN GENERAL.—No tax shall be imposed under section 4661(a) on any taxable chemical described in subparagraph (B) by reason of the transitory presence of such chemical during any process of smelting, refining, or otherwise ex-

tracting any substance not subject to tax under section 4661(a).

"(B) CHEMICALS TO WHICH SUBPARAGRAPH (A) APPLIES.—The chemicals described in this subparagraph are—

"(i) barium sulfide, cupric sulfate, cupric oxide, cuprous oxide, lead oxide, zinc chloride, and zinc sulfate, and

"(ii) any solution or mixture containing any chemical described in clause (i).

"(C) REMOVAL TREATED AS USE.—Nothing in subparagraph (A) shall be construed to apply to any chemical which is removed from or ceases to be part of any smelting, refining, or other extraction process."

(2) CREDIT OR REFUND FOR USE AS QUALIFIED FUEL, ETC.—Subsection (d) of section 4662 (relating to refund or credit for certain uses) is amended by adding at the end thereof the following new paragraph:

"(3) USE AS QUALIFIED FUEL.—Under regulations prescribed by the Secretary, if—

"(A) a tax under section 4661 was paid with respect to any chemical described in subparagraph (D) of subsection (b)(5) without regard to subsection (b)(5), and

"(B) any person uses such chemical as a qualified fuel substance,

then an amount equal to the excess of the tax so paid over the tax determined with regard to subsection (b)(5) shall be allowed as a credit or refund (without interest) to such person in the same manner as if it were an overpayment of tax imposed by this section."

(3) METHANE AND BUTANE USED IN PRODUCTION OF MOTOR FUEL, ETC.—Paragraph (1) of section 4662(b) is amended by inserting "or in the manufacture or production of any motor fuel, diesel fuel, aviation fuel, or jet fuel" after "than as a fuel".

(b) CLARIFICATION OF USE AS FERTILIZER.—

(1) IN GENERAL.—Paragraph (2) of section 4662(b) is amended by striking out subparagraphs (B) and (C) and inserting in lieu thereof the following:

"(B) QUALIFIED FERTILIZER SUBSTANCE.—For purposes of this section, the term 'qualified fertilizer substance' means any substance—

"(i) used in a qualified fertilizer use by the manufacturer, producer, or importer,

"(ii) sold for use by any purchaser in a qualified fertilizer use, or

"(iii) sold for resale by any purchaser for use, or resale for ultimate use, in a qualified fertilizer use.

"(C) QUALIFIED FERTILIZER USE.—The term 'qualified fertilizer use' means any use in the manufacture or production of fertilizer or for direct application as a fertilizer.

"(D) TAXATION OF NONQUALIFIED SALE OR USE.—For purposes of section 4661(a), if no tax was imposed by such section on the sale or use of any chemical by reason of subparagraph (A), the first person who sells or uses such chem-

ical other than in a sale or use described in subparagraph (A) shall be treated as the manufacturer of such chemical."

(2) TECHNICAL AMENDMENTS.—

(A) Subparagraph (A) of section 4662(b)(2) is amended by striking out "qualified substance" and inserting in lieu thereof "qualified fertilizer substance".

(B) Subparagraph (B) of section 4662(d)(2) is amended to read as follows:

"(B) any person uses such substance as a qualified fertilizer substance,".

(c) CONFORMING AMENDMENT.—Subsection (c) of section 4662 (relating to use by manufacturer, etc., considered sale) is amended by striking out "If" and inserting in lieu thereof "Except as provided in subsection (b), if".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall take effect as if included in the amendments made by section 211(a) of the Hazardous Substance Response Revenue Act of 1980.

(2) WAIVER OF LIMITATION.—If refund or credit of any overpayment of tax resulting from the application of the amendments made by this section is prevented at any time before the date which for one year after the date of the enactment of this Act by the operation of any law or rule of law (including res judicata), refund or credit of such overpayment (to the extent attributable to the application of such amendments) may, nevertheless, be made or allowed if claim therefor is filed on or before the date which for one year after the date of the enactment of this Act.

SEC. 1020. FLOOR STOCK REFUND FOR CIGARETTES.

(a) IN GENERAL.—Where, before October 1, 1985, any article subject to tax under section 5701(b) of the Internal Revenue Code of 1954 has been sold by the manufacturer, producer, or importer and on such day is held for sale by any person (hereinafter in this section referred to as the "dealer"), there shall be credited or refunded (without interest) to the manufacturer, producer, or importer an amount equal to the excess of the tax paid by such manufacturer, producer, or importer on such article over the tax which would have been paid if such article were taxed at the rate in effect on October 1, 1985, if—

(1) claim for such credit or refund is filed with the Secretary before July 1, 1986, based on a request submitted to the manufacturer, producer, or importer before April 1, 1986, by the dealer who held the article in respect of which the credit or refund is claimed, and

(2) on or before July 1, 1986, reimbursement has been made to the dealer by the manufacturer, producer, or importer in an amount equal to such excess or written consent has been obtained from the dealer to the allowance of the credit or refund.

(b) LIMITATION ON ELIGIBILITY FOR CREDIT OR REFUND.—No manufacturer, producer, or importer shall be entitled to a credit or refund under subsection (a) unless he has in his possession such evidence of the inventories with respect to which the credit or refund is

claimed as may be required by regulations prescribed by the Secretary.

(c) OTHER LAWS APPLICABLE.—All provisions of law, including penalties, applicable with respect to the taxes imposed by section 5701 of such Code shall, insofar as applicable and not inconsistent with subsections (a) and (b) of this section, apply in respect of the credits and refunds provided for in subsection (a) to the same extent as if the credits or refunds constituted overpayments of the tax.

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

(1) PERSON.—The term "person" includes any State or political subdivision thereof, or any agency or instrumentality of a State or political subdivision thereof.

(2) SECRETARY.—The term "Secretary" means the Secretary of the Treasury or his delegate.

Subtitle C—Estate and Gift Tax Provisions

SEC. 1021. DEFERRAL OF ESTATE TAXES FOR INTEREST IN HOLDING COMPANY WHICH OWNS STOCK IN CLOSELY HELD OPERATING COMPANY.

(a) GENERAL RULE.—Subsection (b) of section 6166 (relating to extension of time for payment of estate tax where estate consists largely of interests in closely held business) is amended by adding at the end thereof the following new paragraph:

"(8) STOCK IN HOLDING COMPANY TREATED AS BUSINESS COMPANY STOCK IN CERTAIN CASES.—

"(A) IN GENERAL.—If the executor elects the benefits of this paragraph, then—

"(i) HOLDING COMPANY STOCK TREATED AS BUSINESS COMPANY STOCK.—For purposes of this section, the portion of the stock of any holding company which represents direct ownership (or indirect ownership through 1 or more other holding companies) by such company in a business company shall be deemed to be stock in such business company.

"(ii) 5-YEAR DEFERRAL FOR PRINCIPAL NOT TO APPLY.—The executor shall be treated as having selected under subsection (a)(3) the date prescribed by section 6151(a).

"(iii) 4-PERCENT INTEREST RATE NOT TO APPLY.—Section 6601(j) (relating to 4-percent rate of interest) shall not apply.

"(B) ALL STOCK MUST BE NON-READILY-TRADABLE STOCK.—No stock shall be taken into account for purposes of applying this paragraph unless it is non-readily-tradable stock (within the meaning of paragraph (7)(B)).

"(C) APPLICATION OF VOTING STOCK REQUIREMENT OF PARAGRAPH (1)(C)(i).—For purposes of clause (i) of paragraph (1)(C), the deemed stock resulting from the application of subparagraph (A) shall be treated as voting stock to the extent that voting stock in the holding company owns directly (or through the voting stock of 1 or more other holding companies) voting stock in the business company.

"(D) DEFINITIONS.—For purposes of this paragraph—

"(i) HOLDING COMPANY.—The term 'holding company' means any corporation holding stock in another corporation.

"(ii) BUSINESS COMPANY.—The term 'business company' means any corporation carrying on a trade or business."

(b) DEFERRAL OF ESTATE TAXES NOT AVAILABLE FOR PASSIVE ASSETS.—Subsection (b) of section 6166 is amended by adding at the end thereof the following new paragraph:

"(9) DEFERRAL NOT AVAILABLE FOR PASSIVE ASSETS.—

"(A) IN GENERAL.—For purposes of subsection (a)(1) and determining the closely held business amount (but not for purposes of subsection (g)), the value of any interest in a closely held business shall not include the value of that portion of such interest which is attributable to passive assets held by the business.

"(B) PASSIVE ASSET DEFINED.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'passive asset' means any asset other than an asset used in carrying on a trade or business.

"(ii) STOCK TREATED AS PASSIVE ASSET.—The term 'passive asset' includes any stock in another corporation unless—

"(I) such stock is treated as held by the decedent by reason of an election under paragraph (8), and

"(II) such stock qualified under subsection (a)(1).

"(iii) EXCEPTION FOR ACTIVE CORPORATIONS.—If—

"(I) a corporation owns 20 percent or more in value of the voting stock of another corporation, or such other corporation has 15 or fewer shareholders, and

"(II) 80 percent or more of the value of the assets of each such corporation is attributal to assets used in carrying on a trade or business,

then such corporations shall be treated as 1 corporation. For purposes of applying subclause (II) to the corporation holding the stock of the other corporation, such stock shall not be taken into account.

(b) ACCELERATION OF PAYMENT.—Paragraph (1) of section 6166(g) (relating to disposition of interest; withdrawal of funds from business) is amended by adding at the end thereof the following new subparagraphs:

"(E) CHANGES IN INTEREST IN HOLDING COMPANY.—If any stock in a holding company is treated as stock in a business company by reason of subsection (b)(8)(A)—

"(i) any disposition of any interest in such stock in such holding company which was included in determining the gross estate of the decedent, or

"(ii) any withdrawal of any money or other property from such holding company attributable to any interest included in determining the gross estate of the decedent,

shall be treated for purposes of subparagraph (A) as a disposition of (or a withdrawal with respect to) the stock qualifying under subsection (a)(1).

"(F) CHANGES IN INTEREST IN BUSINESS COMPANY.—If any stock in a holding company is treated as stock in a business company by reason of subsection (b)(8)(A)—

"(i) any disposition of any interest in such stock in the business company by such holding company, or

"(ii) any withdrawal of any money or other property from such business company attributable to such stock by such holding company owning such stock,

shall be treated for purposes of subparagraph (A) as a disposition of (or a withdrawal with respect to) the stock qualifying under subsection (a)(1)."

(c) UNDISTRIBUTED INCOME OF ESTATE.—Paragraph (2) of section 6166(g) (relating to undistributed income of estate) is amended by adding at the end thereof the following new subparagraph:

"(C) For purposes of this paragraph, if any stock in a corporation is treated as stock in another corporation by reason of subsection (b)(8)(A), any dividends paid by such other corporation to the corporation shall be treated as paid to the estate of the decedent to the extent attributable to the stock qualifying under subsection (a)(1)."

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply with respect to estates of decedents dying after the date of the enactment of this Act.

(2) SPECIAL RULE.—

(A) IN GENERAL.—At the election of the executor, if—

(i) a corporation has 15 or fewer shareholders on June 22, 1984, and at all times thereafter before the date of the decedent's death, and

(ii) stock of such corporation is included in the gross estate of the decedent,

then all other corporations all of the stock of which is owned directly or indirectly by the corporation described in clauses (i) and (ii) shall be treated as one corporation for purposes of section 6166 of the Internal Revenue Code of 1954.

(B) EFFECT OF ELECTION.—Any executor who elects the application of this paragraph shall be treated as having made the election under paragraph (8) of section 6166(b) of such Code.

SEC. 1022. PERMANENT RULES FOR REFORMING GOVERNING INSTRUMENTS CREATING CHARITABLE REMAINDER TRUSTS AND OTHER CHARITABLE INTERESTS.

(a) GENERAL RULE.—Paragraph (3) of section 2055(e) (relating to disallowance of deductions in certain cases) is amended to read as follows:

"(3) REFORMATIONS TO COMPLY WITH PARAGRAPH (2).—

"(A) IN GENERAL.—A deduction shall be allowed under subsection (a) in respect of any qualified reformation.

"(B) QUALIFIED REFORMATION.—For purposes of this paragraph, the term 'qualified reformation' means a

change of a governing instrument by reformation, amendment, construction, or otherwise which changes a reformable interest into a qualified interest but only if—

"(i) any difference between—

"(I) the actuarial value (determined as of the date of the decedent's death) of the qualified interest, and

"(II) the actuarial value (as so determined) of the reformable interest,

does not exceed 5 percent of the actuarial value (as so determined) of the reformable interest,

"(ii) in the case of—

"(I) a charitable remainder interest, the nonremainder interest (before and after the qualified reformation) terminated at the same time, or

"(II) any other interest, the reformable interest and the qualified interest are for the same period, and

"(iii) such change is effective as of the date of the decedent's death.

A nonremainder interest (before reformation) for a term of years in excess of 20 years shall be treated as satisfying subclause (I) of clause (ii) if such interest (after reformation) is for a term of 20 years.

"(C) REFORMABLE INTEREST.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'reformable interest' means any interest for which a deduction would be allowable under subsection (a) at the time of the decedent's death but for paragraph (2).

"(ii) BENEFICIARY'S INTEREST MUST BE FIXED.—The term 'reformable interest' does not include any interest unless, before the remainder vests in possession, all payments to persons other than an organization described in subsection (a) are expressed either in specified dollar amounts or a fixed percentage of the fair market value of the property. For purposes of determining whether all such payments are expressed as a fixed percentage of the fair market value of the property, section 664(d)(3) shall be taken into account.

"(iii) SPECIAL RULE WHERE TIMELY COMMENCEMENT OF REFORMATION.—Clause (ii) shall not apply to any interest if a judicial proceeding is commenced to change such interest into a qualified interest not later than the 90th day after—

"(I) if an estate tax return is required to be filed, the last date (including extensions) for filing such return, or

"(II) if no estate tax return is required to be filed, the last date (including extensions) for filing the income tax return for the 1st taxable year for which such a return is required to be filed by the trust.

"(iv) SPECIAL RULE FOR WILL EXECUTED BEFORE JANUARY 1, 1979, ETC.—In the case of any interest passing under a will executed before January 1, 1979, or under a trust created before such date, clause (ii) shall not apply.

"(D) QUALIFIED INTEREST.—For purposes of this paragraph, the term 'qualified interest' means an interest for which a deduction is allowable under subsection (a).

"(E) LIMITATION.—The deduction referred to in subparagraph (A) shall not exceed the amount of the deduction which would have been allowable for the reformable interest but for paragraph (2).

"(F) SPECIAL RULE WHERE INCOME BENEFICIARY DIES.—If (by reason of the death of any individual, or by termination or distribution of a trust in accordance with the terms of the trust instrument) by the due date for filing the estate tax return (including any extension thereof) a reformable interest is in a wholly charitable trust or passes directly to a person or for a use described in subsection (a), a deduction shall be allowed for such reformable interest as if it had met the requirements of paragraph (2) on the date of the decedent's death. For purposes of the preceding sentence, the term 'wholly charitable trust' means a charitable trust which, upon the allowance of a deduction, would be described in section 4947(a)(1).

"(G) STATUTE OF LIMITATIONS.—The period for assessing any deficiency of any tax attributable to the application of this paragraph shall not expire before the date 1 year after the date on which the Secretary is notified that such reformation has occurred.

"(H) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this paragraph, including regulations providing such adjustments in the application of the provisions of section 508 (relating to special rules relating to section 501(c)(3) organizations), subchapter J (relating to estates, trusts, beneficiaries, and decedents), and chapter 42 (relating to private foundations) as may be necessary by reason of the qualified reformation.

"(I) REFORMATIONS PERMITTED IN CASE OF REMAINDER INTERESTS IN RESIDENCE OR FARM, POOLED INCOME FUNDS, ETC.—The Secretary shall prescribe regulations (consistent with the provisions of this paragraph) permitting reformations in the case of any failure—

"(i) to meet the requirements of section 170(f)(3)(B) (relating to remainder interests in personal residence or farm, etc.), or

"(ii) to meet the requirements of section 642(c)(5)."

(b) INCOME TAX DEDUCTION.—Subsection (f) of section 170 (relating to disallowance of deduction in certain cases and special rules) is amended by adding at the end thereof the following new paragraph:

"(7) REFORMATIONS TO COMPLY WITH PARAGRAPH (2).—

"(A) IN GENERAL.—A deduction shall be allowed under subsection (a) in respect of any qualified reformation (within the meaning of section 2055(e)(3)(B)).

"(B) RULES SIMILAR TO SECTION 2055(e)(3) TO APPLY.—For purposes of this paragraph, rules similar to the rules of section 2055(e)(3) shall apply."

(c) GIFT TAX DEDUCTION.—Subsection (c) of section 2522 is amended by adding at the end thereof the following new paragraph:

"(4) REFORMATIONS TO COMPLY WITH PARAGRAPH (2).—

"(A) IN GENERAL.—A deduction shall be allowed under subsection (a) in respect of any qualified reformation (within the meaning of section 2055(e)(3)(B)),

"(B) RULES SIMILAR TO SECTION 2055(e)(3) TO APPLY.—For purposes of this paragraph, rules similar to the rules of section 2055(e)(3) shall apply."

(d) TREATMENT OF CERTAIN CONTINGENCIES UNDER SECTION 664.—Section 664 (relating to charitable remainder trusts) is amended by adding at the end thereof the following subsection:

"(f) CERTAIN CONTINGENCIES PERMITTED.—

"(1) GENERAL RULE.—If a trust would, but for a qualified contingency, meet the requirements of paragraph (1)(A) or (2)(A) of subsection (d), such trust shall be treated as meeting such requirements.

"(2) VALUE DETERMINED WITHOUT REGARD TO QUALIFIED CONTINGENCY.—For purposes of determining the amount of any charitable contribution (or the actuarial value of any interest), a qualified contingency shall not be taken into account.

"(3) QUALIFIED CONTINGENCY.—For purposes of this subsection, the term 'qualified contingency' means any provision of a trust which provides that, upon the happening of a contingency, the payments described in paragraph (1)(A) or (2)(A) of subsection (d) (as the case may be) will terminate not later than such payments would otherwise terminate under the trust."

(e) EFFECTIVE DATE.—

(1) SUBSECTIONS (a), (b), AND (c).—The amendments made by subsections (a), (b), and (c) shall apply to reformations after December 31, 1978; except that such amendments shall not apply to any reformation to which section 2055(e)(3) of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act) applies. For purposes of applying clause (iii) of section 2055(e)(3)(C) of such Code (as amended by this section), the 90th day described in such clause shall be treated as not occurring before the 90th day after the date of the enactment of this Act.

(2) SUBSECTION (d).—The amendment made by subsection (d) shall apply to transfers after December 31, 1978.

(3) STATUTE OF LIMITATIONS.—

(A) IN GENERAL.—If on the date of the enactment of this Act (or at any time before the date 1 year after such date of enactment), credit or refund of any overpayment of tax attributable to the amendments made by this section is barred by any law or rule of law, such credit or refund of such overpayment may nevertheless be made if claim there-

for is filed before the date 1 year after the date of the enactment of this Act.

(B) NO INTEREST WHERE STATUTE CLOSED ON DATE OF ENACTMENT.—In any case where the making of the credit or refund of the overpayment described in subparagraph (A) is barred on the date of the enactment of this Act, no interest shall be allowed with respect to such overpayment (or any related adjustment) for the period before the date 180 days after the date on which the Secretary of the Treasury (or his delegate) is notified that the reformation has occurred.

SEC. 1023. ALTERNATE VALUATION ELECTION AVAILABLE ONLY WHERE IT RESULTS IN REDUCTION OF GROSS ESTATE AND ESTATE TAX.

(a) GENERAL RULE.—Section 2032 (relating to alternate valuation) is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) ELECTION MUST DECREASE GROSS ESTATE AND ESTATE TAX.—No election may be made under this section with respect to an estate unless such election will decrease—

"(1) the value of the gross estate, and

"(2) the amount of the tax imposed by this chapter (reduced by credits allowable against such tax)."

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply with respect to estates of decedents dying after the date of the enactment of this Act.

SEC. 1024. ALTERNATE VALUATION ELECTION AVAILABLE ON CERTAIN LATE RETURNS.

(a) GENERAL RULE.—Subsection (d) of section 2032 (relating to time of election), as amended by section 1023, is amended to read as follows:

"(d) ELECTION.—

"(1) IN GENERAL.—The election provided for in this section shall be made by the executor on the return of the tax imposed by this chapter. Such election, once made, shall be irrevocable.

"(2) EXCEPTION.—No election may be made under this section if such return is filed more than 1 year after the time prescribed by law (including extensions) for filing such return."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by subsection (a) shall apply to estates of decedents dying after the date of the enactment of this Act.

(2) TRANSITIONAL RULE.—In the case of an estate of a decedent dying before the date of the enactment of this Act if—

(A) a credit or refund of the tax imposed by chapter 11 of the Internal Revenue Code of 1954 is not prevented on the date of the enactment of this Act by the operation of any law or rule of law,

(B) the election under section 2032 of the Internal Revenue Code of 1954 would have met the requirements of such section (as amended by this section and section 1023) had the decedent died after the date of enactment of this Act, and

(C) a claim for credit or refund of such tax with respect to such estate is filed not later than the 90th day after the date of the enactment of this Act,

then such election shall be treated as a valid election under such section 2032. The statutory period for the assessment of any deficiency which is attributable to an election under this paragraph shall not expire before the close of the 2-year period beginning on the date of the enactment of this Act.

SEC. 1025. MODIFICATION OF ELECTION OR AGREEMENT UNDER SECTION 2032A.

(a) IN GENERAL.—Section 2032A(d) (relating to election and agreement) is amended by adding at the end thereof the following new paragraph:

"(3) MODIFICATION OF ELECTION AND AGREEMENT TO BE PERMITTED.—The Secretary shall prescribe procedures which provide that in any case in which—

"(A) the executor makes an election under paragraph (1) within the time prescribed for filing such election, and

"(B) substantially complies with the regulations prescribed by the Secretary with respect to such election, but—

"(i) the notice of election, as filed, does not contain all required information, or

"(ii) signatures of 1 or more persons required to enter into the agreement described in paragraph (2) are not included on the agreement as filed, or the agreement does not contain all required information,

the executor will have a reasonable period of time (not exceeding 90 days) after notification of such failures to provide such information or agreements."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by this section shall apply to estates of decedents dying after December 31, 1976.

(2) REFUND OR CREDIT OF OVERPAYMENT BARRED BY STATUTE OF LIMITATIONS.—Notwithstanding section 6613(a) of the Internal Revenue Code of 1954 or any other period of limitation or lapse of time, a claim for credit or refund of overpayment of the tax imposed by such Code which arises by reason of this section may be filed by any person at any time within the 1-year period beginning on the date of the enactment of this Act. Sections 6613(b) and 6514 of such Code shall not apply to any claim for credit or refund filed under this subsection within such 1-year period.

SEC. 1026. NO GAIN RECOGNIZED FROM NET GIFTS MADE BEFORE MARCH 4, 1981.

"(a) IN GENERAL.—In the case of any transfer of property subject to gift tax made before March 4, 1981, for purposes of subtitle A of the Internal Revenue Code of 1954, gross income of the donor shall not include any amount attributable to the donee's payment of (or agreement to pay) any gift tax imposed with respect to such gift.

(b) GIFT TAX DEFINED.—For purposes of subsection (a), the term "gift tax" means—

(1) the tax imposed by chapter 12 of such Code, and

(2) any tax imposed by a State (or the District of Columbia) on transfers by gifts.

(c) STATUTE OF LIMITATIONS.—If refund or credit of any overpayment of tax resulting from subsection (a) is prevented on the date of the enactment of this Act (or at any time within 1 year after such date) by the operation of any law or rule of law (including res judicata), refund or credit of such overpayment (to the extent attributable to subsection (a)) may nevertheless be made or allowed if claim therefor is filed within 1 year after the date of the enactment of this Act.

SEC. 1027. MARITAL DEDUCTION FOR A USUFRUCT.

(a) IN GENERAL.—Subclause (I) of section 2056(b)(7)(B)(ii) (relating to qualifying income interest for life) is amended by inserting ", or has a usufruct interest for life in the property" after "intervals".

(b) LIMITATION ON DEDUCTIONS FROM GROSS ESTATE.—Paragraph (1) of section 2053(c) (relating to limitations on deductions for expenses, indebtedness, and taxes) is amended by adding at the end thereof the following new subparagraph:

"(C) CERTAIN CLAIMS BY REMAINDERMEN.—No deduction shall be allowed under this section for a claim against the estate by a remainderman relating to any property described in section 2044."

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the amendment made by section 403 of the Economic Recovery Tax Act of 1981.

SEC. 1028. CREDIT AGAINST ESTATE TAX FOR TRANSFERS TO TOIYABE NATIONAL FOREST.

(a) CREDIT ALLOWED.—Subject to the provisions of this section, and notwithstanding any period of limitation or lapse of time, the Secretary of the Treasury or his delegate shall allow credit against the tax imposed by chapter 11 of the Internal Revenue Code of 1954 (relating to the imposition of estate tax)—

(1) upon the estate of Nell J. Redfield for the conveyance by the estate of the United States of real property included in the gross estate and located within and adjacent to the boundaries of the Toiyabe National Forest; and

(2) upon the estate of Elizabeth Schultz Rabe for the conveyance by the estate to the United States of real property included in the gross estate and known as Parcel No. 4 containing 97.60 acres, more or less, located in the County of Douglas, State of Nevada, and described as follows:

The NE¼ of the SW¼, the NW¼ of the SE¼, and a portion of the SE¼ of the NW¼ of Section 23, Township 13 North, Range 18 East, M.D.B.&M., more particularly described as follows:

All that portion of the SE¼ of the NW¼ excepting therefrom the following:

Beginning at a United States Forest Service Brass Cap, being the C-N 1/16 corner of Section 23; thence South 0°45′24″ West 500.00 feet to an iron pipe; thence South 44°50′02″ West 945.42 feet to an iron pipe; thence North 89°46′12″ West 301.78 feet to a point; thence tangent North 20°28′20″ East on the arc of a circular curve to the left *with a radius of 800 feet through a central angle of 40°44′50″ an arc distance of 568.94 feet to a point; thence North 20°02′42″ West 683.17 feet to a point; thence South 88°35′38″ East 1206.29 feet to the Point of Beginning, containing 22.40 acres, more or less.*

(b) AMOUNT OF CREDIT.—The amount allowed as a credit under subsection (a) shall be equal to the lesser of—

(1) the fair market value of the real property transferred by each estate as of the valuation date used for purposes of the tax imposed by chapter 11 of such Code, or

(2) the Federal estate tax liability (and interest thereon) of each estate.

(c) LIMITATIONS.—

(1) The provisions of this section shall apply only if the executor of each estate executes a deed (in accordance with the laws of the State in which such real property is situated) transferring title to the United States before the date which is 90 days after the date of the enactment of this Act, but only if such title is satisfactory to the Attorney General or his delegate.

(2) The provisions of this section shall apply only if the real property transferred is accepted by the Secretary of Agriculture and added to the Toiyabe National Forest. The lands shall be transferred to the Secretary of Agriculture without reimbursement or payment from the Department of Agriculture.

(3) Unless the Secretary of Agriculture determines and certifies to the Secretary of the Treasury that there has been an expeditious transfer of the real property under this section, no interest payable with respect to the tax imposed by chapter 11 of the Internal Revenue Code of 1954 shall be deemed to be waived by reasons of the provisions of this section.

Subtitle D—Charitable Contributions and Exempt Organizations

SEC. 1031. INCREASE IN CHARITABLE VOLUNTEER MILEAGE.

(a) IN GENERAL.—Section 170 (relating to charitable, etc., contributions and gifts) is amended by redesignating subsections (j) and (k) as subsections (k) and (l), respectively, and by inserting after subsection (i) the following new subsection:

"(j) STANDARD MILEAGE RATE FOR USE OF PASSENGER AUTOMOBILE.—For purposes of computing the deduction under this section for use of a passenger automobile the standard mileage rate shall be 12 cents per mile."

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to taxable years beginning after December 31, 1984.

SEC. 1032. CERTAIN ORGANIZATIONS PROVIDING CHILD CARE INCLUDED WITHIN THE DEFINITION OF TAX-EXEMPT ORGANIZATIONS.

(a) IN GENERAL.—Section 501 (relating to exemption from tax on corporations, certain trusts, etc.) is amended by redesignating subsection (k) as subsection (l) and inserting after subsection (j) the following new subsection:

"(k) TREATMENT OF CERTAIN ORGANIZATIONS PROVIDING CHILD CARE.—For purposes of subsection (c)(3) of this section and sections 170(c)(2), 2055(a)(2), and 2522(a)(2), the term 'educational purposes' includes the providing of care of children away from their homes if—

"(1) substantially all of the care provided by the organization is for purposes of enabling individuals to be gainfully employed, and

"(2) the services provided by the organization are available to the general public."

(b) CROSS REFERENCES.—

"(1) Subsection (k) of section 170, as redesignated by section 1031 of this Act, is amended by redesignating paragraphs (1) through (8) as paragraphs (2) through (9), respectively, and by inserting before paragraph (2) (as so redesignated) the following new paragraph:

"(1) For treatment of certain organizations providing child care, see section 501(k)."

(2) Subsection (f) of section 2055 is amended by redesignating paragraphs (2) through (11) as paragraphs (3) through (12), respectively, and by inserting after paragraph (1) the following new paragraph:

"(2) For treatment of certain organizations providing child care, see section 501(k)."

(3) Subsection (d) of section 2522 is amended by redesignating paragraphs (1) and (2) as paragraphs (2) and (3), respectively, and by inserting before paragraph (2) (as so redesignated) the following new paragraph:

"(1) For treatment of certain organizations providing child care, see section 501(k)."

(c) EFFECTIVE DATES.—The amendments made by subsections (a) and (b) shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 1033. RESTRICTIONS ON CHURCH TAX INQUIRIES AND EXAMINATIONS.

(a) IN GENERAL.—Subchapter A of chapter 78 (relating to discovery of liability and enforcement of title) is amended by redesignating section 7611 as section 7612 and inserting after section 7610 the following new section:

"SEC. 7611. RESTRICTIONS ON CHURCH TAX INQUIRIES AND EXAMINATIONS.

"(a) RESTRICTIONS ON INQUIRIES.—

"(1) IN GENERAL.—The Secretary may begin a church tax inquiry only if—

"(A) the reasonable belief requirements of paragraph (2), and

"(B) the notice requirements of paragraph (3), have been met.

"(2) REASONABLE BELIEF REQUIREMENTS.—The requirements of this paragraph are met with respect to any church tax inquiry if an appropriate high-level Treasury official reasonably believes (on the basis of facts and circumstances recorded in writing) that the church—

"(A) may not be exempt, by reason of its status as a church, from tax under section 501(a), or

"(B) may be carrying on an unrelated trade or business (within the meaning of section 513) or otherwise engaged in activities subject to taxation under this title.

"(3) INQUIRY NOTICE REQUIREMENTS.—

"(A) IN GENERAL.—The requirements of this paragraph are met with respect to any church tax inquiry if, before beginning such inquiry, the Secretary provides written notice to the church of the beginning of such inquiry.

"(B) CONTENTS OF INQUIRY NOTICE.—The notice required by this paragraph shall include—

"(i) an explanation of—

"(I) the concerns which gave rise to such inquiry, and

"(II) the general subject matter of such inquiry, and

"(ii) a general explanation of the applicable—

"(I) administrative and constitutional provisions with respect to such inquiry (including the right to a conference with the Secretary before any examination of church records), and

"(II) provisions of this title which authorize such inquiry or which may be otherwise involved in such inquiry.

"(b) RESTRICTIONS ON EXAMINATIONS.—

"(1) IN GENERAL.—The Secretary may begin a church tax examination only if the requirements of paragraph (2) have been met and such examination may be made only—

"(A) in the case of church records, to the extent necessary to determine the liability for, and the amount of, any tax imposed by this title, and

"(B) in the case of religious activities, to the extent necessary to determine whether an organization claiming to be a church is a church for any period.

"(2) NOTICE OF EXAMINATION; OPPORTUNITY FOR CONFERENCE.—The requirements of this paragraph are met with respect to any church tax examination if—

"(A) at least 15 days before the beginning of such examination, the Secretary provides the notice described in paragraph (3) to both the church and the appropriate regional counsel of the Internal Revenue Service, and

"(B) the church has a reasonable time to participate in a conference described in paragraph (3)(A)(iii), but only if the church requests such a conference before the beginning of the examination.

"(3) CONTENTS OF EXAMINATION NOTICE, ET CETERA.—

"(A) IN GENERAL.—The notice described in this paragraph is a written notice which includes—

"(i) a copy of the church tax inquiry notice provided to the church under subsection (a),

"(ii) a description of the church records and activities which the Secretary seeks to examine,

"(iii) an offer to have a conference between the church and the Secretary in order to discuss, and at-

tempt to resolve, concerns relating to such examination, and

"(iv) a copy of all documents which were collected or prepared by the Internal Revenue Service for use in such examination and the disclosure of which is required by the Freedom of Information Act (5 U.S.C. 552).

"(B) EARLIEST DAY EXAMINATION NOTICE MAY BE PROVIDED.—The examination notice described in subparagraph (A) shall not be provided to the church before the 15th day after the date on which the church tax inquiry notice was provided to the church under subsection (a).

"(C) OPINION OF REGIONAL COUNSEL WITH RESPECT TO EXAMINATION.—Any regional counsel of the Internal Revenue Service who receives an examination notice under paragraph (1) may, within 15 days after such notice is provided, submit to the regional commissioner for the region an advisory objection to the examination.

"(4) EXAMINATION OF RECORDS AND ACTIVITIES NOT SPECIFIED IN NOTICE.—Within the course of a church tax examination which (at the time the examination begins) meets the requirements of paragraphs (1) and (2), the Secretary may examine any church records or religious activities which were not specified in the examination notice to the extent such examination meets the requirement of subparagraph (A) or (B) of paragraph (1) (whichever applies).

"(c) LIMITATION ON PERIOD OF INQUIRIES AND EXAMINATIONS.—

"(1) INQUIRIES AND EXAMINATIONS MUST BE COMPLETED WITHIN 2 YEARS.—

"(A) IN GENERAL.—The Secretary shall complete any church tax status inquiry or examination (and make a final determination with respect thereto) not later than the date which is 2 years after the examination notice date.

"(B) INQUIRIES NOT FOLLOWED BY EXAMINATIONS.—In the case of a church tax inquiry with respect to which there is no examination notice under subsection (b), the Secretary shall complete such inquiry (and make a final determination with respect thereto) not later than the date which is 90 days after the inquiry notice date.

"(2) SUSPENSION OF 2-YEAR PERIOD.—The running of the 2-year period described in paragraph (1)(A) and the 90-day period in paragraph (1)(B) shall be suspended—

"(A) for any period during which—

"(i) a judicial proceeding brought by the church against the Secretary with respect to the church tax inquiry or examination is pending or being appealed,

"(ii) a judicial proceeding brought by the Secretary against the church (or any official thereof) to compel compliance with any reasonable request of the Secretary in a church tax examination for examination of church records or religious activities is pending or being appealed, or

"(iii) the Secretary is unable to take actions with respect to the church tax inquiry or examination by

reason of an order issued in any judicial proceeding brought under section 7609,

"(B) for any period in excess of 20 days (but not in excess of 6 months) in which the church or its agents fail to comply with any reasonable request of the Secretary for church records or other information, or

"(C) for any period mutually agreed upon by the Secretary and the church.

"(d) LIMITATIONS ON REVOCATION OF TAX-EXEMPT STATUS, ET CETERA.—

"(1) IN GENERAL.—The Secretary may—

"(A) determine that an organization is not a church which—

"(i) is exempt from taxation by reason of section 501(a), or

"(ii) is described in section 170(c), or

"(B)(i) send a notice of deficiency of any tax involved in a church tax examination, or

"(ii) in the case of any tax with respect to which subchapter B of chapter 63 (relating to deficiency procedures) does not apply, assess any underpayment of such tax involved in a church tax examination,

only if the appropriate regional counsel of the Internal Revenue Service determines in writing that there has been substantial compliance with the requirements of this section and approves in writing of such revocation, notice of deficiency, or assessment.

"(2) LIMITATIONS ON PERIOD OF ASSESSMENT.—

"(A) REVOCATION OF TAX-EXEMPT STATUS.—

"(i) 3-YEAR STATUTE OF LIMITATIONS GENERALLY.—In the case of any church tax examination with respect to the revocation of tax-exempt status under section 501(a), any tax imposed by chapter 1 (other than section 511) may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, only for the 3 most recent taxable years ending before the examination notice date.

"(ii) 6-YEAR STATUTE OF LIMITATIONS WHERE TAX-EXEMPT STATUS REVOKED.—If an organization is not a church exempt from tax under section 501(a) for any of the 3 taxable years described in clause (i), clause (i) shall be applied by substituting '6 most recent taxable years' for '3 most recent taxable years'.

"(B) UNRELATED BUSINESS TAX.—In the case of any church tax examination with respect to the tax imposed by section 511 (relating to unrelated business income), such tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, only with respect to the 6 most recent taxable years ending before the examination notice date.

"(C) EXCEPTION WHERE SHORTER STATUTE OF LIMITATIONS OTHERWISE APPLICABLE.—Subparagraphs (A) and (B) shall not be construed to increase the period otherwise applicable

under subchapter A of chapter 66 (relating to limitations on assessment and collection).

"(e) INFORMATION NOT COLLECTED IN SUBSTANTIAL COMPLIANCE WITH PROCEDURES TO STAY SUMMONS PROCEEDING.—

"(1) IN GENERAL.—If there has not been substantial compliance with—

"(A) the notice requirements of subsection (a) or (b),

"(B) the conference requirement described in subsection (b)(3)(A)(iii), or

"(C) the approval requirement of subsection (d)(1) (if applicable),

with respect to any church tax inquiry or examination, any proceeding to compel compliance with any summons with respect to such inquiry or examination shall be stayed until the court finds that all practicable steps to correct the noncompliance have been taken. The period applicable under paragraph (1) or subsection (c) shall not be suspended during the period of any stay under the preceding sentence.

"(2) REMEDY TO BE EXCLUSIVE.—No suit may be maintained, and no defense may be raised in any proceeding (other than as provided in paragraph (1)), by reason of any noncompliance by the Secretary with the requirements of this section.

"(f) LIMITATIONS ON ADDITIONAL INQUIRIES AND EXAMINATIONS.—

"(1) IN GENERAL.—If any church tax inquiry or examination with respect to any church is completed and does not result in—

"(A) a revocation, notice of deficiency, or assessment described in subsection (d)(1), or

"(B) a request by the Secretary for any significant change in the operational practices of the church (including the adequacy of accounting practices),

no other church tax inquiry or examination may begin with respect to such church during the applicable 5-year period unless such inquiry or examination is approved in writing by the Assistant Commissioner for Employee Plans and Exempt Organizations of the Internal Revenue Service or does not involve the same or similar issues involved in the preceding inquiry or examination. For purposes of the preceding sentence, an inquiry or examination shall be treated as completed not later than the expiration of the applicable period under paragraph (1) of section (c).

"(2) APPLICABLE 5-YEAR PERIOD.—For purposes of paragraph (1), the term 'applicable 5-year period' means the 5-year period beginning on the date the notice taken into account for purposes of subsection (c)(1) was provided. For purposes of the preceding sentence, the rules of subsection (c)(2) shall apply.

"(g) TREATMENT OF FINAL REPORT OF REVENUE AGENT.—Any final report of an agent of the Internal Revenue Service shall be treated as a determination of the Secretary under paragraph (1) of subsection 7428(a) and any church receiving such a report shall be treated for purposes of sections 7428 and 7430 as having exhausted the administrative remedies available to it.

"(h) DEFINITIONS.—For purposes of this section—

"(1) CHURCH.—The term 'church' includes—

"(A) any organization claiming to be a church, and

"(B) any convention or association of churches.

"(2) CHURCH TAX INQUIRY.—The term 'church tax inquiry' means any inquiry to a church (other than an examination) to serve as a basis for determining whether a church—

"(A) is exempt from tax under section 501(a) by reason of its status as a church, or

"(B) is carrying on an unrelated trade or business (within the meaning of section 513) or otherwise engaged in activities which may be subject to taxation under this title.

"(3) CHURCH TAX EXAMINATION.—The term 'church tax examination' means any examination for purposes of making a determination described in paragraph (2) of—

"(A) church records at the request of the Internal Revenue Service, or

"(B) the religious activities of any church.

"(4) CHURCH RECORDS.—

"(A) IN GENERAL.—The term 'church records' means all corporate and financial records regularly kept by a church, including corporate minute books and lists of members and contributors.

"(B) EXCEPTION.—Such term shall not include records acquired—

"(i) pursuant to a summons to which section 7609 applies, or

"(ii) from any governmental agency.

"(5) INQUIRY NOTICE DATE.—The term 'inquiry notice date' means the date the notice with respect to a church tax inquiry is provided under subsection (a).

"(6) EXAMINATION NOTICE DATE.—The term 'examination notice date' means the date the notice with respect to a church tax examination is provided under subsection (b) to the church.

"(7) APPROPRIATE HIGH-LEVEL TREASURY OFFICIAL.—The term 'approporiate high-level Treasury official' means the Secretary of the Treasury or any delegate of the Secretary whose rank is no lower than that of a principal Internal Revenue officer for an internal revenue region.

"(i) SECTION NOT TO APPLY TO CRIMINAL INVESTIGATIONS, ETC.—This section shall not apply to—

"(A) any criminal investigation,

"(B) any inquiry or examination relating to the tax liability of any person other than a church,

"(C) any assessment under section 6851 (relating to termination assessments of income tax) or section 6861 (relating to jeopardy assessments of income taxes, etc),

"(D) any willful attempt to defeat or evade any tax imposed by this title, or

"(E) any knowing failure to file a return of tax imposed by the title."

(b) TECHNICAL AMENDMENT RELATING TO SUBPOENA POWER OF THE DISTRICT COURT FOR THE DISTRICT OF COLUMBIA.—Section 7428 (relating to declaratory judgments relating to status and classification of organizations under section 501(c)(3), etc.) is amended by adding at the end thereof the following new subsection:

"(d) Subpoena Power for District Court for District of Columbia.—In any action brought under this section in the district court of the United States for the District of Columbia, a subpoena requiring the attendance of a witness at a trial or hearing may be served at any place in the United States."

(c) Conforming Amendments.—

(1) Subsection (c) of section 7605 (relating to time and place of examination) is amended to read as follows: "(C) Cross Reference.—

"For provisions restricting church tax inquiries and examinations, see section 7611."

(2) The table of sections for subchapter A of chapter 78 is amended by striking out the item relating to section 7611 and inserting in lieu thereof the following:

"Sec. 7611. Restrictions on church tax inquiries and examinations.
"Sec. 7612. Cross reference."

(d) Effective Date.—The amendments made by this section shall apply with respect to inquiries and examinations beginning after December 31, 1984.

SEC. 1034. ACQUISITION INDEBTEDNESS OF CERTAIN EDUCATIONAL INSTITUTIONS.

"(A) General Rule.—Paragraph (9) of section 514(c) (relating to unrelated debt-financed income) is amended to read as follows:

"(9) Real property acquired by a qualified organization.—

"(A) In general.—Except as provided in subparagraph (B), the term 'acquisition indebtedness' does not, for purposes of this section, include indebtedness incurred by a qualified organization in acquiring or improving any real property.

"(B) Exceptions.—The provisions of subparagraph (A) shall not apply in any case in which—

"(i) the price for the acquisition or improvement is not a fixed amount determined as of the date of the acquisition or the completion of the improvement;

"(ii) the amount of any indebtedness or any other amount payable with respect to such indebtedness, or the time for making any payment of any such amount, is dependent, in whole or in part, upon any revenue, income, or profits derived from such real property;

"(iii) the real property is at any time after the acquisition leased by the qualified organization to the person selling such property to such organization or to any person who bears a relationship described in section 267(b) or 707(b) to such person;

"(iv) the real property is acquired by a qualified trust from, or is at any time after the acquisition leased by such trust to, any person who—

"(I) bears a relationship which is described in subparagraph (C), (E), or (G) of section 4975(e)(2) to any plan with respect to which such trust was formed, or

"(II) bears a relationship which is described in subparagraph (F) or (H) of section 4975(e)(2) to any person described in subclause (I);

"(v) any person described in clause (iii) or (iv) provides the qualified organization with financing in connection with the acquisition or improvement; or

"(vi) the real property is held by a partnership unless the partnership meets the requirements of clauses (i) through (v) and unless—

"(I) all of the partners of the partnership are qualified organizations, or

"(II) each allocation to a partner of the partnership which is a qualified organization is a qualified allocation (within the meaning of section 168(j)(9)).

For purposes of clause (vi)(I), an organization shall not be treated as a qualified organization if any income of such organization would be unrelated business taxable income (determined without regard to this paragraph).

"(C) QUALIFIED ORGANIZATION.—For purposes of this paragraph, the term 'qualified organization' means—

"(i) an organization described in section 170(b)(1)(A)(ii) and its affiliated support organizations described in section 509(a); or

"(ii) any trust which constitutes a qualified trust under section 401.

"(D) OTHER PASS-THRU ENTITIES; TIERED ENTITIES.—Rules similar to the rules of subparagraph (B)(vi) shall also apply in the case of any pass-thru entity other than a partnership and in the case of tiered partnerships and other entities."

(b) TREATMENT OF SEGREGATED ASSET ACCOUNTS.—Section 514 (relating to unrelated debt-financed income) is amended by adding at the end thereof the following new subsection:

"(g) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations to prevent the circumvention of any provision of this section through the use of segregated asset accounts."

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to indebtedness incurred after the date of the enactment of this Act.

(2) EXCEPTION FOR INDEBTEDNESS ON CERTAIN PROPERTY ACQUIRED BEFORE JANUARY 1, 1985.—

(A) The amendment made by subsection (a) shall not apply to any indebtedness incurred before January 1, 1985, by a partnership described in subparagraph (B) if such indebtedness is incurred with respect to property acquired (directly or indirectly) by such partnership before such date.

(B) A partnership is described in this subparagraph if—

(i) before October 21, 1983, the partnership was organized, a request for exemption with respect to such partnership was filed with the Department of Labor, and a private placement memorandum stating the

maximum account of interest in the partnership that would be offered had been circulated,

(ii) the interest in the property to be acquired, directly or indirectly (including through acquiring an interest in another partnership) by such partnership was described in such private placement memorandum, and

(iii) the marketing of partnership interests in such partnership is completed not later than 2 years after the later of the date of enactment of this Act or the date of publication in the Federal Register of such exemption by the Department of Labor and the aggregate amount of interests in such partnership sold does not exceed the amount described in clause (i).

(3) EXCEPTION FOR INDEBTEDNESS ON CERTAIN PROPERTY ACQUIRED BEFORE JANUARY 1, 1986.—

(A) The amendment made by subsection (a) shall not apply to any indebtedness incurred before January 1, 1986, by a partnership described in subparagraph (B) if such indebtedness is incurred with respect to property acquired (directly or indirectly) by such partnership before such date.

(B) A partnership is described in this paragraph if—

(i) before March 6, 1984, the partnership was organized and publicly announced, the maximum amount of interests which would be sold in such partnership, and

(ii) the marketing of partnership interests in such partnership is completed not later than the 90th day after the date of the enactment of this Act and the aggregate amount of interests in such partnership sold does not exceed the maximum amount described in clause (i).

For purposes of clause (i), the maximum amount taken into account shall be the greatest of the amounts shown in the registration statement, prospectus, or partnership agreement.

(C) BINDING CONTRACTS.—For purposes of this paragraph, property shall be deemed to have been acquired before January 1, 1986, if such property is acquired pursuant to a written contract which, on January 1, 1986, and at all times thereafter, required the acquisition of such property and such property is placed in service not later than 6 months after the date such contract was entered into.

SEC. 1035. TRANSITIONAL RULE RELATING TO THE DEFINITION OF QUALIFIED CONSERVATION CONTRIBUTIONS.

(a) IN GENERAL.—Subparagraph (B) of section 170(h)(5) (defining exclusively for conservation purposes) is amended to read as follows:

"(B) NO SURFACE MINING PERMITTED.—

"(i) IN GENERAL.—Except as provided in clause (ii), in the case of a contribution of any interest where there is a retention of a qualified mineral interest, subparagraph (A) shall not be treated as met if at any time there may be extraction or removal of minerals by any surface mining method.

"(ii) SPECIAL RULE.—With respect to any contribution of property in which the ownership of the surface estate and mineral interests were separated before June 13, 1976, and remain so separated, subparagraph (A) shall be treated as met if the probability of surface mining occurring on such property is so remote as to be negligible."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to contributions made after the date of the enactment of this Act.

Subtitle E—Income Tax Credits

SEC. 1041. 1-YEAR EXTENSION OF TARGETED JOBS CREDIT.

(a) IN GENERAL.—Paragraph (3) of section 51(c) (defining wages qualifying for targeted jobs credit) is amended by striking out "December 31, 1984" and inserting in lieu thereof "December 31, 1985".

(b) ADDITIONAL AUTHORIZATION OF APPROPRIATIONS.—Paragraph (2) of section 261(f) of the Economic Recovery Tax Act of 1981 is amended by striking out "fiscal years 1983 and 1984" and inserting in lieu thereof "fiscal years 1983, 1984, and 1985".

(c) TARGETED JOBS CREDIT TECHNICAL AMENDMENTS.—

(1) TREATMENT OF SUCCESSOR EMPLOYERS; TREATMENT OF EMPLOYEES PERFORMING SERVICES FOR OTHER PERSONS.—Section 51 (relating to amount of targeted jobs credit) is amended by adding at the end thereof the following new subsection:

"(j) TREATMENT OF SUCCESSOR EMPLOYERS; TREATMENT OF EMPLOYEES PERFORMING SERVICES FOR OTHER PERSONS.—

"(1) TREATMENT OF SUCCESSOR EMPLOYERS.—Under regulations prescribed by the Secretary, in the case of a successor employer referred to in section 3306(b)(1), the determination of the amount of the credit allowable under section 44B with respect to wages paid by such successor employer shall be made in the same manner as if such wages were paid by the predecessor employer referred to in such section.

"(2) TREATMENT OF EMPLOYEES PERFORMING SERVICES FOR OTHER PERSONS.—No credit shall be allowed under section 44B with respect to remuneration paid by an employer to an employee for services performed by such employee for another person unless the amount reasonably expected to be received by the employer for such services from such other person exceeds the remuneration paid by the employer to such employee for such services."

(3) SPECIAL RULE FOR CERTIFICATION.—Subparagraph (A) of section 51(d)(16) (relating to special rules for certifications) is amended by adding at the end thereof the following new sentence:

"For purposes of the preceding sentence, if on or before the day on which such individual begins work for the employer, such individual has received from a designated local agency (or other agency or organization designated pursuant to a written agreement with such designated local agency) a written preliminary determination that such in-

dividual is a member of a targeted group, then 'the fifth day' shall be substituted for 'the day' in such sentence."

(3) AGE REQUIREMENT FOR QUALIFIED SUMMER YOUTH EMPLOYEE.—Clause (ii) of section 51(d)(12)(A) (defining qualified summer youth employee) is amended by striking out "(as defined in paragraph (14))" and inserting in lieu thereof "(or if later, on May 1 of the calendar year involved)".

(4) TECHNICAL AMENDMENT.—Paragraph (2) of section 51(b) is amended by striking out "(or, in the case of a vocational rehabilitation referral, the day the individual begins work for the employer on or after the beginning of such individual's rehabilitation plan)".

(5) EFFECTIVE DATES.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the amendments made by this section shall apply to individuals who begin work for the employer after the date of the enactment of this Act.

(B) SPECIAL RULE FOR EMPLOYEES PERFORMING SERVICES FOR OTHER PERSONS.—Paragraph (2) of section 51(j) of the Internal Revenue Code of 1954 (as added by this subsection) and the amendment made by paragraph (3) of this subsection shall apply to individuals who begin work for the employer after December 31, 1984.

SEC. 1042. INCREASE IN EARNED INCOME CREDIT.

(a) INCREASE IN RATE OF CREDIT.—Subsection (a) of section 32 (relating to earned income credit), as redesignated by title IV of this Act, is amended by striking out "10 percent" and inserting in lieu thereof "11 percent".

(b) ADJUSTMENT OF CREDIT PHASE-OUT.—Paragraph (2) of section 32(b) (as so redesignated) is amended to read as follows:

"(2) 12⅔ percent of so much of the adjusted gross income (or, if greater, the earned income) of the taxpayer for the taxable year as exceeds $6,500."

(c) CREDIT NOT ALLOWABLE TO TAXPAYERS SUBJECT TO ALTERNATIVE MINIMUM TAX.—Section 32 (as so redesignated) is amended by adding at the end thereof the following new subsection:

"(h) REDUCTION OF CREDIT TO TAXPAYERS SUBJECT TO ALTERNATIVE MINIMUM TAX.—The credit allowed under this section for the taxable year shall be reduced by the amount of tax imposed by section 55 (relating to alternative minimum tax for taxpayers other than corporations) with respect to such taxpayer for such taxable year."

(d) TECHNICAL AMENDMENTS.—

(1) Paragraph (1) of section 32(b) (as so redesignated is amended by striking out "$500" and inserting in lieu thereof "$550".

(2) Subparagraphs (A) and (B) of section 32(f)(2) (as so redesignated) are amended to read as follows:

"(A) for earned income between $0 and $11,000, and

"(B) for adjusted gross income between $6,500 and $11,000."

(3) Clauses (i) and (ii) of section 3507(c)(2)(B) are amended to read as follows:

"(i) of not more than 11 percent of the first $5,000 of earned income, which

"(ii) phases out between $6,500 and $11,000 of earned income, or".

(4) Clauses (i) and (ii) of section 3507(c)(2)(C) are amended to read as follows:

"(i) of not more than 11 percent of the first $2,500 of earned income, which

"(ii) phases out between $3,250 and $5,500 of earned income."

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1984.

SEC. 1043. ALTERNATIVE TEST FOR DEFINITION OF QUALIFIED REHABILITATION BUILDING.

(a) IN GENERAL.—Paragraph (1) of section 48(g) (relating to qualified rehabilitated buildings) is amended by adding at the end thereof the following new subparagraph:

"(E) ALTERNATIVE TEST FOR DEFINITION OF QUALIFIED REHABILITATED BUILDING.—The requirement in clause (iii) of subparagraph (A) shall be deemed to be satisfied if in the rehabilitation process—

"(i) 50 percent or more of the existing external walls of the building are retained in place as external walls,

"(ii) 75 percent or more of the existing external walls of such buildings are retained in place as internal or external walls, and

"(iii) 75 percent or more of the existing internal structural framework of such building is retained in place."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to expenditures incurred after December 31, 1983, in taxable years ending such date.

Subtitle F—Miscellaneous Housing Provisions

SEC. 1051. DISASTER LOSS DEDUCTION WHERE TAXPAYER ORDERED TO DEMOLISH OR RELOCATE RESIDENCE IN DISASTER AREA BECAUSE OF DISASTER.

(a) GENERAL RULE.—Section 165 (relating to losses) is amended by redesignating subsection (k) as subsection (l) and by inserting after subsection (j) the following new subsection:

"(k) TREATMENT AS DISASTER LOSS WHERE TAXPAYER ORDERED TO DEMOLISH OR RELOCATE RESIDENCE IN DISASTER AREA BECAUSE OF DISASTER.—In the case of a taxpayer whose residence is located in an area which has been determined by the President of the United States to warrant assistance by the Federal Government under the Disaster Relief Act of 1974, if—

"(1) not later than the 120th day after the date of such determination, the taxpayer is ordered, by the government of the State or any political subdivision thereof in which such residence is located, to demolish or relocate such residence, and

"(2) the residence has been renderd unsafe for use as a residence by reason of the disaster,

any loss attributable to such disaster shall be treated as a loss which arises from a casualty and which is described in subsection (i).''

(b) EFFECTIVE DATE.—*The amendment made by subsection (a) shall apply to taxable years ending after December 31, 1981, with respect to residences in areas determined by the President of the United States, after such date, to warrant assistance by the Federal Government under the Disaster Relief Act of 1974.*

SEC. 1052. ALLOCATION OF EXPENSES TO PARSONAGE ALLOWANCES.

With respect to any mortgage interest or real property tax costs paid or incurred before January 1, 1986, by any minister of the gospel who owned and occupied a home before January 3, 1983 (or had a contract to purchase a home before such date and subsequently owned and occupied such home), the application of section 265(1) of the Internal Revenue Code of 1954 to such costs shall be determined without regard to Revenue Ruling 83-3 (and without regard to any other regulation, ruling, or decision reaching the same result, or a result similar to the result, set forth in such Revenue Ruling).

SEC. 1053. ARMED FORCES OVERSEAS QUARTERS.

(a) IN GENERAL.—*Subsection (h) of section 1034 (relating to rollover of gain on sale of principal residence) is amended to read as follows:*

''(h) MEMBERS OF ARMED FORCES.—

''(1) IN GENERAL.—*The running of any period of time specified in subsection (a) or (c) (other than the 2 years referred to in subsection (c)(4)) shall be suspended during any time that the taxpayer (or his spouse if the old residence and the new residence are each used by the taxpayer and his spouse as their principal residence) serves on extended active duty with the Armed Forces of the United States after the date of the sale of the old residence, except that any such period of time as so suspended shall not extend beyond the date 4 years after the date of the sale of the old residence.*

''(2) MEMBERS STATIONED OUTSIDE THE UNITED STATES OR REQUIRED TO RESIDE IN GOVERNMENT QUARTERS.—*In the case of any taxpayer who, during any period of time the running of which is suspended by paragraph (1)—*

''(A) is stationed outside of the United States, or

''(B) after returning from a tour of duty outside of the United States and pursuant to a determination by the Secretary of Defense that adequate off-base housing is not available at a remote base site, is required to reside in on-base Government quarters,

any such period of time as so suspended shall not expire before the last day described in subparagraph (A) or (B), as the case may be, except that any such period of time as so suspended shall not extend beyond the date which is 8 years after the date of the sale of the old residence.

''(3) EXTENDED ACTIVE DUTY DEFINED.—*For purposes of this subsection, the term 'extended active duty' means any period of active duty pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period.''*

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to sales of old residences (within the meaning of section 1034 of the Internal Revenue Code of 1954) after the date of the enactment of this Act.

SEC. 1054. TREATMENT OF HOME WON IN LOCAL RADIO CONTEST AND SPECIALLY DESIGNED FOR HANDICAPPED FOSTER CHILD.

(a) IN GENERAL.—If the Federal income tax attributable to the receipt of the prize described in subsection (b) is paid not later than one year after the date of the enactment of this Act, such payment shall be treated for purposes of the Internal Revenue Code of 1954 as being in full satisfaction of such tax and all interest, additions to the tax, additional amounts, and penalties in respect of liability for such Federal income tax.

(b) DESCRIPTION OF PRIZE.—For purposes of subsection (a), the prize described in this subsection is a residence which—

(1) was won by the taxpayer in a local radio contest,

(2) was specially designed to meet the needs of a handicapped foster child of the taxpayer,

(3) is the principal residence (within the meaning of section 1034 of such Code) of the taxpayer, and

(4) had a lien placed on it by the Internal Revenue Service on May 24, 1983, after an Internal Revenue Service supervisor had overruled two payment schedules negotiated with the taxpayer for the payment of taxes, interest, and penalties on income attributable to such residence for the taxpayer's 1980 taxable year.

(c) TAX DETERMINED WITHOUT REGARD TO INTEREST, ETC.—For purposes of subsection (a), the Federal income tax attributable to the prize described in subsection (b) shall be determined without regard to interest, additions to the tax, additional amounts, and penalties.

Subtitle G—Extension of Existing Provisions and Transition Rules

SEC. 1061. EXTENSION OF PAYMENT-IN-KIND TAX TREATMENT ACT OF 1983 TO WHEAT FOR 1984 CROP YEAR.

(a) EXTENSION.—

(1) IN GENERAL.—Section 5 of the Payment-in-Kind Tax Treatment Act of 1983 (relating to definitions and special rules) is amended by redesignating subsection (b) as subsection (c) and by inserting after subsection (a) the following new subsection:

"(b) EXTENSION TO WHEAT PLANTED AND HARVESTED IN 1984.—In the case of wheat—

"(1) any reference in this Act to the 1983 crop year shall include a reference to the 1984 crop year, and

"(2) any reference to the 1983 payment-in-kind program shall include a reference to any program for the 1984 year for wheat which meets the requirements of subparagraphs (A) and (B) of subsection (a)(1)."

(2) DEFINITION OF CROP YEAR.—Paragraph (2) of section 5(a) of such Act is amended to read as follows:

"(2) CROP YEAR.—The term '1983 crop year' means the crop year for any crop the planting or harvesting period for which

occurs during 1983. The term '1984 crop year' means the crop year for wheat the planting and harvesting period for which occurs during 1984.''

(b) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to commodities received for the 1984 crop year (as defined in section 5(a)(2) of the Payment-in-Kind Tax Treatment Act of 1983 as amended by subsection (a)).

SEC. 1062. EXTENSION OF INCREASED DEDUCTION FOR ELIMINATING ARCHITECTURAL AND TRANSPORTATION BARRIERS TO THE HANDICAPPED.

(a) EXTENSION.—

(1) IN GENERAL.—Subsection (d) of section 190 (relating to expenditures to remove architectural and transportation barriers to the handicapped and elderly) is amended to read as follows:

"(d) APPLICATION OF SECTION.—This section shall apply to—

"(1) taxable years beginning after December 31, 1976, and before January 1, 1983, and

"(2) taxable years beginning after December 31, 1983, and before January 1, 1986."

(2) CONFORMING AMENDMENT.—Subsection (c) of section 2122 of the Tax Reform Act of 1976 (26 U.S.C. 190 note) (relating to effective date for allowance of deduction for eliminating architectural and transportation barriers for the handicapped) is amended by striking out "and before January 1, 1983".

(b) INCREASE IN DEDUCTION.—Subsection (c) of section 190 (relating to limitation of deduction) is amended by striking out "$25,000" and inserting in lieu thereof "$35,000".

(c) EFFECTIVE DATE.—The amendment made by subsection (b) shall apply to taxable years beginning after December 31, 1983.

SEC. 1063. PERMANENT DISALLOWANCE OF DEDUCTION FOR EXPENSES OF DEMOLITION OF CERTAIN STRUCTURES.

(a) EXTENSION TO ALL STRUCTURES; DISALLOWANCE MADE PERMANENT.—Section 280B (relating to demolition of certain historic structures) is amended—

(1) by striking out all of subsection (a) which precedes paragraph (1) thereof and inserting in lieu thereof the following: "In the case of the demolition of any structure—"; and

(2) by striking out subsections (b) and (c).

(b) CONFORMING AMENDMENTS.—

(1) The heading for section 280B is amended by striking out "CERTAIN HISTORIC".

(2) The item relating to section 280B in the table of sections for part IX of subchapter B of chapter 1 is amended by striking out "certain historic".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1983.

SEC. 1064. AMORTIZATION OF EXPENDITURES TO REHABILITATE LOW-INCOME RENTAL HOUSING.

Subsection (k) of section 167 (relating to depreciation of expenditures to rehabilitate low-income rental housing) is amended by striking out "January 1, 1984" each place it appears and inserting in lieu thereof "January 1, 1987".

SEC. 1065. RULES TREATING INDIAN TRIBAL GOVERNMENTS AS STATES MADE PERMANENT.

(a) IN GENERAL.—Section 208 of the Indian Tribal Governmental Tax Status Act of 1982 is amended—

(1) by striking out "and before January 1, 1985," each place it appears, and

(2) by striking out ", and shall cease to apply at the close of December 31, 1984" in paragraph (5) thereof.

(b) TREATMENT AS STATE EXPANDED FOR CERTAIN PURPOSES.—Paragraph (6) of section 7871 (relating to Indian tribal governments treated as States for certain purposes) is amended by striking out subparagraphs (B) and (C) and inserting in lieu thereof the following:

"(B) section 105(e) (relating to accident and health plans),

"(C) section 117(b)(2)(A) (relating to scholarships and fellowship grants),

"(D) section 162(e) (relating to appearances, etc., with respect to legislation),

"(E) section 403(b)(1)(A)(ii) (relating to the taxation of contributions of certain employers for employee annuities), and

"(F) section 454(b)(2) (relating to discount obligations).

(c) EFFECTIVE DATE.—The amendment made by subsection (b) shall apply to taxable years beginning after December 31, 1984.

SEC. 1066. TRANSITIONAL RULE FOR TREATMENT OF CERTAIN INCOME FROM S CORPORATIONS.

(a) IN GENERAL.—If—

(1) a corporation had an election in effect under subchapter S of the Internal Revenue Code of 1954 for the taxable years of such corporation beginning in 1982, 1983, and 1984, and

(2) a shareholder of such corporation makes an election to have this section apply,

then any qualified income which such shareholder takes into account by reason of holding stock in such corporation for any taxable year of such corporation beginning in 1983 or 1984 shall be treated for purposes of section 163(d) of the Internal Revenue Code of 1954 as such income would have been treated but for the enactment of the Subchapter S Revision Act of 1982.

(b) QUALIFIED INCOME.—For purposes of subsection (a), the term "qualified income" means any income other than income which is attributable to personal services performed by the shareholder for the corporation.

(c) ELECTION.—The election under subsection (a)(2) shall be made at such time and in such manner as the Secretary of the Treasury or his delegate may by regulations prescribe.

SEC. 1067. SPECIAL LEASING RULES FOR CERTAIN COAL GASIFICATION FACILITIES.

(a) IN GENERAL.—Paragraph (3) of section 208(d) of the Tax Equity and Fiscal Responsibility Act of 1982 is amended by adding at the end thereof the following new subparagraph:

"(G) COAL GASIFICATION FACILITIES.—

"(i) IN GENERAL.—Property is described in this subparagraph if such property—

"(I) is used directly in connection with the manufacture or production of low sulfur gaseous fuel from coal, and

"(II) would be described in subparagraph (A) if 'July 1, 1984' were substituted for 'January 1, 1983'.

"(ii) SPECIAL RULE.—For purposes of determining whether property described in this subparagraph is described in subparagraph (A), such property shall be treated as having been acquired during the period referred to in subparagraph (A)(ii) if at least 20 percent of the cost of such property is paid during such period.

"(iii) LIMITATION ON AMOUNT.—Clause (i) shall only apply to the lease of an undivided interest in the property in an amount which does not exceed the lesser of—

"(I) 50 percent of the cost basis of such property, or

"(II) $67,500,000.

"(iv) PLACED IN SERVICE.—In the case of property to which this subparagraph applies—

"(I) such property shall be treated as placed in service when the taxpayer receives an operating permit with respect to such property from a State environmental protection agency, and

"(II) the term of the lease with respect to such property shall be treated as being 5 years."

(b) SPECIAL RULE FOR SUBSECTION (a).—The amount of any recapture under section 47 of the Internal Revenue Code of 1954 with respect to the credit allowed under section 38 of such Code with respect to progress expenditures (within the meaning of section 46(d) of such Code) shall apply only to the percentage of the cost basis of the coal gasification facility to which the amendment made by subsection (a) applies.

(c) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect as if included in the provision of section 208(d)(3) of the Tax Equity and Fiscal Responsibility Act of 1982.

Subtitle H—Additional Provisions

SEC. 1071. TAX TREATMENT OF REGULATED INVESTMENT COMPANIES.

(a) PERSONAL HOLDING COMPANIES PERMITTED TO BE REGULATED INVESTMENT COMPANIES.—

(1) IN GENERAL.—Subsection (a) of section 851 (defining regulated investment company) is amended by striking out "(other than a personal holding company as defined in section 542)".

(2) SPECIAL RULE FOR RATE OF TAX.—Paragraph (1) of section 852(b) (relating to imposition of tax on regulated investment companies) is amended by adding at the end thereof the following new sentence: "In the case of a regulated investment company which is a personal holding company (as defined in section 542), that tax shall be computed at the highest rate of tax specified in section 11(b)."

(3) REQUIREMENT THAT INVESTMENT COMPANY HAVE NO EARNINGS AND PROFITS ACCUMULATED IN YEAR FOR WHICH IT WAS NOT A REGULATED INVESTMENT COMPANY.—Subsection (a) of section 852 (relating to requirements applicable to regulated investment companies) is amended by striking out "and" at the end of paragraph (1), by striking out the period at the end of paragraph (2) and inserting in lieu thereof ", and", and by adding at the end thereof the following new paragraph:

"(3) either—

"(A) the provisions of this part applied to the investment company for all taxable years ending on or after November 8, 1983, or

"(B) as of the close of the taxable year, the investment company has no earnings and profits accumulated in any taxable year to which the provisions of this part (or the corresponding provisions of prior law) did not apply to it."

(4) PROCEDURES SIMILAR TO DEFICIENCY DIVIDEND PROCEDURES MADE APPLICABLE.—Section 852 is amended by adding at the end thereof the following new subsection:

'(e) PROCEDURES SIMILAR TO DEFICIENCY DIVIDEND PROCEDURES DE APPLICABLE.—

"(1) IN GENERAL.—If—

"(A) there is a determination that the provisions of this part do not apply to an investment company for any taxable year (hereinafter in this subsection referred to as the 'non-RIC year'), and

"(B) such investment company meets the distribution requirements of paragraph (2) with respect to the non-RIC year,

for purposes of applying subsection (a)(3) to subsequent taxable years, the provisions of this part shall be treated as applying to such investment company for the non-RIC year.

"(2) DISTRIBUTION REQUIREMENTS.—

"(A) IN GENERAL.—The distribution requirements of this paragraph are met with respect to any non-RIC year if, within the 90-day period beginning on the date of the determination (or within such longer period as the Secretary may permit), the investment company makes 1 or more qualified designated distributions and the amount of such distributions is not less than the excess of—

"(i) the portion of the accumulated earnings and profits of the investment company (as of the date of the determination) which are attributable to the non-RIC year, over

"(ii) any interest payable under paragraph (3).

"(B) QUALIFIED DESIGNATED DISTRIBUTION.—For purposes of this paragraph, the term 'qualified designated distribution' means any distribution made by the investment company if—

"(i) section 301 applies to such distribution, and

"(ii) such distribution is designated (at such time and in such manner as the Secretary shall by regulations prescribe) as being taken into account under this paragraph with respect to the non-RIC year.

"(C) Effect on dividends paid deduction.—Any qualified designated distribution shall not be included in the amount of dividends paid for purposes of computing the dividends paid deduction for any taxable year.

"(3) Interest charge.—

"(A) In general.—If paragraph (1) applies to any non-RIC year of an investment company, such investment company shall pay interest at the annual rate established under section 6621—

"(i) on an amount equal to 50 percent of the amount referred to in paragraph (2)(A)(i),

"(ii) for the period—

"(I) which begins on the last day prescribed for payment of the tax imposed for the non-RIC year (determined without regard to extensions), and

"(II) which ends on the date the determination is made.

"(B) Coordination with subtitle F.—Any interest payable under subparagraph (A) may be assessed and collected at any time during the period during which any tax imposed for the taxable year in which the determination is made may be assessed and collected.

"(4) Provision not to apply in the case of fraud.—The provisions of this subsection shall not apply if the determination contains a finding that the failure to meet any requirement of this part was due to fraud with intent to evade tax.

"(5) Determination.—For purposes of this subsection, the term 'determination' has the meaning given to such term by section 860(e). Such term also includes a determination by the investment company filed with the Secretary that the provisions of this part do not apply to the investment company for a taxable year."

(5) Effective dates.—

(A) In general.—Except as otherwise provided in this paragraph, the amendments made by this subsection shall apply to taxable years beginning after December 31, 1982.

(B) Investment companies which were regulated investment companies for years ending before November 8, 1983.—In the case of any investment company to which the provisions of part I of subchapter M of chapter 1 of the Internal Revenue Code of 1954 applied for any taxable year ending before November 8, 1983, for purposes of section 852(a)(3)(B) of the Internal Revenue Code of 1954 (as amended by this subsection), no earnings and profits accumulated in any taxable year ending before January 1, 1984, shall be taken into account.

(C) Investment companies beginning business in 1983.—In the case of an investment company which began business in 1983 (and was not a successor corporation), earnings and profits accumulated during its first taxable year shall not be taken into account for purposes of section 852(a)(3)(B) of such Code (as so amended).

(D) Investment companies registering before November 8, 1983.—In the case of any investment company—

(i) which, during the period after December 31, 1981, and before November 8, 1983—

(I) was engaged in the active conduct of a trade or business,

(II) sold substantially all of its operating assets, and

(III) registered under the Investment Company Act of 1940 as either a management company or a unit investment trust, and

(ii) to which the provisions of part I of subchapter M of chapter 1 of the Internal Revenue Code of 1954 applied for its first taxable year beginning after November 8, 1983,

for purposes of section 852(a)(3)(A) of such Code (as amended by paragraph (3)), the provisions of part I of subchapter M of chapter 1 of such Code shall be treated as applying to such investment company for its first taxable year ending after November 8, 1983. For purposes of the preceding sentence, all members of an affiliated group (as defined in section 1504(a) of such Code) filing a consolidated return shall be treated as 1 taxpayer.

(b) SHORT-TERM OBLIGATIONS ISSUED ON A DISCOUNT BASIS.—

(1) IN GENERAL.—Paragraph (2) of section 852(b) (defining investment company taxable income) is amended by adding at the end thereof the following new subparagraph—

"(F) The taxable income shall be computed without regard to section 454(b) (relating to short-term obligations issued on a discount basis) if the company so elects in a manner prescribed by the Secretary."

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to taxable years beginning after December 31, 1978.

SEC. 1072. TECHNICAL MODIFICATIONS TO TIP REPORTING REQUIREMENTS.

(a) LOWER ALLOCATION OF GROSS RECEIPTS.—Subparagraph (C) of section 6053(c)(3) (relating to employee allocation of 8 percent of gross receipts) is amended—

(1) by striking out "The Secretary" and inserting in lieu thereof "Upon the petition of the employer or the majority of employees of such employer, the Secretary", and

(2) by striking out "5 percent" and inserting in lieu thereof "2 percent".

(b) RECORDKEEPING BY TIPPED EMPLOYEES.—The Secretary of the Treasury shall prescribe by regulations within 1 year after the date of the enactment of this Act the applicable recordkeeping requirements for tipped employees.

(c) 50 PERCENT OWNERS NOT TREATED AS EMPLOYEES FOR CERTAIN PURPOSES.—

(1) IN GENERAL.—Paragraph (4) of section 6056(c) (defining large food or beverage establishment) is amended by inserting before the period at the end of the last sentence the following: ", and an individual who owns 50 percent or more in value of the stock of the corporation operating the establishment shall not be treated as an employee".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to calendar years beginning after December 31, 1982.

SEC. 1073. TIPS TREATED AS WAGES FOR PURPOSES OF FEDERAL UNEMPLOYMENT TAX.

(a) GENERAL RULE.—Section 3306 (relating to definitions for purposes of Federal unemployment tax) is amended by adding at the end thereof the following new subsection:

"(s) TIPS TREATED AS WAGES.—For purposes of this chapter, the term 'wages' includes tips which are—

"(1) received while performing services which constitute employment, and

"(2) included in a written statement furnished to the employer pursuant to section 6053(a)."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendment made by subsection (a) shall take effect on January 1, 1986.

(2) EXCEPTION FOR CERTAIN STATES.—In the case of any State the legislature of which—

(A) did not meet in a regular session which begins during 1984 and after the date of the enactment of this Act, and

(B) did not meet in a session which began before the date of the enactment of this Act and remained in session for at least 25 calendar days after such date of enactment,

the amendment made by subsection (a) shall take effect on January 1, 1987.

SEC. 1074. EXCLUSION OF CERTAIN SERVICES FROM THE FEDERAL UNEMPLOYMENT TAX ACT.

Subsection (b) of section 822 of the Economic Recovery Tax Act of 1981 (26 U.S.C. 3306 note) is amended by striking out "and before January 1, 1983" and inserting in lieu thereof "and before January 1, 1985".

SEC. 1075. TAXATION OF UNEMPLOYMENT COMPENSATION NOT TO APPLY TO COMPENSATION PAID FOR WEEKS OF UNEMPLOYMENT ENDING BEFORE DECEMBER 1, 1978.

(a) GENERAL RULE.—Subsection (d) of section 112 of the Revenue Act of 1978 (relating to taxation of unemployment compensation benefits at certain income levels) is amended to read as follows:

"(d) EFFECTIVE DATE.—The amendments made by this section shall apply to payments of unemployment compensation made after December 31, 1978, in taxable years ending after such date; except that such amendments shall not apply to payments made for weeks of unemployment ending before December 1, 1978."

(b) WAIVER OF STATUTE OF LIMITATIONS.—If credit or refund of any overpayment of tax resulting from the amendment made by subsection (a) is barred on the date of the enactment of this Act or at any time during the 1-year period beginning on the date of the enactment of this Act by the operation of any law or rule of law (including res judicata), refund or credit of such overpayment (to the extent attributable to the amendment made by subsection (a)) may, nevertheless, be made or allowed if claim thereof is filed before the close of such 1-year period.

SEC. 1076. EXCLUSION FROM GROSS INCOME OF CANCELLATIONS OF CERTAIN STUDENT LOANS.

(a) IN GENERAL.—Section 108 (relating to income from discharge of indebtedness) is amended by adding at the end thereof the following new subsection:

"(f) STUDENT LOANS.—

"(1) IN GENERAL.—In the case of an individual, gross income does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of any student loan if such discharge was pursuant to a provision of such loan under which all or part of the indebtedness of the individual would be discharged if the individual worked for a certain period of time in certain professions for any of a broad class of employers.

"(2) STUDENT LOAN.—For purposes of this subsection, the term 'student loan' means any loan to an individual to assist the individual in attending an educational organization described in section 170(b)(1)(A)(ii) made by—

"(A) the United States, or an instrumentality or agency thereof,

"(B) a State, territory, or possession of the United States, or the District of Columbia, or any political subdivision thereof, or

"(C) a public benefit corporation—

"(i) which is exempt from taxation under section 501(c)(3),

"(ii) which has assumed control over a State, county, or municipal hospital, and

"(iii) whose employees have been deemed to be public employees under State law, or

"(D) any educational organization so described pursuant to an agreement with any entity described in subparagraph (A), (B), or (C) under which the funds from which the loan was made were provided to such educational organization."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to discharges of indebtedness made on or after January 1, 1983.

SEC. 1077. MIGRATORY BIRD HUNTING STAMPS.

(a) IN GENERAL.—Section 5 of the Act of March 16, 1934 (48 Stat. 451, Chapter 71; 16 U.S.C. 718e) is amended by adding at the end thereof the following new subsection:

"(c) Notwithstanding the provisions of subsection (b), or the prohibition in section 474 of title 18, United States Code, or other provisions of law, the Secretary of the Interior may authorize, with the concurrence of the Secretary of the Treasury,

"(1) the color reproduction, or

"(2) the black and white reproduction,

of migratory bird hunting stamps authorized by sections 1 through 4 and 6 through 9 of this Act, which otherwise satisfies the requirements of clauses (ii) and (iii) of section 504(1) of title 18, United States Code. Any such reproduction shall be subject to those terms and conditions deemed necessary by the Secretary of the Interior by regulation or otherwise and any proceeds received by the Federal

Government as a result of such reproduction shall be paid into the migratory bird conservation fund established under section 4 of this Act."

(b) TECHNICAL AMENDMENTS.—

(1) Clause (i) of section 504(1)(D) of title 18, United States Code, is amended by inserting "and stamps issued under the Migratory Bird Hunting Stamp Act of 1934" after "foreign government".

(2) Clause (ii) of such section is amended by inserting "and illustrations of stamps issued under the "Migratory Bird Hunting Stamp Act of 1934 in color" after "postage stamps in color".

(3) Subsection (b) of section 5 of the Act referred to in subsection (a) is amended by striking out "No person" and inserting in lieu thereof "Except as provided in clauses (i) and (ii) of section 504(1)(D) of title 18, United States Code, no person".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

SEC. 1078. EXCLUSION FROM GROSS INCOME OF PAYMENTS FROM THE UNITED STATES FOREST SERVICE AS A RESULT OF RESTRICTING MOTORIZED TRAFFIC IN THE BOUNDARY WATERS CANOE AREA.

(a) GENERAL RULE.—At the election of the taxpayer, for purposes of the Internal Revenue Code of 1954, gross income does not include the excludable portion of payments received from the United States Forest Service as a result of restricting motorized traffic in the Boundary Waters Canoe Area, pursuant to section 19(a) of "An Act to designate the Boundary Waters Canoe Area Wilderness, to establish the Boundary Waters Canoe Area Mining Protection Area, and for other purposes", approved October 21, 1978 (Public Law 95-495; 92 Stat. 1649).

(b) EXCLUDABLE PORTION.—For purposes of this section, the term "excludable portion" means that portion (or all) of a payment made to any taxpayer during the period after December 31, 1979, and before the later of the date which is 2 years after—

(1) the date of the enactment of this Act, or

(2) the date of such payment,

which payment is reinvested within such period in depreciable property used in a trade or business of such taxpayer as authorized by the Act referred to in subsection (a). In determining whether reinvestment has occurred, no direct tracing is required.

(c) ELECTION.—An election under subsection (a) shall identify such property for which such payment has been allocated. An election may be made at any time before the expiration of the period for making a claim for credit or refund of the tax imposed by chapter 1 of such Code for the taxable year in which the reinvestment occurred, and shall be made in such manner as the Secretary of the Treasury or his delegate shall by regulations prescribe.

(d) BASIS OF PROPERTY.—

(1) IN GENERAL.—The basis of any property, with respect to which an allocation of any payment has been elected, shall be reduced by the amount of such payment.

(2) INCREASE DUE TO REPAYMENT.—The basis of any property described in paragraph (1) shall be increased by the amount of

any repayments made to the United States Forest Service upon the sale of such property.

(e) DENIAL OF DOUBLE BENEFIT.—No deduction or credit shall be allowed under such Code with respect to any expenditure which is properly associated with any amount excluded from gross income under subsection (a).

(f) EFFECTIVE DATE; SPECIAL RULE.—

(1) EFFECTIVE DATE.—The amendments made by this section shall apply to payments made in taxable years beginning after December 31, 1979.

(2) ELECTIONS FOR PRIOR YEARS.—In the case of any taxable year ending before the date of the enactment of this Act—

(A) the period for making the election under subsection (c) shall not expire before the date which is 1 year after the date of the enactment of this Act, and

(B) if, after the application of subparagraph (A), refund or credit of any overpayment of tax resulting from the application of this section is prevented at any time before the close of such 1-year period by the operation of any law or rule of law (including res judicata), refund or credit of such overpayment (to the extent attributable the application of this section) may, nevertheless, be made or allowed if claim therefore is filed before the close of such 1-year period.

SEC. 1079. TAX EXEMPTION OF CORPORATIONS ORGANIZED UNDER ACTS OF CONGRESS.

Paragraph (1) of section 501(c) (relating to list of exempt organizations) is amended by striking out ", under such Act, as amended and supplemented," and inserting in lieu thereof "it is specifically provided in this title (or under such Act as amended and supplemented before the date of the enactment of the Tax Reform Act of 1984) that".

Subtitle I—Studies

SEC. 1081. STUDY OF ALTERNATIVE INCOME TAX SYSTEMS.

(a) IN GENERAL.—The Secretary of the Treasury or his delegate shall conduct a study covering the advisability of—

(1) replacing only the Federal individual income tax, or

(2) replacing both the Federal individual income tax and the Federal corporate income tax,

with an alternative tax system.

(b) CONTENTS OF STUDY.—Such study shall take into account the administrative complexity of the existing Federal income tax system and address the ramifications of replacing that system with an alternative tax system. Such study shall focus on (but not be limited to) the following factors:

(1) protecting the economically disadvantaged,

(2) increasing economic efficiency in both the private and public sectors of the economy,

(3) reducing paperwork and auditing requirements, reducing taxpayer fraud and evasion, and expediting resolution of tax disputes between taxpayers and the Federal Government,

(4) increasing economic incentives for capital formation and productivity,

(5) removing economic disincentives to employment,

(6) excluding certain items, such as social security benefits, from gross income,

(7) equalizing the tax burden on taxpayers with equal ability to pay taxes, and

(8) achieving the appropriate burden of taxes for each income class of taxpayers.

Such study shall also identify the strengths and potential weaknesses of an alternative tax system and propose possible solutions for any such potential weakness.

(c) ALTERNATIVE TAX SYSTEM.—For purposes of this section, the term "alternative tax system" means a system based on—

(1) a simplified income tax based on gross income;

(2) a consumption tax;

(3) a consumption-based tax; or

(4) the broadening of the base and lowering of the rates of the current income tax.

(d) STUDY OF TAX SHELTERS TO BE INCLUDED.—The study conducted under subsection (a) shall include a study of the entire area of tax shelters and how they impact on the equity of the tax system.

(e) REPORTING DATE.—The report of the study required by subsection (a) shall be submitted to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate not later than December 31, 1984.

SEC. 1082. STUDY OF TAXATION BY FOREIGN COUNTRIES ON SERVICES PERFORMED IN THE UNITED STATES.

(a) STUDY.—The Secretary of the Treasury or his delegate shall conduct a study of the practices of foreign countries of taxing income on services performed within the United States, including, but not limited to—

(1) the status of treaty negotiations with such foreign countries with respect to such practices, and

(2) any options to alleviate the taxation of such income by more than 1 country without appropriate credit for taxes paid.

(b) REPORT.—The Secretary of the Treasury or his delegate shall report to the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives the results of the study conducted under subsection (a) no later than December 31, 1984.

DIVISION B—SPENDING REDUCTION ACT OF 1984

SEC. 2001. This division may be cited as the "Spending Reduction Act of 1984".

TABLE OF CONTENTS

TITLE I—GENERAL PROVISIONS

SENSE OF SENATE STATEMENT

SEC. 2101. It is the sense of the Senate that ceilings on fiscal year 1985 appropriation bills shall not exceed, in the aggregate, $139.8 billion for non-defense, discretionary accounts, and shall not exceed $299 billion for defense accounts. Further, it is the sense of the Senate that the allocations of these sums, normally done through the section 302(b) process under the Congressional Budget and Impoundment Control Act of 1974, in the absence of a first concurrent budget resolution for fiscal year 1985 will be done by the Senate Appropriations Committee to guide its subcommittees in their separate deliberations on individual appropriation bills for fiscal year 1985.

SENSE OF HOUSE STATEMENT

SEC. 2102. (a) It is the sense of the House that in fiscal years 1985, 1986, and 1987, Federal deficits be reduced by $182 billion as a result of the first concurrent resolution on the budget for fiscal year 1985 and the Deficit Reduction Act of 1984. Further, it is the sense of the House that these deficit reductions shall be divided among revenue increases, domestic spending reductions, and limits on the growth in military spending.

(b) It is the sense of the House that in the absence of agreement on a first concurrent resolution on the budget for fiscal year 1985 that the House will continue to abide by House Concurrent Resolution 280, as passed the House.

(c) It is the sense of the House that the Congress shall immediately adopt a conference report on the first concurrent resolution on the budget for fiscal year 1985 and that the Congress shall enforce the aggregate levels of revenue and spending provided in such resolution.

RESCISSION

SEC. 2103. Of the amounts provided in Public Law 96–126, the Department of the Interior and Related Agencies Appropriation Act, 1980, for the "Energy Security Reserve", $2,000,000,000 are rescinded, of which $1,154,950,000 is to be derived from the unused portion of the commitment of financial assistance previously awarded to The Oil Shale Company (Colony Shale Oil Project).

TITLE II—CIVIL SERVICE AND MILITARY RETIREMENT PROGRAMS

COST-OF-LIVING ADJUSTMENTS UNDER GOVERNMENT RETIREMENT SYSTEMS

SEC. 2201. (a) Notwithstanding any other provision of law, beginning with the monthly rate payable for December 1984, any annuity or retired or retirement pay payable under any retirement system for Government officers or employees which the President adjusts pur-

suant to section 8340(b) of title 5, United States Code, shall be paid no earlier than the first business day of the succeeding month.

(b) Section 8340(c)(1) of title 5, United States Code, is amended—

(1) in subparagraph (A), by striking out "computer" and inserting in lieu thereof "computed"; and

(2) in subparagraph (B), by striking out "counting" and inserting in lieu thereof "not to exceed 12 months, counting".

TECHNICAL AMENDMENT RELATING TO PREVAILING RATE EMPLOYEES

SEC. 2202. (a) Notwithstanding any other provision of law, effective as of October 1, 1983, any adjustment in a wage schedule or rate—

(1) that applies—

(A) to a prevailing rate employee described in section 5342(a)(2) of title 5, United States Code;

(B) to an employee covered by section 5348 of such title; or

(C) to any other employee subject to section 202(b)(1) of the Omnibus Budget Reconciliation Act of 1983 (Public Law 98-270; 98 Stat. 158);

(2) that results from a wage survey; and

(3) that first becomes effective during the fiscal year ending September 30, 1984;

shall not take effect until the first day of the first applicable pay period beginning after the expiration of the 90-day period beginning on the date on which such adjustment would otherwise have taken effect.

(b) The Office of Personnel Management shall take such actions as may be necessary to carry out the provisions of this section.

DEDUCTION FROM CIVILIAN PAY FOR COST-OF-LIVING ADJUSTMENT OF RETIRED OR RETAINER PAY

SEC. 2203. Subsection (d) of section 301 of the Omnibus Budget Reconciliation Act of 1982 (96 Stat. 791; 5 U.S.C. 5532 note) is repealed, effective with respect to pay periods beginning after the date of enactment of this Act.

LEAVE FOR CERTAIN OVERSEAS EMPLOYEES

SEC. 2204. Subsection (a) of section 6 of the Defense Department Overseas Teachers Pay and Personnel Practices Act (73 Stat. 214; 20 U.S.C. 904(a)) is amended by striking out "except that—" and all that follows through the end of such subsection and inserting in lieu thereof "except that if the school year includes more than eight months, any such teacher who shall have served for the entire school year shall be entitled to ten days of cumulative leave with pay.".

CIVIL SERVICE RETIREMENT DEPOSITS COVERING MILITARY SERVICE

SEC. 2205. The first sentence of section 306(g) of the Omnibus Budget Reconciliation Act of 1982 (5 U.S.C. 8331 note) is amended by striking out "October 1, 1983" and inserting in lieu thereof "October 1, 1985".

ELECTION OF RETIREMENT PLAN

SEC. 2206. (a) For the purposes of this section, the term "covered retirement system" shall have the same meaning as provided in section 203(a)(2) of the Federal Employees' Retirement Contribution Temporary Adjustment Act of 1983 (Public Law 98-168; 97 Stat. 1107).

(b)(1) Any individual who was entitled to make an election under section 208(a) of the Federal Employees' Retirement Contribution Temporary Adjustment Act of 1983 (97 Stat. 1111), but who did not make such an election, may make an election under such section not later than September 15, 1984.

(2)(A) Not later than September 15, 1984, any such individual who made an election under paragraph (1) of section 208(a) of the Federal Employees' Retirement Contribution Temporary Adjustment Act of 1983 may—

(i) make any other election which such individual was entitled to make under such section before January 1, 1984; or

(ii) elect to become a participant in a covered retirement system (if such individual is otherwise eligible to participate in such system), subject to sections 201 through 207 of such Act.

(B) Not later than September 15, 1984, any such individual who made an election under paragraph (2) of section 208(a) of the Federal Employees' Retirement Contribution Temporary Adjustment Act of 1983 may—

(i) make any other election which such individual was entitled to make under such section before January 1, 1984; or

(ii) elect to terminate participation in the covered retirement system with respect to which such individual made the election under such paragraph (2).

(3) An election under this subsection shall be made by a written application submitted to the official by whom the electing individual is paid.

(4) An election made as provided in this subsection shall take effect with respect to service performed on or after the first day of the first applicable pay period commencing after September 15, 1984.

(c)(1) Section 8342(a)(4) of title 5, United States Code, does not apply for the purpose of determining an entitlement to a refund under section 208(c) of the Federal Employees' Retirement Contribution Temporary Adjustment Act of 1983 (97 Stat. 1111).

(2) Paragraph (1) shall take effect with respect to any election made under section 208(a) of such Act or this Act before, on, or after January 1, 1984.

(d) Nothing in this section or the Federal Employees' Retirement Contribution Temporary Adjustment Act of 1983 affects any entitlement to benefits accrued under a covered retirement system before January 1, 1984, except to the extent that any amount refunded under section 208(c) of such Act is not redeposited in the applicable retirement fund.

SALARY ADJUSTMENTS FOR JUDGES

SEC. 2207. Effective on the first day of the first applicable pay period commencing on or after January 1, 1984, each rate of pay subject to adjustment by section 461 of title 28, United States Code, *shall be increased by an amount, rounded to the nearest multiple of $100 (or if midway between multiples of $100, to the next higher multiple of $100), equal to the overall percentage of the adjustment taking effect under section 5305 of title 5, United States Code, in the rates of pay under the General Schedule during fiscal year 1984.*

RETIREMENT BENEFITS FOR NATIVES OF THE PRIBILOF ISLANDS

SEC. 2208. (a) Section 8332(b) of title 5, United States Code, is amended by striking out the period at the end of the second paragraph (13) and inserting in lieu thereof the following: ", and regardless of whether the Native who performs the service retires before, on, or after the effective date of this paragraph.".

(b) Title II of Public Law 89–702, as amended by section 2 of Public Law 98–129, is amended by adding at the end thereof the following new section:

"SEC. 212. (a)(1) An annuity or survivor annuity based on the service of an employee or Member who performed service described in the second paragraph (13) of subsection (b) or subsection (l)(1)(C) of section 8332 of title 5, United States Code, as added by subsections (b) and (e), respectively, of section 209 of this Act, shall, upon application to the Office of Personnel Management, be recomputed in accordance with the second paragraph (13) of subsection (b) and subsection (l), respectively, of such section 8332, regardless of whether the employee or Member retires before, on, or after the effective date of this paragraph.

"(2) Any recomputation of annuity under paragraph (1) of this subsection shall apply with respect to months beginning more than 30 days after the date on which application for such recomputation is received by the Office.".

(c) The amendments made by this section shall take effect as of October 14, 1983.

AMENDMENT TO OMNIBUS BUDGET RECONCILIATION ACT OF 1981

SEC. 2209. Section 1722 of the Omnibus Budget Reconciliation Act of 1981 (Public Law 97–35; 95 Stat. 759) is amended by striking out "1984" and inserting in lieu thereof "1987".

TITLE III—MEDICARE, MEDICAID, AND MATERNAL AND CHILD HEALTH AMENDMENTS

SHORT TITLE OF TITLE

SEC. 2300. This title may be cited as the "Medicare and Medicaid Budget Reconciliation Amendments of 1984".

TABLE OF CONTENTS OF TITLE

Subtitle A—Medicare Amendments

PART I—REIMBURSEMENT AND BENEFIT CHANGES

PART II—ADMINISTRATIVE AND MISCELLANEOUS CHANGES

Subtitle A—Medicare Amendments

PART I—REIMBURSEMENT AND BENEFIT CHANGES

MODIFICATION OF WORKING AGED PROVISION

SEC. 2301. (a) Section 1862(b)(3)(A)(i) of the Social Security Act is amended by striking out "over 64 but" each place is appears.

(b) Section 4(g)(1) of the Age Discrimination in Employment Act of 1967 is amended—

(1) by inserting ", and any employee's spouse aged 65 through 69," after "aged 65 through 69"; and

(2) by inserting ", and the spouse of such employee," after "same conditions as any employee".

(c)(1) The amendment made by subsection (a) shall be effective with respect to items and services furnished on or after January 1, 1985.

(2) The amendment made by subsection (b) shall become effective on January 1, 1985.

PART B PREMIUM

SEC. 2302. (a) Section 1839(e) of the Social Security Act is amended by striking out "1986" each place it appears and inserting in lieu thereof in each instance "1988".

(b) Section 1839 of such Act is amended by adding at the end thereof the following new subsection:

"(f)(1) If no cost-of-living increases becomes effective under section 215(i) in December of 1985 or 1986, the monthly premium of each individual enrolled under this part for each month in the succeeding year shall (except as otherwise provided in subsection (b)) be the same as the monthly premium (disregarding subsection (b)) of the individual for such December.

"(2) If paragraph (1) does not apply to the monthly premiums for 1986 or 1987, if an individual is entitled to monthly benefits under section 202 or 223 for November and for December in the preceeding year, and if the monthly premium for that December and for the following January is deducted from those benefits under section 1840(a)(1), the monthly premium for that individual for that January and for each of the succeeding 11 months for which he is entitled to benefits under section 202 or 223 shall (except as otherwise provided in subsection (b)) be the greater of—

"(A) the monthly premium amount determined under subsection (a)(2) for that January reduced by the amount (if any) necessary to make the monthly benefits under section 202 or 223 for that January after the deduction of the monthly premium (disregarding subsection (b)) for that January at least equal to the monthly benefits under section 202 or 203 for the preceding November after the deduction of the premium (disregarding subsection (b)) for that individual for that November, or

"(B) the monthly premium (disregarding subsection (b)) for that individual for that December.

For purposes of this subsection, retroactive adjustments or payments and deductions on account of work shall not be taken into account in determining the monthly benefits to which an individual is entitled under section 202 or 223.".

(C) The amendments made by this section shall apply to premiums for months beginning with January 1986.

PAYMENT FOR CLINICAL DIAGNOSTIC LABORATORY TESTS

SEC. 2303. (a) Section 1833(a)(1)(D) of the Social Security Act is amended to read as follows: "(D) with respect to clinical diagnostic laboratory tests for which payment is made under this part (i) on the basis of a fee schedule under subsection (h)(1), the amount paid shall be equal to 80 percent (or 100 percent, in the case of such tests for which payment is made on the basis of an assignment described in section 1842(b)(3)(B)(ii) or under the procedure described in section 1870(f)(1)) of the lesser of the amount determined under such fee schedule or the amount of the charges billed for the tests, or (ii) on the basis of a negotiated rate established under subsection (h)(6), the amount paid shall be equal to 100 percent of such negotiated rate;".

(b) Section 1833(a)(2) of such Act is amended—

(1) in subparagraph (B), by inserting "or (D)" after "subparagrah (c)";
(2) by striking out "and" at the end of subparagraph (B);
(3) by adding "and" at the end of subparagraph (C); and
(4) by adding at the end thereof the following new subparagraph:

"(D) with respect to clinical diagnostic laboratory tests for which payment is made under this part (i) on the basis of a fee schedule determined under subsection (h)(1), the amount paid shall be equal to 80 percent (or 100 percent, in the case of such tests for which payment is made on the basis of an assignment described in section 1842(b)(3)(B)(ii), under the procedure described in section 1870(f)(1), or to a provider having an agreement under section 1866) of the lesser of the amount determined under such fee schedule or the amount of the charges billed for the tests, or (ii) on the basis of a negotiated rate established under subsection (h)(6), the amount paid shall be equal to 100 percent of such negotiated rate for such tests;".

(c) Section 1833(b) of the Social Security Act is amended by striking out "and" at the end of clause (2) and by inserting before the period at the end of clause (3) the following: ", and (4) such deductible shall not apply with respect to clinical diagnostic laboratory tests for which payment is made under this part (A) under subsection (a)(1)(D)(i) or (a)(2)(D)(i) on the basis of an assignment described in section 1842(b)(3)(B)(ii), under the procedure described in section 1870(f)(1), or to a provider having an agreement under section 1866, or (B) on the basis of a negotiated rate determined under subsection (h)(6)".

(d) Section 1833(h) of such Act is amended to read as follows:

"(h)(1)(A) The Secretary shall establish fee schedules for clinical diagnostic laboratory tests for which payment is made under this part, other than such tests performed by a provider of services for an inpatient of such provider.

"(B) In the case of clinical diagnostic laboratory tests performed by a physician or by a laboratory (other than tests performed by a hospital laboratory for outpatients of such hospital), the fee schedules established under subparagraph (A) shall be established on a regional, statewide, or carrier service area basis (as the Secretary may determine to be appropriate) for tests furnished during the period beginning on July 1, 1984, and ending on June 30, 1987. For such tests furnished on or after July 1, 1987, the fee schedule shall be established on a nationwide basis.

"(C) In the case of clinical diagnostic laboratory tests performed by a hospital laboratory for outpatients of such hospital, the fee schedules established under subparagraph (A) shall be established on a regional, statewide, or carrier service area basis (as the Secretary may determine to be appropriate) for tests furnished during the period beginning on July 1, 1984, and ending on June 30, 1987. For such tests furnished on or after July 1, 1987, the fee schedule under subparagraph (A) shall not apply with respect to clinical diagnostic laboratory tests performed by a hospital laboratory for outpatients of such hospital.

"(2) Except as provided in paragraph (4), the Secretary shall set the fee schedules at 60 percent (or, in the case of a test performed by a hospital laboratory for outpatients of such hospital, 62 percent) of the prevailing charge level determined pursuant to the third and fourth sentences of section 1842(b)(3) for similar clinical diagnostic laboratory tests for the applicable region, State, or area (or, effective July 1, 1987, for the United States) for the 12-month period beginning July 1, 1984, adjusted annually by a percentage increase or decrease equal to the percentage increase or decrease in the Consumer Price Index for All Urban Consumers (United States city average), and subject to such other adjustments as the Secretary determines are justified by technological changes. The Secretary may make further adjustments or exceptions to the fee schedules to assure adequate reimbursement of (A) emergency laboratory tests needed for the provision of bona fide emergency services, and (B) certain low volume high-cost tests where highly sophisticated equipment or extremely skilled personnel are necessary to assure quality.

"(3) In addition to the amounts provided under the fee schedules, the Secretary shall provide for and establish a nominal fee to cover the appropriate costs in collecting the sample on which a clinical diagnostic laboratory test was performed and for which payment is made under this part, except that not more than one such fee may be provided under this paragraph with respect to samples collected in the same encounter.

"(4) In establishing any fee schedule under this subsection, the Secretary may provide for an adjustment to take into account, with respect to the portion of the expenses of clinical diagnostic laboratory tests attributable to wages, the relative difference between a region's or local area's wage rates and the wage rate presumed in the data on which the schedule is based.

"(5)(A) In the case of a bill or request for payment for a clinical diagnostic laboratory test for which payment may otherwise be made under this part on the basis of an assignment described in section 1842(b)(3)(B)(ii), under the procedure described in section 1870(f)(1), or under a provider agreement under section 1866, payment may be made only to the person or entity which performed or supervised the performance of such test; except that—

"(i) if a physician performed or supervised the performance of such test, payment may be made to another physician with whom he shares his practice, and

"(ii) in the case a test performed at the request of a laboratory by another laboratory, payment may be made to the referring laboratory.

"(B) In the case of such a bill or request for payment for a clinical diagnostic laboratory test for which payment may otherwise be made under this part, and which is not described in subparagraph (A), payment may be made to the beneficiary only on the basis of the itemized bill of the person or entity which performed or supervised the performance of the test.

"(C) Payment for a clinical diagnostic laboratory test performed by a laboratory which is independent of a physician's office or a rural health clinic may only be made on the basis of an assignment described in section 1842(b)(3)(B)(ii), under the procedure described

in section 1870(f)(1), or to a provider of services with an agreement in effect under section 1866.

"(6) In the case of any diagnostic laboratory test which is not paid on the basis of a fee schedule under paragraph (1), the Secretary may establish a payment rate which is acceptable to the person or entity performing the test and which would be considered the full charge for such tests. Such negotiated rate shall be limited to an amount not in excess of the total payment that would have been made for the services in the absence of such rate.".

(e) Section 1842 of such Act is amended by striking out subsection (h) thereof.

(f) The last sentence of section 1866(a)(2)(A) of such Act is amended by inserting "and with respect to clinical diagnostic laboratory tests" after "section 1861(s)(10)".

(g)(1) Section 1902(a) of such Act is amended—

(A) by inserting "and" at the end of paragraph (42);

(B) by striking out paragraph (43); and

(C) by redesignating paragraph (44) as paragraph (43).

(2) Section 1903(i) of such Act is amended—

(A) by striking out the period at the end of paragraph (6) and inserting in lieu thereof "; or ", and

(B) by adding after paragraph (6) the following new paragraph:

"(7) with respect to any amount expended for clinical diagnostic laboratory tests performed by a physician, independent laboratory, or hospital, to the extent such amount exceeds the amount that would be recognized under section 1833(h) for such tests performed for an individual enrolled under part B of title XVIII.".

(h) The Secretary of Health and Human Services shall simplify the procedures under section 1842 of the Social Security Act with respect to claims and payments for clinical diagnostic laboratory tests so as to reduce unnecessary paperwork while assuring that sufficient information is supplied to identify instances of fraud and abuse.

(i)(1) The Comptroller General shall report to the Congress on—

(A) the appropriateness of the fee schedules under section 1833(h) of the Social Security Act and their impact on the volume and quality of clinical diagnostic laboratory services;

(B) the potential impact of the adoption of a national fee schedule; and

(C) the potential impact of applying a national fee schedule to clinical diagnostic laboratory tests provided by hospitals to their outpatients.

(2) The Secretary of Health and Human Services shall report to the Congress with respect to the advisability and feasibility of a system of direct payment to any physician for all clinical diagnostic laboratory tests ordered by such physician.

(3) The reports required by paragraphs (1) and (2) shall be submitted not later than January 1, 1987.

(j)(1) Except as provided in paragraphs (2) and (3), the amendments made by this section shall apply to clinical diagnostic laboratory tests furnished on or after July 1, 1984.

(2) The amendments made by subsection (g)(2) shall apply to payments for calendar quarters beginning on or after October 1, 1984.

(3) The amendments made by this section shall not apply to clinical diagnostic laboratory tests furnished to inpatients of a provider operating under a waiver granted pursuant to section 602(k) of the Social Security Amendments of 1983. Payment for such services shall be made under part B of title XVIII of the Social Security Act at 80 percent (or 100 percent in the case of such tests for which payment is made on the basis of an assignment described in section 1842(b)(3)(B)(ii) of the Social Security Act or under the procedure described in section 1870(f)(1) of such Act) of the reasonable charge for such service. The deductible under section 1833(b) of such Act shall not apply to such tests if payment is made on the basis of such an assignment or procedure.

PACEMAKER REIMBURSEMENT REVIEW AND REFORM

SEC. 2304. (a)(1) The Secretary shall issue revisions to the current guidelines for the payment under part B of title XVIII of the Social Security Act for the transtelephonic monitoring of cardiac pacemakers. Such revised guidelines shall include provisions regarding the specifications for and frequency of transtelephonic monitoring procedures which will be found to be reasonable and necessary.

(2)(A) Except as provided in subparagraph (B), if the guidelines required by paragraph (1) have not been issued and put into effect by October 1, 1984, and until such guidelines have been issued and put into effect, payment may not be made under part B of title XVIII of the Social Security Act for transtelephonic monitoring procedures, with respect to a single-chamber cardiac pacemaker powered by lithium batteries, conducted more frequently than—

(i) weekly during the first month after implantation,

(ii) once every two months during the period representing 80 percent of the estimated life of the implanted device, and

(iii) monthly thereafter.

(B) Subparagraph (A) shall not apply in cases where the Secretary determines that special medical factors (including possible evidence of pacemaker or lead malfunction) justify more frequent transtelephonic monitoring procedures.

(b)(1) The Secretary shall review, and report to the Committees on Energy and Commerce and Ways and Means of the House of Representatives and the Committee on Finance of the Senate, regarding the appropriateness of the amounts recognized as reasonable under part B of title XVIII of the Social Security Act for physicians' services associated with implantation or replacement of pacemaker devices and pacemaker leads. Such review shall take into account the amounts recognized as reasonable with respect to such procedures and the time and difficulty of such procedures at the current time in comparison with such amounts and the time and difficulty of such procedures at the time the amounts for such procedures were first established under such part.

(2) The Prospective Payment Assessment Commission, established under section 1886(e) of the Social Security Act, shall review and report to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate regarding the appropriateness of the payment amounts provided under section 1886(d) of such Act for inpatient hospital services associated with

implantation or replacement of pacemaker devices and pacemaker leads. Such review shall take into account the time, difficulty, and costs associated with such procedures at the current time in comparison with the time, difficulty, and costs associated with such procedures upon which the payment rates for such procedures under part A of title XVIII of such Act are based.

(3) The Secretary and the Commission shall each complete the review described in paragraph (1) or (2), respectively, of this subsection and report on such review not later than March 1, 1985.

(c) Section 1862 of the Social Security Act is amended by adding at the end the following new subsection:

"(h)(1)(A) The Secretary shall, through the Commissioner of the Food and Drug Administration, provide for a registry of all cardiac pacemaker devices and pacemaker leads for which payment was made under this title.

"(B) Such registry shall include the manufacturer, model, and serial number of each such device or lead, the name of the recipient of such device or lead, the date and location of the implantation or removal of the device or lead, the name of the physician implanting or removing such device or lead, the name of the hospital or other provider billing for such procedure, any express or implied warranties associated with such device or lead under contract or State law, and such other information as the Secretary deems to be appropriate.

"(C) Each physician and provider of services performing the implantation or replacement of pacemaker devices and leads for which payment is made or requested to be made under this title shall, in accordance with regulations of the Secretary, submit information respecting such implantation or replacement for the registry.

"(D) Such registry shall be for the purposes of assisting the Secretary in determining when payments may properly be made under this title, in tracing the performance of cardiac pacemaker devices and leads, in determining when inspection by the manufacturer of such a device or lead may be necessary under paragraph (3), and in carrying out studies with respect to the use of such devices and leads. In carrying out any such study, the Secretary may not reveal any specific information which identifies any pacemaker device or lead recipient by name (or which would otherwise identify a specific recipient).

"(E) Any person or organization may provide information to the registry with respect to cardiac pacemaker devices and leads other than those for which payment is made under this title.

"(2) The Secretary may, by regulation, require each provider of services—

"(A) to return, to the manufacturer of the device or lead for testing under paragraph (3), any cardiac pacemaker device or lead which is removed from a patient and payment for the implantation or replacement of which was made or requested by such provider under this title, and

"(B) not to charge any beneficiary for replacement of such a device or lead if the device or lead has not been returned in accordance with subparagraph (A).

"(3) The Secretary may, by regulation, require the manufacturer of a cardiac pacemaker device or lead (A) to test or analyze each pace-

maker device or lead for which payment is made or requested under this title and which is returned to the manufacturer by a provider of services under paragraph (2), and (B) to provide the results of such test or analysis to that provider, together with information and documentation with respect to any warranties covering such device or lead. In any case where the Secretary has reason to believe, based upon information in the pacemaker registry or otherwise available to him, that replacement of a cardiac pacemaker device or lead for which payment is or may be requested under this title is related to the malfunction of a device or lead, the Secretary may require that personnel of the Food and Drug Administration be present at the testing of such device by the manufacturer, to determine whether such device was functioning properly.

"(4) The Secretary may deny payment under this title, in whole or in part and for such period of time as the Secretary determines to be appropriate, with respect to the implantation or replacement of a pacemaker device or lead of a manufacturer performed by a physician and provider of services after the Secretary determines (in accordance with the procedures established under subsection (d)) that—

"(A) the physician or provider of services has failed to submit information to the registry as required under paragraph (1)(C),

"(B) the provider of services has failed to return devices and leads as required under paragraph (2)(A) or has improperly charged beneficiaries as prohibited under paragraph (2)(B), or

"(C) the manufacturer of the device or lead has failed to perform and to report on the testing of devices and leads returned to it as required under paragraph (3).".

(d) The Secretary of Health and Human Services shall promulgate final regulations to carry out this section and the amendment made by this section prior to January 1, 1985, and the amendment made by subsection (c) shall apply to pacemaker devices and leads implanted or removed on or after the effective date of such regulations.

ELIMINATION OF SPECIAL PAYMENT PROVISIONS FOR PREADMISSION DIAGNOSTIC TESTING

SEC. 2305. (a) Section 1833(a)(1) of the Social Security Act is amended by striking out "(F) with respect to" and all that follows through "(G)" and inserting in lieu thereof "and (F)".

(b) Section 1833(a) of such Act is amended—

(1) by adding "and" at the end of paragraph (3);

(2) by striking out "; and" at the end of paragraph (4) and inserting in lieu thereof a period; and

(3) by striking out paragraph (5).

(c) Section 1833(a)(2) of such Act is amended by striking out "and in paragraph (5) of this subsection".

(d) Section 1833(b) and section 1833(i)(3) of such Act are each amended by striking out "subsection (a)(1)(G)" and inserting in lieu thereof "subsection (a)(1)(F)".

(e) The amendments made by this section shall apply to services performed after the date of the enactment of this Act.

(f) The amendments made by this section shall not be construed as prohibiting payment, subject to the applicable copayments, under

part B of title XVIII of the Social Security Act for preadmission diagnostic testing performed in a physician's office to the extent such testing is otherwise reimbursable under regulations of the Secretary.

LIMITATION ON PHYSICIAN FEE PREVAILING AND CUSTOMARY CHARGE LEVELS; PARTICIPATING PHYSICIAN INCENTIVES

SEC. 2306. (a) Section 1842(b) of the Social Security Act is amended by redesignating paragraphs (4) through (6) as paragraphs (5) through (7), respectively, and by inserting after paragraph (3) the following new paragraph:

"(4)(A) In determining the prevailing charge levels under the third and fourth sentences of paragraph (3) for physicians' services furnished during the 15-month period beginning July 1, 1984, the Secretary shall not set any level higher than the same level as was set for the 12-month period beginning July 1, 1983.

"(B) In determining the reasonable charge under paragraph (3) for physicians' services furnished during the 15-month period beginning July 1, 1984, the customary charges shall be the same customary charges as were recognized under this section for the 12-month period beginning July 1, 1983.

"(C) In determining the prevailing charge levels under the third and fourth sentences of paragraph (3) for physicians' services furnished during periods beginning after September 30, 1985, the Secretary shall treat the level as set under subparagraph (A) as having fully provided for the economic changes which would have been taken into account but for the limitations contained in subparagraph (A).

"(D) In determining the customary charges for physicians' services furnished during the 12-month period beginning October 1, 1985, or October 1, 1986, by a physician who is not a participating physician (as defined in subsection (j)(1)) for all of the 12-month period beginning October 1, 1984, the Secretary shall not recognize increases in actual charges for services furnished during the 15-month period beginning on July 1, 1984, above the level of the physician's actual charges billed in the 3-month period ending on June 30, 1984.".

(b)(1) Section 1842(b)(3) of such Act is amended—

(A) in subparagraph (F), by striking out "June 30" and inserting in lieu thereof "September 30";

(B) by striking out "July 1" each place it appears in the third and eighth sentences and inserting in lieu thereof in each instance "October 1"; and

(C) in the third sentence thereof, by striking out "during the last preceding calendar year elapsing prior to" and inserting in lieu thereof "during the 12-month period ending on the March 31 last preceding".

(2) The amendments made by paragraph (1) shall apply to items and services furnished on or after October 1, 1985.

(c) Section 1842 of such Act is amended by adding at the end thereof the following new subsections:

"(j)(1) Any physician or supplier may voluntarily enter into an agreement with the Secretary to become a participating physician or supplier. For purposes of this section, the term 'participating physician or supplier' means a physician or supplier (excluding any pro-

vider of services) who, before October 1 of any year beginning with 1984, enters into an agreement with the Secretary which provides that such physician or supplier will accept payment under this part on the basis of an assignment described in subsection (b)(3)(B)(ii), in accordance with subsection (b)(6)(B), or under the procedure described in section 1870(f)(1) for all items and services furnished to individuals enrolled under this part during the 12-month period beginning on October 1 of such year. In the case of a newly licensed physician or a physician who begins a practice in a new area, in the case of a new supplier who begins a new business, or in such similar cases as the Secretary may specify, such physician or supplier may enter into such an agreement after October 1 of a year, for items and services furnished during the remainder of the 12-month period beginning on such October 1.

"(2) Each carrier having an agreement with the Secretary under subsection (a) shall maintain a toll-free telephone number or numbers at which individuals enrolled under this part may obtain the names, addresses, specialty, and telephone numbers of participating physicians and suppliers.

"(3) In any case in which a carrier having an agreement with the Secretary under subsection (a) is able to develop a system for the electronic transmission to such carrier of bills for services, such carrier shall establish direct lines for the electronic receipt of claims from participating physicians and suppliers.

"(k)(1) Each year the Secretary shall publish a list containing the name, address, specialty, and percent of claims submitted with respect to each physician and supplier during the preceding year that were paid on the basis of an assignment described in subsection (b)(3)(B)(ii), in accordance with subsection (b)(6)(B), or under the procedure described in section 1870(f)(1). The Secretary may limit such list to those physicians and suppliers who accepted such an assignment in a certain percentage of such physician's or supplier's billings or who provide at least a certain volume of services, as the Secretary may determine to be appropriate. Such list shall be organized by such geographical area as the Secretary determines, after consultation with carriers, would facilitate the use of such list by individuals enrolled under this part.

"(2) At the beginning of each fiscal year the Secretary shall publish a directory containing the name, address, and specialty of all participating physicians and suppliers (as defined in subsection (j)(1)) for that fiscal year. The directory shall be organized to make the most useful presentation of the information (as determined by the Secretary) for individuals enrolled under this part.

"(3) The Secretary shall promptly notify individuals enrolled under this part of the publication of such directory and shall make such directory available in each district and branch office of the Social Security Administration, in the offices of carriers, and to senior citizen organizations.

"(4) The Secretary shall provide that the directory shall be available for purchase by the public.

"(l)(1) In the case of a physician who is not a participating physician, the Secretary shall monitor each such physician's actual charges to individuals enrolled under this part for physicians' services furnished during the 15-month period beginning July 1, 1984. If

such physician knowingly and willfully bills individuals enrolled under this part for actual charges in excess of such physician's actual charges for the calendar quarter beginning on April 1, 1984, the Secretary may apply sanctions against such physician in accordance with paragraph (2).

"(2) Subject to paragraph (3), the sanctions which the Secretary may apply under paragraph (1) are—

"(A) barring a physician from participation under the program under this title for a period not to exceed 5 years, in accordance with the procedures of paragraphs (2) and (3) of section 1862(d), or

"(B) the imposition of civil monetary penalties and assessments, in the same manner as such penalties are authorized under section 1128A(a),

or both. No payment may be made under this title with respect to any item or service furnished by a physician during the period when he is barred from participation in the program under this title pursuant to this subsection.

"(3)(A) The Secretary may not bar a physician pursuant to paragraph (2)(A) if such physician is a sole community physician or sole source of essential specialized services in a community.

"(B) The Secretary shall take into account access of beneficiaries to physicians' services for which payment may be made under this part in determining whether to bar a physician from participation under paragraph (2)(A).

"(4) The Secretary may, out of any civil monetary penalty or assessment collected from a physician pursuant to this subsection, make a payment to a beneficiary enrolled under this part in the nature of restitution for amounts paid by such beneficiary to such physician which was determined to be an excess charge under paragraph (1).".

(d)(1) During the 15-month period beginning July 1, 1984, the Secretary of Health and Human Services shall monitor physicians' services in order to determine any changes in the per capita volume and mix of physicians' services provided to beneficiaries under part B of title XVIII of the Social Security Act, classified by participating and nonparticipating physicians, by assigned and nonassigned claims, by specialty, and by geographic area.

(2) A report on changes monitored pursuant to paragraph (1) shall be provided to Congress prior to July 1, 1985.

(3) Such report shall include recommendations in sufficient detail to serve as the basis for legislative action which Congress can take to assure that any burden of effectively constraining the growth of costs in the medicare part B program, which Congress intends to be borne by providers and physicians, is not transferred (in whole or in part) so as to become an additional burden on part B beneficiaries in the form of increased out-of-pocket costs, reduced services, or reduced access to needed physician care.

(e) In addition to any funds otherwise provided for fiscal years 1984 and 1985 for payment to carriers under contracts entered into under section 1842 of the Social Security Act, there are transferred from the Federal Supplementary Medical Insurance Trust Fund, for payments to such carriers under such contracts to implement the

amendments made by this section, not less than $8,000,000 for fiscal year 1984, and not less than $15,000,000 for fiscal year 1985.

(f)(1) Section 1128A(a)(2) of the Social Security Act is amended by inserting before the comma at the end thereof the following: ", or (C) an agreement to be a participating physician or supplier under section 1842(j)(1)".

(2) Section 1877(d) of such Act is amended—

(A) by inserting "or agrees to be a participating physician or supplier under section 1842(j)(1)" after "1842(b)(3)(B)(ii)", and

(B) by striking out "specified in subclause (I) of such section" and inserting in lieu thereof "or agreement".

PAYMENT FOR SERVICES OF TEACHING PHYSICIANS

SEC. 2307. (a)(1) Subparagraph (A) of section 1842(b)(7)(A) of the Social Security Act (as redesignated by section 2306 of this title) is amended by adding at the end the following sentence: "If all the teaching physicians in a hospital agree to have payment made for all of their physicians' services under this part furnished patients in the hospital on the basis of an assignment described in paragraph (3)(B)(ii) or under the procedure described in section 1870(f)(1), notwithstanding clause (ii) of this subparagraph, the carrier shall provide for payment in an amount equal to 90 percent of the prevailing charges paid for similar services in the same locality.".

(2) Section 1842(b)(7)(B) of such Act is amended—

(A) by striking out "physician who has a substantial practice outside the teaching setting" in clause (i) and inserting in lieu thereof "physician who is not a teaching physician (as defined by the Secretary)";

(B) by striking out "outside practice" in clause (i) and inserting in lieu thereof "practice outside the teaching setting";

(C) by striking out "In the case of a physician who does not have a practice described in clause (i)" in clause (ii) and inserting in lieu thereof "In the case of a teaching physician";

(D) by striking out "greater" in clause (ii) and inserting in lieu thereof "greatest";

(E) by striking out "or" at the end of subclause (I) of clause (ii);

(F) by striking out the period at the end of subclause (II) of clause (ii) and inserting in lieu thereof ", or"; and

(G) by adding at the end of clause (ii) the following new subclause:

"(III) 85 percent of the prevailing charges paid for similar services in the same locality.".

(3) The amendments made by this subsection shall apply to services furnished on or after July 1, 1984.

(b)(1) Section 1886(d)(5)(B) of the Social Security Act is amended by adding at the end thereof the following new sentence: "In determining such adjustment the Secretary shall not distinguish between those interns and residents who are employees of a hospital and those interns and residents who furnish services to a hospital but are not employees of such hospital.".

(2) The amendment made by paragraph (1) shall apply to cost reporting periods beginning on or after October 1, 1984.

(c) The Comptroller General shall conduct a study of the amounts billed for physician services and paid by carriers under section 1842(b)(7) of the Social Security Act to determine whether such payments have been made only where the physician satisfies the requirements of section 1842(b)(7)(A)(i) of such Act. The Comptroller General shall submit to the Committees on Ways and Means and on Energy and Commerce of the House of Representatives and to the Committee on Finance of the Senate a report on the results of such study not later than 18 months after the date of the enactment of this Act.

LESSER OF COST OR CHARGES

SEC. 2308. (a) The Secretary of Health and Human Services shall issue regulations which require, for purposes of title XVIII of the Social Security Act, that providers of services calculate and report the lesser-of-cost-or-charges determinations separately with respect to payments for services under part A and services under part B of such title (other than clinical diagnostic laboratory tests paid under section 1833(h)), and that payment under such title be based upon such separate determinations. Such regulations shall apply to cost reporting periods beginning on or after October 1, 1984.

(b)(1) For purposes of applying the nominality test under sections 1814(b)(2) and 1833(a)(2)(B)(ii) of the Social Security Act, the Secretary shall, in addition to those rules for establishing nominality which the Secretary determines to be appropriate, provide that charges representing 60 percent or less of costs shall be considered nominal. The charges used in making such determinations shall be the charges actually billed to charge-paying patients who are not entitled to benefits under either part of such title. Such determination shall be made separately with respect to payments for services under part A and services under part B of such title (other than clinical diagnostic laboratory tests paid under section 1833(h)), or on the basis of inpatient and outpatient services, except that the determination need not be made separately for home health services if the Secretary finds that such separation is not appropriate.

(2)(A) Section 1814(b)(2) of such Act is amended by inserting after "public provider of services" the following: ", or by another provider which demonstrates to the satisfaction of the Secretary that a significant portion of its patients are low-income (and requests that payment be made under this paragraph),".

(B) Section 1833(a)(2)(B)(ii) of such Act is amended by inserting after "public provider of services" the following: ", or by another provider which demonstrates to the satisfaction of the Secretary that a significant portion of its patients are low-income (and requests that payment be made under this clause),".

STUDY OF MEDICARE PART B PAYMENTS

SEC. 2309. (a)(1) The Director of the Office of Technology Assessment shall conduct a study of physician reimbursement under the medicare program and report to Congress on such study not later than December 31, 1985. The report shall include specific findings and recommendations on methods by which payment amounts and *other program policies under part B of title XVIII of the Social Security Act may be modified—*

(A) to eliminate inequities in the relative amounts paid to physicians by type of service, locality, and specialty, with particular attention to any inequities between cognitive services and medical procedures; and

(B) to increase incentives for physicians and other suppliers under such part to accept assignment for services covered under title XVIII of the Social Security Act.

The study shall also examine the influence of payment methodology and payment levels on the utilization of services.

(2) In carrying out the study under paragraph (1)(A), the Director shall take into account the relative time, complexity, investment in professional training, and overhead expenses necessary to the provision of various medical services and procedures, as well as the influence of the changes in technology.

(3) The report under paragraph (1)(A) shall include information on methodologies which could be applied in the development of fee schedules on a national or regional basis for payments under part B of title XVIII of the Social Security Act in a manner consistent with the findings of the study under this subsection.

(4) In preparing the report and recommendations, the Director shall consult with the Secretary of Health and Human Services and, as appropriate, with national organizations of physicians and other interested associations and individuals.

(b) In order to assist the Director in completing the study and to facilitate Congressional review, the Secretary of Health and Human Services shall compile a centralized medicare part B charge data base, utilizing information gathered by the medicare carriers and used by them in making the 1984 reasonable charge updates. Such data shall include information, by procedure, on—

(1) utilization,

(2) assignment rates of physicians and suppliers,

(3) actual, customary, and prevailing charges, and

(4) the differences in charges by physician specialty and locality.

Such information shall be provided to the Director of the Office of Technology Assessment.

(c) The Secretary shall review the report submitted under subsection (a)(1) and shall report to the Congress his comments on the report and recommendations for legislative amendments.

LIMITATION ON INCREASE IN HOSPITAL COSTS PER CASE

SEC. 2310. (a) Section 1886(b)(3)(B) of the Social Security Act is amended—

(1) by striking out "1 percentage point", and by inserting in lieu thereof "one-quarter of 1 percentage point", and

(2) by adding at the end thereof the following: "In determining a percentage change under subsection (e)(4) with respect to discharges occurring in any cost reporting period or fiscal year beginning on or after October 1, 1985, and before October 1, 1986, the Secretary may not establish a percentage increase which exceeds the applicable percentage increase otherwise de-

termined for that period or fiscal year under the preceding sentence.".

(b) The amendments made by this section shall apply to cost reporting periods beginning in, and discharges occurring in, fiscal year 1985 and thereafter.

CLASSIFICATION OF CERTAIN RURAL HOSPITALS

SEC. 2311. (a) Section 1886(d)(5)(C)(i) of the Social Security Act is amended by adding at the end thereof the following: "A hospital which is classified as a rural hospital may appeal to the Secretary to be classified as a rural referral center under this clause on the basis of criteria (established by the Secretary) which shall allow the hospital to demonstrate that it should be so reclassified by reason of certain of its operating characteristics being similar to those of a typical urban hospital located in the same census region. Such characteristics may include wages, scope of services, service area, and the mix of medical specialties. The Secretary shall publish the criteria not later than 30 days after the date of the enactment of this Act, for implementation by October 1, 1984. An appeal allowed under this clause must be submitted to the Secretary (in such form and manner as the Secretary may prescribe) during the quarter before the first quarter of the hospital's cost reporting period (or, in case of a cost reporting period beginning during October 1984, during the first quarter of that period), and the Secretary must make a final determination with respect to such appeal within 60 days after the date the appeal was submitted. Any payment adjustments necessitated by a reclassification based upon the appeal shall be effective at the beginning of such cost reporting period.".

(b) Section 1886(d)(2)(D) of such Act is amended by adding at the end thereof the following: "A hospital located in a Metropolitan Statistical Area shall be deemed to be located in the region in which the majority of the hospitals in the same Metropolitan Statistical Area are located, or, at the option of the Secretary, the region in which the majority of the inpatient discharges (with respect to which payments are made under this title) from hospitals in the same Metropolitan Statistical Area are made.".

(c) Section 1886(d) of such Act is amended by adding at the end thereof the following new paragraph:

"(8) In the case of any hospital which is located in an area which is, at any time after April 20, 1983, reclassified from an urban to a rural area, payments to such hospital for the first two cost reporting periods for which such reclassification is effective shall be made as follows:

"(A) For the first such cost reporting period, payment shall be equal to the amount payable to such hospital for such reporting period on the basis of the rural classification, plus an amount equal to two-thirds of the amount (if any) by which—

"(i) the amount which would have been payable to such hospital for such reporting period on the basis of an urban classification, exceeds

"(ii) the amount payable to such hospital for such reporting period on the basis of the rural classification.

"(B) For the second such cost reporting period, payment shall be equal to the amount payable to such hospital for such reporting period on the basis of the rural classification, plus an amount equal to one-third of the amount (if any) by which—

"(i) the amount which would have been payable to such hospital for such reporting period on the basis of an urban classification, exceeds

"(ii) the amount payable to such hospital for such reporting period on the basis of the rural classification.".

(d)(1) Except as provided in paragraph (2), the amendments made by subsections (b) and (c) shall be effective with respect to cost reporting periods beginning on or after October 1, 1983, and the amendment made by subsection (a) shall be effective with respect to cost reporting periods beginning on or after October 1, 1984.

(2) The amendment made by subsection (b) shall not apply so as to reduce any payment under section 1886(d) of the Social Security Act to a hospital reclassified under such amendment for discharges occurring in any cost reporting period beginning before October 1, 1984.

(e) The Secretary of Health and Human Services shall conduct a study of the distinction between urban and rural hospitals for purposes of the DRG payment provisions under section 1886(d) of the Social Security Act, and the effect which such distinction may have on rural hospitals in the case of those DRG's which have high fixed nonlabor components which do not vary significantly between urban and rural areas (such as those DRG's which involve expensive medical devices). The Secretary also shall conduct a study of the advisability and feasibility of varying by DRG the proportions of the labor and nonlabor components of the Federal payment amount instead of applying the average proportion of those components to all DRG's. The Secretary shall report the results of such studies to the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives within six months after the date of the enactment of this Act.

(f) The Secretary of Health and Human Services shall conduct a study of further refinements which may be appropriate in the inpatient hospital prospective payment provisions of title XVIII of the Social Security Act, in order to address the problems of differences in payment amounts to specific hospitals. The study shall include (but shall not be limited to) the degree of variation in inpatient hospital costs per discharge within each diagnosis-related group. The Secretary shall also present alternative methods of computing the amount of such payments. The study shall include a discussion of the relative merits of a method of payment under which a percentage of the payment amount (for discharges classified within a diagnosis-related group) could be determined on a regional basis. The Secretary shall report the result of the study, and any recommended changes in the prospective payment system, to the Congress prior to September 1, 1984.

PAYMENT FOR SERVICES OF A NURSE ANESTHETIST

SEC. 2312. (a) Section 1886(d)(5) of the Social Security Act is amended by adding at the end thereof the following new subparagraph:

"(E) The Secretary shall provide for an additional payment amount for any subsection (d) hospital equal to the reasonable costs incurred by such hospital for anesthesia services provided by a certified registered nurse anesthetist. Payment under this subparagraph shall be the only payment made to such hospital with respect to such services.".

(b) The second sentence of section 1886(a)(4) of such Act is amended by inserting ", anesthesia services provided by a certified registered nurse anesthetist" after "approved education activities".

(c) The amendments made by subsections (a) and (b) shall apply to cost reporting periods beginning on or after October 1, 1984, and before October 1, 1987.

(d) The Secretary of Health and Human Services shall conduct a study of possible methods of reimbursement under title XVIII of the Social Security Act which would not discourage the use of certified registered nurse anesthetists by hospitals. The Secretary shall report the results of such study to the Congress as soon as is practicable.

PROSPECTIVE PAYMENT ASSESSMENT COMMISSION

SEC. 2313. (a) Section 1886(e)(2) of the Social Security Act is amended by inserting "(without regard to the provisions of title 5, United States Code, governing appointments in the competitive service)" after "appointed by the Director".

(b)(1) Section 1886(e)(6)(C)(i) of such Act is amended to read as follows:

"(i) employ and fix the compensation of an Executive Director (subject to the approval of the Director of the Office) and such other personnel (not to exceed 25) as may be necessary to carry out its duties (without regard to the provisions of title 5, United States Code, governing appointments in the competitive service);".

(2) Section 1886(e)(6)(C)(iii) of such Act is amended by inserting "(without regard to section 3709 of the Revised Statutes (41 U.S.C 5))" after "Commission".

(3) Section 1886(e)(6)(C) of such Act is amended by adding at the end the following: "Section 10(a)(1) of the Federal Advisory Committee Act shall not apply to any portion of a Commission meeting if the Commission, by majority vote, determines that such portion of the such meeting should be closed.".

(4) Section 1886(e)(6)(D) of such Act is amended by adding at the end thereof the following sentence: "Physicians serving as personnel of the Commission may be provided a physician comparability allowance by the Commission in the same manner as Government physicians may be provided such an allowance by an agency under section 5948 of title 5, United States Code, and for such purpose subsection (i) of such section shall apply to the Commission in the same manner as it applies to the Tennessee Valley Authority.".

(c) Section 1862 of such Act is amended by adding at the end the following new subsection:

"(i) In order to supplement the activities of the Prospective Payment Assessment Commission under section 1886(e) in assessing the safety, efficacy, and cost-effectiveness of new and existing medical procedures, the Secretary may carry out, or award grants or contracts for, original research and experimentation of the type described in clause (ii) of section 1886(e)(6)(E) with respect to such a procedure if the Secretary finds that—

"(1) such procedure is not of sufficient commercial value to justify research and experimentation by a commercial organization;

"(2) research and experimentation with respect to such procedure is not of a type that may appropriately be carried out by an institute, division, or bureau of the National Institutes of Health; and

"(3) such procedure has the potential to be more cost-effective in the treatment of a condition than procedures currently in use with respect to such condition.".

(d) Section 1886(e)(6) of such Act is amended by adding at the end the following new subparagraph:

"(J) The Commission shall submit requests for appropriations in the same manner as the Office submits requests for appropriations, but amounts appropriated for the Commission shall be separate from amounts appropriated for the Office.".

(e) The amendments made by this section shall become effective on the date of the enactment of this Act.

REVALUATION OF ASSETS

SEC. 2314. (a) Section 1861(v)(1) of the Social Security Act is amended by adding at the end thereof the following new subparagraph:

"(O)(i) In establishing an appropriate allowance for depreciation and for interest on capital indebtedness and (if applicable) a return on equity capital with respect to an asset of a hospital or skilled nursing facility which has undergone a change of ownership, such regulations shall provide that the valuation of the asset after such change of ownership shall be the lesser of the allowable acquisition cost of such asset to the first owner of record on or after the date of the enactment of this subparagraph, or the acquisition cost of such asset to the new owner.

"(ii) Such regulations shall provide for recapture of depreciation in effect on June 1, 1984.

"(iii) Such regulations shall not recognize, as reasonable in the provision of health care services, costs (including legal fees, accounting and administrative costs, travel costs, and the costs of feasibility studies) attributable to the negotiation or settlement of the sale or purchase of any capital asset (by acquisition or merger) for which any payment has previously been made under this title.".

(b) Section 1902(a)(13) of such Act is amended—

(1) by striking out "and" at the end of subparagraph (A),

(2) by redesignating subparagraph (B) as subparagraph (C), and

(3) by inserting after subparagraph (A) the following new subparagraph:

"(B) that the state shall provide assurances satisfactory to the Secretary that the payment methodology utilized by the State for payments to hospitals, skilled nursing facilities, and intermediate care facilities can reasonably be expected not to increase such payments, solely as a result of a change of ownership, in excess of the increase which would result from the application of section 1861(v)(1)(O); and".

(c)(1) Clause (i) of section 1861(v)(1)(O) of the Social Security Act shall not apply to changes of ownership of assets pursuant to an enforceable agreement entered into before the date of the enactment of this Act.

(2) Clause (iii) of section 1861(v)(1)(O) of such Act shall apply to costs incurred on or after the date of the enactment of this Act.

(3)(A) Except as provided in subparagraph (B), the amendments made by subsection (b) shall apply to medical assistance furnished on or after October 1, 1984.

(B) In the case of a State plan for medical assistance under title XIX of the Social Security Act which the Secretary of Health and Human Services determines requires State legislation in order for the plan to meet the additional requirements imposed by the amendments made by this section, the State plan shall not be regarded as failing to comply with the requirements of such title solely on the basis of its failure to meet these additional requirements before the first day of the first calendar quarter beginning after the close of the first regular session of the State legislature that begins after the date of the enactment of this Act.

TECHNICAL AMENDMENTS RELATING TO THE DRG PAYMENT SYSTEM

SEC. 2315. (a) Section 1886(c)(4)(A) of the Social Security Act is amended by striking out "and (D)" and inserting in lieu thereof "(D) and (E)".

(b) Section 1886(d)(2)(D) of such Act is amended by striking out "Standard".

(c) Section 1886(e)(5) of such Act is amended—

(1) by striking out "for public comment" in the matter before subparagraph (A), and

(2) by inserting "for public comment" in subparagraph (A) after "that fiscal year,".

(d) Section 1866(a)(1)(F) of such Act (as added by section 602(f)(1)(C) of the Social Security Amendments of 1983) is amended by striking out "(c) or (d)" and inserting in lieu thereof "(b), (c), or (d)".

(e) Section 1818(c) of such Act is amended by striking out "subsection (a) of section 1839" and inserting in lieu thereof "subsection (b) of section 1839".

(f)(1) Section 604(c)(3) of the Social Security Amendments of 1983 (Public Law 98–21) is amended by striking out "to implement subsection (d) of section 1886 of the Social Security Act (as so amended)" and inserting in lieu thereof "to implement the amendments made by this title".

(2) Notwithstanding section 604(c) of the Social Security Amendments of 1983, the Secretary of Health and Human Services shall cause to be published in the Federal Register proposed regulations

to carry out subsection (c) of section 1886 of the Social Security Act not later than July 1, 1984, and allow for a period of 45 days for public comment thereon. After consideration of the comments received, the Secretary shall cause to be published in the Federal Register final regulations to carry out such subsection not later than October 1, 1984.

(g) The amendments made by this section shall be effective as though they had been included in the enactment of the Social Security Amendments of 1983 (Public Law 98-21).

(h) The Secretary of Health and Human Services shall, prior to December 31, 1984—

(1) develop and publish a definition of a "hospital that serves a significantly disproportionate number of patients who have low income or are entitled to benefits under part A" of title XVIII of the Social Security Act for purposes of section 1886(d)(5)(C)(i) of that Act, and

(2) identify those hospitals which meet such definition, and make such identity available to the committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate.

PROSPECTIVE PAYMENT WAGE INDEX

SEC. 2316. (a) The Secretary of Health and Human Services, in consultation with the Secretary of Labor, shall conduct a study to develop an appropriate index for purposes of adjusting payment amounts under section 1886(d) of the Social Security Act to reflect area differences in average hospital wage levels, as required under paragraphs (2)(H) and (3)(E) of such section, taking into account wage differences of full time and part time workers. The Secretary of Health and Human Services shall report the results of such study to the Congress not later than 30 days after the date of the enactment of this Act, including any changes which the Secretary determines to be necessary to provide for an appropriate index.

(b) The Secretary shall adjust the payment amounts for hospitals for cost reporting periods beginning on or after October 1, 1983, to reflect any changes made in the wage index pursuant to subsection (a). Any adjustment in such payments to take account of overpayments or underpayments for the first cost reporting period of a hospital to which section 1886(d) of the Social Security Act applies, shall be made by decreasing or increasing payments in the succeeding cost reporting period.

(c) The Secretary shall conduct a study and report to the Congress proposed criteria under which, in the case of a hospital that demonstrates to the Secretary in a current fiscal year that the adjustment being made under paragraph (2)(H) or (3)(E) of section 1886(d) of the Social Security Act for that hospital's discharges in that fiscal year does not accurately reflect the wage levels in the labor market serving the hospital, the Secretary, to the extent he deems appropriate, would modify such adjustment for that hospital for discharges in the subsequent fiscal year to take into account a difference in payment amounts in that current fiscal year to the hospital that resulted from such inaccuracy.

DEADLINE FOR REPORT ON INCLUDING PAYMENT FOR PHYSICIANS' SERVICES TO HOSPITAL INPATIENTS IN DRG PAYMENT AMOUNTS

SEC. 2317. The second sentence of section 603(a)(2)(B) of the Social Security Amendments of 1983 (Public Law 98–21) is amended by striking out "include, in a report to Congress in 1985," and inserting in lieu thereof "submit to Congress, not later than July 1, 1985, a report to Congress which includes".

EMERGENCY ROOM SERVICES

SEC. 2318. (a) Section 1861(v)(1)(K) of the Social Security Act is amended by inserting "(i)" after "(K)" and by adding at the end thereof the following new clause:

"(ii) For purposes of clause (i), the term 'bona fide emergency services' means services provided in a hospital emergency room after the sudden onset of a medical condition manifesting itself by acute symptoms of sufficient severity (including severe pain) such that the absence of immediate medical attention could reasonably be expected to result in—

"(I) placing the patient's health in serious jeopardy;

"(II) serious impairment to bodily functions; or

"(III) serious dysfunction of any bodily organ or part.".

(b) Section 1861(v)(1)(K)(i) of such Act as so designated is amended by striking out "provided in an emergency room" and inserting in lieu thereof "as defined in clause (ii)".

(c) The amendments made by this section shall apply to services furnished on or after the date of the enactment of this Act.

SKILLED NURSING FACILITY REIMBURSEMENT

SEC. 2319. (a)(1) Section 1861(v)(1)(E) of the Social Security Act is amended by striking out clause (i) thereof, and by striking out "(ii)".

(2) Section 1861(v)(7) of such Act is amended by adding at the end thereof the following new subparagraph:

"(D) For further limitations on reasonable cost and determination of payment amounts for routine service costs of skilled nursing facilities, see section 1888.".

(b) Title XVIII of the Social Security Act is amended by adding at the end thereof the following new section:

"PAYMENT TO SKILLED NURSING FACILITIES FOR ROUTINE SERVICE COSTS

"SEC. 1888. (a) The Secretary, in determining the amount of the payments which may be made under this title with respect to routine service costs of extended care services shall not recognize as reasonable (in the efficient delivery of health services) per diem costs of such services to the extent that such per diem costs exceed the following per diem limits, except as otherwise provided in this section:

"(1) With respect to freestanding skilled nursing facilities located in urban areas, the limit shall be equal to 112 percent of the mean per diem routine service costs for freestanding skilled nursing facilities located in urban areas.

"(2) With respect to freestanding skilled nursing facilities located in rural areas, the limit shall be equal to 112 percent of

the mean per diem routine service costs for freestanding skilled nursing facilities located in rural areas.

"(3) With respect to hospital-based skilled nursing facilities located in urban areas, the limit shall be equal to the sum of the limit for freestanding skilled nursing facilities located in urban areas, plus 50 percent of the amount by which 112 percent of the mean per diem routine service costs for hospital-based skilled nursing facilities located in urban areas exceeds the limit for freestanding skilled nursing facilities located in urban areas.

"(4) With respect to hospital-based skilled nursing facilities located in rural areas, the limit shall be equal to the sum of the limit for freestanding skilled nursing facilities located in rural areas, plus 50 percent of the amount by which 112 percent of the mean per diem routine service costs for hospital-based skilled nursing facilities located in rural areas exceeds the limit for freestanding skilled nursing facilities located in rural areas.

In applying this subsection the Secretary shall make appropriate adjustments to the labor related portion of the costs based upon an appropriate wage index.

"(b) With respect to a hospital-based skilled nursing facility, the Secretary shall recognize as reasonable the portion of the cost differences between hospital-based and freestanding skilled nursing facilities attributable to excess overhead allocations (as determined by the Secretary) resulting from the reimbursement principles under this title, nothwithstanding the limits set forth in paragraph (3) or (4) of subsection (a).

"(c) The Secretary may make adjustments in the limits set forth in subsection (a) with respect to any skilled nursing facility to the extent the Secretary deems appropriate, based upon case mix or circumstances beyond the control of the facility.".

(c) The amendments made by subsections (a) and (b) shall apply to cost reporting periods beginning on or after July 1, 1984.

(d) Notwithstanding limits on the cost of skilled nursing facilities which may have been issued under section 1861(v) of the Social Security Act prior to the date of the enactment of this Act, in the case of cost reporting periods beginning on or after October 1, 1982, and prior to July 1, 1984, the cost limits for routine services for urban and rural hospital-based skilled nursing facilities shall be 112 percent of the mean of the respective routine costs for urban and rural hospital-based skilled nursing facilities.

(e) The Secretary of Health and Human Services shall submit to the Congress, prior to December 1, 1984, the report required under section 605(b) of the Social Security Amendments of 1983.

(f)(1) The Secretary of Health and Human Services shall report to the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives, prior to August 1, 1984, the proposals developed, as required under section 1135(c) of the Social Security Act, for prospective reimbursement of skilled nursing facilities.

(2) The Secretary of Health and Human Services shall submit to the Congress, prior to December 1, 1984, a report on the range of options for prospective payment of skilled nursing facilities under title

XVIII of the Social Security Act. The report shall take into account case mix differences among skilled nursing facilities. The report shall analyze the feasibility of permitting inclusion of payments to hospital-based facilities within the DRG payment system under section 1886(d) of such Act.

PAYMENT FOR COSTS OF HOSPITAL-BASED MOBILE INTENSIVE CARE UNITS

SEC. 2320. (a)(1) In the case of a project described in subsection (b), the Secretary of Health and Human Services shall provide, except as provided in paragraph (2), that the amount of payments to hospitals covered under the project during the period described in paragraph (3) shall include payments for their operation of hospital-based mobile intensive care units (as defined by State statute) if the State provides satisfactory assurances that the total amount of payments to such hospitals under titles XVIII and XIX of the Social Security Act under the demonstration project (including any such additional amount of payment) would not exceed the total amount of payments which would have been paid under such titles if the demonstration project were not in effect.

(2) Paragraph (1) shall not apply if the State in which the project is located notifies the Secretary, within 30 days after the date of the enactment of this section, that the State does not want paragraph (1) to apply to that project.

(3) The period referred to in paragraph (1) begins on the date of the enactment of this section and continues so long as the Secretary continues the Statewide waiver referred to in subsection (b), but in no case ends earlier than 90 days after the date final regulations to implement section 1886(c) of the Social Security Act are published.

(b) The project referred to in subsection (a) is the statewide demonstration project established in the State of New Jersey under section 402 of the Social Security Amendments of 1967, as amended by section 222(b) of the Social Security Amendments of 1972 (Public Law 92–603), which project provides for payments to hospitals in the State on a prospective basis and related to a classification of patients by diagnosis-related groups.

(c) Payment for services described in this section shall be considered to be payments for services under part A of title XVIII of the Social Security Act.

COST SHARING FOR DURABLE MEDICAL EQUIPMENT FURNISHED AS A HOME HEALTH BENEFIT

SEC. 2321. (a)(1) The matter in section 1814(b) of the Social Security Act preceding paragraph (1) is amended by inserting "and other than a home health agency with respect to durable medical equipment" after "hospice care".

(2) Section 1814 of such Act is amended by adding at the end thereof the following new subsection:

"Payments to Home Health Agencies for Durable Medical Equipment

"(k) The amount paid to any home health agency with respect to durable medical equipment for which payment may be made under this part shall be—

"(1) the lesser of—

"(A) the reasonable cost of such equipment, as determined under section 1861(v), or

"(B) the customary charges with respect to such equipment,

less the amount the home health agency may charge as described in section 1866(a)(2)(A)(ii), but in no case may the payment for such equipment exceed 80 percent of such reasonable cost, or

"(2) if such equipment is furnished by a public home health agency free of charge or at nominal charge to the public, the amount which the Secretary finds will provide fair compensation to the home health agency.".

(b)(1) The matter in section 1833(a)(2)(A) of such Act preceding clause (i) is amended by inserting "(other than durable medical equipment)" after "home health services".

(2) The matter in section 1833(a)(2)(B) of such Act preceding clause (i) is amended by inserting "items and" after "other".

(c) Section 1866(a)(2)(A)(ii) of such Act is amended by inserting "or which are durable medical equipment furnished as home health services" after "part B".

(d)(1) The first sentence of section 1833(f)(1) of such Act is amended by striking out "as described in section 1861(s)(6)".

(2) Section 1833(f)(2) of such Act is amended—

(A) by striking out "the 20 percent" and inserting in lieu thereof "any", and

(B) by striking out "under subsection (a)".

(3) Section 1833(f)(3) of such Act is amended by striking out "paragraph (1)" and inserting in lieu thereof "subsection (a)".

(4)(A) Subsection (f) of section 1833 of such Act is redesignated as section 1889, is assigned the heading "PURCHASE OF DURABLE MEDICAL EQUIPMENT", and is moved to and inserted at the end of part C after the section added by section 2319 of this title.

(B) Paragraphs (1) through (4) of such section 1888 are redesignated as subsections (a) through (d), respectively.

(e)(1) Section 1861(m)(5) of such Act is amended by striking out ", and the use of medical appliances" and inserting in lieu thereof "and durable medical equipment".

(2) Section 1861(s)(6) of such Act is amended by striking out everything after "durable medical equipment" up to the semicolon.

(3) Section 1861 of such Act is amended by inserting after subsection (m) the following:

"Durable Medical Equipment

"(n) The term 'durable medical equipment' includes iron lungs, oxygen tents, hospital beds, and wheelchairs (which may include a power-operated vehicle that may be appropriately used as a wheelchair, but only where the use of such a vehicle is determined to be

necessary on the basis of the individual's medical and physical condition and the vehicle meets such safety requirements as the Secretary may prescribe) used in the patient's home (including an institution used at his home other than an institution that meets the requirements of subsection (e)(1) or (j)(1) of this section), whether furnished on a rental basis or purchased.".

(4) Section 1861(cc)(1)(G) of such Act is amended by striking out ", appliances, and equipment, including the purchase or rental of equipment" and inserting in lieu thereof "and durable medical equipment".

(f) Section 1814(j)(2) of such Act is amended—

(1) by redesignating subparagraphs (B) and (C) as (C) and (D), respectively, and

(2) by inserting the following after subparagraph (A):

"(B) Subsection (k)(1)(B).".

(g) The amendments made by this section shall apply to items and services furnished on or after the date of the enactment of this Act.

SERVICES OF A CLINICAL PSYCHOLOGIST PROVIDED TO MEMBERS OF AN HMO

SEC. 2322. (a) Section 1861(s)(2)(H) of the Social Security Act is amended by inserting "(i)" after "(H)", by adding "and" at the end of clause (i) as so designated, and by adding at the end thereof the following new clause:

"(ii) services furnished pursuant to a risk-sharing contract under section 1876(g) to a member of an eligible organization by a clinical psychologist (as defined by the Secretary), and such services and supplies furnished as an incident to his services to such a member as would otherwise be covered under this part if furnished by a physician or as an incident to a physician's service; and".

(b) The amendments made by subsection (a) shall be effective with respect to services furnished on or after the date of the enactment of this Act.

COVERAGE OF ADMINISTRATION OF HEPATITIS B VACCINE

SEC. 2323. (a) Section 1861(s)(10) of the Social Security Act is amended—

(1) by inserting "(A)" after "(10)";

(2) by striking out the period at the end thereof and inserting in lieu thereof "; and"; and

(3) by adding at the end thereof the following new subparagraph:

"(B) hepatitis B vaccine and its administration, furnished to an individual who is at high or intermediate risk of contracting hepatitis B (as determined by the Secretary under regulations).".

(b)(1) Paragraphs (1)(B), (2)(A), and (3) of section 1833(a) of such Act are each amended by striking out "1861(s)(10)" and inserting in lieu thereof "1861(s)(10)(A)".

(2) Section 1833(b)(1) of such Act is amended by striking out "1861(s)(10)" and inserting in lieu thereof "1861(s)(10)(A)".

(3) Section 1861(aa)(1)(A) of such Act is amended by striking out "section 1861(s)(10)" and inserting in lieu thereof "subsection (s)(10)(A)".

(4) The last sentence of section 1866(a)(2)(A) of such Act is amended by striking out "1861(s)(10)" and inserting in lieu thereof "1861(s)(10)(A)".

(b) Section 1833 of such Act is amended by adding at the end thereof the following new subsection:

"(k) With respect to services described in section 1861(s)(10)(B), the Secretary may provide, instead of the amount of payment otherwise provided under this part, for payment of such an amount or amounts as reasonably reflects the general cost of efficiently providing such services.".

(c) Section 1881(b) of such Act is amended by adding at the end thereof the following new paragraph:

"(11) Hepatitis B vaccine and its administration, when provided to a patient determined to have end stage renal disease, shall not be included as dialysis services for purposes of payment under any prospective payment amount or comprehensive fee established under this section. Payment for such vaccine and its administration shall be made separately in accordance with section 1833.".

(d) The amendments made by this section apply to services furnished on or after September 1, 1984.

(e) The Secretary shall monitor the provision of hepatitis B vaccine under part B of title XVIII of the Social Security Act, and shall review any changes in medical technology which may have an effect on the amounts which should be paid for such service.

COVERAGE OF HEMOPHILIA CLOTTING FACTOR

SEC. 2324. (a) Section 1861(s)(2) of the Social Security Act is amended by striking out "and" at the end of subparagraph (G) and by adding at the end thereof the following new subparagraph:

"(I) blood clotting factors, for hemophilia patients competent to use such factors to control bleeding without medical or other supervision, and items related to the administration of such factors, subject to utilization controls deemed necessary by the Secretary for the efficient use of such factors;".

(b) The amendments made by subsection (a) shall be effective with respect to items and services purchased on or after the date of the enactment of this Act.

PAYMENT FOR DEBRIDEMENT OF MYCOTIC TOENAILS

SEC. 2325. The Secretary shall provide, pursuant to section 1862(a) of the Social Security Act, that payment will not be made under part B of title XVIII of such Act for a physician's debridement of mycotic toenails to the extent such debridement is performed for a patient more frequently than once every 60 days, unless the medical necessity for more frequent treatment is documented by the billing physician.

CONTRACTS FOR MEDICARE CLAIMS PROCESSING

SEC. 2326. (a) During each of the fiscal years 1984 and 1985, the Secretary of Health and Human Services may enter into not more than two agreements under section 1816 of the Social Security Act, and not more than two contracts under section 1842 of such Act, on the basis of competitive bidding, without regard to the nominating process under section 1816(a) of such Act during the term of the agreement. Such procedure may be used only for the purpose of replacing an agency or organization or carrier which over a period of time has been in the lowest 20th percentile of agencies and organizations or carriers having agreements or contracts under the respective section, as measured by the Secretary's cost and performance criteria. Any agency or organization or carrier selected on the basis of competitive bidding must perform all of the duties listed in section 1816(a)(1) of such Act, or the duties listed in paragraphs (1) through (4) of section 1842(a) of such Act, as the case may be, and must be a health insuring organization (as determined by the Secretary).

(b) Section 1816(e)(4) of such Act is amended by adding at the end thereof the following new sentence: "By not later than July 1, 1987, the Secretary shall limit the number of such regional agencies or organizations to not more than ten.".

(c)(1) Section 1816(f) of such Act is amended by striking out ", by regulation," in clause (2), and by adding at the end thereof the following: "Such standards and criteria shall be published in the Federal Register, and opportunity shall be provided for public comment prior to implementation.".

(2) Section 1842(b)(2) of such Act is amended by adding at the end thereof the following new sentence: "The Secretary shall publish in the Federal Register standards and criteria for the efficient and effective performance of contract obligations under this section, and opportunity shall be provided for public comment prior to implementation.".

(d)(1) Section 1816(c) of such Act is amended by adding at the end the following new sentence: "The Secretary shall provide that in determining the necessary and proper cost of administration, the Secretary shall, with respect to each agreement, take into account the amount that is reasonable and adequate to meet the cost which must be incurred by an efficiently and economically operated agency or organization in carrying out the terms of its agreement.".

(2) Section 1842(c) of such Act is amended by adding at the end the following new sentence: "The Secretary shall provide that in determining a carrier's necessary and proper cost of administration, the Secretary shall, with respect to each contract, take into account the amount that is reasonable and adequate to meet the costs which must be incurred by an efficiently and economically operated carrier in carrying out the terms of its contract.".

(3) The amendments made by this subsection shall apply to agreements and contracts entered into or renewed after September 30, 1984.

(e)(1) The Comptroller General shall conduct a study on—

(A) the ability of the Health Care Financing Administrator to manage competitive bidding for agreements and contracts under

sections 1816 and 1842 of the Social Security Act, and on the relative costs and efficiency of such competitive agreements and contracts as compared to current reimbursement for such agreements and contracts;

(B) the need (if any) for eliminating the provider nomination procedure under section 1816(a) of such Act;

(C) the disparities (if any) in costs and quality of claims processing among the various entities performing claims processing pursuant to sections 1816 and 1842 of such Act;

(D) whether the standards of the Secretary of Health and Human Services for evaluating costs and performance of intermediaries and carriers are adequate and properly applied; and

(E) whether the Secretary's statutory authority is sufficient to deal with inefficient intermediaries and carriers either through the contract negotiation and budget review process or through the process for termination or nonrenewal of contracts.

(2) The Comptroller General shall submit a report on the results of such study to the Congress not later than 12 months after the date of the enactment of this Act.

PART II—ADMINISTRATIVE AND MISCELLANEOUS CHANGES

REPEAL OF EXCLUSION OF FOR-PROFIT ORGANIZATIONS FROM RESEARCH AND DEMONSTRATION GRANTS

SEC. 2331. (a) Section 1110(a)(1) of the Social Security Act is amended by striking out "nonprofit".

(b) The first sentence of section 402(a)(1) of the Social Security Amendments of 1967 (Public Law 90–248) is amended by striking out "nonprofit".

(c) The amendments made by this section shall become effective on the date of the enactment of this Act.

PRESIDENTIAL APPOINTMENT OF AND PAY LEVEL FOR THE ADMINISTRATOR OF THE HEALTH CARE FINANCING ADMINISTRATION

SEC. 2332. (a) Title XI of the Social Security Act is amended by inserting after section 1116 the following new section:

"APPOINTMENT OF THE ADMINISTRATOR OF THE HEALTH CARE FINANCING ADMINISTRATION

"SEC. 1117. The Administrator of the Health Care Financing Administration shall be appointed by the President by and with the advice and consent of the Senate.".

(b) Section 5315 of title 5, United States Code, is amended by adding at the end thereof the following:

"Administrator of the Health Care Financing Administration.".

(c) The amendments made by this section shall apply to appointments made after the date of the enactment of this Act.

EXCLUSION OF CERTAIN ENTITIES OWNED OR CONTROLLED BY INDIVIDUALS CONVICTED OF MEDICARE- OR MEDICAID-RELATED CRIMES

SEC. 2333. (a) Section 1128 of the Social Security Act is amended—

(1) by redesignating subsections (b), (c), and (d) as subsections (c), (d), and (e), respectively, and

(2) by inserting after subsection (a) the following new subsection:

"(b) Whenever the Secretary determines, with respect to an entity, that a person who has a direct or indirect ownership or control interest of 5 percent or more in the entity, or who is an officer, director, agent, or managing employee (as defined in section 1126(b)) of such entity, is a person described in section 1126(a), the Secretary—

"(1) may bar from participation in the program under title XVIII, for such period as he may deem appropriate, each such entity otherwise eligible to participate in such program;

"(2) shall promptly notify each appropriate State agency administering or supervising the administration of a State plan approved under title XIX of the fact and circumstances of the determination, and may require each such agency to bar the entity from participation under the State plan for such period as he specifies, which may not exceed the period established pursuant to paragraph (1); and

"(3) shall promptly notify the appropriate State or local agency or authority having responsibility for the licensing or certification of such entity of the fact and circumstances of such determination, request that appropriate investigations be made and sanctions invoked in accordance with applicable State law and policy, and request that such State or local agency or authority keep the Secretary and the Inspector General of the Department of Health and Human Services fully and currently informed with respect to any actions taken in response to such request.".

(b) Section 1128(e) of such Act (as redesignated by subsection (a)(1)) is amended—

(1) by inserting "or entity" after "Any person", and

(2) by striking out "(a) or (b)" and inserting in lieu thereof "(a), (b), or (c)".

(c) The amendments made by this section become effective on the date of the enactment of this Act and shall apply to convictions of persons occurring after such date.

PROVIDER REPRESENTATION IN PEER REVIEW ORGANIZATIONS

SEC. 2334. (a) Section 1153(b)(3) of the Social Security Act is amended by inserting "(A)" after "(3)" and by adding at the end thereof the following new subparagraph:

"(B) For purposes of subparagraph (A), an entity shall not be considered to be affiliated with a health care facility or association of facilities by reason of management, ownership, or common control if the management, ownership, or common control consists only of not more than 20 percent of the members of the governing board of the entity being affiliated (through management, ownership, or common control) with one or more of such facilities or associations.".

(b) Section 1153(b)(2)(A) of such Act is amended—

(1) by striking out "an entity which directly" and inserting in lieu thereof "an entity (other than a self-insured employer) which directly"; and

(2) by adding at the end thereof the following new sentence: "For purposes of this paragraph, an entity shall not be considered to be affiliated with another entity which makes payments (directly or indirectly) to any practitioner or provider, by reason of management, ownership, or common control, if the management, ownership, or common control consists only of one individual member of the governing board being affiliated (through management, ownership, or common control) with a health maintenance organization or competitive medical plan which is an 'eligible organization' as defined in section 1876(b).".

(c) The amendments made by this section shall become effective on the date of the enactment of this Act.

REPEAL OF SPECIAL TUBERCULOSIS TREATMENT REQUIREMENTS UNDER MEDICARE AND MEDICAID

SEC. 2335. (a) Section 1814(a) of the Social Security Act is amended—

(1) in paragraph (2), by striking out subparagraph (B) and redesignating subparagraphs (C), (D), and (E) as subparagraphs (B), (C), and (D), respectively;

(2) in paragraph (3), by striking out "and inpatient tuberculosis hospital services";

(3) by striking out paragraph (5) and redesignating paragraphs (6), (7), and (8) as paragraphs (5), (6), and (7), respectively; and

(4) in the matter following paragraph (7) (as so redesignated), by striking out "(D), or (E)" and inserting in lieu thereof "or (D)".

(b)(1) Subsections (d) and (g) of section 1861 of such Act are repealed.

(2) The fifth sentence of section 1861(3) of such Act is amended by striking out "or tuberculosis unless it is a tuberculosis hospital (as defined in subsection (g)) or".

(3) Section 1861(j) of such Act is amended in the matter following paragraph (15) by striking out "or tuberculosis".

(c) Section 1863 of such Act is amended by striking out "(g)(4),".

(d) Section 1866 of such Act is amended—

(1) in subsection (b)(3), by striking out "tuberculosis hospital services and"; and

(2) in subsection (d), by striking out "inpatient tuberculosis hospital services and".

(e) Section 1902(a)(28) of such Act is amended by striking out "and tuberculosis".

(f) Section 1905(a) of such Act is amended by striking out "tuberculosis or" each place it appears in paragraphs (1), (4)(A), (14), and (15) and in the subdivision (B) after paragraph (18).

(g) The amendments made by this section shall become effective on the date of the enactment of this Act.

ACCESS TO HOME HEALTH SERVICES

SEC. 2336. (a) Sections 1814(a) and 1835(a) of the Social Security Act are each amended by adding at the end the following new sentence: "For purposes of the preceding sentence, service by a physician as an uncompensated officer or director of a home health agency shall not constitute having a significant ownership interest in, or a significant financial or contractual relationship with, such agency.".

(b) The third sentence of section 1814(a) of the Social Security Act and the fourth sentence of section 1835(a) of such Act are each amended by inserting before the period at the end the following: ", except that such prohibition shall not apply with respect to a home health agency which is a sole community home health agency (as determined by the Secretary)".

(c)(1) The amendments made by subsection (a) shall apply to certifications and plans of care made or established on or after the date of the enactment of this Act.

(2) The Secretary shall provide, not later than 90 days after the date of the enactment of this Act, for such revision of regulations as may be required to reflect the amendments made by subsection (b).

NORMALIZATION OF TRUST FUND TRANSFERS

SEC. 2337. (a) Section 1817(a) of the Social Security Act is amended—

(1) by striking out "monthly on the first day of each calendar month" in the next to last sentence and inserting in lieu thereof "from time to time",

(2) by striking out "to be paid to or deposited into the Treasury during such month" in such sentence and inserting in lieu thereof "paid to or deposited into the Treasury", and

(3) by striking out the last sentence.

(b) The amendments made by subsection (a) shall become effective on the first day of the month following the month in which this Act is enacted.

ENROLLMENT AND PREMIUM PENALTY WITH RESPECT TO WORKING AGED PROVISION

SEC. 2338 (a) The second sentence of section 1839(b) of the Social Security Act is amended by adding before the period at the end the following: ", but there shall not be taken into account months in which the individual has met the conditions specified in clauses (i) and (iii) of section 1862(b)(3)(A) and can demonstrate that the individual was enrolled in a group health plan described in clause (iv) of such section by reason of the individual's (or the individual's spouse's) current employment".

(b) Section 1837 of such Act is amended by adding at the end the following new subsection:

"(i)(1) In the case of an individual who—

"(A) meets the conditions described in clauses (i) and (iii) of section 1862(b)(3)(A),

"(B) at the time the individual first satisfies paragraph (1) or (2) of section 1836, is enrolled in a group health plan described

in section 1862(b)(3)(A)(iv) by reason of the individual's (or the individual's spouse's) current employment, and

"(C) has elected not to enroll (or to be deemed enrolled) under this section during the individual's initial enrollment period,

there shall be a special enrollment period described in paragraph (3).

"(2) In the case of an individual who—

"(A) meets the conditions described in clauses (i) and (iii) of section 1862(b)(3)(A),

"(B) has enrolled (or has been deemed to have enrolled) in the medical insurance program established under this part during the individual's initial enrollment period and any subsequent special enrollment period under this subsection during which the individual was not enrolled in a group health plan described in section 1862(b)(3)(A)(iv) by reason of the individual's (or individual's spouse's) current employment, and

"(C) has not terminated enrollment under this section at any time at which the individual is not enrolled in such a group health plan by reason of the individual's (or individual's spouse's) current employment,

there shall be a special enrollment period described in paragraph (3).

"(3) The special enrollment period referred to in paragraphs (1) and (2) is the period—

"(A) beginning with the first day of the third month before the month in which the individual attains the age of 70 and ending seven months later, or

"(B) beginning with the first day of the first month in which the individual is no longer enrolled in a group health plan described in section 1862(b)(3)(A)(iv) by reason of current employment and ending seven months later,

whichever period results in earlier coverage.".

(c) Section 1838 of such Act is amended by adding at the end the following new subsection:

"(e) Notwithstanding subsection (a), in the case of an individual who enrolls during a special enrollment period pursuant to—

"(1) subparagraph (A) of section 1837(i)(3)—

"(A) before the month in which he attains the age of 70, the coverage period shall begin on the first day of the month in which he has attained the age of 70, or

"(B) in or after the month in which he attains the age of 70, the coverage period shall begin on the first day of the month following the month in which he so enrolls; or

"(2) subparagraph (B) of section 1837(i)(3)—

"(A) in the first month of the special enrollment period, the coverage period shall begin on the first day of such month, or

"(B) in a month after the first month of the special enrollment period, the coverage period shall begin on the first day of the month following the month in which he so enrolls.".

(d)(1) The amendment made by subsection (a) shall apply to months beginning with January 1983 for premiums for months be-

ginning with the first month which begins more than 30 days after the date of the enactment of this Act.

(2)(A) The amendments made by subsections (b) and (c) shall apply to enrollments in months beginning with the first effective month, except that in the case of any individual who would have had a special enrollment period under section 1837(i) of the Social Security Act that would have begun before such first effective month, such period shall be deemed to begin with the first day of such first effective month.

(B) For purposes of subparagraph (A), the term "first effective month" means the first month which begins more than 90 days after the date of the enactment of this Act.

INDIRECT PAYMENT OF SUPPLEMENTARY MEDICAL INSURANCE BENEFITS

SEC. 2339. (a) The first sentence of section 1842(b)(6) of the Social Security Act, as redesignated by section 2306 of this title, is amended—

(1) by inserting "(i) after "(A)",

(2) by striking out "(B)" and inserting in lieu thereof "(ii), and

(3) by inserting before the period the following: ", or (B) to an entity (i) which provides coverage of the services under a health benefits plan, but only to the extent that payment is not made under this part, (ii) which has paid the person who provided the service an amount (including the amount payable under this part) which that person has accepted as payment in full for the service, and (iii) to which the individual has agreed in writing that payment may be made under this part".

(b) The second sentence of such section is amended by striking out "or (B)".

CERTIFICATION OF PSYCHIATRIC HOSPITALS

SEC. 2340. (a) Section 1861(f) of the Social Security Act is amended—

(1) by adding "and" at the end of paragraph (3);

(2) by striking out "; and" at the end of paragraph (4) and inserting in lieu thereof a period;

(3) by striking out paragraph (5); and

(4) in the second sentence, by striking out "if the institution is accredited" and all that follows through "Secretary".

(b) Section 1905(h)(1)(A) of such Act is amended to read as follows:

"(A) inpatient services which are provided in an institution (or distinct part thereof) which is a psychiatric hospital as defined in section 1861(f);".

(c) The amendments made by this section shall become effective on the date of the enactment of this Act.

INCLUDING PODIATRISTS IN DEFINITION OF "PHYSICIAN" FOR OUTPATIENT PHYSICAL THERAPY SERVICES AND INCLUDING PODIATRISTS AND DENTISTS IN DEFINITION OF "PHYSICIAN" FOR OUTPATIENT AMBULATORY SURGERY

SEC. 2341. (a) Section 1861(p)(1) of the Social Security Act is amended by striking out "section 1861(r)(1)" and inserting in lieu thereof "paragraph (1) or (3) of section 1861(r)".

(b) Section 1832(a)(2)(F)(ii) of such Act is amended by striking out "section 1861(r)(1)" and inserting in lieu thereof "paragraph (1), (2), or (3) of section 1861(r)".

(c) Section 1861(r)(3) of such Act is amended—

(1) by striking out "and (m)" the first place it appears and inserting in lieu thereof ", (m), and (p)(1)", and

(2) by inserting ", 1832(a)(2)(F)(ii)," after "1814(a)" the first place it appears.

(d) The amendments made by this section apply to services furnished on or after the date of the enactment of this Act.

ESTABLISHMENT BY PHYSICAL THERAPISTS OF PLANS FOR PHYSICAL THERAPY

SEC. 2342. (a) Section 1861(p)(2) of the Social Security Act is amended by striking out ", and is periodically reviewed, by a physician (as so defined)" and inserting in lieu thereof "by a physician (as so defined) or by a qualified physical therapist and is periodically reviewed by a physician (as so defined)".

(b) Section 1835(a)(2)(C)(ii) of such Act is amended by striking out ", and is periodically reviewed, by a physician" and inserting in lieu thereof "by a physician or by the qualified physical therapist providing such services and is periodically reviewed by a physician".

(c) The amendments made by this section apply to plans of care established on or after the date of the enactment of this Act.

HOSPICE CONTRACTING FOR CORE SERVICES

SEC. 2343. (a) Section 1861(dd)(2)(A)(ii)(I) of the Social Security Act is amended by inserting "except as otherwise provided in paragraph (5)," before "and" at the end thereof.

(b) Section 1861(dd) of such Act is amended by adding at the end thereof the following new paragraph:

"(5)(A) The Secretary may waive the requirements of paragraph (2)(A)(ii)(I) for an agency or organization with respect to all or part of the nursing care described in paragraph (1)(A) if such agency or organization—

"(i) is located in an area which is not an urbanized area (as defined by the Bureau of the Census);

"(ii) was in operation on or before January 1, 1983; and

"(iii) has demonstrated a good faith effort (as determined by the Secretary) to hire a sufficient number of nurses to provide such nursing care directly.

"(B) Any waiver, which is in such form and containing such information as the Secretary may require and which is requested by an agency or organization under subparagraph (A), shall be deemed to be granted unless such request is denied by the Secretary within 60 days after such request is received by the Secretary. The granting

of a waiver under subparagraph (A) shall not preclude the granting of any subsequent waiver request should such a waiver again become necessary.".

(c) The amendments made by subsections (a) and (b) shall become effective on the date of the enactment of this Act.

(d) The Secretary of Health and Human Services shall conduct a study of the necessity and appropriateness of the requirements that certain "core" services be furnished directly by a hospice, as required under section 1861(dd)(2)(A)(ii)(I) of the Social Security Act. The Secretary shall report the results of such study to the Congress with the report required under section 122(i)(1) of the Tax Equity and Fiscal Responsibility Act of 1982.

MEDICARE RECOVERY AGAINST CERTAIN THIRD PARTIES

SEC. 2344. (a) Section 1862(b)(1) of the Social Security Act is amended—

(1) in the first sentence, by inserting "promptly" after "to be made";

(2) in the second sentence, by inserting "or could be" after "has been"; and

(3) by inserting after the second sentence the following new sentences: "In order to recover payment made under this title for an item or service, the United States may bring an action against any entity which would be responsible for payment with respect to such item or service (or any portion thereof) under such a law, policy, plan, or insurance, or against any entity (including any physician or provider) which has been paid with respect to such item or service under such law, policy, plan, or insurance, and may join or intervene in any action related to the events that gave rise to the need for such item or service. The United States shall be subrogated (to the extent of payment made under this title for an item or service) to any right of an individual or any other entity to payment with respect to such item or service under such a law, policy, plan, or insurance.".

(b) Section 1862(b)(2)(B) of such Act is amended—

(1) in the first sentence, by inserting "or could be" after "has been"; and

(2) by inserting after the first sentence the following new sentences: "In order to recover payment made under this title for an item or service, the United States may bring an action against any entity which would be responsible for payment with respect to such item or service (or any portion thereof) under such a plan, or against any entity (including any physician or provider) which has been paid with respect to such item or service under such plan, and may join or intervene in any action related to the events that gave rise to the need for such item or service. The United States shall be subrogated (to the extent of payment made under this title for an item or service) to any right of an individual or any other entity to payment with respect to such item or service under such a plan.".

(c) Section 1862(b)(3)(A)(ii) of such Act is amended—

(1) in the first sentence, by inserting "or could be" after "has been"; and

(2) by inserting after the first sentence the following new sentences: "In order to recover payment made under this title for an item or service, the United States may bring an action against any entity which would be responsible for payment with respect to such item or service (or any portion thereof) under such a plan, or against any entity (including any physician or provider) which has been paid with respect to such item or service under such plan, and may join or intervene in any action related to the events that gave rise to the need for such item or service. The United States shall be subrogated (to the extent of payment made under this title for an item or service) to any right of an individual or any other entity to payment with respect to such item or service under such a plan.".

(d) The amendments made by this section shall apply to items and services furnished on or after the date of the enactment of this Act.

CONFIDENTIALITY OF ACCREDITATION SURVEYS

SEC. 2345. (a) Section 1865(a) of the Social Security Act is amended—

(1) in paragraph (2), by striking out "(on a confidential basis)"; and

(2) by adding at the end thereof the following new sentence: "The Secretary may not disclose any accreditation survey made and released to him by the Joint Commission on Accreditation of Hospitals, the American Osteopathic Association, or any other national accreditation body, of an entity accredited by such body.".

(b) The amendments made by this section shall become effective on the date of the enactment of this Act, and shall apply with respect to surveys released to the Secretary on, before, or after such date.

USE OF ADDITIONAL ACCREDITING ORGANIZATIONS UNDER MEDICARE

SEC. 2346. (a) The third sentence of section 1865(a) of the Social Security Act is amended—

(1) by striking out "section 1861(e), (j), (o), or (dd)" and inserting in lieu thereof "section 1832(a)(2)(F)(i), 1861(e), 1861(f), 1861(j), 1861(o), 1861(p)(4)(A) or (B), paragraphs (11) and (12) of section 1861(s), section 1861(aa)(2), 1861(cc)(2), or 1861(dd)(2)"; and

(2) by striking out "institution or agency" each place it appears and inserting in lieu thereof in each instance "entity".

(b) The amendments made by this section shall become effective on the date of the enactment of this Act.

FUNDING FOR PSRO REVIEW

SEC. 2347. (a)(1) Section 1866(a)(1)(F) of the Social Security Act is amended by striking out "maintain an agreement" and all that follows through "under which the organization", and inserting in lieu thereof "maintain an agreement with a professional standards review organization (if there is such an organization in existence in the area in which the hospital is located) or with a utilization and *quality control peer review organization which has a contract with the Secretary under part B of title XI for the area in which the hospital is located, under which the organization".*

(2) Section 602(l)(1) of the Social Security Amendments of 1983 is repealed.

(b) Notwithstanding section 604(a)(2) of the Social Security Amendments of 1983, the requirement that a hospital maintain an agreement with a utilization and quality control peer review organization, as contained in section 1866(a)(1)(F) of the Social Security Act, shall become effective on November 15, 1984.

(c)(1) Section 1153(b)(2)(A) of the Social Security Act is amended by striking out "During the first twelve months in which the Secretary is entering into contracts under this section" and inserting in lieu thereof "Prior to November 15, 1984".

(2) Section 1153(b)(2)(B) of such Act is amended by striking out "after the expiration of the twelve-month period referred to in subparagraph (A)" and inserting in lieu thereof "after November 14, 1984".

(3) Section 1153(b)(2) of such Act is amended by striking out subparagraph (C).

(d) The provisions of, and amendments made by, this section shall become effective on the date of the enactment of this Act.

PAYMENT FOR SERVICES FOLLOWING TERMINATION OF PARTICIPATION AGREEMENTS WITH HOME HEALTH AGENCIES OR HOSPICE PROGRAMS

SEC. 2348. (a) Section 1866(b)(4)(B) of the Social Security Act is amended by striking out "after the calendar year in which such termination is effective" and inserting in lieu thereof "more than 30 days after such effective date".

(b) The amendment made by this section shall apply to terminations issued on or after the date of the enactment of this Act.

ELIMINATION OF HEALTH INSURANCE BENEFITS ADVISORY COUNCIL

SEC. 2349. (a) Section 1867 of the Social Security Act is repealed.

(b)(1) The first sentence of section 1863 of such Act is amended by striking out "the Health Insurance Benefits Advisory Council established by section 1867, appropriate State agencies," and inserting in lieu thereof "appropriate State agencies".

(2) The first sentence of section 7(d)(4) of the Railroad Retirement Act of 1974 is amended by striking out "1867,".

(3) Section 361 of the Social Security Amendments of 1977 (Public Law 95–216) is amended by striking out subsection (i).

(c) The amendments made by this section shall become effective on the date of the enactment of this Act.

HEALTH MAINTENANCE ORGANIZATIONS AND COMPETITIVE MEDICAL PLANS

SEC. 2350. (a)(1) Section 1876(c)(3)(A) of the Social Security Act is amended—

(A) by inserting "(i)" after "(3)(A)",

(B) by inserting "and including the 30-day period specified under clause (ii)" after "30 days duration every year", and

(C) by adding at the end thereof the following new clause:

"(ii) For each area served by more than one eligible organization under this section, the Secretary (after consultation with such organizations) shall establish a single 30-day period each year during which all eligible organizations serving the area must provide for open enrollment under this section. The Secretary shall determine annual per capita rates under subsection (a)(1)(A) in a manner that assures that individuals enrolling during such a 30-day period will not have premium charges increased or any additional benefits decreased for 12 months beginning on the date the individual's enrollment becomes effective. An eligible organization may provide for such other open enrollment period or periods as it deems appropriate consistent with this section.".

(2) The Secretary of Health and Human Services may phase in, over a period of not longer than three years, the application of the amendments made by paragraph (1) to all applicable areas in the United States if the Secretary determines that it is not administratively feasible to establish a single 30-day open enrollment period for all such applicable areas before the end of the period.

(b)(1) The first sentence of section 1876(g)(2) of such Act is amended by inserting before the period at the end thereof the following: "and except that an organization (with the approval of the Secretary) may provide that a part of the value of such additional benefits be withheld and reserved by the Secretary as provided in paragraph (5)".

(2) Section 1876(g) of such Act is amended by adding at the end thereof the following new paragraph:

"(5) An organization having a risk-sharing contract under this section may (with the approval of the Secretary and during a period of not longer than four years) provide that a part of the value of additional benefits otherwise required to be provided by reason of paragraph (2) be withheld and reserved in the Federal Hospital Insurance Trust Fund and in Federal Supplementary Medical Insurance Trust Fund (in such proportions as the Secretary determines to be appropriate) by the Secretary for subsequent annual contract periods, to the extent required to stabilize and prevent undue fluctuation in the additional benefits offered in those subsequent periods by the organization in accordance with paragraph (3). Any of such value of additional benefits which is not provided to members of the organization in accordance with paragraph (3) prior to the end of such period, shall revert for the use of such trust funds.".

(3) The Secretary of Health and Human Services may not approve the use of a stabilization fund by an eligible organization under section 1876(g)(5) of the Social Security Act for any period beginning later than four years after the date of the enactment of this Act.

(4) The Secretary of Health and Human Services shall report to the Congress with respect to the use of stabilization funds by eligible organizations under section 1876(g)(5) of the Social Security Act, and shall assess the need for such funds. The report shall be submitted not later than 54 months after the month in which this Act is enacted.

(c) Section 1876(g)(4)(A) of such Act is amended—

(1) by inserting "and skilled nursing facilities" after "hospitals";

(2) by inserting "another appropriate basis for payment established under this title" after "section 1861(v))"; and

(3) by striking out "hospital".

(d) The amendments made by this section shall become effective on the date of the enactment of this Act.

JUDICIAL REVIEW OF PROVIDER REIMBURSEMENT REVIEW BOARD DECISIONS

SEC. 2351. (a)(1) The third sentence of section 1878(f)(1) of the Social Security Act is amended by striking out "such determination is rendered" and inserting in lieu thereof "notification of such determination is received".

(2) The amendment made by paragraph (1) shall be effective with respect to any civil action commenced on or after the date of the enactment of this Act.

(b)(1) The last sentence of section 1878(f)(1) of such Act is amended by inserting "or which have obtained a hearing under subsection (b)" after "common ownership or control".

(2) The amendment made by paragraph (1) shall be effective with respect to any appeal or action brought on or after the date of the enactment of this Act.

(c) Notwithstanding section 604 of the Social Security Amendments of 1983 (Public Law 98–21)—

(1) the amendments made by section 602(h)(2)(A) of that Act shall be effective with respect to any appeal or action brought on or after April 20, 1983; and

(2) the amendments made by section 602(h)(2)(B) of that Act shall be effective with respect to any appeal or action brought on or after the date of the enactment of this Act.

FLEXIBLE SANCTIONS FOR NONCOMPLIANCE WITH REQUIREMENTS FOR END STAGE RENAL DISEASE FACILITIES

SEC. 2352. (a) Section 1881(c)(3) of the Social Security Act is amended by adding at the end thereof the following new sentence: "If the Secretary determines that the facility's or provider's failure to cooperate with network plans and goals does not jeopardize patient health or safety or justify termination of certification, he may instead, after reasonable notice to the provider or facility and to the public, impose such other sanctions as he determines to be appropriate, which sanctions may include denial of reimbursement with respect to some or all patients admitted to the facility after the date of notice to the facility or provider, and graduated reduction in reimbursement for all patients.".

(b) The amendment made by this section shall apply to determinations made by the Secretary on or after the date of the enactment of this Act.

PAYMENTS TO PROMOTE CLOSURE AND CONVERSION OF UNDERUTILIZED HOSPITAL FACILITIES

SEC. 2353. (a) The Secretary of Health and Human Services shall carry out a study and report to the Congress on the modifications required in section 1884 of the Social Security Act in order to conform the closure and conversion program authorized in that section to the prospective payment system under section 1886(d) of such Act, so as to provide assistance to hospitals which may have particular problems in converting facilities (or parts thereof) from acute care to less intensive care or in closing facilities (or parts thereof). The report shall include recommendations as to how, and whether, implementation of section 1884 as modified may result in reductions in total hospital inpatient costs and total expenditures under title XVIII of the Social Security Act. The Secretary shall submit the report prior to March 31, 1985.

(b) During the period prior to March 31, 1985, and notwithstanding section 2101(c) of the Omnibus Budget Reconciliation Act of 1981 (Public Law 97-35), the Secretary shall not implement section 1884 of the Social Security Act.

MISCELLANEOUS TECHNICAL CORRECTIONS RELATING TO MEDICARE

SEC. 2354. (a)(1) Section 1122(b) of the Social Security Act is amended—

(A) by striking out the period at the end of paragraph (1) and inserting in lieu thereof a comma, and

(B) by striking out "(or the Mental Retardation Facilities and Community Mental Health Centers Construction Act of 1963)".

(2) Section 1122(i)(3) of such Act is amended by striking out "5703(b)" and inserting in lieu thereof "5703".

(3) Section 1128A(g) of such Act is amended by striking out "Professional Standards Review Organization" and inserting in lieu thereof "utilization and quality control peer review organization".

(4) Section 1129(a) of such Act is amended by striking out "Sate" and inserting in lieu thereof "State".

(5) The heading of title XI of such Act is amended by striking out "PROFESSIONAL STANDARDS REVIEW" and inserting in lieu thereof "PEER REVIEW".

(b)(1) The last sentence of sections 1814(a) of such Act and the last sentence of section 1835(a) of such Act are each amended by striking out "contractural" and inserting in lieu thereof "contractual".

(2) Sections 1817(c) and 1841(c) of such Act are each amended by striking out "under the Second Liberty Bond Act, as amended" and inserting in lieu thereof "under chapter 31 of title 31, United States Code".

(3) Section 1818(c)(1) of such Act is amended by striking out "Act" and inserting in lieu thereof "section".

(4) Section 1818(d)(2) of such Act is amended by striking out "if midway between multiples of $1" and inserting in lieu thereof ", if a multiple of 50 cents but not a multiple of $1,".

(5) Section 1833(a)(2) of such Act is amended by indenting subparagraphs (A) and (B) two additional ems so as to align their left margins with the left margin of subparagraph (C) and by appropri-

ately further indenting the clauses and subclauses of such subparagraphs.

(6) Section 1832(a)(2)(F)(ii)(II) of such Act is amended by striking out "Organization" and inserting in lieu thereof "organization".

(7) Section 1833(a)(1) of such Act is amended by striking out "and" at the end thereof.

(8) Section 1835(a)(2) of such Act is amended—

(A) by striking out "and" at the end of subparagraphs (B) and (C), and

(B) by indenting subparagraph (D) two additional ems so as to align its left margin with the left margin of subparagraph (C).

(9) Section 1835(e) of such Act is amended—

(A) by inserting "(i)" in paragraph (2) after "written assurances that",

(B) by striking out "(B)" in paragraph (2) and inserting in lieu thereof "(ii)",

(C) by striking out "return for" in paragraph (2) and inserting in lieu thereof "return of", and

(D) by striking out "(1) such hospital" and "(2) the Secretary" and inserting in lieu thereof "(A) such hospital" and "(B) the Secretary", respectively.

(10) Section 1837(g)(1) of such Act is amended by striking out "section 226(a)(2)(B)" and "section 1839(e)" and inserting in lieu thereof "section 226(b)" and "section 1839(d)", respectively.

(11) Sections 1840(d)(1), 1840(d)(2), and 1841(h) of such Act are each amended by striking out "Civil Service Commission" and inserting in lieu thereof "Director of the Office of Personnel Management" each place it appears.

(12) Section 1841(h) of such Act is amended by striking out "it" and inserting in lieu thereof "the Director".

(13) Section 1842(b)(3)(B)(ii)(II) of such Act is amended by striking out the period following "title".

(14) The ninth sentence of section 1842(b)(3) of such Act is amended by striking out "(i)" and "(ii)" and inserting in lieu thereof "(I)" and "(II)", respectively.

(15) Section 1843(d)(3)(B) of such Act is amended by striking out "1937" and inserting in lieu thereof "1974".

(16) Section 1844(a)(1)(B)(ii) of such Act is amended by striking out the period and inserting in lieu thereof "; plus".

(17) Sections 1864(c) and 1875(b) of such Act are each amended by striking out "the" after "Joint Commission on".

(18) Section 1861(j)(2) of such Act is amended by striking out "provision of" and inserting in lieu thereof "provision for".

(19) Section 1861(j)(13) of such Act is amended by striking out "a nursing home" and inserting in lieu thereof "an institution".

(20) Section 1861(u) of such Act is amended by striking out "or" before "home health agency".

(21) Section 1861(v)(1) of such Act is amended—

(A) by redesignating the clause (B) in subparagraph (A) as subparagraph (B) and by indenting the first line of such subparagraph 2 spaces;

(B) by aligning subparagraphs (C) and (D) flush with the left margin (but with appropriate indentation in the case of the clauses and subclauses of subparagraph (C)); and

(C) by inserting a comma after "section 1832(a)(2)(B)(i)" in subparagraph (D).

(22) Section 1861(v)(1)(C)(i) of such Act is amended by inserting a dash after "but only if".

(23) Section 1861(v)(1)(E)(ii) of such Act is amended by striking out "uses" and inserting in lieu thereof "use".

(24) Section 1861(v)(1)(I) of such Act is amended by striking out "to the Secretary, or upon request to the Comptroller General" in clauses (i) and (ii) and inserting in lieu thereof "by the Secretary, or upon request by the Comptroller General".

(25) Section 1861(v)(3) of such Act is amended by striking out "semiprivate" and inserting in lieu thereof "semi-private".

(26) Section 1861(z)(2) of such Act is amended by striking out "subparagraph (1)" and inserting in lieu thereof "paragraph (1)".

(27) Section 1861(aa)(2)(I) of such Act is amended by striking out "ultilization" and inserting in lieu thereof "utilization".

(28) Section 1861(cc)(1)(F) of such Act is amended by striking out "self administered" and inserting in lieu thereof "self-administered".

(29) Section 1861(cc)(2)(F) of such Act is amended by striking out "standard establishment" and inserting in lieu thereof "standards established".

(30) Section 1862(a)(12) of such Act is amended by striking out the second comma after "dental procedure".

(31) Section 1862(b)(3)(A)(iii) of such Act is amended by inserting "before the month" after "ending with the month".

(32) Section 1863 of such Act is amended by striking out "(j)(11)" and inserting in lieu thereof "(j)(15)".

(33) Section 1866(a)(1)(E) of such Act is amended by adding at the end a comma.

(34) Section 1866(b) of such Act is amended by moving the alignment of paragraph (3) two ems to the left so as to align its left margin with the left margin of paragraph (4).

(35) Section 1869(b)(1)(B) of such Act is amended by striking out ", or section 1818, or section 1819" and inserting in lieu thereof "or section 1818".

(36) Section 1872 of such Act is amended—

(A) by striking out the comma after "206", and

(B) by striking out "(f),".

(37) Section 1876(b)(2)(D) of such Act is amended by striking out "paragraph (1)" and inserting in lieu thereof "subparagraph (A)".

(38) Section 1876(c)(4)(A)(i) of such Act is amended by striking out "promptly as appropriate" and inserting in lieu thereof "with reasonable promptness".

(39) Section 1878(c) of such Act is amended by striking out "inadmissable" and inserting in lieu thereof "inadmissible".

(40) Section 1878(e) of such Act is amended by striking out ", (e), and (f)" and inserting in lieu thereof "and (e)".

(41) Section 1881 of such Act is amended by striking out "end-stage" and inserting in lieu thereof "end stage" each place it appears.

(42) Section 1886(a)(2)(B) of such Act is amended by striking out "disportionate" and inserting in lieu thereof "disproportionate".

(43) Section 1886(b)(3)(A)(ii) of such Act is amended by inserting "of" after "in the case".

(44) Section 1886(d)(3)(D)(i)(I) of such Act is amended by striking out "(C)," and inserting in lieu thereof "(C))".

(c)(1)(A) Section 903(a)(4) of Public Law 96-499 is amended by striking out "new paragraph".

(B) Section 937(c) of Public Law 96-499 is amended by striking out "on on" and inserting in lieu thereof "on or".

(2) Section 2353(h)(1) of Public Law 97-35 is amended by striking out the comma after "XIX".

(3)(A) Section 114(c)(2)(C)(ii) of Public Law 97-248 is amended by inserting "and enrolled under part B" after "part A".

(B) Section 114(c)(3)(E) of Public Law 97-248 is amended—

(i) by striking out "section 1833(a)(1) of the Social Security Act or", and

(ii) by adding before the period at the end the following: ", or reimbursement on a reasonable cost basis under section 1833(a)(1)(A) of such Act".

(C) Section 149 of Public Law 97-248 is amended by striking out "part" and inserting in lieu thereof "subtitle".

(d) Section 162(i)(2) of the Internal Revenue Code of 1954 is amended by striking out "213(e)" and inserting in lieu thereof "213(d)".

(e)(1) Except as provided in paragraph (2), the amendments made by this section shall be effective on the date of the enactment of this Act; but none of such amendments shall be construed as changing or affecting any right, liability, status, or interpretation which existed (under the provisions of law involved) before that date.

(2) The amendments made by paragraphs (1), (2), and (3) of subsection (c) shall be effective as if they had been originally included in Public Laws 96-499, 97-35, and 97-248, respectively.

WAIVERS FOR SOCIAL HEALTH MAINTENANCE ORGANIZATIONS

SEC. 2355. (a) In the case of a project described in subsection (b), the Secretary of Health and Human Services shall approve, with appropriate terms and conditions as defined by the Secretary, applications or protocols submitted for waivers described in subsection (c), and the evaluation of such protocols, in order to carry out such project. Such approval shall be effected not later than 30 days after the date on which the application or protocol for a waiver is submitted or not later than 30 days after the date of the enactment of this Act in the case of an application or protocol submitted before the date of the enactment of this Act.

(b) A project referred to in subsection (a) is a project—

(1) to demonstrate the concept of a social health maintenance organization with the organizations as described in Project No. 18-P-9 7604/1—04 of the University Health Policy Consortium of Brandeis University;

(2) which provides for the integration of health and social services under the direct financial management of a provider of services;

(3) under which all medicare services will be provided by or under arrangements made by the organization at a fixed annual prepaid capitation rate for medicare of 100 percent of the adjusted average per capita cost;

(4) under which medicaid services will be provided at a rate approved by the Secretary;

(5) under which all payors will share risk for no more than two years, with the organization being at full risk in the third year;

(6) which is being provided funds under a grant provided by the Secretary of Health and Human Services; and

(7) with respect to which substantial private funds are being provided other than under the grant referred to in paragraph (5).

(c) The waivers referred to in subsection (a) are appropriate waivers of—

(1) certain requirements of title XVIII of the Social Security Act, pursuant to section 402(a) of the Social Security Amendments of 1967 (as amended by section 222 of the Social Security Amendments of 1972); and

(2) certain requirements of title XIX of the Social Security Act, pursuant to section 1115 of such Act.

(d)(1) The Secretary of Health and Human Services shall submit a preliminary report to the Congress on the status of the projects and waivers referred to in subsection (a) 45 days after the date of the enactment of this Act.

(2) The Secretary shall submit a final report to the Congress on the projects referred to in subsection (a) not later than 42 months after the date of the enactment of this Act.

Subtitle B—Medicaid and Maternal and Child Health Amendments

MEDICAID COVERAGE FOR PREGNANT WOMEN AND CHILDREN

SEC. 2361. (a) Clause (i) of section 1902(a)(10)(A)(i) of the Social Security Act is amended to read as follows:

"(i) all individuals—

"(I) who are receiving aid or assistance under any plan of the State approved under title I, X, XIV, or XVI, or part A or part E of title IV (including individuals eligible under this title by reason of section 402(a)(37), or considered by the State to be receiving such aid as authorized under sections 414(g)),

"(II) with respect to whom supplemental security income benefits are being paid under title XVI, or

"(III) who are qualified pregnant women or children as defined in section 1905(n);".

(b) Section 1905 of such Act is amended by adding at the end thereof the following new subsection:

"(n) The term 'qualified pregnant woman or child' means—

"(1) a pregnant woman who—

"(A) would be eligible for aid to families with dependent children under part A of title IV (or would be eligible for

such aid if coverage under the State plan under part A of title IV included aid to families with dependent children of unemployed parents pursuant to section 407) if her child had been born and was living with her in the month such aid would be paid, and such pregnancy has been medically verified; or

"(B) is a member of a family which would be eligible for aid under the State plan under part A of title IV pursuant to section 407 if the plan required the payment of aid pursuant to such section; and

"(2) a child who is under 5 years of age, who was born after September 30, 1983, and who meets the income and resources requirements of the State plan under part A of title IV.".

(c) Section 406(g) of such Act is amended by striking out "(1)" after "(g)", by striking out paragraph (2), and by redesignating subparagraphs (A) and (B) as paragraphs (1) and (2).

(d)(1) Except as provided in paragraph (2), the amendments made by this section shall apply to calendar quarters beginning on or after October 1, 1984, without regard to whether or not final regulations to carry out such amendments have been promulgated by such date.

(2) In the case of a State plan for medical assistance under title XIX of the Social Security Act which the Secretary of Health and Human Services determines requires State legislation in order for the plan to meet the additional requirements imposed by the amendments made by this section, the State plan shall not be regarded as failing to comply with the requirements of such title solely on the basis of its failure to meet these additional requirements before the first day of the first calendar quarter beginning after the close of the first regular session of the State legislature that begins after the date of the enactment of this Act.

CLARIFICATION OF MEDICAID ENTITLEMENT FOR CERTAIN NEWBORNS

SEC. 2362. (a) Section 1902(e) of the Social Security Act is amended by adding at the end the following new paragraph:

"(4) A child born to a woman eligible for and receiving medical assistance under a State plan on the date of the child's birth shall be deemed to have applied for medical assistance and to have been found eligible for such assistance under such plan on the date of such birth and to remain eligible for such assistance for a period of one year so long as the child is a member of the woman's household and the woman remains eligible for such assistance.".

(b) The amendment made by subsection (a) shall apply to children born on or after October 1, 1984.

RECERTIFICATION OF SNF AND ICF PATIENTS

SEC. 2363. (a)(1) Section 1902(a) of the Social Security Act, as amended by section 2303(g) of this title, is amended—

(A) in paragraph (30)—

(i) by inserting "(A)" after "(30)", and

(ii) by adding at the end the following new subparagraph:

"(B) provide, under the program described in subparagraph (A), that—

"(i) each admission to a hospital, skilled nursing facility, intermediate care facility, or hospital for mental diseases is reviewed or screened in accordance with criteria established by medical and other professional personnel who are not themselves directly responsible for the care of the patient involved, and who do not have a significant financial interest in any such institution and are not, except in the case of a hospital, employed by the institution providing the care involved, and

"(ii) the information developed from such review or screening, along with the data obtained from prior reviews of the necessity for admission and continued stay of patients by such professional personnel, shall be used as the basis for establishing the size and composition of the sample of admissions to be subject to review and evaluation by such personnel, and any such sample may be of any size up to 100 percent of all admissions and must be of sufficient size to serve the purpose of (I) identifying the patterns of care being provided and the changes occurring over time in such patterns so that the need for modification may be ascertained, and (II) subjecting admissions to early or more extensive review where information indicates that such consideration is warranted to a hospital, skilled nursing facility, intermediate care facility, or hospital for mental diseases;"; and

(B) by striking out "and" at the end of paragraph (42), by striking out the period at the end of paragraph (43) and inserting in lieu thereof "; and", and by inserting after paragraph (43) the following new paragraph:

"(44) in each case for which payment for inpatient hospital services, skilled nursing facility services, intermediate care facility services, or inpatient mental hospital services is made under the State plan—

"(A) a physician certifies at the time of admission, or, if later, the time the individual applies for medical assistance under the State plan (and the physician, or a physician assistant or nurse practitioner under the supervision of a physician, recertifies, where such services are furnished over a period of time, in such cases, at least as often as required under section 1903(g)(6) (or, in the case of services that are intermediate care facility services provided in an institution for the mentally retarded, every year), and accompanied by such supporting material, appropriate to the case involved, as may be provided in regulations of the Secretary), that such services are or were required to be given on an inpatient basis because the individual needs or needed such services, and

"(B) such services were furnished under a plan established and periodically reviewed and evaluated by a physician.".

(2) Section 1903(g)(1) of such Act is amended—

(A) in the matter preceding subparagraph (A), by striking out "care as an inpatient" and all that follows through "hospital for mental diseases on" and inserting in lieu thereof "inpatient hospital services or intermediate care facility services for 60 days, skilled nursing facility services for 30 days, or inpatient mental hospital services for",

(B) in the matter before subparagraph (A), by striking out "which for purposes of this section means the four calendar quarters ending with June 30," and by striking out "in the same fiscal year", and

(C) by striking out "(including tuberculosis hospitals)" and all that follows through the end of subparagraph (D) and inserting in lieu thereof ", skilled nursing facility services, or intermediate care facility services furnished beyond 60 days (or inpatient mental hospital services furnished beyond 90 days), such State has an effective program of medical review of the care of patients in mental hospitals, skilled nursing facilities, and intermediate care facilities pursuant to paragraphs (26) and (31) of section 1902(a) whereby the professional management of each case is reviewed and evaluated at least annually by independent professional review teams.".

(4) Section 1903(g) of such Act is further amended by striking out paragraph (6) and inserting in lieu thereof the following:

"(6)(A) Recertifications required under section 1902(a)(44) shall be conducted at least every 60 days in the case of inpatient hospital services.

"(B) Such recertifications in the case of skilled nursing facility services shall be conducted at least—

"(i) 30 days after the date of the initial certification,

"(ii) 60 days after the date of the initial certification,

"(iii) 90 days after the date of the initial certification, and

"(iv) every 60 days thereafter.

"(C) Such recertifications in the case of intermediate care facility services shall be conducted at least—

"(i) 60 days after the date of the initial certification,

"(ii) 180 days after the date of the initial certification,

"(iii) 12 months after the date of the initial certification,

"(iv) 18 months after the date of the initial certification,

"(v) 24 months after the date of the initial certification, and

"(vi) every 12 months thereafter.

"(D) For purposes of determining compliance with the schedule established by this paragraph, a recertification shall be considered to have been done on a timely basis if it was performed not later than 10 days after the date the recertification was otherwise required and the State establishes good cause why the physician or other person making such recertification did not meet such schedule.".

(b) Such section is further amended by adding at the end the following new paragraph:

"(7) It is the duty and responsibility of the Secretary to assure that standards which govern the provision of care in skilled nursing facilities and intermediate care facilities under plans approved under this title, and the enforcement of such standards, are adequate to protect the health and safety of residents and to promote the effective and efficient use of public moneys.".

(c) The amendments made by subsection (a) apply to calendar quarters beginning on or after the date of the enactment of this Act, except that, in the case of individuals admitted to skilled nursing facilities before such date, the amendments made by this section shall not require recertifications sooner or more frequently than were required under the law in effect before such date.

WAIVER OF CERTAIN MEMBERSHIP REQUIREMENTS FOR CERTAIN HEALTH MAINTENANCE ORGANIZATIONS

SEC. 2364. Section 1903(m)(2) of the Social Security Act is amended—

(1) by inserting "except as provided under subparagraph (F)," in subparagraph (A)(vi) after "(I)", and

(2) by adding at the end the following new subparagraphs:

"(E) In the case of a health maintenance organization that—

"(i) is a nonprofit organization with at least 25,000 members,

"(ii) is and has been a qualified health maintenance organization (as defined in section 1310(d) of the Public Health Service Act) for a period of at least four years,

"(iii) provides basic health services through members of the staff of the organization,

"(iv) is located in an area designated as medically underserved under section 1302(7) of the Public Health Service Act, and

"(v) previously received a waiver of the requirement described in subparagraph (A)(ii) under section 1115,

the Secretary may modify or waive the requirement described in subparagraph (A)(ii) but only if the Secretary determines that special circumstances warrant such modification or waiver and that the organization has taken and is taking reasonable efforts to enroll individuals who are not entitled to benefits under the State plan approved under this title or under title XVIII.

"(F)(i) In the case of a contract with a health maintenance organization described in clause (ii), a State plan may restrict the period in which requests for termination of enrollment without cause under subparagraph (A)(vi)(I) are permitted to the first month of each period of enrollment, each such period of enrollment not to exceed six months in duration, but only if the State provides notification, at least twice per year, to individuals enrolled with such organization of the right to terminate such enrollment and the restriction on the exercise of this right. Such restriction shall not apply to requests for termination of enrollment for cause.

"(ii) A health maintenance organization referred to in clause (i) is an organization which—

"(I) is a qualified health maintenance organization (as defined in section 1310(d) of the Public Health Service Act) or a health maintenance organization which is receiving (and has received during the previous two years) a grant of at least $100,000 under section 329(d)(1)(A) or 330(d)(1) of the Public Health Service Act or has received at least $100,000 (by grant, subgrant, or subcontract) under the Appalachian Regional Development Act of 1965, and

"(II) meets the requirement of subparagraph (A)(ii).".

INCREASE IN MEDICAID CEILING AMOUNT FOR PUERTO RICO, THE VIRGIN ISLANDS, GUAM, THE NORTHERN MARIANA ISLANDS, AND AMERICAN SAMOA

SEC. 2365. (a) Section 1108(c) of the Social Security Act is amended to read as follows:

"(c) The total amount certified by the Secretary under title XIX with respect to a fiscal year for payment to—

"(1) Puerto Rico shall not exceed $63,400,000;

"(2) the Virgin Islands shall not exceed $2,100,000;

"(3) Guam shall not exceed $2,000,000;

"(4) the Northern Mariana Islands shall not exceed $550,000; and

"(5) American Samoa shall not exceed $1,150,000.".

(b) The amendment made by subsection (a) shall be effective for fiscal years beginning on or after October 1, 1983.

PAYMENT FOR PSYCHIATRIC HOSPITAL SERVICES

SEC. 2366. The provisions of section 1902(a)(13) of the Social Security Act, insofar as they require a reduction of the amount of payment otherwise to be made to a public psychiatric hospital due to the level of care received in such hospital, shall not apply to payments to hospitals before July 1, 1985, and such a reduction made for payments during the 12-month period ending June 30, 1986, and during the 12-month period ending June 30, 1987, shall be one-third and two-thirds, respectively, of the amount of the reduction which would have been made without regard to this section.

MANDATORY ASSIGNMENT OF RIGHTS OF PAYMENT BY MEDICAID RECIPIENTS

SEC. 2367. (a) Section 1902(a) of the Social Security Act (as amended by section 2303 and 2363 of this title) is amended—

(1) by striking out "and" at the end of paragraph (43);

(2) by striking out the period at the end of paragraph (44) and inserting in lieu thereof "; and"; and

(3) by inserting after paragraph (44) the following new paragraph:

"(45) provide for mandatory assignment of rights of payment for medical support and other medical care owed to recipients, in accordance with section 1912.".

(b) Section 1912(a) of such Act is amended by striking out "State plan for medical assistance may" and inserting in lieu thereof "State plan for medical assistance shall".

(c)(1) Except as provided in paragraph (2), the amendments made by this section shall become effective on October 1, 1984.

(2) In the case of a State plan for medical assistance under title XIX of the Social Security Act which the Secretary of Health and Human Services determines requires State legislation in order for the plan to meet the additional requirements imposed by the amendments made by this section, the State plan shall not be regarded as failing to comply with the requirements of such title solely on the basis of its failure to meet these additional requirements before the first day of the first calendar quarter beginning after the close of

the first regular session of the State legislature that begins after the date of the enactment of this Act.

REQUIREMENTS FOR MEDICAL REVIEW AND INDEPENDENT PROFESSIONAL REVIEW UNDER MEDICAID

SEC. 2368. (a) Section 1902(a)(31) of the Social Security Act is amended to read as follows:

"(31) with respect to skilled nursing facility services (and with respect to intermediate care facility services, where the State plan includes medical assistance for such services) provide—

"(A) with respect to each patient receiving such services, for a written plan of care, prior to admission to or authorization of benefits in such facility, in accordance with regulations of the Secretary, and for a regular program of independent professional review (including medical evaluation) which shall periodically review his need for such services;

"(B) with respect to each skilled nursing or intermediate care facility within the State, for periodic onsite inspections of the care being provided to each person receiving medical assistance, by one or more independent professional review teams (composed of a physician or registered nurse and other appropriate health and social service personnel), including with respect to each such person (i) the adequacy of the services available to meet his current health needs and promote his maximum physical well-being, (ii) the necessity and desirability of his continued placement in the facility, and (iii) the feasibility of meeting his health care needs through alternative institutional or noninstitutional services; and

"(C) for full reports to the State agency by each independent professional review team of the findings of each inspection under subparagraph (B), together with any recommendations;".

(b) Section 1902(a)(26) of such Act is amended to read as follows:

"(26) if the State plan includes medical assistance for inpatient mental hospital services provide—

"(A) with respect to each patient receiving such services, for a regular program of medical review (including medical evaluation) of his need for such services, and for a written plan of care;

"(B) for periodic inspections to be made in all mental institutions within the State by one or more medical review teams (composed of physicians and other appropriate health and social service personnel) of the care being provided to each person receiving medical assistance, including (i) the adequacy of the services available to meet his current health needs and promote his maximum physical well-being, (ii) the necessity and desirability of his continued placement in the institution, and (iii) the feasibility of meeting his health care needs through alternative institutional or noninstitutional services; and

"(C) for full reports to the State agency by each medical review team of the findings of each inspection under subparagraph (B), together with any recommendations;".

(c) The amendments made by this section shall become effective on the date of the enactment of this Act.

FLEXIBILITY IN SETTING PAYMENT RATES FOR HOSPITALS FURNISHING LONG-TERM CARE SERVICES UNDER MEDICAID

SEC. 2369. (a)(1) Section 1913(b)(1) of the Social Security Act is amended by striking out "Payment" and inserting in lieu thereof "Except as provided in paragraph (3), payment".

(2) Section 1913(b) of such Act is amended by adding at the end thereof the following new paragraph:

"(3) Payment to all such hospitals, for any skilled nursing or intermediate care facility services furnished pursuant to subsection (a), may be made at a payment rate established by the State in accordance with the requirements of section 1902(a)(13)(A).".

(b) The amendments made by this section shall apply to payments for services furnished after the date of the enactment of this Act.

AUTHORITY OF THE SECRETARY TO ISSUE AND ENFORCE SUBPOENAS UNDER MEDICAID

SEC. 2370. (a) Title XIX of the Social Security Act is amended by adding at the end thereof the following new section:

"APPLICATION OF PROVISIONS OF TITLE II RELATING TO SUBPOENAS

SEC. 1918. The provisions of subsections (d) and (e) of section 205 of this Act shall apply with respect to this title to the same extent as they are applicable with respect to title II.".

(b) The amendment made by this section shall become effective on the date of the enactment of this Act.

MEDICAID CLINIC ADMINISTRATION

SEC. 2371. (a) Section 1905(a)(9) of the Social Security Act is amended to read as follows:

"(9) clinic services furnished by or under the direction of a physician, without regard to whether the clinic itself is administered by a physician;".

(b) The amendment made by subsection (a) shall apply to services furnished on or after the date of the enactment of this Act.

INCREASE IN AUTHORIZATION FOR MATERNAL AND CHILD HEALTH BLOCK GRANT

SEC. 2372. (a) Section 501(a) of the Social Security Act is amended by striking out "$373,000,000 for fiscal year 1982 and for each fiscal year thereafter" and inserting in lieu thereof "$478,000,000 for fiscal year 1984 and each fiscal year thereafter".

(b) The amendment made by subsection (a) shall be effective for fiscal years beginning on or after October 1, 1983.

MISCELLANEOUS TECHNICAL AMENDMENTS

SEC. 2373. (a)(1) Section 503(a) of the Social Security Act is amended by striking out "section 203 of the Intergovernmental Cooperation Act of 1968 (42 U.S.C. 4213)" and inserting in lieu thereof "section 6503(a) of title 31, United States Code".

(2) Section 506(d)(3) of such Act is amended by striking out "section 202 of the Intergovernmental Cooperation Act of 1968 (42 U.S.C. 4212)" and inserting in lieu thereof "section 6503(b) of title 31, United States Code".

(b)(1) Section 1902(a)(9) of such Act is amended by indenting subparagraph (C) two additional ems so as to align its left margin with the left margin of subparagraph (B).

(2) Section 1902(a)(10) of such Act is amended by indenting subparagraph (A) (and each of its clauses and subclauses) two additional ems so as to align its left margin (before clause (i)) with the left margin of subparagraph (B).

(3) Section 1902(a)(13)(A) of such Act is amended by striking out "(A)" and all that follows through "hospital" the first place it appears and inserting in lieu thereof "(A) for payment (except where the State agency is subject to an order under section 1914) of the hospital".

(4) Section 1902(a)(20)(B) of such Act is amended by striking out "periodical" and inserting in lieu thereof "periodic".

(5) Section 1902(a)(20)(C) of such Act is amended by striking out ", section 603(a)(1)(A) (i) and (ii),".

(6) Section 1902(a)(26)(B)(ii) of such Act is amended by striking out "homes" and inserting in lieu thereof "facilities".

(7) Section 1902(a)(33)(A) of such Act is amended by striking out "penultimate sentence" and inserting in lieu thereof "second sentence".

(8) Section 1902(a)(42)(B) of such Act is amended by striking out "part" and inserting in lieu thereof "title".

(9) Section 1902(a) of such Act is amended by striking out "For purposes of paragraphs (9)(A)" and all that follows through "do not include" in the last sentence of the third to last paragraph and inserting in lieu thereof "The provisions of paragraphs (9)(A), (31), and (33) and of section 1903(i)(4) shall not apply to".

(10) Section 1902(f) of such Act is amended by striking out "clause (10)(A)" and "clause (10)(C)" and inserting in lieu thereof "paragraph (10)(A)" and "paragraph (10)(C)", respectively, each place each appears.

(11) Section 1903(g)(4)(B) of such Act is amended—

(A) by striking out "paragraph (26)" and inserting in lieu thereof "paragraphs (26)", and

(B) by striking out "deligence" and inserting in lieu thereof "diligence".

(12) Section 1903(m)(2)(B)(i) of such Act is amended—

(A) by striking out "(II)" before "for the period",

(B) by striking out "of such section" in subclause (II) and inserting in lieu thereof "of section 1905(a)", and

(C) by striking out "peroid" and inserting in lieu thereof "period".

(13) Section 1903(m)(2) of such Act is amended by aligning subparagraph (C) flush with the left margin.

(14) Section 1903(s)(3)(B) of such Act is amended by striking out "nonfederal" and inserting in lieu thereof "non-Federal".

(15) Section 1905(a)(4) of such Act is amended by inserting a semicolon before "(B)".

(16) Section 1905(a)(17) of such Act is amended by striking out "he" and inserting in lieu thereof "the nurse-midwife" each place it appears.

(17) The last sentence of section 1905(a) of such Act is amended by striking out "clauses (vi)" and inserting in lieu thereof "clause (vi)", and by striking out "well being" and inserting in lieu thereof "well-being".

(18) The second sentence of section 1905(b) of such Act is amended by striking out everything that follows "the provisions of" and inserting in lieu thereof "section 1101(a)(8)(B).".

(19) Section 1905(d)(1) of such Act is amended by striking out "which meet" and inserting in lieu thereof "the institution meets".

(20) Section 1905(m) of such Act is amended by striking out "he" each place it appears and inserting in lieu thereof "the nurse".

(21) Section 1915(c)(1) of such Act is amended by striking out "under this part" and inserting in lieu thereof "under this title".

(c)(1) The Secretary of Health and Human Services shall not take any compliance, disallowance, penalty, or other regulatory action against a State during the moratorium period described in paragraph (2) by reason of such State's plan under title XIX of the Social Security Act being determined to be in violation of section 1902(a)(10)(C)(i)(III) of such Act on account of such plan's having a standard or methodology which the Secretary interprets as being less restrictive than the standard or methodology required under such section.

(2) The moratorium period is the period beginning on the date of the enactment of this Act and ending 18 months after the date on which the Secretary submits the report required under paragraph (3).

(3) The Secretary shall report to the Congress within 12 months after the date of the enactment of this Act with respect to the appropriateness, and impact on States and recipients of medical assistance, of applying standards and methodologies utilized in cash assistance programs to those recipients of medical assistance who do not receive cash assistance, and any recommendations for changes in such requirements.

(4) No provision of law shall repeal or suspend the moratorium imposed by this subsection unless such provision specifically amends or repeals this subsection.

Subtitle C—Recovery of Hill-Burton Funds

RECOVERY OF HILL-BURTON FUNDS

SEC. 2381. (a) Section 609 of the Public Health Service Act is amended to read as follows:

"RECOVERY

SEC. 609. (a) If any facility with respect to which funds have been paid under section 606 shall, at any time within 20 years after the completion of construction or modernization—

"(1) be sold or transferred to any entity (A) which is not qualified to file an application under section 605, or (B) which is not approved as a transferee by the State agency designated pursuant to section 604, or its successor, or

"(2) cease to be a public health center or a public or other nonprofit hospital, outpatient facility, facility for long-term care, or rehabilitation facility,

the United States shall be entitled to recover, whether from the transferor or the transferee (or, in the case of a facility which has ceased to be public or nonprofit, from the owners thereof) an amount determined under subsection (c).

"(b) The transferor of a facility which is sold or transferred as described in subsection (a)(1), or the owner of a facility the use of which is changed as described in subsection (a)(2), shall provide the Secretary written notice of such sale, transfer, or change not later than the expiration of 10 days from the date on which such sale, transfer, or change occurs.

"(c)(1) Except as provided in paragraph (2), the amount the United States shall be entitled to recover under subsection (a) is an amount bearing the same ratio to the then value (as determined by the agreement of the parties or in an action brought in the district court of the United States for the district for which the facility involved is situated) of so much of the facility as constituted an approved project or projects as the amount of the Federal participation bore to the cost of the construction or modernization of such project or projects.

"(2)(A) After the expiration of—

"(i) 180 days after the date of the sale, transfer, or change of use for which a notice is required by subsection (b), in the case of a facility which is sold or transferred or the use of which changes after the date of the enactment of this subsection, or

"(ii) thirty days after the date of the enactment of this subsection or if later 180 days after the date of the sale, transfer, or change of use for which a notice is required by subsection (b), in the case of a facility which was sold or transferred or the use of which changed before the date of the enactment of this subsection.

the amount which the United States is entitled to recover under paragraph (1) with respect to a facility shall be the amount prescribed by paragraph (1) plus interest, during the period described in subparagraph (B), at a rate (determined by the Secretary) based on *the average of the bond equivalent of the weekly ninety-day Treasury bill auction rate.*

"(B) The period referred to in subparagraph (A) is the period beginning—

"(i) in the case of a facility which was sold or transferred or the use of which changed before the date of the enactment of this subsection, thirty days after such date or if later 180 days after the date of the sale, transfer, or change of use for which a notice is required by subsection (b),

"(ii) in the case of a facility with respect to which notice is provided in accordance with subsection (b), upon the expiration of 180 days after the receipt of such notice, or

"(iii) in the case of a facility with respect to which such notice is not provided as prescribed by subsection (b), on the date of the sale, transfer, or change of use for which such notice was to be provided,

and ending on the date the amount the United States is entitled to under paragraph (1) is collected.

"(d)(1) The Secretary may waive the recovery rights of the United States under subsection (a)(1) with respect to a facility in any State if the Secretary determines, in accordance with regulations, that the entity to which the facility was sold or transferred—

"(A) has established an irrevocable trust—

"(i) in an amount equal to the greater of twice the cost of the remaining obligation of the facility under clause (2) of section 603(e) or the amount, determined under subsection (c), that the United States is entitled to recover, and

"(ii) which will only be used by the entity to provide the care required by clause (2) of section 603(e); and

"(B) will meet the obligation of the facility under clause (1) of section 603(e).

"(2) The Secretary may waive the recovery rights of the United States under subsection (a)(2) with respect to a facility in any State if the Secretary determines, in accordance with regulations, that there is good cause for waiving such rights with respect to such facility.

"(e) The right of recovery of the United States under subsection (a) shall not constitute a lien on any facility with respect to which funds have been paid under section 606.".

(b) Section 1622 of such Act is amended to read as follows:

"RECOVERY

"SEC. 1622. (a) If any facility with respect to which funds have been paid under this title shall, at any time within 20 years after the completion of construction or modernization—

"(1) be sold or transferred to any entity (A) which is not qualified to file an application under section 1621 or 1642 or (B) which is not approved as a transferee by the State Agency of the State in which such facility is located, or its successor, or

"(2) cease to be a public health center or a public or other nonprofit hospital, outpatient facility, facility for long-term care, or rehabilitation facility,

the United States shall be entitled to recover, whether from the transferor or the transferee (or, in the case of a facility which has ceased to be public or nonprofit, from the owners thereof) an amount determined under subsection (c).

"(b) The transferor of a facility which is sold or transferred as described in subsection (a)(1), or the owner of a facility the use of which is changed as described in subsection (a)(2), shall provide the Secretary written notice of such sale, transfer, or change not later than the expiration of 10 days from the date on which such sale, transfer, or change occurs.

"(c)(1) Except as provided in paragraph (2), the amount the United States shall be entitled to recover under subsection (a) is an amount bearing the same ratio to the then value (as determined by the agreement of the parties or in an action brought in the district court of the United States for the district for which the facility involved is situated) of so much of the facility as constituted an approved project or projects as the amount of the Federal participation bore to the cost of the construction or modernization of such project or projects.

"(2)(A) After the expiration of—

"(i) 180 days after the date of the sale, transfer, or change of use for which a notice is required by subsection (b) in the case of a facility which is sold or transferred or the use of which changes after the date of the enactment of this subsection, or

"(ii) thirty days after the date of enactment of this subsection or if later 180 days after the date of the sale, transfer, or change of use for which a notice is required by subsection (b), in the case of a facility which was sold or transferred or the use of which changed before the date of the enactment of this subsection,

the amount which the United States is entitled to recover under paragraph (1) with respect to a facility shall be the amount prescribed by paragraph (1) plus interest, during the period described in subparagraph (B), at a rate (determined by the Secretary) based on the average of the bond equivalent of the weekly 90-day Treasury bill auction rate.

"(B) The period referred to in subparagraph (A) is the period beginning—

"(i) in the case of a facility which was sold or transferred or the use of which changed before the date of the enactment of this subsection, thirty days after such date or if later 180 days after the date of the sale, transfer, or change of use for which a notice is required by subsection (b).

"(ii) in the case of a facility with respect to which notice is provided in accordance with subsection (b), upon the expiration of 180 days after the receipt of such notice, or

"(iii) in the case of a facility with respect to which such notice is not provided as prescribed by subsection (b), on the date of the sale, transfer, or changessation for which such notice was to be provided,

and ending on the date the amount the United States is entitled to under paragraph (1) is collected.

"(d)(1) The Secretary may waive the recovery rights of the United States under subsection (a)(1) with respect to a facility in any State

if the Secretary determines, in accordance with regulations, that the entity to which the facility was sold or transferred—

"(A) has established an irrevocable trust—

"(i) in an amount equal to the greater of twice the cost of the remaining obligation of the facility under clause (ii) of section 1621(b)(1)(K) or the amount, determined under subsection (c), that the United States is entitled to recover, and

"(ii) which will only be used by the entity to provide the care required by clause (ii) of section 1621(b)(1)(K); and

"(B) will meet the obligation of the facility under clause (i) of section 1621(b)(1)(K).

"(2) The Secretary may waive the recovery rights of the United States under subsection (a)(2) with respect to a facility in any State if the Secretary determines, in accordance with regulations, that there is good cause for waiving such rights with respect to such facility.

"(e) The right of recovery of the United States under subsection (a) shall not constitute a lien on any facility with respect to which funds have been paid under this title.".

(c) Not later than the expiration of the one-hundred-and-eighty-day period beginning on the date of the enactment of this section, the Secretary shall have in effect regulations and personnel to place in effect the amendments made by this section.

Subtitle D—Uncompensated Services Provided by Skilled Nursing Facilities and Intermediate Care Facilities

STUDY

SEC. 2391. (a) The Secretary of Health and Human Services shall conduct a study relating to compliance with sections 603(e)(2) and 1621(b)(1)(K)(ii) of the Public Health Service Act (as such sections were in effect on September 30, 1979) to determine whether the regulations implementing such sections should distinguish between hospitals and long-term care facilities assisted under titles VI and XVI of such Act. Not later than January 1, 1985, the Secretary shall transmit to the Congress a report of the results of the study.

(b) Subsection (a) shall take effect October 1, 1984.

TITLE IV—SMALL BUSINESS PROGRAMS

SBA DISASTER LOANS

SEC. 2401. Section 18(a) of the Small Business Act is amended by striking out "October 1, 1986" and by inserting in lieu thereof "October 1, 1987".

TITLE V—VETERANS' PROGRAMS

PART A—COST SAVINGS UNDER THE VETERANS' ADMINISTRATION PENSION PROGRAM

EFFECTIVE DATE FOR AWARD OF PENSION FOR NON-SERVICE-CONNECTED DISABILITY OR DEATH

SEC. 2501. (a)(1) Subsection (b)(3) of section 3010 of title 38, United States Code, is amended—

(A) by inserting "(A)" after "(3)";

(B) by inserting "described in subparagraph (B) of this paragraph" after "to a veteran";

(C) by striking out "an application therefor is received" and inserting in lieu thereof "the veteran applies for a retroactive award"; and

(D) by adding at the end the following new subparagraph:

"(B) A veteran referred to in subparagraph (A) of this paragraph is a veteran who is permanently and totally disabled and who is prevented by a disability from applying for disability pension for a period of at least 30 days beginning on the date on which the veteran became permanently and totally disabled.".

(2) Subsection (d) of such section is amended to read as follows:

"(d)(1) The effective date of an award of death compensation or dependency and indemnity compensation for which application is received within one year from the date of death shall be the first day of the month in which the death occurred.

"(2) The effective date of an award of death pension for which application is received within 45 days from the date of death shall be the first day of the month in which the death occurred.".

(b) The amendments made by subsection (a)(1) and the provisions of paragraph (2) of section 3010(d) of title 38, United States Code, as added by subsection (a)(2), shall take effect with respect to applications that are first received after September 30, 1984, for benefits under chapter 15 of title 38, United States Code.

PART B—ACTIONS TO INCREASE RECEIPTS AND REDUCE COSTS UNDER THE VETERANS' ADMINISTRATION HOME-LOAN GUARANTY PROGRAM

INCREASE IN FEE FOR HOME LOANS GUARANTEED BY THE VETERANS' ADMINISTRATION AND EXTENSION OF FEE TO VENDEE LOANS

SEC. 2511. (a) Section 1829 of title 38, United States Code, is amended—

(1) in subsection (a)—

(A) by inserting "and from each person obtaining a loan from the Administrator to finance the purchase of real property from the Administrator," after "under this chapter,";

(B) by striking out "one-half of"; and

(C) by striking out "to the veteran" after "in the loan";

(2) by striking out subsection (c); and

(3) by redesignating subsection (d) as subsection (c) and striking out "September 30, 1985" in such subsection and inserting in lieu thereof "September 30, 1987".

(b) Section 1824(c) of such title is amended by striking out "and (2)" and inserting in lieu thereof "(2) amounts received by the Administrator as fees collected under section 1829 of this title, and (3)".

(c)(1) The amendments made by subsection (a)(1) shall apply with respect to loans closed after the end of the 30-day period beginning on the date of the enactment of this Act.

(2) The amendments made by subsections (a)(2) and (b) shall apply with respect to loans closed on or after the date of the enactment of this Act.

(3) The amendment made by subsection (a)(3) shall take effect on the date of the enactment of this Act.

ACTIONS TO REDUCE COSTS UNDER HOME-LOAN PROGRAM

SEC. 2512. (a) Section 1816 of title 38, United States Code, is amended—

(1) in subsection (a)—

(A) by designating the first sentence as paragraph (1), the second and third sentences as paragraph (2), and the fourth sentence as paragraph (3);

(B) by striking out "Administrator who shall thereupon" in paragraph (1) (as so designated) and inserting in lieu thereof "Administrator of such default. Upon receipt of such notice, the Administrator may, subject to subsection (c) of this section,"; and

(C) by striking out "guaranteed, and shall" in paragraph (1) (as so designated) and inserting in lieu thereof "guaranteed. If the Administrator makes such a payment, the Administrator shall"; and

(2) by adding at the end the following new subsections:

"(c)(1) For purposes of this subsection—

"(A) The term 'defaulted loan' means a loan that is guaranteed under this chapter, that was made for a purpose described in section 1810(a) of this title, and that is in default.

"(B) The term 'liquidation sale' means a judicial sale or other disposition of real property to liquidate a defaulted loan that is secured by such property.

"(C) The term 'net value', with respect to real property, means the amount equal to (i) the fair market value of the property, minus (ii) the total of the amounts which the Administrator estimates the Administrator would incur (if the Administrator were to acquire and dispose of the property) for property taxes, assessments, liens, property maintenance, property improvement, administration, resale, and other costs resulting from the acquisition and disposition of the property.

"(D) The term 'total indebtedness', with respect to a defaulted loan, means the amount equal to the total of (i) the unpaid principal of the loan, (ii) the interest on the loan as of the date of the liquidation sale of the property securing the loan (or such earlier date following the expiration of a reasonable period of

time for such sale to occur as the Administrator may specify pursuant to regulations prescribed by the Administrator to implement this subsection), and (iii) such reasonably necessary and proper charges (as specified in the loan instrument and permitted by such regulations) associated with liquidation of the loan, including advances for taxes, insurance, and maintenance or repair of the real property securing the loan.

"(2)(A) Except as provided in subparagraph (B) of this paragraph, this subsection applies to any case in which the holder of a defaulted loan undertakes to liquidate the loan by means of a liquidation sale.

"(B) This subsection does not apply to a case in which the Administrator proceeds under subsection (a)(2) of this section.

"(3)(A) Before carrying out a liquidation sale of real property securing a defaulted loan, the holder of the loan shall notify the Administrator of the proposed sale. Such notice shall be provided in accordance with regulations prescribed by the Administrator to implement this subsection.

"(B) After receiving a notice described in subparagraph (A) of this paragraph, the Administrator shall determine the net value of the property securing the loan and the amount of the total indebtedness under the loan and shall notify the holder of the loan of the determination of such net value.

"(4) A case referred to in paragraphs (5), (6), and (7) of this subsection as being described in this paragraph is a case in which the net value of the property securing a defaulted loan exceeds the amount of the total indebtedness under the loan minus the amount guaranteed under this chapter.

"(5) In a case described in paragraph (4) of this subsection, if the holder of the defaulted loan acquires the property securing the loan at a liquidation sale for an amount that does not exceed the lesser of the net value of the property or the total indebtedness under the loan—

"(A) the holder shall have the option to convey the property to the United States in return for payment by the Administrator of an amount equal to the lesser of such net value or total indebtedness; and

"(B) the liability of the United States under the loan guaranty under this chapter shall be limited to the amount of such total indebtedness minus the net value of the property.

"(6) In a case described in paragraph (4) of this subsection, if the holder of the defaulted loan either does not acquire the property securing the loan at the liquidation sale or acquires the property at such sale for an amount that exceeds the lesser of the net value of the property or the total indebtedness under the loan—

"(A) the Administrator may not accept conveyance of the property except as provided in paragraph (7) of this subsection; and

"(B) the liability of the United States under the loan guaranty under this chapter shall be limited to the amount equal to (i) the amount of such total indebtedness, minus (ii) the amount realized by the holder incident to the sale or the net value of the property, whichever is greater.

"(7) In a case described in paragraph (4) of this subsection, if the holder of the defaulted loan acquires the property securing the loan at the liquidation sale for an amount that exceeds the lesser of the total indebtedness under the loan or the net value and that was the minimum amount for which, under applicable State law, the property was permitted to be sold at the liquidation sale—

"(A) the Administrator may accept conveyance of the property to the United States for a price not exceeding the lesser of the amount for which the holder acquired the property or the total indebtedness under the loan; and

"(B) the liability of the United States under the loan guaranty under this chapter is as provided in paragraph (6)(B) of this subsection.

"(8) If the net value of the property securing a defaulted loan is not greater than the amount of the total indebtedness under the loan minus the amount guaranteed under this chapter—

"(A) the Administrator may not accept conveyance of the property from the holder of the loan; and

"(B) the liability of the United States under the loan guaranty shall be limited to the amount of the total indebtedness under the loan minus the amount realized by the holder of the loan incident to the sale at a liquidation sale of the property.

"(9) In no event may the liability of the United States under a guaranteed loan exceed the amount guaranteed with respect to that loan under section 1803(b) of this title. All determinations under this subsection of net value and total indebtedness shall be made by the Administrator.

"(d)(1) Of the number of purchases made during any fiscal year of real property acquired by the Administrator as the result of a default on a loan guaranteed under this chapter for a purpose described in section 1810(a) of this title, not more than 75 percent, nor less than 60 percent, of such purchases may be financed by a loan made by the Administrator. The maximum percentage stated in the preceding sentence may be increased to 80 percent for any fiscal year if the Administrator determines that such an increase is necessary in order to maintain the effective functioning of the loan guaranty program.

"(2) In carrying out paragraph (1) of this subsection, the Administrator, to the maximum extent consistent with that paragraph and with maintaining the effective functioning of the loan guaranty program under this chapter, shall minimize the number of loans made by the Administrator to finance purchases of real property from the Administrator described in that paragraph.

"(3) Notes securing such loans may be sold with recourse only to the extent that the Administrator determines that selling such notes with recourse is necessary in order to maintain the effective functioning of the loan guaranty program under this chapter.".

(b)(1) Subchapter III of chapter 37 of title 38, United States Code, is amended by adding at the end the following new section:

"§1830. Use of attorneys in court

"(a) Within 180 days after the date of the enactment of this section, the Administrator shall take appropriate steps to authorize attorneys employed by the Veterans' Administration to exercise the

right of the United States to bring suit in court to foreclose a loan made or acquired by the Administrator under this chapter and to recover possession of any property acquired by the Administrator under this chapter. With the concurrence of the Attorney General of the United States, the Administrator may acquire the services of attorneys, other than those who are employees of the Veterans' Administration, to exercise that right. The activities of attorneys in bringing suit under this section shall be subject to the direction and supervision of the Attorney General and to such terms and conditions as the Attorney General may prescribe.

"(b) Nothing in this section derogates from the authority of the Attorney General under sections 516 and 519 of title 28 to direct and supervise all litigation to which the United States or an agency or officer of the United States is a party."

(2) The table of sections at the beginning of such chapter is amended by inserting after the item relating to section 1829 the following new item:

"1830. Use of attorneys in court.".

(c)(1) The amendments made by subsection (a) shall take effect on October 1, 1984.

(2) Subsections (c) and (d) of section 1816 of title 38, United States Code (as added by subsection (a) of this section), shall cease to have effect on October 1, 1987.

(3) The amendments made by subsection (b) shall take effect on the date of the enactment of this Act.

(d) Not later than 180 days after the date of the enactment of this Act, the Administrator of Veterans' Affairs and the Attorney General of the United States shall submit to the appropriate committees of the Congress a joint report that—

(1) describes and explains the actions taken by the Administrator and the Attorney General to implement section 1830 of title 38, United States Code, as added by subsection (b); and

(2) sets forth their views with respect to the advisability of actions, pursuant to the second sentence of subsection (a) of such section, to employ private attorneys to bring actions described in that section.

(e)(1) Not later than December 1, 1986, the Administrator of Veterans' Affairs shall submit to the Committees on Veterans' Affairs of the Senate and House of Representatives a report on the administration and functioning of the loan guaranty program conducted by the Veterans' Administration under chapter 37 of title 38, United States Code, and the status of the Veterans' Administration Loan Guaranty Revolving Fund established under section 1824(a) of such title.

(2) The report shall include—

(A) a description of the actions taken by the Administrator during the period beginning on June 1, 1984, and ending on September 30, 1986, and the actions planned as of September 30, 1986 (together with a schedule for completing any actions planned), to maintain the effective functioning of that program and to ensure the solvency of the Fund, including actions with respect to the acquisition of properties following liquidation sales, the making of loans (known as "vendee loans") to finance the sale of properties so acquired, the quality of property ap-

praisals by the Veterans' Administration, and assessments of home-buyer credit worthiness;

(B) the Administrator's evaluation of the effects of the amendments made by subsection (a) (relating to acquisition of properties after liquidation sales and to vendee loans), including the Administrator's evaluation of the effects of subsection (d) of section 1816 of title 38, United States Code (as added by subsection (a)(2)) (relating to vendee loans), on the operation and effective functioning of such program; and

(C) the recommendations of the Administrator regarding any need for administrative or legislative action with respect to such program, including the Administrator's recommendations as to whether or not subsection (c)(2) (providing for the termination of provisions relating to the acquisition of properties and to vendee loans) should be amended.

TITLE VI—OASDI, SSI, AFDC, AND OTHER PROGRAMS

TABLE OF CONTENTS

Subtitle A—Improvements in OASDI Program

Subtitle A—Improvements in OASDI Program

SOCIAL SECURITY COVERAGE FOR FEDERAL EMPLOYEES; TREATMENT OF LEGISLATIVE BRANCH EMPLOYEES NOT COVERED BY CIVIL SERVICE RETIREMENT SYSTEM

SEC. 2601. (a)(1) Section 210(a)(5)(B) of the Social Security Act is amended to read as follows:

"(B) is performed by an individual who—

"(i) has been continuously performing service described in subparagraph (A) since December 31, 1983, and for purposes of this clause—

"(I) if an individual performing service described in subparagraph (A) returns to the performance of such service after being separated therefrom for a period of less than 366 consecutive days, regardless of whether the period began before, on, or after December 31, 1983, then such service shall be considered continuous,

"(II) if an individual performing service described in subparagraph (A) returns to the performance of such service after being detailed or transferred to an international organization as described under section 3343 of subchapter III of chapter 33 of title 5, United States Code, or under section 3581 of chapter 35 of such title, then the service performed for that organization shall be considered service described in subparagraph (A),

"(III) if an individual performing service described in subparagraph (A) is reemployed or reinstated after being separated from such service for the purpose of accepting employment with the American Institute of Taiwan as provided under section 3310 of chapter 48 of title 22, United States Code, then the service performed for that Institute shall be considered service described in subparagraph (A), and

"(IV) if an individual performing service described in subparagraph (A) returns to the performance of such service after performing service as a member of a uniformed service (including, for purposes of this clause, service in the National Guard and temporary service in the Coast Guard Reserve) and after exercising restoration or reemployment rights as provided under chapter 43 of title 38, United States Code, then the service so performed as a member of a uniformed service shall be considered service described in subparagraph (A); or

"(ii) is receiving an annuity from the Civil Service Retirement and Disability Fund, or benefits (for service as an employee) under another retirement system established by a law of the United States for employees of the Federal Government (other than for members of the uniformed services);".

(2) Section 210(a)(5) of such Act is further amended (in the matter which follows "except that this paragraph shall not apply with respect to—")—

(A) by striking out "(i)", "(ii)", "(iii)", "(iv)", and "(v)" and inserting in lieu thereof "(C)", "(D)", "(E)", "(F)", and "(G)", respectively;

(B) by striking out "(I)", "(II)", and "(III)" and inserting in lieu thereof "(i)", "(ii)", and "(iii)", respectively; and

(C) by striking out subparagraph (G) (as redesignated by subparagraph (A) of this paragraph) and inserting in lieu thereof the following:

"(G) Any other service in the legislative branch of the Federal Government if such service—

"(i) is performed by an individual who was not subject to subchapter III of chapter 83 of title 5, United States Code, or to another retirement system established by a law of the United States for employees of the Federal Government (other than for members of the uniformed services), on December 31, 1983, or

"(ii) is performed by an individual who has, at any time after December 31, 1983, received a lump-sum payment under section 8342(a) of title 5, United States Code, or under the corresponding provision of the law establishing the other retirement system described in clause (i), or

"(iii) is performed by an individual after such individual has otherwise ceased to be subject to subchapter III of chapter 83 of title 5, United States Code (without

having an application pending for coverage under such subchapter), while performing service in the legislative branch (determined without regard to the provisions of subparagraph (B) relating to continuity of employment), for any period of time after December 31, 1983,

and for purposes of this subparagraph (G) an individual is subject to such subchapter III or to any such other retirement system at any time only if (a) such individual's pay is subject to deductions, contributions, or similar payments (concurrent with the service being performed at that time) under section 8334(a) of such title 5 or the corresponding provision of the law establishing such other system, or (in a case to which section 8332(k)(1) of such title applies) such individual is making payments of amounts equivalent to such deductions, contributions, or similar payments while on leave without pay, or (b) such individual is receiving an annuity from the Civil Service Retirement and Disability Fund, or is receiving benefits (for service as an employee) under another retirement system established by a law of the United States for employees of the Federal Government (other than for members of the uniformed services);".

(b)(1) Section 3121(b)(5)(B) of the Internal Revenue Code of 1954 is amended to read as follows:

"(B) is performed by an individual who—

"(i) has been continuously performing service described in subparagraph (A) since December 31, 1983, and for purposes of this clause—

"(I) if an individual performing service described in subparagraph (A) returns to the performance of such service after being separated therefrom for a period of less than 366 consecutive days, regardless of whether the period began before, on, or after December 31, 1983, then such service shall be considered continuous,

"(II) if an individual performing service described in subparagraph (A) returns to the performance of such service after being detailed or transferred to an international organization as described under section 3343 of subchapter III of chapter 33 of title 5, United States Code, or under section 3581 of chapter 35 of such title, then the service performed for that organization shall be considered service described in subparagraph (A),

"(III) if an individual performing service described in subparagraph (A) is reemployed or reinstated after being separated from such service for the purpose of accepting employment with the American Institute in Taiwan as provided under section 3310 of chapter 48 of title 22, United States Code, then the service performed for that Institute shall be considered service described in subparagraph (A), and

"(IV) if an individual performing service described in subparagraph (A) returns to the perform-

ance of such service after performing service as a member of a uniformed service (including, for purposes of this clause, service in the National Guard and temporary service in the Coast Guard Reserve) and after exercising restoration or reemployment rights as provided under chapter 43 of title 38, United States Code, then the service so performed as a member of a uniformed service shall be considered service described in subparagraph (A); or

"(ii) is receiving an annuity from the Civil Service Retirement and Disability Fund, or benefits (for service as an employee) under another retirement system established by a law of the United States for employees of the Federal Government (other than for members of the uniformed service);".

(2) Section 3121(b)(5) of such Code is further amended (in the matter which follows "except that this paragraph shall not apply with respect to—")—

(A) by striking out "(i)", "(ii)", "(iii)", "(iv)", and "(v)" and inserting in lieu thereof "(C)", "(D)", "(E)", "(F)", and "(G)", respectively;

(B) by striking out "(I)", "(II)", and "(III)" and inserting in lieu thereof "(i)", "(ii)", "(iii)", respectively; and

(C) by striking out subparagraph (G) (as redesignated by subparagraph (A) of this paragraph) and inserting in lieu thereof the following:

"(G) any other service in the legislative branch of the Federal Government if such service—

"(i) is performed by an individual who was not subject to subchapter III of chapter 83 of title 5, United States Code, or to another retirement system established by a law of the United States for employees of the Federal Government (other than for members of the uniformed services), on December 31, 1983, or

"(ii) is performed by an individual who has, at any time after December 31, 1983, received a lump-sum payment under section 8342(a) of title 5, United States Code, or under the corresponding provision of the law establishing the other retirement system described in clause (i), or

"(iii) is performed by an individual after such individual has otherwise ceased to be subject to subchapter III of chapter 83 of title 5, United States Code (without having an application pending for coverage under such subchapter), while performing service in the legislative branch (determined without regard to the provisions of subparagraph (B) relating to continuity of employment), for any period of time after December 31, 1983,

and for purposes of this subparagraph (G) an individual is subject to such subchapter III or to any such other retirement system at any time only if (a) such individual's pay is subject to deductions, contributions, or similar payments (concurrent with the service being performed at that time) under section 8334(a) of such title 5 or the corresponding *provision of the law establishing such other system, or (in a case to which section 8332(k)(1) of such title applies) such individual is making payments of amounts equivalent to such deductions, contributions, or similar payments while on leave without pay, or (b) such individual is receiving an annuity from the Civil Service Retirement and Disability Fund, or is receiving benefits (for service as an employee) under another retirement system established by a law of the United States for employees of the Federal Government (other than for members of the uniformed services);".*

(c) For purposes of section 210(a)(5)(G) of the Social Security Act and section 3121(b)(5)(G) of the Internal Revenue Code of 1954, an individual shall not be considered to be subject to subchapter III of chapter 83 of title 5, United States Code, if he is contributing a reduced amount by reason of the Federal Empoyees' Retirement Contribution Temporary Adjustment Act of 1983.

(d)(1) Any individual who—

(A) was subject to subchapter III of chapter 83 of title 5, United States Code, or to another retirement system established by a law of the United States for employees of the Federal Government (other than for members of the uniformed services), on December 31, 1983 (as determined for purposes of section 210(a)(5)(G) of the Social Security Act), and

(B)(i) received a lump-sum payment under section 8342(a) of such title 5, or under the corresponding provision of the law establishing the other retirement system described in subparagraph (A), after December 31, 1983, and prior to June 15, 1984, or received such a payment on or after June 15, 1984, pursuant to an application which was filed in accordance with such section 8342(a) or the corresponding provision of the law establishing such other retirement system prior to that date, or

(ii) otherwise ceased to be subject to subchapter III of chapter 83 of title 5, United States Code, for a period after December 31, 1983, to which section 210(a)(5)(G)(iii) of the Social Security Act applies,

shall, if such individual again becomes subject to subchapter III of chapter 83 of title 5 (or effectively applies for coverage under such subchapter) after the date on which he last ceased to be subject to such subchapter but prior to, or within 30 days after, the date of the enactment of this Act, requalify for the exemption from social security coverage and taxes under section 210(a)(5) of the Social Security Act and section 3121(b)(5) of the Internal Revenue Code of 1954 as if the cessation of coverage under title 5 had not occurred.

(2) An individual meeting the requirements of subparagraphs (A) and (B) of paragraph (1) who is not in the employ of the United States or an instrumentality thereof on the date of the enactment of this Act may requalify for such exemptions in the same manner as under paragraph (1) if such individual again becomes subject to subchapter III of chapter 83 of title 5 (or effectively applies for coverage under such subchapter) within 30 days after the date on which he first returns to service in the legislative branch after such date of enactment, if such date (on which he returns to service) is

within 365 days after he was last in the employ of the United States or an instrumentality thereof.

(3) If an individual meeting the requirements of subparagraphs (A) and (B) of paragraph (1) does not again become subject to subchapter III of chapter 83 of title 5 (or effectively apply for coverage under such subchapter) prior to the date of the enactment of this Act or within the relevant 30-day period as provided in paragraph (1) or (2), social security coverage and taxes by reason of section 210(a)(5)(G) of the Social Security Act and section 3121(b)(5)(G) of the Internal Revenue Code of 1954 shall, with respect to such individual's service in the legislative branch of the Federal Government, become effective with the first month beginning after such 30-day period.

(4) The provisions of paragraphs (1) and (2) shall apply only for purposes of reestablishing an exemption from social security coverage and taxes, and do not affect the amount of service to be credited to an individual for purposes of title 5, United States Code.

(e)(1) For purposes of section 210(a)(5) of the Social Security Act (as in effect in January 1983 and as in effect on and after January 1, 1984) and section 3121(b)(5) of the Internal Revenue Code of 1954 (as so in effect), service performed in the employ of a nonprofit organization described in section 501(c)(3) of the Internal Revenue Code of 1954 by an employee who is required by law to be subject to subchapter III of chapter 83 of title 5, United States Code, with respect to such service, shall be considered to be service performed in the employ of an instrumentality of the United States.

(2) For purposes of section 203 of the Federal Employees' Retirement Contribution Temporary Adjustment Act of 1983, service described in paragraph (1) which is also "employment" for purposes of title II of the Social Security Act, shall be considered to be "covered service".

(f) Except as provided in subsection (d), the amendments made by subsections (a) and (b) (and the provisions of subsection (3)) shall be effective with respect to service performed after December 31, 1983.

PROCEDURES TO PREVENT OVERPAYMENTS DUE TO FAILURE TO REPORT EARNINGS

SEC. 2602. (a) Section 203(h) of the Social Security Act is amended by adding at the end thereof the following new paragraph:

"(4) The Secretary shall develop and implement procedures in accordance with this subsection to avoid paying more than the correct amount of benefits to any individual under this title as a result of such individual's failure to file a correct report or estimate of earnings or wages. Such procedures may include identifying categories of individuals who are likely to be paid more than the correct amount of benefits and requesting that they estimate their earnings or wages more frequently than other persons subject to deductions under this section on account of earnings or wages.".

(b) The amendment made by subsection (a) shall be effective upon the date of the enactment of this Act.

SPECIAL SOCIAL SECURITY TREATMENT FOR CHURCH EMPLOYEES

SEC. 2603. (a)(1) Section 210(a)(8) of the Social Security Act is amended by inserting "(A)" after "(8)", by striking out "this paragraph" and inserting in lieu thereof "this subparagraph", and by adding at the end thereof the following new subparagraph:

"(B) Service performed in the employ of a church or qualified church-controlled organization if such church or organization has in effect an election under section 3121(w) of the Internal Revenue Code of 1954, other than service in an unrelated trade or business (within the meaning of section 513(a) of such Code);".

(2) Section 3121(b)(8) of the Internal Revenue Code of 1954 is amended by inserting "(A)" after "(8)", by striking out "this paragraph" and inserting in lieu thereof "this subparagraph", and by adding at the end thereof the following new subparagraph:

"(B) service performed in the employ of a church or qualified church-controlled organization if such church or organization has in effect an election under subsection (w), other than service in an unrelated trade or business (within the meaning of section 513(a));".

(b) Section 3121 of the Internal Revenue Code of 1954 is amended by adding at the end thereof the following new subsection:

"(w) EXEMPTION OF CHURCHES AND QUALIFIED CHURCH-CONTROLLED ORGANIZATIONS.—

"(1) GENERAL RULE.—Any church or qualified church-controlled organization (as defined in paragraph (3)) may make an election within the time period described in paragraph (2), in accordance with such procedures as the Secretary determines to be appropriate, that services performed in the employ of such church or organization shall be excluded from employment for purposes of title II of the Social Security Act and chapter 21 of this Code. An election may be made under this subsection only if the church or qualified church-controlled organization states that such church or organization is opposed for religious reasons to the payment of the tax imposed under section 3111.

"(2) TIMING AND DURATION OF ELECTION.—An election under this subsection must be made prior to the first date, more than 90 days after the date of the enactment of this subsection, on which a quarterly employment tax return for the tax imposed under section 3111 is due, or would be due but for the election, from such church or organization. An election under this subsection shall apply to current and future employees, and shall apply to service performed after December 31, 1983. The election may not be revoked by the church or organization, but shall be permanently revoked by the Secretary if such church or organization fails to furnish the information required under section 6051 to the Secretary for a period of 2 years or more with respect to remuneration paid for such services by such church or organization, and, upon request by the Secretary, fails to furnish all such previously unfurnished information for the period covered by the election. Such revocation shall apply retroactively to the beginning of the 2-year period for which the information was not furnished.

"(3) DEFINITIONS—

"(A) For purposes of this subsection, the term 'church' means a church, a convention or association of churches, or an elementary or secondary school which is controlled, operated, or principally supported by a church or by a convention or association of churches.

"(B) For purposes of this subsection, the term 'qualified church-controlled organization' means any church-controlled tax-exempt organization described in section 501(c)(3), other than an organization which—

"(i) offers goods, services, or facilities for sale, other than on an incidental basis, to the general public, other than goods, services, or facilities which are sold at a nominal charge which is substantially less than the cost of providing such goods, services, or facilities; and

"(ii) normally receives more than 25 percent of its support from either (I) governmental sources, or (II) receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in activities which are not unrelated trades or businesses, or both.".

(c)(1) Section 211(c)(2) of the Social Security Act is amended—

(A) by striking out "and" at the end of subparagraph (E);

(B) by striking out the semicolon at the end of subparagraph (F) and inserting in lieu thereof ", and"; and

(C) by adding at the end thereof the following new subparagraph:

"(G) service described in section 210(a)(8)(B);".

(2) Section 1402(c)(2) of the Internal Revenue Code of 1954 is amended—

(A) by striking out "and" at the end of subparagraph (E);

(B) by striking out the semicolon at the end of subparagraph (F) and inserting in lieu thereof ", and"; and

(C) by adding at the end thereof the following new subparagraph:

"(G) service described in section 3121(b)(8)(B);".

(d)(1) Section 211(a) of the Social Security Act is amended—

(A) by striking out "and" at the end of paragraph (11);

(B) by striking out the period at the end of paragraph (12) and inserting in lieu thereof "; and"; and

(C) by inserting after paragraph (12) the following new paragraph:

"(13) With respect to remuneration for services which are treated as services in a trade or business under subsection (c)(2)(G)—

"(A) no deduction for trade or business expenses provided under the Internal Revenue Code of 1954 (other than the deduction under paragraph (11) of this subsection) shall apply;

"(B) the provisions of subsection (b)(2) shall not apply; and

"(C) if the amount of such remuneration from an employer for the taxable year is less than $100, such remuneration

from that employer shall not be included in self-employment income.".

(2) Section 1402(a) of the Internal Revenue Code of 1954 is amended—

(A) by striking out "and" at the end of paragraph (12);

(B) by striking out the period at the end of paragraph (13) and inserting in lieu thereof "; and "; and

(C) by inserting after paragraph (13) the following new paragraph:

"(14) with respect to remuneration for services which are treated as services in a trade or business under subsection (c)(2)(G)—

"(A) no deduction for trade or business expenses provided under this Code (other than the deduction under paragraph (12)) shall apply;

"(B) the provisions of subsection (b)(2) shall not apply; and

"(C) if the amount of such remuneration from an employer for the taxable year is less than $100, such remuneration from that employer shall not be included in self-employment income.".

(e) The amendments made by this section shall apply to service performed after December 31, 1983.

(f) In any case where a church or qualified church-controlled organization makes an election under section 3121(w) of the Internal Revenue Code of 1954, the Secretary of the Treasury shall refund (without interest) to such church or organization any taxes paid under sections 3101 and 3111 of such Code with respect to service performed after December 31, 1983, which is covered under such election. The refund shall be conditional upon the church or organization agreeing to pay to each employee (or former employee) the portion of the refund attributable to the tax imposed on such employee (or former employee) under section 3101, and such employee (or former employee) may not receive any other refund payment of such taxes.

Subtitle B—Improvements in SSI and AFDC Programs

Part 1—IMPROVEMENTS IN SSI PROGRAM

INCREASE IN DOLLAR LIMITATIONS UNDER ASSETS TEST

SEC. 2611. (a) Section 2611(a)(1)(B) of the Social Security Act is amended—

(1) by striking out "$2,250" and inserting in lieu thereof "the applicable amount determined under paragraph (3)(A)"; and

(2) by striking out "$1,500" and inserting in lieu thereof "the applicable amount determined under paragraph (3)(B)".

(b) Section 1611(a)(2)(B) of such Act is amended by striking out "$2,250" and inserting in lieu therof "the applicable amount determined under paragraph (3)(A)".

(c) Section 1611(a) of such act is further amended by adding at the end thereof the following new paragraph:

"(3)(A) The dollar amount referred to in clause (i) of paragraph (1)(B), and in paragraph (2)(B), shall be $2,250 prior to January 1, 1985, and shall be increased to $2,400 on January 1, 1985, to $2,550 on January 1, 1986, to $2,700 on January 1, 1987, to $2,850 on January 1, 1988, and to $3,000 on January 1, 1989.

"(B) The dollar amount referred to in clause (ii) of paragraph (1)(B), shall be $1,500 prior to January 1, 1985, and shall be increased to $1,600 on January 1, 1985, to $1,700 on January 1, 1986, to $1,800 on January 1, 1987, to $1,900 on January 1, 1988, and to $2,000 on January 1, 1989.".

(d) Section 1621(b)(2)(B) of such Act is amended—

(1) by striking out "$1,500" and inserting in lieu thereof "the applicable amount determined under section 1611(a)(3)(B)"; and

(2) by striking out "$2,250" and inserting in lieu thereof "the applicable amount determined under section 1611(a)(3)(A)".

LIMITATION OF RECOUPMENT RATE IN CASE OF OVERPAYMENTS

SEC. 2612. (a) Section 1631(b)(1) of the Social Security Act is amended—

(1) by inserting "(A)" after "The Secretary" in the second sentence; and

(2) by striking out the period at the end of the second sentence and inserting in lieu thereof the following: ", and (B) shall in any event make the adjustment or recovery (in the case of payment of more than the correct amount of benefits), in the case of an individual or eligible spouse receiving benefit payments under this title (including supplementary payments of the type described in section 1616(a) and payments pursuant to an agreement entered into under section 212(a) of Public Law 93-66), in amounts which in the aggregate do not exceed (for any month) the lesser of (i) the amount of his or their benefit under this title for that month or (ii) an amount equal to 10 percent of his or their income for that month (including such benefit but excluding any other income excluded pursuant to section 1612(b)), unless fraud, willful misrepresentation, or concealment of material information was involved on the part of the individual or spouse in connection with the overpayment, or unless the individual requests that such adjustment or recovery be made at a higher or lower rate and the Secretary determines that adjustment or recovery at such rate is justified and appropriate. The availability (in the case of an individual who has been paid more than the correct amount of benefits) of procedures for adjustment or recovery at a limited rate under clause (B) of the preceding sentence shall not, in and of itself, prevent or restrict the provision (in such case) of more substantial relief under clause (A) of such sentence.".

(b) If an adjustment referred to in section 1631(b)(1) of the Social Security Act is in effect with respect to an individual or eligible spouse on the date of the enactment of this Act, and the amount of such adjustment for a month is greater than the amount described in section 1631(b)(1)(B)(ii) of such Act, as added by subsection (a),

the Secretary shall notify the individual whose benefits are being adjusted, in writing, of his or her right to have the adjustment reduced to the amount described in such section 1631(b)(1)(B)(ii).

TREATMENT OF OVERPAYMENTS WHEN RECIPIENT'S COUNTABLE ASSETS EXCEED LIMITS IN CERTAIN CASES

SEC. 2613. Section 1631(b) of the Social Security Act is amended—

(1) by redesignating paragraph (3) as paragraph (4); and

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

"(3) If any overpayment with respect to an individual (or an individual and his or her spouse) is attributable solely to the ownership or possession by such individual (and spouse if any) of resources having a value which exceeds the applicable dollar figure specified in paragraph (1)(B) or (2)(B) of section 1611(a) by $50 or less, such individual (and spouse if any) shall be deemed for purposes of the second sentence of paragraph (1) to have been without fault in connection with the overpayment, and no adjustment or recovery shall be made under the first sentence of such paragraph, unless the Secretary finds that the failure of such individual (and spouse if any) to report such value correctly and in a timely manner was knowing and willful.".

EXCLUSION OF UNDERPAYMENTS FROM RESOURCES

SEC. 2614. Section 1613(a) of the Social Security Act is amended—

(1) by striking out "and" after the semicolon at the end of paragraph (5);

(2) by striking out the period at the end of paragraph (6) and inserting in lieu thereof "; and"; and

(3) by inserting after paragraph (6) the following new paragraph:

"(7) any amount received from the United States which is attributable to underpayments of benefits due for one or more prior months, under this title or title II, to such individual (or spouse) or to any other person whose income is deemed to be included in such individual's (or spouse's) income for purposes of this title; but the application of this paragraph in the case of any such individual (and eligible spouse if any), with respect to any amount so received from the United States, shall be limited to the first 6 months following the month in which such amount is received, and written notice of this limitation shall be given to the recipient concurrently with the payment of such amount.".

ADJUSTMENTS IN SSI BENEFITS ON ACCOUNT OF RETROACTIVE BENEFITS UNDER TITLE II

SEC. 2615. (a) Section 1127 of the Social Security Act is amended to read as follows:

"ADJUSTMENTS IN SSI BENEFITS ON ACCOUNT OF RETROACTIVE BENEFITS UNDER TITLE II

"SEC. 1127. (a) Notwithstanding any other provision of this Act, in any case where an individual—

"(1) is entitled to benefits under title II that were not paid in the months in which they were regularly due; and

"(2) is an individual or eligible spouse eligible for supplemental security income benefits for one or more months in which the benefits referred to in clause (1) were regularly due,

then any benefits under title II that were regularly due in such month or months, or supplemental security income benefits for such month or months, which are due but have not been paid to such individual or eligible spouse shall be reduced by an amount equal to so much of the supplemental security income benefits, whether or not paid retroactively, as would not have been paid or would not be paid with respect to such individual or spouse if he had received such benefits under title II in the month or months in which they were regularly due.

"(b) For purposes of this section, the term 'supplemental security income benefits' means benefits paid or payable by the Secretary under title XVI, including State supplementary payments under an agreement pursuant to section 1616(a) or an administration agreement under section 212(b) of Public Law 93-66.

"(c) From the amount of the reduction made under subsection (a), the Secretary shall reimburse the State on behalf of which supplementary payments were made for the amount (if any) by which such State's expenditures on account of such supplementary payments for the month or months involved exceeded the expenditures which the State would have made (for such month or months) if the individual had received the benefits under title II at the times they were regularly due. An amount equal to the portion of such reduction remaining after reimbursement of the State under the preceding sentence shall be covered into the general fund of the Treasury.".

(b) The amendment made by this section shall apply for purposes of reducing retroactive benefits under title II of the Social Security Act or retroactive supplemental security income benefits payable beginning with the seventh month following the month in which this Act is enacted; except that in the case of retroactive title II benefits other than those which result from a determination of entitlement following an application for benefits under title II or from a reinstatement of benefits under title II following a period of suspension or termination of such benefits, it shall apply when the Secretary of Health and Human Services determines that it is administratively feasible.

EXCLUSION FROM INCOME OF CERTAIN ALASKA BONUS PAYMENTS

SEC. 2616. Section 1612(b)(2)(B) of the Social Security Act is amended to read as follows:

"(B) monthly (or other periodic) payments received by any individual, under a program established prior to July 1, 1973 (or any program established prior to such date but subsequently amended so as to conform to State or Federal constitutional standards), if (i) such payments are made by the State of which

the individual receiving such payments is a resident, (ii) eligibility of any individual for such payments is not based on need and is based solely on attainment of age 65 or any other age set by the State and residency in such State by such individual, and (iii) on or before September 30, 1985, such individual (I) first becomes an eligible individual or an eligible spouse under this title, and (II) satisfies the twenty-five-year residency requirement of such program as such program was in effect prior to January 1, 1983.".

PART 2—IMPROVEMENTS IN AFDC PROGRAM

GROSS INCOME LIMITATION

SEC. 2621. Section 402(a)(18) of the Social Security Act is amended by striking out "150 percent of the State's standard of need" and inserting in lieu thereof "185 percent of the State's standard of need".

WORK EXPENSE DEDUCTION

SEC. 2622. Section 402(a)(8)(A)(ii) of the Social Security Act is amended by striking out all that follows "the first $75 of the total of such earned income for such month" and inserting in lieu thereof a semicolon.

CONTINUATION OF $30 DISREGARD FROM EARNED INCOME

SEC. 2623. (a) Section 402(a)(8)(A)(iv) of the Social Security Act is amended by inserting "(I)" after "equal to", and by inserting "(II)" after "plus".

(b) Section 402(a)(8)(B)(ii)(I) of such Act is amended—

(1) by striking out all that precedes "specified in subparagraph (A)(ii)" and inserting in lieu thereof the following:

"(I) shall not disregard—

"(a) under subclause (II) of subparagraph (A)(iv), in a case where such subclause has already been applied to the income of the persons involved for four consecutive months while they were receiving aid under the plan, or

"(b) under subclause (I) of subparagraph (A)(iv), in a case where such subclause has already been applied to the income of the persons involved for twelve consecutive months while they were receiving aid under the plan,

any earned income of any of the persons"; and

(2) by striking out "and subparagraph (A)(iv) has not already been applied to their income for four consecutive months while they were receiving aid under the plan".

(c) Section 402(a)(8)(B)(ii)(II) of such Act is amended by striking out "shall not apply" where it first appears and all that follows down through "any month thereafter" and inserting in lieu thereof the following: "shall not apply the provisions of subclause (II) of such subparagraph to any month after such month, or apply the provisions of subclause (I) of such subparagraph to any month after the eighth month following such month, for so long as he continues

to receive aid under the plan, and shall not apply the provisions of either such subclause to any month thereafter".

WORK TRANSITION IN THE CASE OF CERTAIN FAMILIES WHO LOSE AFDC BENEFITS BECAUSE OF EARNED INCOME

SEC. 2624. (a) Section 402(a) of the Social Security Act is amended—

(1) by striking out "and" after the semicolon at the end of paragraph (35);

(2) by striking out the period at the end of paragraph (36) and inserting in lieu thereof "; and"; and

(3) by adding after paragraph (36) the following new paragraph:

"(37) provide that, in any case where a family has ceased to receive aid under the plan because (by reason of paragraph (8)(B)(ii)(II)) the provisions of paragraph (8)(A)(iv) no longer apply, such family shall be considered for purposes of title XIX to be receiving aid to families with dependent children under such plan for a period of 9 months after the last month for which the family actually received such aid; and the State may at its option extend such period by an additional period of up to 6 months in the case of a family that would be eligible during such additional period to receive aid under the plan (without regard to this paragraph) if such paragraph (8)(A)(iv) applied.".

(b)(1) The amendments made by this section shall apply with respect to months beginning on or after October 1, 1984.

(2) Such amendments shall apply with respect to families which ceased to receive aid under the applicable State plan (for the reason stated in section 402(a)(37) of the Social Security Act as added by subsection (a) of this section) before October 1, 1984, as well as with respect to families which cease to receive aid (for that reason) on or after that date; but any family which ceased to receive such aid before that date, in order to be eligible to be treated as receiving aid under the plan for any period after ceasing to receive such aid (as provided for in such section 402(a)(37))—

(A) must make its application for such treatment no later than the end of the sixth month after the month in which final regulations governing the application of such section 402(a)(37) are promulgated by the Secretary of Health and Human Services (and in the case of any such family the term "last month for which the family actually received such aid" as used in such section 402(a)(37) means the month before the month in which the family makes such application);

(B) must be a family that would have been continuously eligible for aid under the State plan (without regard to the amendments made by this section), from the time it ceased to receive such aid to the time of its application under subparagraph (A), if section 402(a)(8)(A)(iv) of such Act applied; and

(C) must fully disclose, in its application under subparagraph (A), any health insurance coverage which its members may have in effect.

CLARIFICATION OF EARNED INCOME PROVISION

SEC. 2625. (a) Section 402(a)(8) of the Social Security Act is amended by striking out "and" at the end of subparagraph (A), by adding "and" at the end of subparagraph (B), and by adding at the end thereof the following new subparagraph:

"(C) provide that in implementing this paragraph the term 'earned income' shall mean gross earned income, prior to any deductions for taxes or for any other purposes;".

(b) The amendments made by subsection (a) shall become effective on the date of the enactment of this Act.

EXCLUSION OF BURIAL PLOTS, FUNERAL AGREEMENTS, AND CERTAIN PROPERTY FROM LIMITATION ON FAMILY RESOURCES

SEC. 2626. Section 402(a)(7)(B) of the Social Security Act is amended by inserting "(i)" after "for purposes of this subparagraph", and by inserting before the semicolon at the end thereof the following: ", (ii) under regulations prescribed by the Secretary, burial plots (one for each such child, relative, and other individual), and funeral agreements or (iii) for such period or periods of time as the Secretary may prescribe, real property which the family is making a good-faith effort to dispose of, but any aid payable to the family for any such period shall be conditioned upon such disposal, and any payments of such aid for that period shall (at the time of the disposal) be considered overpayments to the extent that they would not have been made had the disposal occurred at the beginning of the period for which the payments of such aid were made".

FEDERAL MATCHING FOR EXPENSES INCURRED BY STATES IN REIMBURSING AFDC RECIPIENTS FOR TRANSPORTATION AND DAY CARE COSTS ATTRIBUTABLE TO PARTICIPATION IN CWEP

SEC. 2627. Section 409(a)(1)(F) of the Social Security Act is amended—

(1) by inserting "(i) except as provided in clause (ii)" after "that"; and

(2) by inserting before the period at the end thereof the following: ", and (ii) to the extent that the State is unable to provide for the costs involved through the furnishing of services directly to the individuals participating in the program, participants who are recipients of aid under the State's plan approved under section 402 will instead be reimbursed for transportation costs directly related to their participation in the program (in amounts equal to the cost of transportation by the most appropriate means as determined by the State agency), and for day care expenses directly attributable to such participation (in amounts determined by the State agency to be reasonable, necessary, and cost-effective but not in excess of the comparable maximum day care deduction allowed under section 402(a)(8)(A)(iii) for recipients of aid under the plan generally); and amounts

paid as reimbursement to participants under clause (i) or (ii) shall be considered, for purposes of section 403(a), to be expenditures made for the proper and efficient administration of the State's plan approved under section 402".

MONTHLY REPORTING AND RETROSPECTIVE BUDGETING

SEC. 2628. (a) Section 402(a)(13) of the Social Security Act is amended—

(1) by striking out "provide that—" and inserting in lieu thereof "with respect to families who are required to report monthly to the State agency pursuant to paragraph (14) (and at the option of the State with respect to other families), provide that—"; and

(2) by striking out "but only where the Secretary determines it to be appropriate" in subparagraphs (A) and (B) and inserting in lieu thereof "(but only where the Secretary determines it to be appropriate, in the case of families who are required to report monthly to the State agency pursuant to paragraph (14))".

(b) Section 402(a)(14) of such Act is amended—

(1) by striking out "(A) provide that" and inserting in lieu thereof "with respect to families in the category of recent work history or earned income cases (and at the option of the State with respect to families in other categories), provide (A) that";

(2) by striking out "with the prior approval of the Secretary" and inserting in lieu thereof "(with the prior approval of the Secretary in recent work history and earned income cases)"; and

(3) by striking out "upon the State's showing to the satisfaction of the Secretary that" and inserting in lieu thereof "upon a determination that".

(c) Section 402(a) of such Act is further amended by adding at the end thereof (after and below paragraph (37), as added by section 2624(a) of this Act) the following new sentence: "The Secretary may waive any of the requirements imposed under or in connection with paragraphs (13) and (14) of this subsection to the extent necessary to make such requirements compatible with the corresponding reporting and budgeting requirements by the Food Stamp Act of 1977.".

TREATMENT OF EARNED INCOME TAX CREDIT IN DETERMINING COUNTABLE INCOME

SEC. 2629. Section 402(d)(1) of the Social Security Act is amended to read as follows:

"(1) For purposes of paragraphs (7) and (8) of subsection (a), any refund of Federal income taxes made by reason of section 32 of the Internal Revenue Code of 1954 (relating to earned income credit) and any payment made by an employer under section 3507 of such Code (relating to advance payment of earned income credit) shall be considered earned income.".

FEDERALLY ASSISTED PILOT PROJECTS TO DEMONSTRATE ONE-STOP SERVICE DELIVERY SYSTEMS

SEC. 2630. Part A of title XI of the Social Security Act is amended by adding at the end thereof the following new section:

"PILOT PROJECTS TO DEMONSTRATE THE USE OF INTEGRATED SERVICE DELIVERY SYSTEMS FOR HUMAN SERVICES PROGRAMS

"SEC. 1136. (a) In order to develop and demonstrate ways of improving the delivery of services to individuals and families who need them under the various human services programs, by eliminating programmatic fragmentation and thereby assuring that an applicant for services under any one such program will be informed of and have access to all of the services which may be available to him or his family under the other human services programs being carried out in the community involved, any State having an approved plan under part A of title IV may, subject to the provisions of this section, establish and conduct one or more pilot projects to demonstrate the use of integrated service delivery systems for human services programs in that State or in one or more political subdivisions thereof.

"(b) The integration of service delivery systems for human services programs in any State or locality under a pilot project established under this section shall involve or include—

"(1) the development of a common set of terms for use in all of the human services programs involved;

"(2) the development for each applicant of a single comprehensive family profile which is suitable for use under all of the human services programs involved;

"(3) the establishment and maintenance of a single resources directory by which the citizens of the community involved may be informed of and gain access to the services which are available under all such programs;

"(4) the development of a unified budget and budgeting process, and a unified accounting system, with standardized audit procedures;

"(5) the implementation of unified planning, needs assessment, and evaluation;

"(6) the consolidation of agency locations and related transportation services;

"(7) the standardization of procedures for purchasing services from nongovermental sources;

"(8) the creation of communications linkages among agencies to permit the serving of individual and family needs across program and agency lines;

"(9) the development, to the maximum extent possible, of uniform application and eligibility determination procedures; and

"(10) any other methods, arrangements, and procedures which the Secretary determines are necessary or desirable for, and consistent with, the establishment and operation of an integrated service delivery system.

"(c)(1) Any State which desires to establish and conduct a pilot project under this section, after having published a description of the proposed project and invited comments thereon from interested persons in the community or communities which would be affected, shall submit an application to the Secretary (in such form and containing such information as the Secretary may require) within 6 months after the date of the enactment of this section. The proposed project may be statewide in operation or may be limited to one or

more political subdivisions of the State; and the application shall in any event include or be accompanied by satisfactory assurances that the project as proposed would be permitted under applicable State and local law.

"(2) The Secretary shall consider all applications and accompanying comments and materials which are submitted under paragraph (1), and, no later than 9 months after the date of the enactment of this section, shall approve no fewer than 3 nor more than 5 of the proposed projects (including one such project to be operated on a statewide basis). In considering and approving such applications the Secretary shall take into account the size and characteristics of the population that would be served by each proposed project, the desirability of wide geographic distribution among the projects, the number and nature of the human services programs which are in active operation in the various communities involved, and such other factors as may tend to indicate whether or not a particular proposed project would provide a useful and effective demonstration of the value of an integrated service delivery system. Each project approved under this paragraph shall be deemed for purposes of this section to begin on the first day of the month following the month in which the application with respect to such project is approved.

"(3) The Secretary shall approve any application for a project under this section only after determining that the conduct of such project will not lower or restrict the levels of aid, assistance, benefits, or services, or the income or resource standards, deductions, or exclusions, under any of the human services programs involved, and will not delay the provision of aid, assistance, benefits, or services under any of such programs.

"(d)(1) Any State whose application is approved under subsection (c) may submit to the Secretary a request for the waiver of any requirement which would otherwise apply with respect to the proposed project under any of the laws governing the human services programs to be included in the project; and—

"(A) if the law involved is within the jurisdiction of the Secretary and authority to grant the waiver involved is otherwise available to the Secretary under this title, title IV, or any other provision of law, the Secretary shall approve such request upon a determination that the waiver is necessary for the project to provide a useful and effective demonstration of the value of an integrated service delivery system; and

"(B) if the law involved is within the jurisdiction of a Federal agency other than the Department of Health and Human Services and authority to grant the waiver involved is available to the head of such other agency under that law or any other provision of law, the Secretary shall transmit such request (on behalf of the requesting State) to the head of such other agency, who shall approve such request upon a determination that the waiver is necessary for the project to provide a useful and effective demonstration of the value of an integrated service delivery system and who shall certify such approval to the Secretary.

"(2) If under the law governing any of the human services programs included within a project there are provisions establishing safeguards which limit or restrict the use or disclosure of information (concerning applicants for or recipients of benefits or services)

which has been obtained or developed by the agency involved in the conduct of that program, and a waiver of such provisions is granted under paragraph (1) in order to make such information available for purposes of the project—

"(A) the State shall provide each applicant for and recipient of aid, assistance, benefits, or services under the proposed integrated service delivery system with a clear and readily comprehensible notice that such information may be disclosed to and used by project personnel, or exchanged with the other agencies having responsibility for human services programs included within the project;

"(B) the State shall take such steps as may be necessary to ensure that the information disclosed will be used only for purposes of, and by persons directly connected with, such project; and

"(C) the State's application with respect to the project under subsection (c) shall contain or be accompanied by satisfactory assurances that the preceding requirements of this paragraph will be fully complied with.

"(e) The Secretary shall from time to time pay to each State which has an approved pilot project under this section, in such manner and according to such schedule as may be agreed upon by the Secretary and such State, amounts equal in the aggregate to—

"(1) 90 percent of the costs incurred by such State and its political subdivisions in carrying out such project during the first 18 months after the date on which the project begins,

"(2) 80 percent of any such costs incurred during the 12-month period beginning with the nineteenth month after such date, and

"(3) 70 percent of any such costs incurred during the 12-month period beginning with the thirty-first month after such date.

"(f)(1) For purposes of this section, the term 'human services program' includes the program of aid to families with dependent children under part A of title IV, the supplemental security income benefits program under title XVI, the Federal food stamp program, and any other Federal or federally assisted program (other than a program under the Rehabilitation Act of 1973) which provides aid, assistance, or benefits based wholly or partly on need or on income-related qualifications to specified classes or types of individuals or families or which is designed to help in crisis or emergency situations by meeting the basic human needs of individuals or families whose own resources are insufficient for that purpose.

"(2) In carrying out this section the Secretary shall regularly consult with the Secretary of Labor, the Secretary of Agriculture, the Secretary of Housing and Urban Development, and the head of any other Federal agency having jurisdiction over or responsibility for one or more human services programs, in order to ensure that the administrative efforts of the various agencies involved are coordinated with respect to all of the pilot projects being carried out under this section.

"(g) The Secretary shall require each State which is carrying out a pilot project under this section to submit periodic reports on the progress of such project, giving particular attention to the cost-effec-

tiveness of the integrated service delivery system involved and the extent to which such system is improving the delivery of services. No pilot project under this section shall be conducted for a period of longer than 42 months. The first such report shall be submitted no later than 3 months after the date on which the project begins.

"(h) The Secretary shall from time to time submit to the Congress a report on the progress and current status of each of the approved pilot projects under this section. Each such report shall reflect the periodic reports theretofore submitted to the Secretary by the States involved under subsection (g), and shall contain such additional comments, findings, and recommendations with respect to the operation of the program under this section as the Secretary may determine to be appropriate.

"(i) The Comptroller General shall, at such time or times as he determines to be appropriate, review and evaluate any or all of the pilot projects undertaken pursuant to this section, and shall from time to time report to the Congress on the results of such reviews and evaluations together with his findings and recommendations with respect thereto.

"(j) There are authorized to be appropriated, for the four-fiscal-year period beginning with the fiscal year 1985, such sums, not to exceed $8,000,000 in the aggregate, as may be necessary to carry out this section.".

EXEMPTION OF CERTAIN PREGNANT WOMEN FROM REGISTRATION FOR WORK OR TRAINING

SEC. 2631. Section 402(a)(19)(A) of the Social Security Act is amended—

(1) by striking out "or" at the end of clause (vii);

(2) by adding "or" after the semicolon at the end of clause (viii); and

(3) by inserting immediately after clause (viii) the following new clause:

"(ix) a woman who is pregnant if it has been medically verified that the child is expected to be born in the month in which such registration would otherwise be required or within the 3-month period immediately following such month;".

TREATMENT OF NONRECURRING LUMP SUM INCOME

SEC. 2632. (a) Section 402(a)(17) of the Social Security Act is amended by adding at the end thereof (after and below subparagraph (B)) the following:

"except that the State may at its option recalculate the period of ineligibility otherwise determined under subparagraph (A) (but only with respect to the remaining months in such period) in any one or more of the following cases: (i) an event occurs which, had the family been receiving aid under the State plan for the month of the occurrence, would result in a change in the amount of aid payable for such month under the plan, or (ii) the income received has become unavailable to the members of the family for reasons that were beyond the control of such members, or (iii) the family incurs, becomes responsible for, and

pays medical expenses (as allowed by the State) in a month of ineligibility determined under subparagraph (A) (which expenses may be considered as an offset against the amount of income received in the first month of such ineligibility);".

(b) Section 402(a)(17) of such Act is further amended—

(1) by striking out "a person specified in paragraph (8)(A) (i) or (ii)" in the matter preceding subparagraph (A) and inserting in lieu thereof "a child or relative applying for or receiving aid to families with dependent children, or any other person whose need the State considers when determining the income of a family,"; and

(2) effective on the date of the enactment of this Act, by striking out "an amount of income" in the matter preceding subparagraph (A) and inserting in lieu thereof "an amount of earned or unearned income".

WAIVER OF OVERPAYMENT RECOUPMENT WHEN COST OF COLLECTION WOULD EXCEED AMOUNT DUE

SEC. 2633. (a) Section 402(a)(22) of the Social Security Act is amended by adding at the end thereof (after and below subparagraph (C)) the following:

"except that no recovery need be attempted or carried out under subparagraph (B) in any case, other than a case involving fraud on the part of the recipient, where (as determined by the State agency in accordance with criteria for determining cost-effectiveness, and with dollar limitations, which shall be prescribed by the Secretary in regulations) the cost of recovery would equal or exceed the amount of the overpayment involved;".

(b) Section 402(a)(22)(A) of such Act is amended by inserting after "current recipient of such aid" the following: "(including a current recipient whose overpayment occurred during a prior period of eligibility)".

EXCEPTIONS TO REQUIREMENTS FOR PROTECTIVE PAYMENTS

SEC. 2634. (a) Section 402(a)(19)(F)(i) of the Social Security Act is amended by striking out "will be made" and inserting in lieu thereof "will be made unless the State agency, after making reasonable efforts, is unable to locate an appropriate individual to whom such payments can be made".

(b) Section 402(a)(26)(B) of such Act is amended by inserting before the semicolon at the end thereof the following: "unless the State agency, after making reasonable efforts, is unable to locate an appropriate individual to whom such payments can be made".

ELIGIBILITY REQUIREMENTS FOR ALIENS

SEC. 2635. Section 415(c)(1) of the Social Security Act is amended by striking out "Any individual" and all that follows down through "be required to provide" where it first appears and inserting in lieu thereof the following: "Any individual who is an alien and whose sponsor was a public or private agency shall be ineligible for aid under a State plan approved under this part during the period of three years after his or her entry into the United States, *unless the State agency administering such plan determines that such sponsor either no longer exists or has become unable to meet such individual's needs; and such determination shall be made by the State agency based upon such criteria as it may specify in the State plan, and upon such documentary evidence as it may therein require. Any such individual, and any other individual who is an alien (as a condition of his or her eligibility for aid under a State plan approved under this part during the period of three years after his or her entry into the United States), shall be required to provide".*

PROVISION BY STATE AGENCIES OF INFORMATION REGARDING FUGITIVE FELONS

SEC. 2636. Section 402(a)(9) of the Social Security Act is amended by inserting before the semicolon at the end thereof the following: "; but such safeguards shall not prevent the State agency or the local agency responsible for the administration of the State plan in the locality (whether or not the State has enacted legislation allowing public access to Federal welfare records) from furnishing a State or local law enforcement officer, upon his request, with the current address of any recipient if the officer furnishes the agency with such recipient's name and social security account number and satisfactorily demonstrates that such recipient is a fugitive felon, that the location or apprehension of such felon is within the officer's official duties, and that the request is made in the proper exercise of those duties".

PAYMENT SCHEDULE FOR REIMBURSEMENT OF CERTAIN BACK CLAIMS DUE THE STATES

SEC. 2637. The payment schedule contemplated by section 136 of Public Law 97–276 for reimbursement of expenditures described in that section is hereby established as follows:

(1) For expenditures identified in the decree entered by the United States District Court for the District of Columbia on July 21, 1983, in the case of State of Connecticut v. Heckler, No. 81–2237, and allowed by the Secretary of Health and Human Services prior to the date of the enactment of this Act, payment shall be made, by supplemental grant award or otherwise, within 30 days after the date of the enactment of this Act; and

(2) for any other expenditure described in such section 136 which was identified in such decree or in any other decree entered by a Federal court in a suit (with respect to such an expenditure) filed prior to September 30, 1982, payment shall be made, by supplemental grant award or otherwise, as soon as the expenditure or portion thereof involved is finally determined by the Secretary to be an allowable claim under the substantive provisions of the applicable title of the Social Security Act.

MODIFICATION OF REQUIREMENTS FOR WORK SUPPLEMENTATION PROGRAM

SEC. 2638. (a)(1) Section 414 (b)(6) of the Social Security Act is amended—

(A) by inserting "(A)" before "may"; and

(B) by inserting ", and (B) during one or more of the first nine months of an individual's employment pursuant to a program under this section, may apply to the wages of the individual the provisions of section 402 (a)(8)(A)(iv) without regard to the provisions of (B)(ii)(II) of such section" before the period.

(2) Section 414 (c)(3) of such Act is amended—

(A) by inserting "or" after the semicolon in subparagraph (A);

(B) by striking out "a public or nonprofit entity" in subparagraph (B) and inserting in lieu thereof "any other employer";

(C) by striking out "; or" in subparagraph (B) and inserting in lieu thereof a period; and

(D) by striking out subparagraph (C).

(3) Section 414 (d) of such Act is amended—

(A) by striking out "for any quarter for expenditure incurred in operating" and inserting in lieu thereof "for expenditures incurred in making payments to individuals and employers under"; and

(B) by striking out all after "equal to the" and inserting in lieu thereof: "amount which would otherwise be payable under such section if the family of each individual employed in the program established in such State under this section had received the maximum amount of aid payable under the State plan to such a family with no income (without regard to adjustments under subsection (b) of this section) for a period of months equal to the lesser of (1) nine months, or (2) the number of months in which such individual was employed in such program.".

(4) Section 414 (h) of such Act is amended by inserting "(except during any period in which such individual is employed under such work supplementation program)" before the period.

(b) Section 51(c)(2) of the Internal Revenue Code of 1954 is amended to read as follows:

"(2) On-the-job training and work supplementation payments.—

"(A) Exclusion for employers receiving on-the-job training payments.—The term 'wages' shall not include any amounts paid or incurred by an employer for any period to any individual for whom the employer receives federally funded payments for on-the-job training of such individual for such period.

"(B) Reduction for work supplementation payments to employers.—The amount of wages which would (but for this subparagraph) be qualified wages under this section for an employer with respect to an individual for a taxable year shall be reduced by an amount equal to the amount of the payments made to such employer (however utilized by such employer) with respect to such individual for such taxable year under a program established under section 414 of the Social Security Act.".

(c)(1) The amendments made by subsection (a) shall become effective on the date of the enactment of this Act.

(2) The amendments made by subsection (b) shall apply with respect to payments made on or after the date of the enactment of this Act.

3-YEAR EXTENSION OF PROVISIONS FOR DISREGARDING IN-KIND ASSISTANCE

SEC. 2639. (a) Section 402(a)(36) of the Social Security Act is amended to read as follows:

"(36) provide, at the option of the State, that in making the determination for any month under paragraph (7), the State agency shall not include as income any support or maintenance assistance furnished to or on behalf of the family which (as determined under regulations of the Secretary by such State agency as the chief executive officer of the State may designate) is based on need for such support and maintenance, including assistance received to assist in meeting the costs of home energy (including both heating and cooling), and which is (A) assistance furnished in kind by a private nonprofit agency, or (B) assistance furnished by a supplier of home heating oil or gas, by an entity whose revenues are primarily derived on a rate-of-return basis regulated by a State or Federal governmental entity, or by a municipal utility providing home energy.".

(b) Section 1612(b)(13) of such Act is amended to read as follows:

"(13) any support or maintenance assistance furnished to or on behalf of such individual (and spouse if any) which (as determined under regulations of the Secretary by such State agency as the chief executive officer of the State may designate) is based on need for such support or maintenance, including assistance received to assist in meeting the costs of home energy (including both heating and cooling), and which is (A) assistance furnished in kind by a private nonprofit agency, or (B) assistance furnished by a supplier of home heating oil or gas, by an entity providing home energy whose revenues are primarily derived on a rate-of-return basis regulated by a State or Federal governmental entity, or by a municipal utility providing home energy.".

(c)(1) Section 545 of the Surface Transportation Assistance Act of 1982 is amended by striking out subsections (a), (b), and (c).

(2) Section 404 of the Social Security Amendments of 1983 is repealed.

(d) The amendments made by this section shall be effective with respect to months which begin after September 30, 1984; but sections 402(a)(36) and 1612(b)(13) of the Social Security Act (as amended by subsections (a) and (b) of this section) shall be effective only with respect to months which end before October 1, 1987.

PARENTS AND SIBLINGS OF DEPENDENT CHILD INCLUDED IN AFDC FAMILY; DISREGARD OF CHILD SUPPORT PAYMENTS

SEC. 2640. (a) Section 402(a) of the Social Security Act (as amended by section 2624 of this Act) is further amended—

(1) by striking out "and" at the end of paragraph (36);

(2) by striking out the period at the end of paragraph (37) and inserting in lieu thereof "; and"; and

(3) by inserting immediately after paragraph (37) the following new paragraphs:

"(38) provide that in making the determination under paragraph (7) with respect to a dependent child and applying paragraph (8), the State agency shall (except as otherwise provided in this part) include—

"(A) any parent of such child, and

"(B) any brother or sister of such child, if such brother or sister meets the conditions described in clauses (1) and (2) of section 406(a), if such parent, brother, or sister is living in the same home as the dependent child, and any income of or available for such parent, brother, or sister shall be included in making such determination and applying such paragraph with respect to the family (notwithstanding section 205(j), in the case of benefits provided under title II); and

"(39) provide that in making the determination under paragraph (7) with respect to a dependent child whose parent or legal guardian is under the age selected by the State pursuant to section 406(a)(2), the State agency shall (except as otherwise provided in this part) include any income of such minor's own parents or legal guardians who are living in the same home as such minor and dependent child, to the same extent that income of a stepparent is included under paragraph (31).".

(b)(1) Section 457(b) of such Act is amended by redesignating paragraphs (1), (2), and (3) as paragraphs (2), (3), and (4), respectively, and by inserting immediately before the paragraph redesignated as paragraph (2) the following new paragraph:

"(1) the first $50 of such amounts as are collected periodically which represent monthly support payments shall be paid to the family without affecting its eligibility for assistance or decreasing any amount otherwise payable as assistance to such family during such month;".

(2) Section 457(b) of such Act, as amended by paragraph (1) of this subsection, is further amended—

(A) by inserting "which are in excess of any amount paid to the family under paragraph (1) and" after "periodically" in paragraph (2);

(B) by striking out "paragraph (1)" in paragraph (3) and inserting in lieu thereof "paragraph (2)"; and

(C) by striking out "paragraphs (1) and (2)" in paragraph (4) and inserting in lieu thereof "paragraphs (1), (2), and (3)".

(c) Section 402(a)(8)(A) of such Act is amended by striking out "and" after the semicolon at the end of clause (iv), and by adding after clause (v) the following new clause:

"(vi) shall disregard the first $50 of any child support payments received in such month with respect to the dependent child or children in any family applying for or receiving aid to families with dependent children (including support payments collected and paid to the family under section 457(b)); and".

CWEP WORK FOR FEDERAL AGENCIES

SEC. 2641. (a) Section 409(a) of the Social Security Act is amended by adding at the end thereof the following new paragraph:

"(4)(A) Participants in community work experience programs under this section may, subject to subparagraph (B), perform work in the public interest (which otherwise meets the requirements of this section) for a Federal office or agency with its consent, and, notwithstanding section 1342 of title 31, United States Code, or any other provision of law, such agency may accept such services, but such participants shall not be considered to be Federal employees for any purpose.

"(B) The State agency shall provide appropriate workers' compensation and tort claims protection to each participant performing work for a Federal office or agency pursuant to subparagraph (A) on the same basis as such compensation and protection are provided to other participants in community work experience programs in the State.".

(b) The amendment made by subsection (a) shall become effective on the date of the enactment of this Act.

EARNED INCOME OF FULL-TIME STUDENTS

SEC. 2642. (a) Section 402(c)(18) of the Social Security Act is amended by inserting before the semicolon at the end thereof the following: ", except that in determining the total income of the family the State may exclude any earned income of a dependent child who is a full-time student, in such amounts and for such period of time (not to exceed 6 months) as the State may determine".

(b) Section 402(a)(8)(A) of such Act (as amended by section 2640(c) of this Act) is further amended by striking out "and" after the semicolon at the end of clause (v), and by adding after clause (vi) the following new clause:

"(vii) may disregard all or any part of the earned income of a dependent child who is a full-time student and who is applying for aid to families with dependent children, but only if the earned income of such child is excluded for such month in determining the family's total income under paragraph (18); and".

(c) The amendments made by this section shall become effective June 1, 1984.

PART 3—GENERAL EFFECTIVE DATE

GENERAL EFFECTIVE DATE

SEC. 2646. Except as otherwise specifically provided in this subtitle, the provisions of parts 1 and 2 and the amendments made thereby shall take effect on October 1, 1984.

Subtitle C—Implementation of Grace Commission Recommendations

INCOME AND ELIGIBILITY VERIFICATION PROCEDURES

SEC. 2651. (a) Part A of title XI of the Social Security Act (as amended by section 2630 of this Act) is further amended by adding at the end thereof the following new section:

"INCOME AND ELIGIBILITY VERIFICATION SYSTEM

"SEC. 1136. (a) In order to meet the requirements of this section, a State must have in effect an income and eligibility verification system under which—

"(1) the State shall require, as a condition of eligibility for benefits under any program listed in subsection (b), that each applicant for or recipient of benefits under that program furnish to the State his social security account number (or numbers, if he has more than one such number), and the State shall utilize such account numbers in the administration of that program so as to enable the association of the records pertaining to the applicant or recipient with his account number;

"(2) wage information from agencies administering State unemployment compensation laws available pursuant to section 3304(a)(16) of the Internal Revenue Code of 1954, wage information reported pursuant to paragraph (3) of this subsection, and wage, income, and other information from the Social Security Administration and the Internal Revenue Service available pursuant to section 6103(l)(7) of such Code, shall be requested and utilized to the extent that such information may be useful in verifying eligibility for, and the amount of, benefits available under any program listed in subsection (b), as determined by the Secretary of Health and Human Services (or, in the case of the unemployment compensation program, by the Secretary of Labor, or, in the case of the food stamp program, by the Secretary of Agriculture);

"(3) employers in such State are required, effective September 30, 1988, to make quarterly wage reports to a State agency (which may be the agency administering the State's unemployment compensation law) except that the Secretary of Labor (in consultation with the Secretary of Health and Human Services and the Secretary of Agriculture) may waive the provisions of this paragraph if he determines that the State has in effect an alternative system which is as effective and timely for purposes of providing employment related income and eligibility data for the purposes described in paragraph (2);

"(4) the State agencies administering the programs listed in subsection (b) adhere to standardized formats and procedures established by the Secretary of Health and Human Services (in consultation with the Secretary of Agriculture) under which—

"(A) the agencies will exchange with each other information in their possession which may be of use in establishing or verifying eligibility or benefit amounts under any other such program;

"(B) such information shall be made available to assist in the child support program under part D of title IV of

this Act, and to assist the Secretary of Health and Human Services in establishing or verifying eligibility or benefit amounts under titles II and XVI of this Act, but subject to the safeguards and restrictions established by the Secretary of the Treasury with respect to information released pursuant to section 6103(l) of the Internal Revenue Code of 1954; and

"(C) the use of such information shall be targeted to those uses which are most likely to be productive in identifying and preventing ineligibility and incorrect payments;

"(5) adequate safeguards are in effect so as to assure that—

"(A) the information exchanged by the State agencies is made available only to the extent necessary to assist in the valid administrative needs of the program receiving such information, and the information released pursuant to section 6103(l) of the Internal Revenue Code of 1954 is only exchanged with agencies authorized to receive such information under such section 6103(l); and

"(B) the information is adequately protected against unauthorized disclosure for other purposes, as provided in regulations established by the Secretary of Health and Human Services, or, in the case of the unemployment compensation program, the Secretary of Labor, or, in the case of the food stamp program, the Secretary of Agriculture, or in the case of information released pursuant to section 6103(l) of the Internal Revenue Code of 1954, the Secretary of the Treasury;

"(6) all applicants for and recipients of benefits under any such program shall be notified at the time of application, and periodically thereafter, that information available through the system will be requested and utilized; and

"(7) accounting systems are utilized which assure that programs providing data receive appropriate reimbursement from the programs utilizing the data for the costs incurred in providing the data.

"(b) The programs which must participate in the income verification system are—

"(1) the aid to families with dependent children program under part A of title IV of this Act;

"(2) the medicaid program under title XIX of this Act;

"(3) the unemployment compensation program under section 3304 of the Internal Revenue Code of 1954;

"(4) the food stamp program under the Food Stamp Act of 1977; and

"(5) any State program under a plan approved under title I, X, XIV, or XVI of this Act.

"(c)(1) In order to protect applicants for and recipients of benefits under the programs identified in subsection (b), or under the supplemental security income program under title XVI, from the improper use of information obtained from the Secretary of the Treasury under section 6103(1)(7)(B) of the Internal Revenue Code of 1954, no Federal, State, or local agency receiving such information may terminate, deny, suspend, or reduce any benefits of an individual until

such agency has taken appropriate steps to independently verify information relating to—

"(A) the amount of the asset or income involved,

"(B) whether such individual actually has (or had) access to such asset or income for his own use, and

"(C) the period or periods when the individual actually had such asset or income.

"(2) Such individual shall be informed by the agency of the findings made by the agency on the basis of such verified information, and shall be given an opportunity to contest such findings, in the same manner as applies to other information and findings relating to eligibility factors under the program.".

(b)(1) Section 402(a)(25) of the Social Security Act is amended to read as follows:

"(25) provide that information is requested and exchanged for purposes of income and eligibility verification in accordance with a State system which meets the requirements of section 1137 of this Act;".

(2) Section 402(a)(29) of such Act is repealed.

(3) Section 411 of such Act is repealed.

(c) Section 1902(a) of the Social Security Act (as amended by section 2367 of this Act) is further amended—

(1) by striking out "and" at the end of paragraph (44);

(2) by striking out the period at the end of paragraph (45) and inserting in lieu thereof "; and"; and

(3) by inserting after paragraph (45) the following new paragraph:

"(46) provide that information is requested and exchanged for purposes of income and eligibility verification in accordance with a State system which meets the requirements of section 1137 of this Act.".

(d) Section 303 of the Social Security Act is amended by adding at the end thereof the following new subsection:

"(f) The State agency charged with the administration of the State law shall provide that information shall be requested and exchanged for purposes of income and eligibility verification in accordance with a State system which meets the requirements of section 1137 of this Act.".

(e) Section 2(a) of the Social Security Act is amended—

(1) by striking out the period at the end of paragraph (10) and inserting in lieu thereof "; and"; and

(2) by adding at the end thereof the following new paragraph:

"(11) provide that information is requested and exchanged for purposes of income and eligibility verification in accordance with a State system which meets the requirements of section 1137 of this Act.".

(f) Section 1002(a) of the Social Security Act is amended—

(1) by striking out "and" at the end of clause (12); and

(2) by inserting before the period at the end thereof the following: "; and (14) provide that information is requested and exchanged for purposes of income and eligibility verification in accordance with a State system which meets the requirements of section 1137 of this Act".

(g) Section 1402(a) of the Social Security Act is amended—

(1) by striking out "and" at the end of clause (11); and

(2) by inserting before the period at the end thereof the following: "; and (13) provide that information is requested and exchanged for purposes of income and eligibility verification in accordance with the State system which meets the requirements of section 1137 of this Act".

(h) Section 1602(a) of the Social Security Act (as in effect with respect to Puerto Rico, Guam, and the Virgin Islands) is amended—

(1) by striking out "and" at the end of paragraph (13);

(2) by striking out the period at the end of paragraph (14) and inserting in lieu thereof "; and"; and

(3) by inserting after paragraph (14) the following new paragraph:

"(15) provide that information is requested and exchanged for purposes of income and eligibility verification in accordance with a State system which meets the requirements of section 1137 of this Act.".

(i) Section 11(e)(19) of the Food Stamp Act of 1977 is amended to read as follows:

"(19) that information is requested and exchanged for purposes of income and eligibility verification in accordance with a State system which meets the requirements of section 1137 of the Social Security Act and that any additional information available from agencies administering State unemployment compensation laws under the provisions of section 303(d) of the Social Security Act shall be requested and utilized by the State agency (described in section 3(n)(1) of this Act) to the extent permitted under the provisions of section 303(d) of the Social Security Act;".

(j) Section 1631(e)(1)(B) of the Social Security Act is amended by adding at the end thereof the following: "For this purpose and for purposes of federally administered supplementary payments of the type described in section 1616(a) of this Act (including payments pursuant to an agreement entered into under section 212(a) of Public Law 93-66), the Secretary shall, as may be necessary, request and utilize information available pursuant to section 6103(l)(7) of the Internal Revenue Code of 1954, and any information which may be available from State systems under section 1137 of this Act, and shall comply with the requirements applicable to States (with respect to information available pursuant to section 6103(l)(7)(B) of such Code) under subsections (a) (6) and (c) of such section 1137.".

(k)(1) Section 6103(l)(7) of the Internal Revenue Code of 1954 is amended to read as follows:

"(7) DISCLOSURE OF RETURN INFORMATION TO FEDERAL, STATE, AND LOCAL AGENCIES ADMINISTERING CERTAIN PROGRAMS UNDER THE SOCIAL SECURITY ACT OR THE FOOD STAMP ACT OF 1977.—

"(A) RETURN INFORMATION FROM SOCIAL SECURITY ADMINISTRATION.—The Commissioner of Social Security shall, upon written request, disclose return information from returns with respect to net earnings from self-employment (as defined in section 1402), wages (as defined in section 3121(a) or 3401(a)), and payments of retirement income, which have been disclosed to the Social Security Administration as provided by paragraph (1) or (5) of this subsec-

tion, to any Federal, State, or local agency administering a program listed in subparagraph (D).

"(B) RETURN INFORMATION FROM INTERNAL REVENUE SERVICE.—The Secretary shall, upon written request, disclose current return information from returns with respect to unearned income from the Internal Revenue Service files to any Federal, State, or local agency administering a program listed in subparagraph (D).

"(C) RESTRICTION ON DISCLOSURE.—The Commissioner of Social Security and the Secretary shall disclose return information under subparagraphs (A) and (B) only for purposes of, and to the extent necessary in, determining eligibility for, or the correct amount of, benefits under a program listed in subparagraph (D).

"(D) PROGRAMS TO WHICH RULE APPLIES.—The programs to which this paragraph applies are:

"(i) aid to families with dependent children provided under a State plan approved under part A of title IV of the Social Security Act;

"(ii) medical assistance provided under a State plan approved under title XIX of the Social Security Act;

"(iii) supplemental security income benefits provided under title XVI of the Social Security Act, and federally administered supplementary payments of the type described in section 1616(a) of such Act (including payments pursuant to an agreement entered into under section 212(a) of Public Law 93-66);

"(iv) any benefits provided under a State plan approved under title I, X, XIV, or XVI of the Social Security Act (as those titles apply to Puerto Rico, Guam, and the Virgin Islands);

"(v) unemployment compensation provided under a State law described in section 3304 of this Code;

"(vi) assistance provided under the Food Stamp Act of 1977; and

"(vii) State-administered supplementary payments of the type described in section 1616(a) of the Social Security Act (including payments pursuant to an agreement entered into under section 212(a) of Public Law 93-66).".

(2) Section 6103(a)(2) of such Code is amended by striking out "or of any local child support enforcement agency" and inserting in lieu thereof ", any local child support enforcement agency, or any local agency administering a program listed in subsection (l)(7)(D)".

(l)(1) The amendments made by subsections (j) and (k) shall become effective on the date of the enactment of this Act.

(2) Except as otherwise specifically provided, the amendments made by subsections (a) through (i) shall become effective on April 1, 1985. In the case of any State which submits a plan describing a good faith effort by such State to come into compliance with the requirements of such subsections, the Secretary of Health and Human Services (or, in the case of the State unemployment compensation program, the Secretary of Labor, or, in the case of the food stamp program, the Secretary of Agriculture) may by waiver grant a delay

in the effective date of such subsections, except that no such waiver may delay the effective date of section 1137(c) of the Social Security Act (as added by subsection (a) of this section), or delay the effective date of any other provision of or added by this section beyond September 30, 1986.

COLLECTION AND DEPOSIT OF PAYMENTS TO EXECUTIVE AGENCIES

SEC. 2652. (a)(1) Subchapter II of chapter 37 of title 31, United States Code, is amended by adding at the end thereof the following new section:

"§ 3720. Collection of payments

"(a) Each head of an executive agency (other than an agency subject to section 9 of the Act of May 18, 1933 (48 Stat. 63, chapter 32; 16 U.S.C. 831h)) shall, under such regulations as the Secretary of the Treasury shall prescribe, provide for the timely deposit of money by officials and agents of such agency in accordance with section 3302, and for the collection and timely deposit of sums owed to such agency by the use of such procedures as withdrawals and deposits by electronic transfer of funds, automatic withdrawals from accounts at financial institutions, and a system under which financial institutions receive and deposit, on behalf of the executive agency, payments transmitted to post office lockboxes. The Secretary is authorized to collect from any agency not complying with the requirements imposed pursuant to the preceding sentence a charge in an amount the Secretary determines to be the cost to the general fund caused by such noncompliance.

"(b) The head of an executive agency shall pay to the Secretary of the Treasury charges imposed pursuant to subsection (a). Payments shall be made out of amounts appropriated or otherwise made available to carry out the program to which the collections relate. The amounts of the charges paid under this subsection shall be deposited in the Cash Management Improvement Fund established by subsection (c).

"(c) There is established in the Treasury of the United States a revolving fund to be known as the 'Cash Management Improvements Fund'. Sums in the fund shall be available without fiscal year limitation for the payment of expenses incurred in developing the methods of collection and deposit described in subsection (a) of this section and the expenses incurred in carrying out collections and deposits using such methods, including the costs of personal services and the costs of the lease or purchase of equipment and operating facilities.".

(2) The analysis of subchapter II of chapter 37 of title 31, United States Code, is amended by adding at the end thereof the following new item:

"3720. Collection of payments.".

(3) The Secretary of the Treasury shall prescribe regulations, including regulations under section 3720 of title 31, United States Code, designed to achieve by October 1, 1986, full implementation of the purposes of this subsection.

(b)(1) Subsection (c) of section 3302 of title 31, United States Code, is amended—

(A) by inserting "(1)" after the subsection designation;

(B) by striking out ", but not later than the 30th day after the custodian receives the money,";

(C) by inserting after the first sentence the following new sentence: "Except as provided in paragraph (2), money required to be deposited pursuant to this subsection shall be deposited not later than the third day after the custodian receives the money,"; and

(D) by adding at the end thereof the following new paragraph:

"(2) The Secretary of the Treasury may by regulation prescribe that a person having custody or possession of money required by this subsection to be deposited shall deposit such money during a period of time that is greater or lesser than the period of time specified by the second sentence of paragraph (1).".

(2) The amendments made by this subsection shall become effective January 1, 1985.

COLLECTION OF NON-TAX DEBTS OWED TO FEDERAL AGENCIES

SEC. 2653. (a)(1) Subchapter II of chapter 37 of title 31, United States Code, as amended by section 2652(a)(1) of this Act, is further amended by adding at the end thereof the following new section:

"§ 3721. Reduction of tax refund by amount of debt

"(a) Any Federal agency that is owed a past-due legally enforceable debt (other than any OASDI overpayment and past-due support) by a named person shall, in accordance with regulations issued pursuant to subsection (d), notify the Secretary of the Treasury of the amount of such debt.

"(b) No Federal agency may take action pursuant to subsection (a) with respect to any debt until such agency—

"(1) notifies the person incurring such debt that such agency proposes to take action pursuant to such paragraph with respect to such debt;

"(2) gives such person at least 60 days to present evidence that all or part of such debt is not past-due or not legally enforceable;

"(3) considers any evidence presented by such person and determines that an amount of such debt is past due and legally enforceable; and

"(4) satisfies such other conditions as the Secretary may prescribe to ensure that the determination made under paragraph (3) with respect to such debt is valid and that the agency has made reasonable efforts to obtain payment of such debt.

"(c) Upon receiving notice from any Federal agency that a named person owes to such agency a past-due legally enforceable debt, the Secretary of the Treasury shall determine whether any amounts, as refunds of Federal taxes paid, are payable to such person. If the Secretary of the Treasury finds that any such amount is payable, he shall reduce such refunds by an amount equal to the amount of

such debt, pay the amount of such reduction to such agency, and notify such agency of the individual's home address.

"(d) The Secretary of the Treasury shall issue regulations prescribing the time or times at which agencies must submit notices of past-due legally enforceable debts, the manner in which such notices must be submitted, and the necessary information that must be contained in or accompany the notices. The regulations shall specify the minimum amount of debt to which the reduction procedure established by subsection (c) may be applied and the fee that an agency must pay to reimburse the Secretary of the Treasury for the full cost of applying such procedure. Any fee paid to the Secretary pursuant to the preceding sentence may be used to reimburse appropriations which bore all or part of the cost of applying such procedure.

"(e) Any Federal agency receiving notice from the Secretary of the Treasury that an erroneous payment has been made to such agency under subsection (c) shall pay promptly to the Secretary, in accordance with such regulations as the Secretary may prescribe, an amount equal to the amount of such erroneous payment (without regard to whether any other amounts payable to such agency under such subsection have been paid to such agency).

"(f) For purposes of this section—

"(1) the term 'Federal agency' means a department, agency, or instrumentality of the United States (other than an agency subject to section 9 of the Act of May 18, 1933 (48 Stat. 63, chapter 32; 16 U.S.C. 831h)), and includes a Government corporation (as such term is defined in section 103 of title 5, United States Code);

"(2) the term 'past-due support' means any delinquency subject to section 464 of the Social Security Act; and

"(3) the term 'OASDI overpayment' means any overpayment of benefits made to an individual under title II of the Social Security Act".

(2) The analysis of subchapter II of chapter 37 of title 31, United States Code, as amended by section 2652(a)(2) of this Act, is further amended by adding at the end thereof the following new item:

"3721. Reduction of tax refund by amount of debt".

(b)(1) Section 6402 of the Internal Revenue Code of 1954 (relating to authority to make credits or refunds) is amended by adding at the end thereof the following new subsections:

"(d) COLLECTION OF DEBTS OWED TO FEDERAL AGENCIES.—

"(1) IN GENERAL.—Upon receiving notice from any Federal agency that a named person owes a past-due legally enforceable debt (other than any OASDI overpayment and past-due support subject to the provisions of subsection (c)) to such agency, the Secretary shall—

"(A) reduce the amount of any overpayment payable to such person by the amount of such debt;

"(B) pay the amount by which such overpayment is reduced under subparagraph (A) to such agency; and

"(C) notify the person making such overpayment that such overpayment has been reduced by an amount necessary to satisfy such debt.

"(2) PRIORITIES FOR OFFSET.—Any overpayment by a person shall be reduced pursuant to this subsection after such overpayment is reduced pursuant to subsection (c) with respect to past-due support collected pursuant to an assignment under section 402(a)(26) of the Social Security Act and before such overpayment is credited to the future liability for tax of such person pursuant to subsection (b). If the Secretary receives notice from a Federal agency or agencies of more than one debt subject to paragraph (1) that is owed by a person to such agency or agencies, any overpayment by such person shall be applied against such debts in the order in which such debts accrued.

"(3) DEFINITIONS.—For purposes of this subsection the term 'OASDI overpayment' means any overpayment of benefits made to an individual under title II of the Social Security Act.

"(e) REVIEW OF REDUCTIONS.—No court of the United States shall have jurisdiction to hear any action, whether legal or equitable, brought to restrain or review a reduction authorized by subsection (c) or (d). No such reduction shall be subject to review by the Secretary in an administrative proceeding. No action brought against the United States to recover the amount of any such reduction shall be considered to be a suit for refund of tax. This subsection does not preclude any legal, equitable, or administratve action against the Federal agency to which the amount of such reduction was paid.

"(f) FEDERAL AGENCY.—For purposes of this section, the term 'Federal agency' means a department, agency, or instrumentality of the United States (other than an agency subject to section 9 of the Act of May 18, 1933 (48 Stat. 63, chapter 32; 16 U.S.C. 831h)), and includes a Government corporation (as such term is defined in section 103 of title 5, United States Code).

"(g) CROSS REFERENCE.—For procedures relating to agency notification of the Secretary, see section 3721 of title 31, United States Code.".

(2) Subsection (a) of section 6402 of such Code is amended by striking out "subsection (c)" and inserting in lieu thereof "subsections (c) and (d)".

(3)(A) Subsection (l) of section 6103 of such Code (relating to confidentiality and disclosure of returns and information), as amended by section 453 of this Act, is further amended by adding at the end thereof the following new paragraph:

"(10) DISCLOSURE OF CERTAIN INFORMATION TO AGENCIES REQUESTING A REDUCTION UNDER SECTION 6402(c) OR 6402(d).—

"(A) RETURN INFORMATION FROM INTERNAL REVENUE SERVICE.—The Secretary may, upon receiving a written request, disclose to officers and employees of an agency seeking a reduction under section 6402(c) or 6402(d)—

"(i) the fact that a reduction has been made or has not been made under such subsection with respect to any person;

"(ii) the amount of such reduction; and

"(iii) taxpayer identifying information of the person against whom a reduction was made or not made.

"(B) RESTRICTION ON USE OF DISCLOSED INFORMATION.—Any officers and employees of an agency receiving return information under subparagraph (A) shall use such infor-

mation only for the purposes of, and to the extent necessary in, establishing appropriate agency records or in the defense of any litigation or administrative procedure ensuing from reduction made under section 6402(c) or section 6402(d).".

(B)(i) Section 6103(p)(3)(A) of such Code (relating to procedure and recordkeeping), as so amended, is amended by striking out "or (9)" and inserting in lieu thereof "(9), or (10)".

(ii) Section 6103(p)(4) of such Code, as so amended, is amended by striking out "(l) (1), (2), (3), or (5)" and inserting in lieu thereof "(l) (1), (2), (3), (5), or (10)".

(iii) Section 6103(p)(4)(F)(ii) of such Code, as so amended, is amended by striking out "(l) (1), (2), (3), or (5)" and inserting in lieu thereof "(l) (1), (2), (3), (5), or (10)".

(4) Section 7213(a)(2) of such Code (relating to unauthorized disclosure of information), as so amended, is amended by striking out "(l) (6), (7), (8), or (9)" and inserting in lieu thereof "(l) (6), (7), (8), (9), or (10)".

(c) The amendments made by this section shall apply with respect to refunds payable under section 6402 of the Internal Revenue Code of 1954 after December 31, 1985, and before January 1, 1988.

Subtitle D—Technical Corrections

CHANGES IN OASDI PROVISIONS NECESSITATED BY THE 1983 AMENDMENTS

SEC. 2661. (a) Section 201(l)(3)(B)(i) of the Social Security Act is amended by inserting "Insurance" after "Survivors".

(b)(1) Section 202(c)(1) of such Act is amended (in the matter appearing between subparagraphs (D) and (E) of such section)—

(A) by striking out all that follows "has attained" and precedes ", the first month" in clause (i) and inserting in lieu thereof "retirement age (as defined in section 216(l))";

(B) by striking out all that follows "has not attained" and precedes ", or" in clause (ii)(I) and inserting in lieu thereof "retirement age (as defined in section 216(l))"; and

(C) by striking out "to which" in the matter following clause (ii) and inserting in lieu thereof "in which".

(2) Section 202(c)(5)(A) of such Act is amended by striking out "classes (i) and (ii)" and inserting in lieu thereof "clauses (i) and (ii)".

(c)(1) Section 202(e)(2)(A) of such Act is amended by striking out all that follows "subsection (q)," and precedes "subparagraph (D) of this paragraph" and inserting in lieu thereof "paragraph (7) of this subsection, and".

(2) Section 202(e)(2)(C) of such Act is amended—

(A) by striking out the period immediately after "deceased individual"; and

(B) by inserting a closing parenthesis after "paragraph (3) of such subsection (w)".

(3) Paragraph (7) of section 202(e) of such Act is amended by striking out "paragraph (2)(B)," and inserting in lieu thereof "paragraph (2)(D),".

(d)(1) Section 202(f)(1)(C)(ii) of such Act is amended by striking out all that follows "attained" and precedes ", and" and inserting in lieu thereof "retirement age (as defined in section 216(l))".

(2) Section 202(f)(2)(A) of such Act is amended by striking out "paragraph (3)(B)," and inserting in lieu thereof "paragraph (3)(D),".

(3) Section 202(f)(3)(C) of such Act is amended by striking out the period immediately after "deceased individual".

(e) Section 202(q)(9)(B)(i) of such Act is amended by striking out "section 216(a)" and inserting in lieu thereof "section 216(l)".

(f) Section 202(x) of such Act is amended by adding at the beginning thereof the following heading:

"Limitation on Payments to Prisoners".

(g)(1)(A) Section 203(d) of such Act is amended—

(i) by striking out "on seven or more different calendar days of which he engaged" in paragraph (1)(A) and inserting in lieu thereof "for more than forty-five hours of which such individual engaged"; and

(ii) by striking out "on seven or more different calendar days" in paragraph (2) and inserting in lieu thereof "for more than forty-five hours".

(B) The amendments made by subparagraph (A) shall apply only with respect to months beginning with the second month after the month in which this Act is enacted.

(2)(A) Section 203(f) of such Act is amended by adding at the end thereof the following new paragraph:

"(9) For purposes of paragraphs (3), (5)(D)(i), and (8)(D), the term 'retirement age (as defined in section 216(l))', with respect to any individual entitled to monthly insurance benefits under section 202, means the retirement age (as so defined) which is applicable in the case of old-age insurance benefits, regardless of whether or not the particular benefits to which the individual is entitled (or the only such benefits) are old-age insurance benefits.".

(B) The amendment made by subparagraph (A) shall be effective as though it had been enacted on April 20, 1983, as a part of section 201 of the Social Security Amendments of 1983.

(h) Section 205(r) of such Act is amended—

(1) by striking out "(r)(3)(A) and (r)(3)(B)" in paragraph (4) and inserting in lieu thereof "subparagraphs (A) and (B) of paragraph (3)";

(2) by striking out "the Act" in paragraph (7) and inserting in lieu thereof "this Act"; and

(3) by striking out the heading and inserting in lieu thereof the following:

"USE OF DEATH CERTIFICATES TO CORRECT PROGRAM INFORMATION".

(i)(1) Section 209(e) of such Act is amended by striking out the semicolon after "Act of 1974".

(2) The next to last unnumbered paragraph of section 209 of such Act is amended by striking out "section 414(h)(2) of such Code" in

subdivision (2) and inserting in lieu thereof "section 414(h)(2) of such Code where the pickup referred to in such section is pursuant to a salary reduction agreement (whether evidenced by a written instrument or otherwise)".

(j) Section 210(a) of such Act in the matter preceding paragraph (1), is amended by striking out the matter which follows "such affiliate" and precedes "or (C)" and the matter which follows "section 233" and precedes "except", and by inserting in lieu thereof a comma and a semicolon, respectively.

(k)(1) Section 215(a)(7)(B)(ii)(I) of such Act is amended by striking out "who initially become eligible for old-age or disability insurance benefits" and inserting in lieu thereof "who become eligible (as defined in paragraph (3)(B)) for old-age insurance benefits (or became eligible as so defined for disability insurance benefits before attaining age 62)".

(2) Section 215(a)(7)(C)(ii) of such Act is amended by striking out "survivors" and inserting in lieu thereof "survivor's".

(3) Section 215(f)(9)(B)(i) of such Act is amended by striking out "as though such primary insurance amount had initially been computed without regard to subsection (a)(7) or (d)(5)" and inserting in lieu thereof "as though the recomputed primary insurance amount were being computed under subsection (a)(7) or (d)(5)".

(4) Section 215(i)(5)(A) of such Act is amended by adding at the end thereof the following new sentence: "Any amount so increased that is not a multiple of $0.10 shall be decreased to the next lower multiple of $0.10.".

(5) Section 215(i)(5)(B) of such Act is amended—

(A) by striking out clause (iii) and inserting in lieu thereof the following:

"(iii) multiplying such quotient by 100 so as to yield such applicable additional percentage (which shall be rounded to the nearest one-tenth of 1 percent),";

(B) by striking out "ending with such subsequent calendar year" in clauses (iv) and (v) and inserting in lieu thereof "ending with the year before such subsequent calendar year"; and

(C) by striking out "initially became eligible for an old-age or disability insurance benefit" in clause (v) and inserting in lieu thereof "became eligible (as defined in subsection (a)(3)(B)) for the old-age or disability insurance benefit that is being increased under this subsection".

(l)(1) Section 216(f) of such Act is amended by adding at the end thereof the following new sentence: "For purposes of subparagraph (C) of section 202(c)(1), a divorced husband shall be deemed not to be married throughout the month which he becomes divorced.".

Section 216(h)(3)(A)(i) of such Act (as in effect after the application of section 2662(c)(1) of this Act) is amended by striking out "(as defined in section 216(l))" and inserting in lieu thereof "(as defined in subsection (l))".

(3) Section 216(i)(2) of such Act (as amended by section 2662(c)(1) of this Act)) is amended by striking out "(as defined in section 216(l))" in subparagraphs (B) and (D) and inserting in lieu thereof "(as defined in subsection (l))".

(m) Subparagraph (B) of section 223(c)(1) of such Act is amended by moving clause (iii) two ems to the left, and by moving the preceding provisions of such subparagraph two ems to the right, so that the left margin of such subparagraph and its clauses is indented four ems and is aligned with the margin of subparagraph (A) of such section.

(n) Section 229(b) of such Act is amended by adding at the end thereof the following new sentence: "Additional adjustments may be made in the amounts so authorized to be appropriated to the extent that the amounts transferred in accordance with clauses (i) and (ii) of section 151(b)(3)(B) of the Social Security Amendments of 1983 with respect to wages deemed to have been paid in 1983 were in excess of or were less than the amount which the Secretary, on the basis of appropriate data, determines should have been so transferred.".

(o)(1) Subsection (f) of section 86 of the Internal Revenue Code of 1954 is amended by redesignating paragraphs (1), (2), (3), and (4) as paragraphs (2), (3), (4), and (5), respectively, and by inserting before paragraph (2) (as so redesignated) the following new paragraph:

"(1) section 37(c)(3)(A) (relating to reduction for amounts received as pension or annuity),".

(2) Subsection (a) of section 132 of such Code is amended by striking out paragraphs (6) and (7) and by redesignating paragraph (8) as paragraph (6).

(3) Effective January 1, 1984, subparagraph (B) of section 3121(v)(1) of such Code is amended to read as follows:

"(B) any amount treated as an employer contribution under section 414(h)(2) where the pickup referred to in such section is pursuant to a salary reduction agreement (whether evidenced by a written instrument or otherwise).".

(4) Effective January 1, 1985, subparagraph (B) of section 3306(r)(1) of such Code is amended to read as follows:

"(B) any amount treated as an employer contribution under section 414(h)(2) where the pickup referred to in such section is pursuant to a salary reduction agreement (whether evidenced by a written instrument or otherwise).".

(5) Section 6334(c) of such Code is amended by inserting "including section 207 of the Social Security Act)" immediately after "any other law of the United States".

CHANGES IN TEXT OF THE 1983 AMENDMENTS

SEC. 2662. (a) Section 101(d) of the Social Security Amendments of 1983 (Public Law 98–21) is amended by striking out "remuneration paid" and inserting in lieu thereof "service performed".

(b) Section 112(f) of such Amendments is amended by inserting "of such Act" after "section 201(a)".

(c) Section 201(c) of such Amendments is amended—

(1) by inserting "the" immediately before "age of 65" in paragraph (1); and

(2) by inserting "the" immediately before "age of sixty-five" in paragraph (3).

(d) Section 301(a)(5) of such Amendments is amended by striking out "Section 202(c)" and inserting in lieu thereof "Effective with re-

spect to monthly insurance benefits for months after December 1984 (but only on the basis of applications filed on or after January 1, 1985), section 202(c)".

(e) Section 305(d)(2) of such Amendments is amended by inserting "each place it appears" immediately before "in subsection (c)(4)(C)".

(f)(1) Section 422A(c)(9) of the Internal Revenue Code of 1954 (relating to special rule when disabled) is amended by striking out "section 105(d)(4)" and inserting in lieu thereof "section 37(e)(3)".

(2)(A) Section 324(d)(1) of the Social Security Amendments of 1983 is amended by adding at the end thereof the following new sentence: "For purposes of applying such amendments to remuneration paid after December 31, 1983, which would have been taken into account before January 1, 1984, if such amendments had applied to periods before January 1, 1984, such remuneration shall be taken into account when paid (or, at the election of the payor, at the time which would be appropriate if such amendments had applied).".

(B) Section 324(d)(2) of such Amendments is amended by adding at the end thereof the following new sentence: "For purposes of applying such amendments to remuneration paid after December 31, 1984, which would have been taken into account before January 1, 1985, if such amendments had applied to periods before January 1, 1985, such remuneration shall be taken into account when paid (or, at the election of the payor, at the time which would be appropriate if such amendments had applied).".

(C) Section 324(d)(4) of such Amendments is amended by adding at the end thereof the following new sentence: "For purposes of this paragraph, any plan or agreement to make payments described in paragraph (2), (3), or (13)(A)(iii) of section 3121(a) of such Code (as in effect on the day before the date of the enactment of this Act) shall be treated as a nonqualified deferred compensation plan.".

(g) Section 327(d) of such Amendments (relating to codification of Rowan decision with respect to meals and lodging) is amended to read as follows:

"(d)(1) The amendment made by subsection (a) shall apply to remuneration paid after December 31, 1983.

"(2) The amendments made by subsection (b) and subsection (c)(4) shall apply to remuneration (other than amounts excluded under section 119 of the Internal Revenue Code of 1954) paid after March 4, 1983, and to any such remuneration paid on or before such date which the employer treated as wages when paid.

"(3) The amendments made by paragraphs (1), (2), and (3) of subsection (c) shall apply to remuneration paid after December 31, 1984.".

(h) Section 338(b) of such Amendments is further amended by adding at the end thereof the following new paragraph:

"(6) The provisions of section 8344 of title 5, United States Code, shall not apply to service by an individual as a member of the Panel.".

(3) The amendments made by this subsection shall take effect on January 1, 1984.

(i) Section 339(b) of such Amendments is amended to read as follows:

"(b) Section 223 of such Act is amended by adding at the end thereof the following new subsection:

"(h) For provisions relating to limitation on payments to prisoners, see section 202(x).'."

(j) Section 111(e) of such Amendments is amended by inserting "Budget" before "Reconciliation".

OTHER TECHNICAL CORRECTIONS IN THE SOCIAL SECURITY ACT AND RELATED PROVISIONS

SEC. 2663. (a)(1)(A) The fourth sentence of section 201(d) of the Social Security Act is amended—

(i) by striking out "the Second Liberty Bond Act, as amended," and inserting in lieu thereof "chapter 31 of title 31, United States Code,"; and

(ii) by striking out "public-debt obligation" and inserting in lieu thereof "public-debt obligations".

(B) Section 201(g)(1)(B) of such Act is amended by striking out "clauses" in the first sentence and inserting in lieu thereof "clause".

(2)(A)(i) Section 202(d)(1) of such Act, in clause (ii) in the matter which follows subparagraph (C) and precedes subparagraph (D), is amended by striking out "paragraphs" and "paragraph" and inserting in lieu thereof "subparagraphs" and "subparagraph", respectively.

(ii) Section 202(d)(1)(G) of such Act is amended—

(I) by striking out the comma after "age of 18";

(II) by striking out "the age of 22," and inserting in lieu thereof "the age of 22—";

(III) by striking out ", or, subject to section 223(e), the termination month (and for purposes" and inserting in lieu thereof the following:

"(i) the termination month, subject to section 223(e) (and for purposes";

(IV) by striking out "after the 15 months" and all that follows down through "such earlier month." and inserting in lieu thereof the following:

"after the 15 months following such period of trial work in which he engages or is determined able to engage in substantial gainful activity),

or (if later) the earlier of—

"(ii) the first month during no part of which he is a full-time elementary or secondary school student, or

"(iii) the month in which he attains the age of 19,

but only if he was not under a disability (as so defined) in such earlier month."; and

(V) by indenting all of clause (i) (as designated and amended by the preceding provisions of this subparagraph) four ems, so as to align its left margin with the margins of clauses (ii) and (iii) (as so designated).

(iii) The second sentence of section 202(d)(7)(A) of such Act is amended by striking out "the date of the enactment of this paragraph" and inserting in lieu thereof "the effective date of this sentence".

(B) Section 202(e)(1) of such Act is amended—

(i) by striking out the first comma after "age 60" in the matter following subparagraph (F)(ii); and

(ii) by striking out "he engages" in the last sentence and inserting in lieu thereof "she engages".

(C) Section 202(f)(1) of such Act is amended by striking out the first comma after "age 60" in the matter following subparagraph (F)(ii).

(D) Section 202(f)(3)(D)(i) of such Act is amended by striking out the semicolon after "applicable,".

(E) Section 2202(a)(1)(B) of Public Law 97-35 is amended by striking out "as".

(F)(i) Section 202(q)(3)(G) of the Social Security Act is amended by striking out "as if the period" and inserting in lieu thereof "if the period".

(ii) Section 202(q)(7)(E) of such Act is amended by striking out "he attained retirement age" and inserting in lieu thereof "she or he attained retirement age".

(G) Section 202(t)(4)(E) of such Act is amended—

(i) by inserting "of 1937 or 1974" after "Railroad Retirement Act" where it first appears; and

(ii) by inserting before the semicolon at the end thereof the following: "of 1937 or section 18(2) of the Railroad Retirement Act of 1974".

(H) Section 202(u)(1)(B) of such Act is amended by striking out ", 112, or 113".

(3)(A) Section 2034(a)(8) of such Act is amended by adding a period at the end thereof.

(B) Section 203(d)(2) of such Act is amended by striking out "an individual who is entitled" and inserting in lieu thereof "an individual under the age of seventy who is entitled".

(C) Section 203(f)(5)(B)(ii) of such Act is amended by striking out "702(a)(9)" and inserting in lieu thereof "702(a)(8)".

(D) Section 203(f)(8) of such Act is amended by indenting subparagraphs (B) and (C) two additional ems (for a total indentation of four ems) so as to align their left margins with the margins of subparagraphs (A) and (D).

(4)(A) Section 205(c)(5)(D) of such Act is amended by inserting "of 1937 or 1974" after "Railroad Retirement Act" each place it appears.

(B) Section 205(c)(5)(I) of such Act is amended by inserting before the simicolon at the end thereof the following: "or section 7(b)(7) of the Railroad Retirement Act of 1974".

(C) Section 205(e) of such Act is amended by striking out "on order" and inserting in lieu thereof "an order".

(D) Section 205(h) of such Act is amended by striking out "section 24 of the Judicial Code of the United States" and inserting in lieu thereof "section 1331 or 1346 of title 28, United States Code,".

(E) Section 205(i) of such Act is amended by striking out all that follows "through" and precedes "and prior" and inserting in lieu thereof "the Fiscal Service of the Department of the Treasury,".

(F) Section 205(p)(1) of such Act is amended by striking out "section 1420(e) of the Internal Revenue Code" and inserting in lieu thereof "section 3122 of the Internal Revenue Code of 1954".

(5) Section 208 of such Act is amended by indenting paragraphs (f) through (h) two ems so as to align their left margins with the mar-

gins of paragraphs (a) through (e) and by appropriately further indenting subdivisions (1), (2), and (3) of paragraph (g)).

(6)(A) Section 209 of such Act is amended—

(i) by indenting paragraphs (5) through (9) of subsection (a) two ems so as to align their left margins with the margins of the preceding paragraphs of such subsection;

(ii) by striking out "(p) Remuneration" and inserting in lieu thereof "(p)(1) Remuneration";

(iii) by striking out the period at the end of paragraph (p)(1) as redesignated by clause (ii) of this subparagraph and inserting in lieu thereof a semicolon;

(iv) by striking out "(p) Any contribution" and inserting in lieu thereof "(2) Any contribution"; and

(v) by indenting subsections (e), (f), and (k) through (r) two ems so as to align their left margins with the margins of subsections (a) through (d) and subsections (g), (h), and (j) (appropriately further indenting paragraphs (1) and (2) of subsection (f) and paragraphs (1) and (2) of subsection (m)).

(B) The seventh unnumbered paragraph from the end of section 209 of such Act (relating to remuneration for service performed as a member of a uniformed service) is amended by striking out "section 102(10) of the Servicemen's and Veterans' Survivor Benefits Act" and inserting in lieu thereof "chapter 3 and section 1009 of title 37, United States Code".

(7)(A) Section 210(a)(1) of such Act is amended by striking out "(A)" and all that follows down through "or (B)".

(B) Section 210(a)(7) of such Act is amended by indenting subparagraph (D) two additional ems (for a total indentation of four ems) so as to align its left margin with the margins of subparagraphs (A) through (C).

(C) Section 210(a)(9) of such Act is amended by striking out "section 1532 of the Internal Revenue Code" and inserting in lieu thereof "section 3231 of the Internal Revenue Code of 1954".

(D) Section 210(a)(19) of such Act is amended by striking out the comma after "; or".

(E) Section 210(l)(2) of such Act is amended—

(i) by striking out "section 102 of the Servicemen's and Veterans' Survivor Benefits Act" and inserting in lieu thereof "paragraph (21) of section 101 of title 38, United States Code"; and

(ii) by striking out "such section" and inserting in lieu thereof "paragraph (22) of such section".

(F) Section 210(l)(3) of such Act is amended by striking out "such section 102" and inserting in lieu thereof "paragraph (23) of such section 101".

(G) Section 210(m) of such Act is amended—

(i) by striking out "a reserve component of a uniformed service as defined in section 102(3) of the Servicemen's and Veterans' Survivor Benefits Act" in the first sentence and inserting in lieu thereof "a reserve component as defined in section 101(27) of title 38, United States Code";

(ii) by inserting ", the National Oceanic and Atmospheric Administration Corps," after "Coast and Geodetic Survey" in the first sentence;

(iii) by striking out "military or naval" each place it appears in paragraph (5) and inserting in lieu thereof "military, naval, or air"; and

(iv) by striking out "Universal Military Training and Service Act" in paragraph (5)(B) and inserting in lieu thereof "Military Selective Service Act".

(8)(A) Section 211(a) of such Act is amended by striking out "chapter 1 of the Internal Revenue Code", "such chapter", and "section 183 of such code" in the matter preceding paragraph (1) and inserting in lieu thereof "subtitle A of the Internal Revenue Code of 1954", "such subtitle", and "section 702(a)(8) of such Code", respectively.

(B) Section 211(a)(3) of such Act is amended—

(i) by striking out "chapter 1 of the Internal Revenue Code" and inserting in lieu thereof "subtitle A of the Internal Revenue Code of 1954"; and

(ii) by inserting "or" before "(C)".

(C) Section 211(a)(4) of such Act is amended by striking out "section 23(s) of such code" and inserting in lieu thereof "section 172 of the Internal Revenue Code of 1954".

(D) Section 211(a) of such Act is further amended by striking out "702(a)(9)" in clauses (iii) and (iv) (in the matter following paragraph (12)) and inserting in lieu thereof in each instance "702(a)(8)".

(E) Section 211(b)(1) of such Act is amended by indenting subparagraphs (D), (G), (H), and (I) an additional two ems (for a total indentation of four ems) so as to align their left margins with the margins of the other subparagraphs of such section.

(F) Section 211(c) of such Act is amended by striking out "section 23 of the Internal Revenue Code" and inserting in lieu thereof "section 162 of the Internal Revenue Code of 1954".

(G) Section 211(c)(3) of such Act is amended by striking out "section 1532 of the Internal Revenue Code" and inserting in lieu thereof "section 3231 of the Internal Revenue Code of 1954".

(H) Section 211(d) of such Act is amended by striking out "supplement F of chapter 1 of the Internal Revenue Code" and inserting in lieu thereof "subchapter K of chapter 1 of the Internal Revenue Code of 1954".

(I) Section 211(e) of such Act is amended by striking out "chapter 1 of the Internal Revenue Code", "chapter 1 of such code", and "such chapter 1" and inserting in lieu thereof "subtitle A of the Internal Revenue Code of 1954", "subtitle A of such Code", and "such subtitle A", respectively.

(9)(A) Section 213(a)(1) of such Act is amended by striking out "means" and inserting in lieu thereof "mean".

(B) Section 213(a)(2)(B)(ii) of such Act is amended by striking out "equal to $3,000" and inserting in lieu thereof "equal $3,000".

(10)(A) Section 215(a)(1) of such Act is amended—

(i) by striking out "of such benefits" in subparagraph (B)(i) and inserting in lieu thereof "for such benefits";

(ii) by striking out "amounts" in subparagraph (B)(iii) and inserting in lieu thereof "amount"; and

(iii) by striking out "section 217" in subparagraph (C)(ii) and inserting in lieu thereof "section 217".

(B) Section 215(a)(4) of such Act is amended by indenting subparagraph (B) two ems so as to align its left margin with the margin of subparagraph (A) (and by appropriately further indenting clauses (i) and (ii) of such subparagraph (B)).

(C) Section 215(f)(2)(A) of such Act is amended by striking out "primary insurance account" and inserting in lieu thereof "primary insurance amount".

(D) Section 215(h) of such Act is amended—

(i) by adding at the beginning thereof the following heading: "Service of Certain Public Health Service Officers"; and

(ii) by striking out "Civil Service Commission" in paragraph (1) and inserting in lieu thereof "Director of the Office of Personnel Management".

(11)(A) Section 2203(d)(4) of Public Law 97–35 is amended by inserting after "at the end of paragraph (3)" the following: "(after and below subparagraph (C)(ii))".

(B) Section 216(i)(2)(F)(ii) of the Social Security Act is amended by striking out "enacted," in the matter immediately preceding subdivision (I) and inserting in lieu thereof "enacted—".

(12)(A) Section 217(d) of such Act is amended by indenting paragraphs (1) and (2) two ems.

(B) Section 217(e)(1) of such Act is amended by inserting ", National Oceanic and Atmospheric Administration Corps," after "Coast and Geodetic Survey" in the last sentence.

(C) Section 217(f)(1) of such Act is amended by striking out "Civil Service Commission" and inserting in lieu thereof "Director of the Office of Personnel Management".

(13) Section 218(i) of such Act is amended by striking out "subchapter A or E of chapter 9 of the Internal Revenue Code" and inserting in lieu thereof "chapter 21 and subtitle F of the Internal Revenue Code of 1954".

(14) Section 221(e) of such Act is amended by striking out "Federal Disability Trust Fund is charged" and inserting in lieu thereof "Federal Disability Insurance Trust Fund is charged".

(15)(A) Subsections (a) and (b)(1) of section 222 of such Act are amended by striking out "the Vocational Rehabilitation Act" each place it appears and inserting in lieu thereof "title I of the Rehabilitation Act of 1973".

(B) Section 222(b)(3) of such Act is amended by striking out "equal" and inserting in lieu thereof "equals".

(C) Section 222(b)(4) of such Act is amended by striking out "full-time student" and inserting in lieu thereof "full-time elementary or secondary school student".

(16) Section 223(d)(2)(A) of such Act is amended by striking out "an individual" and inserting in lieu thereof "An individual".

(17) Section 226(b) of such Act is amended (in the matter following paragraph (2)(C)) by striking out "part (A)" and inserting in lieu thereof "part A".

(18) The last sentence of section 230(c) of such Act is amended by striking out "(3)(f)(3)" and inserting in lieu thereof "3(f)(3)".

(b)(1) Section 302(b) of such Act is amended by striking out all that follows "through" and precedes "and prior" and inserting in lieu thereof "the Fiscal Service of the Department of the Treasury".

(2) Section 303(a)(4) of such Act is amended by striking out "1606(b)" and inserting in lieu thereof "3305(b)".

(3) Section 303(a)(5) of such Act (as amended by the 1983 Amendments) is amended—

(A) by striking out "1606(b)" and inserting in lieu thereof "3305(b)"; and

(B) by striking out the punctuation mark immediately before the last proviso and inserting in lieu thereof a colon.

(4) Section 303(c) of such Act is amended by striking out "That" in paragraphs (1) and (2) and inserting in lieu thereof "that".

(5) Section 303(e)(2)(A)(i) of such Act is amended by striking out "child support obligatons" and inserting in lieu thereof "child support obligations".

(c)(1)(A) Section 402(a)(9) of such Act is amended by striking out "use of disclosure" and inserting in lieu thereof "use of disclosure".

(B) Section 402(a)(14) of such Act is amended by striking out "(A) provide that" and inserting in lieu thereof "provide (A) that".

(C) Section 402(a)(19)(F)(i) of such Act is amended by striking out "or section 408" and inserting in lieu thereof "or section 472".

(D) Section 402(a)(19)(G) of such Act is amended by striking out the comma before "that" in clause (iv).

(E) Section 401(a) of such Act is further amended—

(i) by striking out "must" immediately before the first of its 36 numbered subdivisions and inserting n lieu thereof "must—";

(ii) by indenting and aligning such numbered subdivisions (without altering any of the numbering, language, or punctuation) to the extent necessary to make each of such subdivisions a numbered paragraph with its left margin indented two ems (and with any designated internal subdivisions within such paragraphs (including the numbered subdivisions in subparagraphs (A) and (B) of paragraph (8) and in subparagraph (A) of paragraph (14) but not including such subparagraphs themselves, and not including any of the subdivisions in paragraphs (9), (10), (15), (19)(G), (25), (30), (31), (33), and (36)) being appropriately further indented and aligned as subparagraphs or clauses);

(iii) by striking out "and" after the semicolon at the end of paragraph (5);

(iv) by striking out "clause" each place it appears in paragraphs (15)(A), (15)(B), and (19)(F) and inserting in lieu thereof "paragraph"; and

(v) by striking out "section 402(a)(7)" in paragraph (19)(D) and inserting in lieu thereof "paragraph (7)".

(F) Section 402(c) of such Act is amended by striking out "clause" each place it appears and inserting in lieu thereof "paragraph".

(G) Section 402(d)(2) of such Act is amended by striking out "section 43" and "section 43(g)" and inserting in lieu thereof "section 32" and "section 32(g)", respectively.

(2)(A) Section 403(b)(3) of such Act is amended by striking out all that follows "through" and precedes "and prior" and inserting in lieu thereof "the Fiscal Service of the Department of the Treasury".

(B) Clause (ii) in the last sentence of section 403(j) of such Act is amended by striking out the comma after "excess payments".

(3)(A) Section 406(b)(2) of such Act is amended by adding "and" after the semicolon at the end of clause (C), by striking out clause (D), and by redesignating clause (E) as clause (D).

(B)(i) The last sentence of section 406(b) of such Act, and section 402(a)(19)(F)(i) of such Act, are each amended by striking out "clauses (A) through (E)" and inserting in lieu thereof "clauses (A) through (D)".

(ii) Section 402(a)(26)(B) of such Act is amended by striking out "subparagraphs (A) through (E)" and inserting in lieu thereof "clauses (A) through (D)".

(4)(A) Section 407(b)(1)(C) of such Act is amended by striking out "such father", and "he" each place it appears, and by inserting in lieu thereof in each instance "such parent".

(B) Section 407(b)(2)(A) of such Act is amended by striking out "thirty days" and inserting in lieu thereof "30 days".

(5) Section 409(a) of such Act is amended—

(A) by striking out "vacanies" in paragraph (1)(B) and inserting in lieu thereof "vacancies"; and

(B) by striking out "part (C)" in paragraph (3) and inserting in lieu thereof "part C".

(6) Section 410 of such Act is amended by striking out "Food Stamp Act of 1964" in subsections (a) and (c) and inserting in lieu thereof "Food Stamp Act of 1977".

(7)(A) Section 414(b)(5) of such Act is amended by striking out "receipients" and inserting in lieu thereof "recipients".

(B) Section 415(b)(1)(B)(ii) of such Act is amended by striking out "determinig" and inserting in lieu thereof "determining".

(8) Section 420(b) of such Act is amended by striking out the comma immediately after "preceding sentence".

(9) Section 441 of such Act is amended by striking out "(a)".

(10) Section 444(d) of such Act is amended by striking out "rereferred" and inserting in lieu thereof "referred".

(11) Section 445(b)(1)(E) of such Act is amended by striking out "Comprehensive Employment and Training Act of 1973" and inserting in lieu thereof "Job Training Partnership Act".

(12) The second sentence of section 452(c)(2) of such Act is amended by striking out "preceding section" and inserting in lieu thereof "preceding sentence".

(13) Section 453(b)(2) of such Act is amended by striking out ", or the United States" and inserting in lieu thereof "of the United States".

(14) Section 454 of such Act is amended—

(A) by striking out "of such parent" in paragraph (9)(C);

(B) by striking out "collection and distribution," in clause (A)(ii) of paragraph (16) and inserting in lieu thereof "collection, and distribution"; and

(C) by indenting paragraph (17) two ems so as to align its left margin with the margins of the preceding paragraphs, and amending such paragraph (as so indented)—

(i) by striking out "to accept" and inserting in lieu thereof "provide that the State will accept",

(ii) by striking out "and to impose" and inserting in lieu thereof "will impose",

(iii) by striking out "to transmit" and inserting in lieu thereof "will transmit", and

(iv) by striking out ", otherwise to comply" and inserting in lieu thereof "will otherwise comply".

(15) Section 456 of such Act is amended—

(A) by inserting "(1)" after "SEC. 456. (a)";

(B) by striking out "(1) The amount" and inserting in lieu thereof "(2) The amount";

(C) by striking out "(2) Any" and inserting in lieu thereof "(3) Any"; and

(D) by striking out "paragraphs (1)(A) and (B)" and inserting in lieu thereof "subparagraphs (A) and (B) of paragraph (2)".

(16) The heading of section 458 of such Act is amended by striking out "STATES" and inserting in lieu thereof "STATES".

(17) Section 462(f)(2) of such Act is amended by striking out "dependents" and inserting in lieu thereof "dependents' ".

(18)(A) Section 474(b)(4)(A) of such Act is amended by striking out "subparagraph (c)" and inserting in lieu thereof "subparagraph (C)".

(B) Section 474(c)(2) of such Act is amended by striking out "relvant" and inserting in lieu thereof "relevant".

(C) Section 474(d)(1) of such Act is amended—

(i) by striking out "and (c)" the second place it appears and inserting in lieu thereof "and (C)"; and

(ii) by striking out "secretary" and inserting in lieu thereof "Secretary".

(d)(1) Section 901(c) of such Act is amended by aligning paragraphs (1) through (4) (including the subparagraphs in paragraph (3)) flush with the left margin (but with appropriate indentation in the case of the subparagraphs and clauses in paragraph (1)).

(2) Section 901(f) of such Act is amended by moving paragraph (3) two ems to the left, so that its left margin is in flush alignment with the margins of the other paragraphs in such section.

(3) Section 904(b) of such Act is amended by striking out "the Second Liberty Bond Act, as amended," and inserting in lieu thereof "chapter 31 of title 31, United States Code,".

(4) Section 908(d) of such Act is amended by striking out "5703(b)" and inserting in lieu thereof "5703".

(e)(1)(A) Subparagraphs (C) and (D) of section 1101(a)(8) of such Act are amended by indenting them 2 ems so as to align their left margin with the left margin of subparagraphs (A) and (B) of such section.

(B) Paragraph (9) of section 1101(a) of such Act is amended by indenting it (including subparagraphs (A) through (D) and clauses (i) and (ii) of subparagraph (C)) 2 ems so as to align the left margin at the beginning of such paragraph with the left margin of paragraph (8)(A) of such section.

(2)(A) Section 1107(a) of such Act is amended by striking out "subchapter E of chapter 1 or subchapter A, C, or E of chapter 9 of the Internal Revenue Code," and inserting in lieu thereof "of chapter 2, 21, or 23 of the Internal Revenue Code of 1954, or of any provision of subtitle F of such Code which corresponds (within the meaning of section 7852(b) of such Code) to a provision contained in subchapter E of chapter 9 of the Internal Revenue Code of 1939,".

(B) The amendment made by subparagraph (A) shall not apply to returns filed or representations made on or before the date of the enactment of this Act.

(3) Section 1107(b) of such Act is amended by striking out "former wife divorced," each place it appears and inserting in lieu thereof "divorced wife, divorced husband, surviving divorced wife, surviving divorced husband, surviving divorced mother, surviving divorced father,".

(4)(A) Section 1114(g) of such Act is amended by striking out the period after "Code" and inserting in lieu thereof a comma.

(B) Section 1114(h)(1) of such Act is amended by striking out "sections 281, 283, and 1914 of title 18 of the United States Code, and section 190 of the Revised Statutes (5 U.S.C. 99)" and insert in lieu thereof "sections 203, 205, and 209 of title 18, United States Code".

(5) Section 1115(a) of such Act is amended by striking out "VI,", "602,", and "603,".

(6) Section 1116 of such Act is amended—

(A) by striking out "VI," in subsections (a)(1), (b), and (d);

(B) by striking out "604," in subsection (a)(3); and

(C) by striking out "XVI," and all that follows through "part A" in subsection (d) and inserting in lieu thereof "XVI, or XIX, or part A".

(7) Section 1131(a) of such Act is amended—

(A) by striking out the period after "section 204(d) of this Act" in paragraph (2)(B) and inserting in lieu thereof a comma; and

(B) by moving the matter following paragraph (2)(B) two ems to the left so that it is flush with the left margin.

(f) Title XIII of such Act is repealed.

(g)(1) Section 1611(c) of such Act is amended by adding at the beginning thereof the following heading:

"Period for Determination of Benefits".

(2) Section 1611(g) of such Act is amended by striking out "or individuals" and inserting in lieu thereof "or such individual".

(3) Section 1612(b)(2) of such Act is amended by indenting subparagraph (B) two ems so as to align its left margin with the margin of subparagraph (A).

(4) Section 1612(b)(9) of such Act is amended by inserting a comma after "child".

(5) The heading of section 1613(c) of such Act is amended to read as follows:

"Disposal of Resources For Less Than Fair Market Value".

(6) Section 1614(a)(3) of such Act is amended by moving subparagraph (E) two ems to the left, so that its left margin is in flush alignment with the margins of the other subparagraphs in such section.

(7) Section 1614(d)(1) of such Act is amended by striking out "man and women" and inserting in lieu thereof "man and woman".

(8) Section 1615 of such Act is amended by striking out "the Vocational Rehabilitation Act" in subsections (a), (c), and (d) and inserting in lieu thereof "title I of the Rehabilitation Act of 1973".

(9) Section 1618 of such Act is amended—

(A) by moving subsection (d) two ems to the left, so that its left margin is in flush alignment with the margins of the other subsections in such section;

(B) by striking out the comma after "levels of its" in such subsection (d); and

(C) by inserting a comma after "1980", and after "1976" each place it appears, in such subsection.

(10) Section 1621(e) of such Act is amended by striking out "severably" and inserting in lieu thereof "severally".

(11)(A) Section 1631(d)(1) of such Act is amended by striking out "equity or" and inserting in lieu thereof "equity and".

(B) Section 1631(b)(2) of such Act is amended by striking out "section 43" and "section 43(g)" and inserting in lieu thereof "section 32" and "section 32(g)", respectively.

(12) Section 1631(d)(1) of such Act is amended by striking out "(e), and (f)" and inserting in lieu thereof "and (e)".

(h)(1) Section 2002(b) of such Act is amended by striking out "section 203 of the Intergovernmental Cooperation Act of 1968 (42 U.S.C. 4213)" and inserting in lieu thereof "section 6503 of title 31, United States Code,".

(2) Section 2006(c) of such Act is amended by striking out "section 202 of the Intergovernmental Cooperation Act of 1968 (42 U.S.C. 4212)" and inserting in lieu thereof "section 6503 of title 31, United States Code".

(i)(1) Section 3121(b)(1) of the Internal Revenue Code of 1954 is amended by striking out "(A)" and all that follows down through "or (B)".

(2) Section 3121(i)(2) of such Code is amended by striking out "section 102(10) of the Servicemen's and Veterans' Survivor Benefits Act" and inserting in lieu thereof "chapter 3 and section 1009 of title 37, United States Code".

(3) Section 3121(m)(2) of such Code is amended—

(A) by striking out "section 102 of the Servicemen's and Veterans' Survivor Benefits Act" and inserting in lieu thereof "paragraph (21) of section 101 of title 38, United States Code"; and

(B) by striking out "such section" and inserting in lieu thereof "paragraph (22) of such section".

(4) Section 3121(m)(3) of such Code is amended by striking out "such section 102" and inserting in lieu thereof "paragraph (23) of such section 101".

(5) Section 3121(n) of such Code is amended—

(A) by striking out "a reserve component of a uniformed service as defined in section 102(3) of the Servicemen's and Veterans' Survivor Benefits Act" in the first sentence and inserting in lieu thereof "a reserve component as defined in section 101(27) of title 38, United States Code";

(B) by inserting ", the National Oceanic and Atmospheric Administration Corps," after "Coast and Geodetic Survey" in the first sentence;

(C) by striking out "military or naval" each place it appears in paragraph (5) and inserting in lieu thereof "military, naval, or air"; and

(D) by striking out "Universal Military Training and Service Act" in paragraph (5)(B) and inserting in lieu thereof "Military Selective Service Act".

(j)(1) Section 1101(a)(6) of the Social Security Act is amended by striking out "means" and all that follows and inserting in lieu thereof "means the Secretary of Health and Human Services.".

(2) The following provisions of such Act are amended by striking out "Health, Education, and Welfare" wherever it appears and inserting in lieu thereof "Health and Human Services":

(A) In title II—

(i) subsections (a)(3), (a)(4), (b)(1), (b)(2), (g)(1), (g)(2), (g)(4), and (i)(1) of section 201;

(ii) subsections (q)(4)(B), (q)(6)(B), and (r)(1) of section 218; and

(iii) subsections (b)(3) and (b)(4) of section 231;

(B) in title IV—

(i) subsections (b)(2) and (b)(3) of section 403;

(ii) subsection (a) of section 431;

(iii) subsection (b) of section 436;

(iv) section 439;

(v) section 441;

(vi) section 443;

(vii) subsection (a) of section 444;

(viii) subsection (a) of section 452;

(ix) subsection (b)(1) of section 453;

(x) paragraph (8)(B) of section 454; and

(xi) section 460;

(C) in title VII—

(i) section 702; and

(ii) subsection (c)(1) of section 706;

(D) in title XI—

(i) section 1102;

(ii) subsection (b) of section 1106;

(iii) subsection (b) of section 1107;

(iv) subsection (c) of section 1114;

(v) section 1120; and

(vi) subsection (a) of section 1126;

(E) in title XVI, section 1602; and

(F) in title XVIII—

(i) subsections (a), (f)(1), (g), and (h) of section 1817;

(ii) subsections (a)(2) and (d)(1) of section 1840;

(iii) subsections (f), (g), (h), and (i) of section 1841; and

(iv) subsection (b)(3) of section 1842.

(3) The following provisions of such Act are amended by striking out "of Health, Education, and Welfare" wherever it appears:

(A) In title II—

(i) subsections (a)(10)(B) and (l)(4)(A) of section 210;

(ii) subsections (a)(2), (a)(3), (b)(2), (e)(2), (e)(3), and (f)(1) of section 217;

(iii) subsections (a)(1), (c)(4), (d)(3), (d)(7), (h)(2), (h)(3), (i), (j), (k)(1), (l), and (p)(2) of section 218;

(iv) subsection (g) of section 228; and

(v) subsection (d) of section 233;

(B) in title IV—

(i) subsection (a)(3) of section 403; and

(ii) subsection (e) of section 407; and

(C) in title XIX, section 1901.

(4) Section 205(l) of such Act is amended by striking out "employee" and all that follows down through "designated" and inserting in lieu thereof "employee of the Department of Health and Human Services designated".

(5) The following provisions of the Internal Revenue Code of 1954 are amended by striking out "Health, Education, and Welfare" each place it appears and inserting in lieu thereof "Health and Human Services":

(A) Subsection (d)(6)(B)(ii) of section 51;

(B) subsections (c)(1), (c)(2)(E), (g)(1), (g)(3)(A), and (g)(3)(B) of section 1402;

(C) subsection (b)(10)(B) of section 3121;

(D) subsections (d) and (f) of section 6057;

(E) subsection (l)(5) of section 6103; and

(F) paragraph (5) of section 6613(d).

(k) Sections 432(d), 432(f)(1), 433(g), and 434(b) of the Social Security Act are each amended by striking out "of Labor" wherever it appears.

(l) Any reference to the Federal Security Administrator which may remain in the provisions of title II, IV, VII, or XI of the Social Security Act (other than section 1101(a)(6) of such Act) is amended—

(1) by substituting "Secretary" or "Secretary's" for the term "Administrator" or "Administrator's", where the reference is to that term alone;

(2) by substituting "Secretary of Health, Education, and Welfare" for the term "Federal Security Administrator", where the reference is to that term, if the provision containing such reference is amended by paragraph (2) or (3) of subsection (j) (in which case the amendment of such provision under this paragraph shall be deemed to have taken effect immediately prior to the amendment of such provision under such paragraph (2) or (3)); and

(3) by substituting "Secretary of Health and Human Services" for the term "Federal Security Administrator" in any other case where the reference is to that term;

and any reference to the Federal Security Agency which may remain in such provisions is amended by substituting "Department of Health and Human Services" for the term "Federal Security Agency"; but nothing in this subsection shall affect the exercise under section 402(a)(5) of such Act of the functions, powers, and duties relating to the prescription of personnel standards on a merit basis which were transferred from the Secretary of Health, Education, and Welfare by section 208(a)(3)(D) of Public Law 91-648.

EFFECTIVE DATES

SEC. 2664. (a) Except as otherwise specifically provided, the amendments made by sections 2661 and 2662 shall be effective as though they had been included in the enactment of the Social Security Amendments of 1983 (Public Law 98-21).

(b) Except to the extent otherwise specifically provided in this subtitle, the amendments made by section 2663 shall be effective on the date of the enactment of this Act; but none of such amendments shall be construed as changing or affecting any right, liability, status, or interpretation which existed (under the provisions of law involved) before that date.

Subtitle E—Trade Adjustment Assistance

LIMITATIONS ON TRADE READJUSTMENT ALLOWANCES

SEC. 2671. The first sentence of section 233(a)(3) of the Trade Act of 1974 (19 U.S.C. 2293(a)(3)) is amended to read as follows: "Notwithstanding paragraph (1), in order to assist the adversely affected worker to complete training approved for him under section 236, and in accordance with regulations prescribed by the Secretary, payments may be made as trade readjustment allowances for up to 26 additional weeks in the 26-week period that—

"(A) follows the last week of entitlement to trade readjustment allowances otherwise payable under this chapter; or

"(B) begins with the first week of such training, if such training is approved after the last week described in subparagraph (A).".

JOB SEARCH AND RELOCATION ALLOWANCES

SEC. 2672. (a) Section 237(a)(1) of the Trade Act of 1974 (19 U.S.C. 2297(a)(1)) is amended by striking out "$600" and inserting in lieu thereof "$800".

(b) Section 238(d)(2) of the Trade Act of 1974 (19 U.S.C. 2298(d)(2)) is amended by striking out "$600" and inserting in lieu thereof "$800".

ASSISTANCE TO INDUSTRY

SEC. 2673. Section 265 of the Trade Act of 1974 (19 U.S.C. 2355) is amended—

(1) by amending subsection (a)—

(A) by inserting "or workers" immediately after "substantial number of firms", and

(B) by inserting "223 or" immediately before "251"; and

(2) by striking out "$2,000,000" in subsection (b) and inserting in lieu thereof "$10,000,000".

Subtitle F—Certain Provisions Relating to Puerto Rico and the Virgin Islands

SEC. 2681. CLARIFICATION OF DEFINITION OF ARTICLES PRODUCED IN PUERTO RICO OR THE VIRGIN ISLANDS.

(a) IN GENERAL.—Section 7652 of the Internal Revenue Code of 1954 (relating to shipments to the United States) is amended by redesignating subsection (c) as subsection (e) and by inserting after subsection (b) the following new subsections:

"(c) ARTICLES CONTAINING DISTILLED SPIRITS.—For purposes of subsection (a)(3) and (b)(3), any article containing distilled spirits shall in no event be treated as produced in Puerto Rico or the

Virgin Islands unless at least 92 percent of the alcoholic content in such article is attributable to rum.

"(d) ARTICLES OTHER THAN ARTICLES CONTAINING DISTILLED SPIRITS.—For purposes of subsection (a)(3) and (b)(3)—

"(1) VALUE ADDED REQUIREMENT FOR PUERTO RICO.—Any article, other than an article containing distilled spirits, shall in no event be treated as produced in Puerto Rico unless the sum of—

"(A) the cost or value of the materials produced in Puerto Rico, plus

"(B) the direct costs of processing operations performed in Puerto Rico,

equals or exceeds 50 percent of the value of such article as of the time it is brought into the United States.

"(2) PROHIBITION OF FEDERAL EXCISE TAX SUBSIDIES.—

"(A) IN GENERAL.—No amount shall be transferred under subsection (a)(3) or (b)(3) in respect of taxes imposed on any article, other than an article containing distilled spirits, if the Secretary determines that a Federal excise tax subsidy was provided by Puerto Rico or the Virgin Islands (as the case may be) with respect to such article.

"(B) FEDERAL EXCISE TAX SUBSIDY.—For purposes of this paragraph, the term 'Federal excise tax subsidy' means any subsidy—

"(i) of a kind different from, or

"(ii) in an amount per value or volume of production greater than,

the subsidy which Puerto Rico or the Virgin Islands offers generally to industries producing articles not subject to Federal excise taxes.

"(3) DIRECT COSTS OF PROCESSING OPERATIONS.—For purposes of this subsection, the term 'direct cost of processing operations' has the same meaning as when used in section 213 of the Caribbean Basin Economic Recovery Act.".

(b) EFFECTIVE DATES AND SPECIAL RULES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by subsection (a) shall apply with respect to articles brought into the United States on or after March 1, 1984.

(2) EXCEPTION FOR PUERTO RICO FOR PERIODS BEFORE JANUARY 1, 1985.—

(A) IN GENERAL.—Subject to the limitations of subparagraphs (B) and (C), the amendments made by subsection (a) shall not apply with respect to articles containing distilled spirits brought into the United States from Puerto Rico after February 29, 1984, and before January 1, 1985.

(B) $130,000,000 LIMITATION.—In the case of such articles brought into the United States after February 29, 1984, and before July 1, 1984, the aggregate amount payable to Puerto Rico by reason of subparagraph (A) shall not exceed the excess of—

(i) $130,000,000, over

(ii) the aggregate amount payable to Puerto Rico under section 7652(a) of the Internal Revenue Code of 1954 with respect to such articles which were brought

into the United States after June 30, 1983, and before March 1, 1984.

(C) $75,000,000 LIMITATION.—In the case of such articles brought into the United States after June 30, 1984, and before January 1, 1985, the aggregate amount payable to Puerto Rico by reason of subparagraph (A) shall not exceed $75,000,000.

(3) LIMITATION ON PAYMENTS OTHER THAN TRANSPORTATION COSTS TO UNITED STATES DISTILLERS AFTER JUNE 30, 1984, AND BEFORE JANUARY 1, 1985.—

(A) IN GENERAL.—Incentive payments paid after June 30, 1984, and before January 1, 1985, to each United States distiller with respect to articles containing distilled spirits which fail to satisfy the requirements of section 7652(c) of the Internal Revenue Code of 1954, as added by this section, may not exceed $1,500,000.

(B) PAYMENTS IN EXCESS OF LIMITATION.—If any United States distiller receives, with respect to such articles brought into the United States—

(i) any incentive payment in excess of $1,500,000, or

(ii) any other payment (other than for transportation costs),

such distiller shall pay to the United States the total amount of all incentive payments and other payments (other than for transportation costs) received after June 30, 1984, and before January 1, 1985.

(C) INCENTIVE PAYMENT.—For purposes of this paragraph, the term "incentive payment" means any payment, in a form and manner determined as of March 1, 1984 (other than a payment for transportation costs) made directly or indirectly by Puerto Rico to any United States distiller as an incentive to engage in redistillation operations.

(D) TRANSPORTATION COSTS.—For purposes of this paragraph, the term "transportation costs" means direct costs of transportation to and from Puerto Rico with respect to any article containing distilled spirits.

SEC. 2682. LIMITATIONS ON TRANSFERS OF EXCISE TAX REVENUES TO PUERTO RICO AND THE VIRGIN ISLANDS.

(a) IN GENERAL.—Section 7652 of the Internal Revenue Code of 1954 (relating to shipments to the United States) is amended by adding at the end thereof the following new subsection:

"(f) LIMITATION ON COVER OVER OF TAX ON DISTILLED SPIRITS.—For purposes of this section, with respect to taxes imposed under section 5001 or this section on distilled spirits, the amount covered into the treasuries of Puerto Rico and the Virgin Islands shall not exceed the lesser of the rate of—

"(1) $10.50, or

"(2) the tax imposed under section 5001(a)(1), on each proof gallon.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to articles containing distilled spirits brought into the United States after September 30, 1985.

TITLE VII—COMPETITION IN CONTRACTING

SHORT TITLE

SEC. 2701. This title may be cited as the "Competition in Contracting Act of 1984".

Subtitle A—Amendments to the Federal Property and Administrative Services Act of 1949

PROCUREMENT PROCEDURES

SEC. 2711. (a)(1) Section 303 of the Federal Property and Administrative Services Act of 1949 (41 U.S.C. 253) is amended to read as follows:

"COMPETITION REQUIREMENTS

"SEC. 303. (a)(1) Except as provided in subsections (b), (c), and (g) and except in the case of procurement procedures otherwise expressly authorized by statute, an executive agency in conducting a procurement for property or services—

"(A) shall obtain full and open competition through the use of competitive procedures in accordance with the requirements of this title and the modifications to regulations promulgated pursuant to section 2752 of the Competition in Contracting Act of 1984; and

"(B) shall use the competitive procedure or combination of competitive procedures that is best suited under the circumstances of the procurement.

"(2) In determining the competitive procedures appropriate under the circumstance, an executive agency—

"(A) shall solicit sealed bids if—

"(i) time permits the solicitation, submission, and evaluation of sealed bids;

"(ii) the award will be made on the basis of price and other price-related factors;

"(iii) it is not necessary to conduct discussions with the responding sources about their bids; and

"(iv) there is a reasonable expectation of receiving more than one sealed bid; and

"(B) shall request competitive proposals if sealed bids are not appropriate under clause (A).

"(b)(1) An executive agency may provide for the procurement of property or services covered by this section using competitive procedures but excluding a particular source in order to establish or maintain any alternative source or sources of supply for that property or service if the agency head determines that to do so—

"(A) would increase or maintain competition and would likely result in reduced overall costs for such procurement, or for any anticipated procurement, of such property or services;

"(B) would be in the interest of national defense in having a facility (or a producer, manufacturer, or other supplier) available for furnishing the property or service in case of a national emergency or industrial mobilization; or

"(C) would be in the interest of national defense in establishing or maintaining an essential engineering, research, or development capability to be provided by an educational or other nonprofit institution or a federally funded research and development center.

"(2) In fulfilling the statutory requirements relating to small business concerns and socially and economically disadvantaged small business concerns, an executive agency shall use competitive procedures but may restrict a solicitation to allow only such business concerns to compete.

"(c) An executive agency may use procedures other than competitive procedures only when—

"(1) the property or services needed by the executive agency are available from only one responsible source and no other type of property or services will satisfy the needs of the executive agency;

"(2) the executive agency's need for the property or services is of such an unusual and compelling urgency that the Government would be seriously injured unless the executive agency is permitted to limit the number of sources from which it solicits bids or proposals;

"(3) it is necessary to award the contract to a particular source or sources in order (A) to maintain a facility, producer, manufacturer, or other supplier available for furnishing property or services in case of a national emergency or to achieve industrial mobilization, or (B) to establish or maintain an essential engineering, research, or development capability to be provided by an educational or other nonprofit institution or a federally funded research and development center;

"(4) the terms of an international agreement or treaty between the United States Government and a foreign government or international organization, or the written directions of a foreign government reimbursing the executive agency for the cost of the procurement of the property or services for such government, have the effect of requiring the use of procedures other than competitive procedures;

"(5) a statute expressly authorizes or requires that the procurement be made through another executive agency or from a specified source, or the agency's need is for a brand-name commercial item for authorized resale;

"(6) the disclosure of the executive agency's needs would compromise the national security unless the agency is permitted to limit the number of sources from which it solicits bids or proposals; or

"(7) the head of the executive agency—

"(A) determines that it is necessary in the public interest to use procedures other than competitive procedures in the particular procurement concerned, and

"(B) notifies the Congress in writing of such determination not less than 30 days before the award of the contract.

"(d)(1) For the purposes of applying subsection (c)(1)—

"(A) in the case of a contract for property or services to be awarded on the basis of acceptance of an unsolicited research proposal, the property or services shall be considered to be available from only one source if the source has submitted an unsolicited research proposal that demonstrates a unique and innovative concept the substance of which is not otherwise available to the United States and does not resemble the substance of a pending competitive procurement; and

"(B) in the case of a follow-on contract for the continued development or production of a major system or highly specialized equipment when it is likely that award to a source other than the original source would result in (i) substantial duplication of cost to the Government which is not expected to be recovered through competition, or (ii) unacceptable delays in fulfilling the executive agency's needs, such property may be deemed to be available only from the original source and may be procured through procedures other than competitive procedures.

"(2) The authority of the head of an executive agency under subsection (c)(7) may not be delegated.

"(e) An executive agency using procedures other than competitive procedures to procure property or services by reason of the application of subsection (c)(2) or (c)(6) shall request offers from as many potential sources as is practicable under the circumstances.

"(f)(1) Except as provided in paragraph (2), an executive agency may not award a contract using procedures other than competitive procedures unless—

"(A) the contracting officer for the contract justifies the use of such procedures in writing and certifies the accuracy and completeness of the justification;

"(B) the justification is approved—

"(i) in the case of a contract for an amount exceeding $100,000 (but equal to or less than $1,000,000), by the competition advocate for the procuring activity (without further delegation);

"(ii) in the case of a contract for an amount exceeding $1,000,000 (but equal to or less than $10,000,000), by the head of the procuring activity or a delegate who, if a member of the armed forces, is a general or flag officer or, if a civilian, is serving in a position in grade GS-16 or above under the General Schedule (or in a comparable or higher position under another schedule); or

"(iii) in the case of a contract for an amount exceeding $10,000,000, by the senior procurement executive of the agency designated pursuant to section 16(3) of the Office of Federal Procurement Policy Act (41 U.S.C. 414(3)) (without further delegation); and

"(C) Any required notice has been published with respect to such contract pursuant to section 18 of the Office of Federal Procurement Policy Act and all bids or proposals received in response to such notice have been considered by such executive agency.

"(2) In the case of a procurement permitted by subsection (c)(2), the justification and approval required by paragraph (1) may be

made after the contract is awarded. The justification and approval required by paragraph (1) is not required in the case of a procurement permitted by subsection (c)(7) or in the case of a procurement conducted under the Act of June 25, 1938 (41 U.S.C. 46 et seq.), popularly referred to as the Wagner-O'Day Act.

"(3) The justification required by paragraph (1)(A) shall include—

"(A) a description of the agency's needs;

"(B) an identification of the statutory exception from the requirement to use competitive procedures and a demonstration, based on the proposed contractor's qualifications or the nature of the procurement, of the reasons for using that exception;

"(C) a determination that the anticipated cost will be fair and reasonable;

"(D) a description of the market survey conducted or a statement of the reasons a market survey was not conducted;

"(E) a listing of the sources, if any, that expressed in writing an interest in the procurement; and

"(F) a statement of the actions, if any, the agency may take to remove or overcome a barrier to competition before a subsequent procurement for such needs.

"(4) The justification required by paragraph (1)(A) and any related information shall be made available for inspection by the public consistent with the provisions of section 552 of title 5, United States Code.

"(5) In no case may an executive agency—

"(A) enter into a contract for property or services using procedures other than competitive procedures on the basis of the lack of advance planning or concerns related to the amount of funds available to the agency for procurement functions; or

"(B) procure property or services from another executive agency unless such other executive agency complies fully with the requirements of this title in its procurement of such property or services.

The restriction set out in clause (B) is in addition to, and not in lieu of, any other restriction provided by law.

"(g)(1) In order to promote efficiency and economy in contracting and to avoid unnecessary burdens for agencies and contractors, the regulations modified, in accordance with section 2752 of the Competition in Contracting Act of 1984 shall provide for special simplified procedures for small purchases of property and services.

"(2) For the purposes of this title, a small purchase is a purchase or contract for an amount which does not exceed $25,000.

"(3) A proposed purchase or contract for an amount above $25,000 may not be divided into several purchases or contracts for lesser amounts in order to use the small purchase procedures required by paragraph (1).

"(4) In using small purchase procedures, an executive agency shall promote competition to the maximum extent practicable.".

(2) Title III of such Act is further amended by inserting after section 303 the following new sections:

"PLANNING AND SOLICITATION REQUIREMENTS

"SEC. 303A. (a)(1) In preparing for the procurement of property or services, an executive agency shall—

"(A) specify its needs and solicit bids or proposals in a manner designed to achieve full and open competition for the procurement;

"(B) use advance procurement planning and market research; and

"(C) develop specifications in such manner as is necessary to obtain full and open competition with due regard to the nature of the property or services to be acquired.

"(2) Each solicitation under this title shall include specifications which—

"(A) consistent with the provisions of this title, permit full and open competition;

"(B) include restrictive provisions or conditions only to the extent necessary to satisfy the needs of the executive agency or as authorized by law.

"(3) For the purposes of paragraphs (1) and (2), the type of specification included in a solicitation shall depend on the nature of the needs of the executive agency and the market available to satisfy such needs. Subject to such needs, specifications may be stated in terms of—

"(A) function, so that a variety of products or services may qualify;

"(B) performance, including specifications of the range of acceptable characteristics or of the minimum acceptable standards; or

"(C) design requirements.

"(b) In addition to the specifications described in subsection (a), each solicitation for sealed bids or competitive proposals (other than for small purchases) shall at a minimum include—

"(1) a statement of—

"(A) all significant factors (including price) which the executive agency reasonably expects to consider in evaluating sealed bids or competitive proposals; and

"(B) the relative importance assigned to each of those factors; and

"(2)(A) in the case of sealed bids—

"(i) a statement that sealed bids will be evaluated without discussions with the bidders; and

"(ii) the time and place for the opening of the sealed bids; or

"(B) in the case of competitive proposals—

"(i) a statement that the proposals are intended to be evaluated with, and awards made after, discussions with the offerors, but might be evaluated and awarded without discussions with the offerors; and

"(ii) the time and place for submission of proposals.

"EVALUATION AND AWARD

"SEC. 303B. (a) An executive agency shall evaluate sealed bids and competitive proposals based solely on the factors specified in the solicitation.

"(b) All sealed bids or competitive proposals received in response to a solicitation may be rejected if the agency head determines that such action is in the public interest.

"(c) Sealed bids shall be opened publicly at the time and place stated in the solicitation. The executive agency shall evaluate the bids without discussions with the bidders and, except as provided in subsection (b), shall award a contract with reasonable promptness to the responsible source whose bid conforms to the solicitation and is most advantageous to the United States, considering only price and the other price-related factors included in the solicitation. The award of a contract shall be made by transmitting written notice of the award to the successful bidder.

"(d)(1) The executive agency shall evaluate competitive proposals and may award a contract—

"(A) after discussions conducted with the offerors at any time after receipt of the proposals and before the award of the contract; or

"(B) without discussions with the offerors (other than discussions conducted for the purpose of minor clarification) when it can be clearly demonstrated from the existence of full and open competition or accurate prior cost experience with the product or service that acceptance of an initial proposal without discussions would result in the lowest overall cost to the Government.

"(2) In the case of award of a contract under paragraph (1)(A), the executive agency shall conduct, before such award, written or oral discussions with all responsible sources who submit proposals within the competitive range, considering only price and the other factors included in the solicitation.

"(3) In the case of award of a contract under paragraph (1)(B), the executive agency shall award the contract based on the proposals as received (and as clarified, if necessary, in discussions conducted for the purpose of minor clarification).

"(4) Except as otherwise provided in subsection (b), the executive agency shall award a contract with reasonable promptness to the responsible source whose proposal is most advantageous to the United States, considering only price and the other factors included in the solicitation. The executive agency shall award the contract by transmitting written notice of the award to such source and shall promptly notify all other offerors of the rejection of their proposals.

"(e) If the agency head considers that a bid or proposal evidences a violation of the antitrust laws, such agency head shall refer the bid or proposal to the Attorney General for appropriate action.".

(3) Section 309 of such Act (41 U.S.C. 259) is amended by adding at the end thereof the following new subsections:

"(b) The term 'competitive procedures' means procedures under which an executive agency enters into a contract pursuant to full and open competition. Such term also includes—

"(1) procurement of architectural or engineering services conducted in accordance with title IX of this Act (40 U.S.C. 541 et seq.);

"(2) the competitive selection of basic research proposals resulting from a general solicitation and the peer review or scientific review (as appropriate) of such proposals; and

"(3) the procedures established by the Administrator for the multiple awards schedule program of the General Services Administration if—

"(A) participation in the program has been open to all responsible sources; and

"(B) orders and contracts under such procedures result in the lowest overall cost alternative to meet the needs of the Government.

"(c) The terms 'full and open competition' and 'responsible source' have the same meanings provided such terms in section 4 of the Office of Federal Procurement Policy Act (41 U.S.C. 403).".

(b) The table of contents of such Act is amended by striking out the item relating to section 303 and inserting in lieu thereof the following:

"Sec. 303. Competition requirements.
"Sec. 303A. Planning and solicitation requirements.
"Sec. 303B. Evaluation and award.".

(c) The amendments made by this section do not supersede or affect the provisions of section 8(a) of the Small Business Act (15 U.S.C. 637(a)).

COST OR PRICING DATA

SEC. 2712. Section 304 of the Federal Property and Administrative Services Act of 1949 (41 U.S.C. 254) is amended by adding at the end thereof the following new subsection:

"(d)(1) A prime contractor or any subcontractor shall be required to submit cost or pricing data under the circumstances listed below, and shall be required to certify that, to the best of such contractor's or subcontractor's knowledge and belief, the cost or pricing data submitted were accurate, complete, and current—

"(A) before the award of any prime contract under this title using procedures other than sealed-bid procedures, if the contract price is expected to exceed $100,000;

"(B) before the pricing of any contract change or modification, if the price adjustment is expected to exceed $100,000, or such lesser amount as may be prescribed by the agency head;

"(C) before the award of a subcontract at any tier, when the prime contractor and each higher tier subcontractor have been required to furnish such a certificate, if the price of such subcontract is expected to exceed $100,000; or

"(D) before the pricing of any contract change or modification to a subcontract covered by clause (C), if the price adjustment is expected to exceed $100,000, or such lesser amount as may be prescribed by the agency head.

"(2) Any prime contract or change or modification thereto under which a certificate is required under paragraph (1) shall contain a provision that the price to the Government, including profit or fee, shall be adjusted to exclude any significant sums by which it may

be determined by the agency head that such price was increased because the contractor or any subcontractor required to furnish such a certificate, furnished cost or pricing data which, as of a date agreed upon between the parties (which date shall be as close to the date of agreement on the price as is practicable), were inaccurate, incomplete, or noncurrent.

"(3) For the purpose of evaluating the accuracy, completeness, and currency of cost or pricing data required to be submitted by this subsection, any authorized representative of the agency who is an employee of the United States Government shall have the right, until the expiration of three years after final payment under the contract or subcontract, to examine all books, records, documents, and other data of the contractor or subcontractor related to the proposal for the contract, the discussions conducted on the proposal, pricing, or performance of the contract or subcontract.

"(4) When cost or pricing data are not required to be submitted by this subsection, such data may nevertheless be required by the agency if the agency head determines that such data are necessary for the evaluation by the executive agency of the reasonableness of the price of the contract or subcontract.

"(5) The requirements of this subsection need not be applied to contracts or subcontracts—

"(A) where the price is based on—

"(i) adequate price competition,

"(ii) established catalog or market prices of commercial items sold in substantial quantities to the general public, or

"(iii) prices set by law or regulation, or

"(B) in exceptional cases, where the agency head determines that the requirements of this subsection may be waived and states in writing the reasons for such determination.".

AUTOMATED DATA PROCESSING DISPUTE RESOLUTION

SEC. 2713. (a) Section 111 of the Federal Property and Administrative Services Act of 1949 (40 U.S.C. 759) is amended by adding at the end thereof the following new subsection:

"(h)(1) Upon request of an interested party in connection with any procurement conducted under the authority of this section (including procurements conducted under delegations of procurement authority), the board of contract appeals of the General Services Administration (hereafter in this subsection referred to as the 'board'), shall review any decision by a contracting officer alleged to violate a statute or regulation. Such review shall be conducted under the standard applicable to review of contracting officer final decisions by boards of contract appeals. An interested party who has filed a protest under subchapter V of chapter 35 of title 31, United States Code, with respect to a procurement or proposed procurement may not file a protest with respect to that procurement or proposed procurement under this subsection.

"(2)(A) When a protest under this subsection is filed before the award of a contract in a protested procurement, the board, at the request of an interested party and within 10 days of the filing of the protest, shall hold a hearing to determine whether the board should

suspend the procurement authority of the Administrator or the Administrator's delegation of procurement authority for the protested procurement on an interim basis until the board can decide the protest.

"(B) The board shall suspend the procurement authority of the Administrator or the Administrator's delegation of procurement authority unless the Federal agency concerned establishes that—

"(i) absent action by the board, contract award is likely to occur within 30 days of the hearing; and

"(ii) urgent and compelling circumstances which significantly affect interests of the United States will not permit waiting for the decision of the board.

"(3)(A) If the Board receives notice of a protest under this subsection after the contract has been awarded but within 10 days after the contract award, the board shall, at the request of an interested party and within 10 days after the date of the filing of the protest, hold a hearing to determine whether the board should suspend the procurement authority of the Administrator or the Administrator's delegation of procurement authority for the challenged procurement on an interim basis until the board can decide the protest.

"(B) The board shall suspend the procurement authority of the Administrator or the Administrator's delegation of procurement authority to acquire any goods or services under the contract which are not previously delivered and accepted unless the Federal agency concerned establishes that urgent and compelling circumstances which significantly affect interests of the United States will not permit waiting for the decision of the board.

"(4)(A) The board shall conduct such proceedings and allow such discovery as may be required for the expeditious, fair, and reasonable resolution of the protest.

"(B) Subject to any deadlines imposed by section 9(a) of the Contract Disputes Act of 1978 (41 U.S.C. 608(a)), the board shall give priority to protests filed under this subsection. The board shall issue its final decision within 45 working days after the date of the filing of the protest, unless the board's chairman determines that the specific and unique circumstances of the protest require a longer period, in which case the board shall issue such decision within the longer period determined by the chairman.

"(C) The board may dismiss a protest the board determines is frivolous or which, on its face, does not state a valid basis for protest.

"(5)(A) In making a decision on the merits of protests brought under this section, the board shall accord due weight to the policies of this section and the goals of economic and efficient procurement set forth in this section.

"(B) If the board determines that a challenged agency action violates a statute or regulation or the conditions of any delegation of procurement authority issued pursuant to this section, the board may suspend, revoke, or revise the procurement authority of the Administrator or the Administrator's delegation of procurement authority applicable to the challenged procurement.

"(C) Whenever the board makes such a determination, it may, in accordance with section 1304 of title 31, United States Code, further

declare an appropriate interested party to be entitled to the costs of—

"(i) filing and pursuing the protest, including reasonable attorney's fees, and

"(ii) bid and proposal preparation.

"(6)(A) The final decision of the board may be appealed by the head of the Federal agency concerned and by any interested party, including interested parties who intervene in any protest filed under this subsection, as set forth in the Contract Disputes Act of 1978 (41 U.S.C. 601 et seq.).

"(B) If the board revokes, suspends, or revises the procurement authority of the Administrator or the Administrator's delegation of procurement authority after the contract award, the affected contract shall be presumed valid as to all goods or services delivered and accepted under the contract before the suspension, revocation, or revision of such procurement authority or delegation.

"(C) Nothing contained in this subsection shall affect the board's power to order any additional relief which it is authorized to provide under any statute or regulation. However, the procedures set forth in this subsection shall only apply to procurements conducted under the authority contained in this section. In addition, nothing contained in this subsection shall affect the right of any interested party to file a protest with the contracting agency or to file an action in a district court of the United States or the United States Claims Court.

"(8) Not later than January 15, 1985, the board shall adopt and issue such rules and procedures as may be necessary to the expeditious disposition of protests filed under the authority of this subsection.

"(9) For purposes of this subsection—

"(A) the term 'protest' means a written objection by an interested party to a solicitation by a Federal agency for bids or proposals for a proposed contract for the procurement of property or services or a written objection to a proposed award or the award of such a contract; and

"(B) the term 'interested party' means, with respect to a contract or proposed contract described in subparagraph (A), an actual or prospective bidder or offeror whose direct economic interest would be affected by the award of the contract or by failure to award the contract.".

(b) The amendment made by this section shall cease to be effective on January 15, 1988.

CONFORMING AMENDMENTS

SEC. 2714. (a)(1) Section 302 of the Federal Property and Administrative Services Act of 1949 (41 U.S.C. 252) is amended—

(A) by striking out the second sentence in subsection (b); and

(B) by striking out subsections (c), (d), (e), and (f) and inserting in lieu thereof the following:

"(c)(1) This title does not (A) authorize the erection, repair, or furnishing of any public building or public improvement, but such authorization shall be required in the same manner as heretofore, or (B) permit any contract for the construction or repair of build-

ings, roads, sidewalks, sewers, mains, or similar items using procedures other than sealed-bid procedures under section 303(a)(2)(A), if the conditions set forth in section 303(a)(2)(A) apply or the contract is to be performed outside the United States.

"(2) Section 303(a)(2)(A) does not require the use of sealed-bid procedures in cases in which section 204(e) of title 23, United States Code, applies.".

(2) The heading of section 304 of such Act (41 U.S.C. 254) is amended to read as follows:

"CONTRACT REQUIREMENTS".

(3) Section 304 of such Act (41 U.S.C. 254) is amended—

(A) by striking out "negotiated pursuant to section 302(c)" in the first sentence of subsection (a) and inserting in lieu thereof "awarded after using procedures other than sealed-bid procedures";

(B) by striking out "negotiated pursuant to section 302(c)" in the second sentence of subsection (a) and inserting in lieu thereof "awarded after using procedures other than sealed-bid procedures"; and

(C) by striking out "negotiated without advertising pursuant to authority contained in this Act" in the first sentence of subsection (c) and inserting in lieu thereof "awarded after using procedures other than sealed-bid procedures".

(4) Section 307 of such Act (41 U.S.C. 257) is amended—

(A) by striking out the first sentence of subsection (a) and inserting in lieu thereof the following: "Determinations and decisions provided in this Act to be made by the Administrator or other agency head shall be final. Such determinations or decisions may be made with respect to individual purchases or contracts or, except for determinations or decisions under sections 303, 303A, and 303B, with respect to classes of purchases or contracts.";

(B) by striking out "Except as provided in subsection (b)," in the second sentence of subsection (a) and inserting in lieu thereof "Except as provided in section 303(d)(2),";

(C) by striking out "this chapter" in such sentence and inserting in lieu thereof "this Act";

(D) by striking out subsection (b);

(E) by striking out "by paragraphs (11), (12), (13), or (14) of section 302(c)," in subsection (c);

(F) by redesignating subsection (c) as subsection (b); and

(G) by striking out subsection (d).

(5) Section 308 of such Act (41 U.S.C. 258) is amended by striking out "entered into pursuant to section 302(c) without advertising," and inserting in lieu thereof "made or awarded after using procedures other than sealed-bid procedures".

(6) Section 310 of such Act (41 U.S.C. 260) is amended by striking out "section 302(c)(15) of this title without regard to the advertising requirements of sections 302(c) and 303" and inserting in lieu thereof "the provisions of this title relating to procedures other than sealed-bid procedures".

(b) The table of contents of such Act is amended by striking out the item relating to section 304 and inserting in lieu thereof the following:

"Sec. 304. Contract requirements.".

Subtitle B—Amendments To Title 10, United States Code

DECLARATION OF POLICY

SEC. 2721. Section 2301 of title 10, United States Code, is amended to read as follows:

"§ 2301. Congressional defense procurement policy

"(a) The Congress finds that in order to ensure national defense preparedness, conserve fiscal resources, and enhance defense production capability, it is in the interest of the United States that property and services be acquired for the Department of Defense in the most timely, economic, and efficient manner. It is therefore the policy of Congress that—

"(1) full and open competitive procedures shall be used by the Department of Defense in accordance with the requirements of this chapter;

"(2) services and property (including weapon systems and associated items) for the Department of Defense be acquired by any kind of contract, other than cost-plus-a-percentage-of-cost contracts, but including multiyear contracts, that will promote the interest of the United States;

"(3) contracts, when appropriate, provide incentives to contractors to improve productivity through investment in capital facilities, equipment, and advanced technology;

"(4) contracts for advance procurement of components, parts, and materials necessary for manufacture or for logistics support of a weapon system should, if feasible and practicable, be entered into in a manner to achieve economic-lot purchases and more efficient production rates;

"(5) the head of an agency use advance procurement planning and market research and prepare contract specifications in such a manner as is necessary to obtain full and open competition with due regard to the nature of the property or services to be acquired; and

"(6) the head of an agency encourage the development and maintenance of a procurement career management program to ensure a professional procurement work force.

"(b) Further, it is the policy of Congress that procurement policies and procedures for the agencies named in section 2303 of this title shall in accordance with the requirements of this chapter—

"(1) promote full and open competition;

"(2) be implemented to support the requirements of such agencies in time of war or national emergency as well as in peacetime;

"(3) promote responsiveness of the procurement system to agency needs by simplifying and streamlining procurement processes;

"(4) promote the attainment and maintenance of essential capability in the defense industrial base and the capability of the United States for industrial mobilization;

"(5) provide incentives to encourage contractors to take actions and make recommendations that would reduce the costs to the United States relating to the purchase or use of property or services to be acquired under contracts;

"(6) promote the use of commercial products whenever practicable; and

"(7) require descriptions of agency requirements, whenever practicable, in terms of functions to be performed or performance required.

"(c) Further, it is the policy of Congress that a fair proportion of the purchases and contracts entered into under this chapter be placed with small business concerns.".

CLARIFICATION OF APPLICABILITY OF CHAPTER 137 OF TITLE 10 TO THE SECRETARY OF DEFENSE; DEFINITIONS

SEC. 2722. (a) Section 2302 of title 10, United States Code, is amended to read as follows:

"§ 2302. Definitions

"In this chapter:

"(1) 'Head of an agency' means the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, the Secretary of the Air Force, the Secretary of Transportation, and the Administrator of the National Aeronautics and Space Administration.

"(2) 'Competitive procedures' means procedures under which the head of an agency enters into a contract pursuant to full and open competition. Such term also includes—

"(A) procurement of architectural or engineering services conducted in accordance with title IX of the Federal Property and Administrative Services Act of 1949 (41 U.S.C. 541 et seq.);

"(B) the competitive selection for award of basic research proposals resulting from a general solicitation and the peer review or scientific review (as appropriate) of such proposals; and

"(C) the procedures established by the Administrator of General Services for the multiple award schedule program of the General Services Administration if—

"(i) participation in the program has been open to all responsible sources; and

"(ii) orders and contracts under such program result in the lowest overall cost alternative to meet the needs of the United States.

"(3) The terms 'full and open competition' and 'responsible source' have the same meanings provided such terms in section 4 of the Office of Federal Procurement Policy Act (41 U.S.C. 403).".

(b) Section 2303 of such title is amended—

(1) in subsection (a)—

(A) by striking out "purchase, and contract to purchase," and inserting in lieu thereof "procurement";

(B) by striking out "named in subsection (b), and all services," and inserting in lieu thereof "(other than land) and all services";

(C) by redesignating clauses (1) through (5) as clauses (2) through (6), respectively; and

(D) by inserting before clause (2) (as so redesignated) the following new clause:

"(1) The Department of Defense.";

(2) by striking out subsection (b); and

(3) by redesignating subsection (c) as subsection (b).

PROCUREMENT PROCEDURES

SEC. 2723. (a)(1) Section 2304 of title 10, United States Code, is amended—

(A) by striking out subsections (a) through (e) and (g), (h), and (i);

(B) by redesignating subsection (f) as subsection (h); and

(C) by inserting after the section heading the following:

"(a)(1) Except as provided in subsections (b), (c), and (g) and except in the case of procurement procedures otherwise expressly authorized by statute, the head of an agency in conducting a procurement for property or services—

"(A) shall obtain full and open competition through the use of competitive procedures in accordance with the requirements of this chapter and the modifications to regulations promulgated pursuant to section 2752 of the Competition in Contracting Act of 1984; and

"(B) shall use the competitive procedure or combination of competitive procedures that is best suited under the circumstances of the procurement.

"(2) In determining the competitive procedure appropriate under the circumstances, the head of an agency—

"(A) shall solicit sealed bids if—

"(i) time permits the solicitation, submission, and evaluation of sealed bids;

"(ii) the award will be made on the basis of price and other price-related factors;

"(iii) it is not necessary to conduct discussions with the responding sources about their bids; and

"(iv) there is a reasonable expectation of receiving more than one sealed bid; and

"(B) shall request competitive proposals if sealed bids are not appropriate under clause (A).

"(b)(1) The head of an agency may provide for the procurement of property or services covered by this chapter using competitive procedures but excluding a particular source in order to establish or maintain an alternative source or sources of supply for that property or service if the head of the agency determines that to do so—

"(A) would increase or maintain competition and would likely result in reduced overall costs for such procurement, or for any anticipated procurement, of property or services;

"(B) would be in the interest of national defense in having a facility (or a producer, manufacturer, or other supplier) available for furnishing the property or service in case of a national emergency or industrial mobilization; or

"(C) would be in the interest of national defense in establishing or maintaining an essential engineering, research, or development capability to be provided by an educational or other nonprofit institution or a federally funded research and development center.

"(2) In fulfilling the statutory requirements relating to small business concerns and socially and economically disadvantaged small business concerns, the head of an agency shall use competitive procedures but may restrict a solicitation to allow only such business concerns to compete.

"(c) The head of an agency may use procedures other than competitive procedures only when—

"(1) the property or services needed by the agency are available from only one responsible source and no other type of property or services will satisfy the needs of the agency;

"(2) the agency's need for the property or services is of such an unusual and compelling urgency that the United States would be seriously injured unless the agency is permitted to limit the number of sources from which it solicits bids or proposals;

"(3) it is necessary to award the contract to a particular source or sources in order (A) to maintain a facility, producer, manufacturer, or other supplier available for furnishing property or services in case of a national emergency or to achieve industrial mobilization, or (B) to establish or maintain an essential engineering, research, or development capability to be provided by an educational or other nonprofit institution or a federally funded research and development center;

"(4) the terms of an international agreement or a treaty between the United States and a foreign government or international organization, or the written directions of a foreign government reimbursing the agency for the cost of the procurement of the property or services for such government, have the effect of requiring the use of procedures other than competitive procedures;

"(5) a statute expressly authorizes or requires that the procurement be made through another agency or from a specified source, or the agency's need is for a brand-name commercial item for authorized resale;

"(6) the disclosure of the agency's needs would compromise the national security unless the agency is permitted to limit the number of sources from which it solicits bids or proposals; or

"(7) the head of the agency—

"(A) determines that it is necessary in the public interest to use procedures other than competitive procedures in the particular procurement concerned, and

"(B) notifies the Congress in writing of such determination not less than 30 days before the award of the contract.

"(d)(1) For the purposes of applying subsection (c)(1)—

"(A) in the case of a contract for property or services to be awarded on the basis of acceptance of an unsolicited research

proposal, the property or services shall be considered to be available from only one source if the source has submitted an unsolicited research proposal that demonstrates a unique and innovative concept the substance of which is not otherwise available to the United States and does not resemble the substance of a pending competitive procurement; and

"(B) in the case of a follow-on contract for the continued development or production of a major system or highly specialized equipment when it is likely that award to a source other than the original source would result in (i) substantial duplication of cost to the United States which is not expected to be recovered through competition, or (ii) unacceptable delays in fulfilling the agency's needs, such property may be deemed to be available only from the original source and may be procured through procedures other than competitive procedures.

(2) The authority of the head of an agency under subsection (c)(7) may not be delegated.

"(e) The head of an agency using procedures other than competitive procedures to procure property or services by reason of the application of subsection (c)(2) or (c)(6) shall request offers from as many potential sources as is practicable under the circumstances.

"(f)(1) Except as provided in paragraph (2), the head of an agency may not award a contract using procedures other than competitive procedures unless—

"(A) the contracting officer for the contract justifies the use of such procedures in writing and certifies the accuracy and completeness of the justification;

"(B) the justification is approved—

"(i) in the case of a contract for an amount exceeding $100,000 (but equal to or less than $1,000,000), by the competition advocate for the procuring activity (without further delegation);

"(ii) in the case of a contract for an amount exceeding $1,000,000 (but equal to or less than $10,000,000), by the head of the procuring activity or a delegate who, if a member of the armed forces, is a general or flag officer or, if a civilian, is serving in a position in grade GS-16 or above under the General Schedule (or in a comparable or higher position under another schedule); or

"(iii) in the case of a contract for an amount exceeding $10,000,000, by the senior procurement executive of the agency designated pursuant to section 16(3) of the Office of Federal Procurement Policy Act (41 U.S.C. 414(3)) (without further delegation); and

"(C) any required notice has been published with respect to such contract pursuant to section 18 of the Office of Federal Procurement Policy Act and all bids or proposals received in response to that notice have been considered by the head of the agency.

"(2) In the case of a procurement permitted by subsection (c)(2), the justification and approval required by paragraph (1) may be made after the contract is awarded. The justification and approval required by paragraph (1) is not required in the case of a procurement permitted by subsection (c)(7) or in the case of a procurement con-

ducted under the Act of June 25, 1938 (41 U.S.C. 46 et seq.), popularly referred to as the Wagner-O'Day Act.

"(3) The justification required by paragraph (1)(A) shall include—

"(A) a description of the agency's needs;

"(B) an identification of the statutory exception from the requirement to use competitive procedures and a demonstration, based on the proposed contractor's qualifications or the nature of the procurement, of the reasons for using that exception;

"(C) a determination that the anticipated cost will be fair and reasonable;

"(D) a description of the market survey conducted or a statement of the reasons a market survey was not conducted;

"(E) a listing of the sources, if any, that expressed in writing an interest in the procurement; and

"(F) a statement of the actions, if any, the agency may take to remove or overcome any barrier to competition before a subsequent procurement for such needs.

"(4) The justification required by paragraph (1)(A) and any related information shall be made available for inspection by the public consistent with the provisions of section 552 of title 5.

"(5) In no case may the head of an agency—

"(A) enter into a contract for property or services using procedures other than competitive procedures on the basis of the lack of advance planning or concerns related to the amount of funds available to the agency for procurement functions; or

"(B) procure property or services from another agency unless such other agency complies fully with the requirements of this chapter in its procurement of such property or services.

The restriction contained in clause (B) is in addition to, and not in lieu of, any other restriction provided by law.

"(g)(1) In order to promote efficiency and economy in contracting and to avoid unnecessary burdens for agencies and contractors, the regulations modified in accordance with section 2752 of the Competition in Contracting Act of 1984 shall provide for special simplified procedures for small purchases of property and services.

"(2) For the purposes of this chapter, a small purchase is a purchase or contract for an amount which does not exceed $25,000.

"(3) A proposed purchase or contract for an amount above $25,000 may not be divided into several purchases or contracts for lesser amounts in order to use the small purchase procedures required by paragraph (1).

"(4) In using small purchase procedures, the head of an agency shall promote competition to the maximum extent practicable.".

(2) The heading of such section is amended to read as follows:

"§ 2304. Contracts: competition requirements".

(b) Section 2305 of such title is amended to read as follows:

"§ 2305. Contracts: planning, solicitation, evaluation, and award procedures

"(a)(1)(A) In preparing for the procurement of property or services, the head of an agency shall—

"(i) specify the agency's needs and solicit bids or proposals in a manner designed to achieve full and open competition for the procurement;

"(ii) use advance procurement planning and market research; and

"(iii) develop specifications in such manner as is necessary to obtain full and open competition with due regard to the nature of the property or services to be acquired.

"(B) Each solicitation under this chapter shall include specifications which—

"(i) consistent with the provisions of this chapter, permit full and open competition; and

"(ii) include restrictive provisions or conditions only to the extent necessary to satisfy the needs of the agency or as authorized by law.

"(C) For the purposes of subparagraphs (A) and (B), the type of specification included in a solicitation shall depend on the nature of the needs of the agency and the market available to satisfy such needs. Subject to such needs, specifications may be stated in terms of—

"(i) function, so that a variety of products or services may qualify;

"(ii) performance, including specifications of the range of acceptable characteristics or of the minimum acceptable standards; or

"(iii) design requirements.

"(2) In addition to the specifications described in paragraph (1), a solicitation for sealed bids or competitive proposals (other than for small purchases) shall at a minimum include—

"(A) a statement of—

"(i) all significant factors (including price) which the head of the agency reasonably expects to consider in evaluating sealed bids or competitive proposals; and

"(ii) the relative importance assigned to each of those factors; and

"(B)(i) in the case of sealed bids—

"(I) a statement that sealed bids will be evaluated without discussions with the bidders; and

"(II) the time and place for the opening of the sealed bids; or

"(ii) in the case of competitive proposals—

"(I) a statement that the proposals are intended to be evaluated with, and awards made after, discussions with the offerors, but might be evaluated and awarded without discussions with the offerors; and

"(II) the time and place for submission of proposals.

"(b)(1) The head of an agency shall evaluate sealed bids and competitive proposals based solely on the factors specified in the solicitation.

"(2) All sealed bids or competitive proposals received in response to a solicitation may be rejected if the head of the agency determines that such action is in the public interest.

"(3) Sealed bids shall be opened publicly at the time and place stated in the solicitation. The head of the agency shall evaluate the

bids without discussions with the bidders and, except as provided in paragraph (2), shall award a contract with reasonable promptness to the responsible bidder whose bid conforms to the solicitation and is most advantageous to the United States, considering only price and the other price-related factors included in the solicitation. The award of a contract shall be made by transmitting written notice of the award to the successful bidder.

"(4)(A) The head of an agency shall evaluate competitive proposals and may award a contract—

"(i) after discussions conducted with the offerors at any time after receipt of the proposals and before the award of the contract; or

"(ii) without discussions with the offerors (other than discussions conducted for the purpose of minor clarification) when it can be clearly demonstrated from the existence of full and open competition or accurate prior cost experience with the product or service that acceptance of an initial proposal without discussions would result in the lowest overall cost to the United States.

"(B) In the case of award of a contract under subparagraph (A)(i), the head of the agency shall conduct, before such award, written or oral discussions with all responsible sources who submit proposals within the competitive range, considering only price and the other factors included in the solicitation.

"(C) In the case of award of a contract under subparagraph (A)(ii), the head of the agency shall award the contract based on the proposals received (and as clarified, if necessary, in discussions conducted for the purpose of minor clarification).

"(D) Except as provided in paragraph (2), the head of the agency shall award a contract with reasonable promptness to the responsible source whose proposal is most advantageous to the United States, considering only price and the other factors included in the solicitation. The head of the agency shall award the contract by transmitting written notice of the award to such source and shall promptly notify all other offerors of the rejection of their proposals.

"(5) If the head of an agency considers that a bid or proposal evidences a violation of the antitrust laws, he shall refer the bid or proposal to the Attorney General for appropriate action.".

(c) The amendments made by this section do not supersede or affect the provisions of section 8(a) of the Small Business Act (15 U.S.C. 637(a)).

COST OR PRICING DATA; CONFORMING AMENDMENTS

SEC. 2724. (a) The second sentence of subsection (a) of section 2306 of title 10, United States Code, is amended to read as follows: "Subject to the limitation in the preceding sentence, the other provisions of this section, and other applicable provisions of law, the head of an agency, in awarding contracts under this chapter after using procedures other than sealed-bid procedures, may enter into any kind of contract that he considers will promote the best interests of the United States".

(b) Subsection (b) of such section is amended by striking out "negotiated under section 2304" in the first sentence of subsection (b)

and inserting in lieu thereof "awarded under this chapter after using procedures other than sealed-bid procedures".

(c) Subsection (c) of such section is amended by striking out "section 2304 of this title," and inserting in lieu thereof "this chapter".

(d) Subsection (e) of such section is amended by striking out "$25,000 or" in clause (2) and inserting in lieu thereof "the greater of (A) the small purchase amount under section 2304(g) of this title, or (B)".

(e) Subsection (f) of such section is amended—

(A) in paragraph (1)—

(i) by striking out "his" in the matter preceding clause (A) and inserting in lieu thereof "such contractor's or subcontractor's"

(ii) by striking out "he" in the matter preceding clause (A)

(iii) by striking out "negotiated prime contract under this title where" in clause (A) and inserting in lieu thereof "prime contract under this chapter entered into after using procedures other than sealed-bid procedures, if";

(iv) by striking out "for which" in clauses (B) and (D) and inserting in lieu thereof "if";

(v) by striking out "where" in clause (C) and inserting in lieu thereof "when";

(vi) by striking out "$500,000" each place it appears and inserting in lieu thereof "$100,000"; and

(vii) by striking out "prior to" each place it appears and inserting in lieu thereof "before";

(B) in paragraph (2), by striking out "negotiated" both places it appears;

(C) by redesignating paragraph (3) as paragraph (5) and striking out "negotiation," in such paragraph and inserting in lieu thereof "proposal for the contract, the discussions conducted on the proposal,";

(D) by inserting a period after "noncurrent" in paragraph (2);

(E) by striking out ": Provided, That the requirements" in paragraph (2) and inserting in lieu thereof the following:

"(3) The requirements"; and

(F) by inserting after paragraph (3) (as designated by clause (E)) the following new paragraph:

"(4) When cost or pricing data is not required to be submitted by this subsection, such data may nevertheless be required by the head of the agency if the head of the agency determines that such data is necessary for the evaluation by the agency of the reasonableness of the price of the contract or subcontract.".

(f) The heading of such section is amended to read as follows:

"§ 2306. Kinds of contracts; cost or pricing data: truth in negotiation".

DETERMINATIONS AND DECISIONS

SEC. 2725. Section 2310 of title 10, United States Code, is amended—

(1) in subsection (a)—

(A) by inserting ", except for determinations and decisions under section 2304 or 2305 of title," in the first sentence after "contract or"; and

(B) by inserting ", including a determination or decision under section 2304 or 2305 of this title," in the second sentence after "decision"; and

(2) by striking out subsection (b) and inserting in lieu thereof the following:

"(b) Each determination or decision under section 2306(c), 2306(g)(1), 2307(c), or 2313(c) of this title shall be based on a written finding by the person making the determination or decision, which finding shall set out facts and circumstances that—

"(1) clearly indicate why the type of contract selected under section 2306(c) of this title is likely to be less costly than any other type or that it is impracticable to obtain property or services of the kind or quality required except under such a contract;

"(2) support the findings required by section 2306(g)(1) of this title;

"(3) clearly indicate why advance payments under section 2307(c) of this title would be in the public interest; or

"(4) clearly indicate why the application of section 2313(b) of this title to a contract or subcontract with a foreign contractor or foreign subcontractor would not be in the public interest.

Such a finding is final and shall be kept available in the agency for at least six years after the date of the determination or decision. A copy of the finding shall be submitted to the General Accounting Office with each contract to which it applies.".

LIMITATION ON AUTHORITY TO DELEGATE CERTAIN FUNCTIONS

SEC. 2726. Section 2311 of title 10, United States Code, is amended—

(1) by striking out "The head" and inserting in lieu thereof "Except as provided in section 2304(d)(2) of this title, the head"; and

(2) by striking out "chapter" and all that follows and inserting in lieu thereof "chapter.".

CONFORMING AMENDMENTS

SEC. 2727. (a) The table of sections at the beginning of chapter 137 of title 10, United States Code, is amended—

(1) by striking out the item relating to section 2301 and inserting in lieu thereof the following:

"2301. Congressional defense procurement policy."; and

(2) by striking out the items relating to sections 2304, 2305, and 2306 and inserting in lieu thereof the following:

"2304. Contracts: competition requirements.
"2305. Contracts: planning, solicitation, evaluation, and award procedures.
"2306. Kinds of contracts; cost or pricing data: truth in negotiation.".

(b) Subsection (h) of section 2304 of such title (as redesignated by section 2723(a)(1)(B)) is amended—

(1) by striking out "negotiated under this section" and inserting in lieu thereof "awarded after using procedures other than sealed-bid procedures"; and

(2) by striking out "formal advertising" and inserting in lieu thereof "sealed-bid procedures".

(c) Section 2313(b) of such title is amended by striking out "negotiated under this chapter" and inserting in lieu thereof "awarded after using procedures other than sealed-bid procedures".

(d) Section 2356 of such title is amended by striking out "the formal advertising prescribed by section 2305 of this title" and inserting in lieu thereof "a solicitation for sealed bids under chapter 137 of this title".

Subtitle C—Amendments to the Office of Federal Procurement Policy Act

DEFINITIONS

SEC. 2731. The section of the Office of Federal Procurement Policy Act relating to definitions (41 U.S.C. 403) is redesignated as section 4 and is amended—

(1) by striking out "and" at the end of paragraph (4);

(2) by striking out the period at the end of paragraph (5) and inserting in lieu thereof "; and"; and

(3) by adding at the end thereof the following new paragraphs:

"(6) the term 'competitive procedures' means procedures under which an agency enters into a contract pursuant to full and open competition;

"(7) the term 'full and open competition', when used with respect to a procurement, means that all responsible sources are permitted to submit sealed bids or competitive proposals on the procurement; and

"(8) the term 'responsible source' means a prospective contractor who—

"(A) has adequate financial resources to perform the contract or the ability to obtain such resources;

"(B) is able to comply with the required or proposed delivery or performance schedule, taking into consideration all existing commercial and Government business commitments;

"(C) has a satisfactory performance record;

"(D) has a satisfactory record of integrity and business ethics;

"(E) has the necessary organization, experience, accounting and operational controls, and technical skills, or the ability to obtain such organization, experience, controls, and skills;

"(F) has the necessary production, construction, and technical equipment and facilities, or the ability to obtain such equipment and facilities; and

"(G) is otherwise qualified and eligible to receive an award under applicable laws and regulations.".

PROCUREMENT NOTICE AND RECORDS; ADVOCATES FOR COMPETITION

SEC. 2732. (a) The Office of Federal Procurement Policy Act is further amended by adding at the end thereof the following new sections:

"PROCUREMENT NOTICE

"SEC. 18. (a)(1) Except as provided in subsection (c)—

"(A) an executive agency intending to solicit bids or proposals for a contract for property or services for a price expected to exceed $10,000 shall furnish for publication by the Secretary of Commerce a notice described in subsection (b); and

"(B) an executive agency awarding a contract for property or services for a price exceeding $25,000 shall furnish for publication by the Secretary of Commerce a notice announcing such award if there is likely to be any subcontract under such contract.

"(2) The Secretary of Commerce shall publish promptly in the Commerce Business Daily each notice required by paragraph (1).

"(3) Whenever an executive agency is required by paragraph (1)(A) to furnish a notice of a solicitation to the Secretary of Commerce, such executive agency may not—

"(A) issue such solicitation earlier than 15 days after the date on which such notice is published by the Secretary of Commerce; or

"(B) establish a deadline for the submission of all bids or proposals in response to such solicitation that is earlier than 30 days after the date on which such solicitation is issued.

"(b) Each notice required by subsection (a)(1)(A) shall include—

"(1) an accurate description of the property or services to be contracted for, which description is not unnecessarily restrictive of competition;

"(2) the name, business address, and telephone number of the officer or employee of the executive agency who may be contacted for the purpose of obtaining a copy of the solicitation;

"(3) the name, business address, and telephone number of the contracting officer;

"(4) a statement that all responsible sources may submit a bid, proposal, or quotation which shall be considered by the executive agency; and

"(5) in the case of a procurement using procedures other than competitive procedures, a statement of the reason justifying the use of such procedures and the identity of the intended source.

"(c)(1) A notice is not required under subsection (a)(1) if—

"(A) the notice would disclose the executive agency's needs and the disclosure of such needs would compromise the national security;

"(B) the proposed procurement would result from acceptance of any unsolicited proposal that demonstrates a unique and innovative research concept, and the publication of any notice of such unsolicited research proposal would disclose the originality of thought or innovativeness of the proposal or would disclose proprietary information associated with the proposal;

"(C) the procurement is made against an order placed under a requirements contract, or

"(D) the procurement is made for perishable subsistence supplies.

"(2) The requirements of subsection (a)(1)(A) do not apply to any procurement under conditions described in clause (2), (3), (4), (5), or (7) of section 303(c) of the Federal Property and Administrative Services Act of 1949 (41 U.S.C. 253(c)) or clause (2), (3), (4), (5), or (7) of section 2304(c) of title 10, United States Code.

"(3) The requirements of subsection (a)(1)(A) shall not apply in the case of any procurement for which the head of the executive agency makes a determination in writing, with the concurrence of the Administrator, that it is not appropriate or reasonable to publish a notice before issuing a solicitation.

"RECORD REQUIREMENTS

"SEC. 19. (a) Each executive agency shall establish and maintain for a period of five years a computer file, by fiscal year, containing unclassified records of all procurements, other than small purchases, in such fiscal year.

"(b) The record established under subsection (a) shall include—

"(1) with respect to each procurement carried out using competitive procedures—

"(A) the date of contract award;

"(B) information identifying the source to whom the contract was awarded;

"(C) the property or services obtained by the Government under the procurement; and

"(D) the total cost of the procurement;

"(2) with respect to each procurement carried out using procedures other than competitive procedures—

"(A) the information described in clauses (1)(A), (1)(B), (1)(C), and (1)(D);

"(B) the reason under section 303(c) of the Federal Property and Administrative Services Act of 1949 (41 U.S.C. 253(c)) or section 2304(c) of title 10, United States Code, as the case may be, for the use of such procedures; and

"(C) the identity of the organization or activity which conducted the procurement.

"(c) The information that is included in such record pursuant to subsection (b)(1) and relates to procurements resulting in the submission of a bid or proposal by only one responsible source shall be separately categorized from the information relating to other procurements included in such record. The record of such information shall be designated 'noncompetitive procurements using competitive procedures'.

"(d) The information included in the record established and maintained under subsection (a) shall be transmitted to the General Services Administration and shall be entered in the Federal Procurement Data System referred to in section 6(d)(4).

"ADVOCATES FOR COMPETITION

"SEC. 20. (a)(1) There is established in each executive agency an advocate for competition.

"(2) The head of each executive agency shall—

"(A) designate for the executive agency and for each procuring activity of the executive agency one officer or employee serving in a position authorized for such executive agency on the date of enactment of the Competition in Contracting Act of 1984 (other than the senior procurement executive designated pursuant to section 16(3)) to serve as the advocate for competition;

"(B) not assign such officers or employees any duties or responsibilities that are inconsistent with the duties and responsibilities of the advocates for competition; and

"(C) provide such officers or employees with such staff or assistance as may be necessary to carry out the duties and responsibilities of the advocate for competition, such as persons who are specialists in engineering, technical operations, contract administration, financial management, supply management, and utilization of small and disadvantaged business concerns.

"(b) The advocate for competition of an executive agency shall—

"(1) be responsible for challenging barriers to and promoting full and open competition in the procurement of property and services by the executive agency;

"(2) review the procurement activities of the executive agency;

"(3) identify and report to the senior procurement executive of the executive agency designated pursuant to section 16(3)—

"(A) opportunities and actions taken to achieve full and open competition in the procurement activities of the executive agency; and

"(B) any condition or action which has the effect of unnecessarily restricting competition in the procurement actions of the executive agency; and

"(4) prepare and transmit to such senior procurement executive an annual report describing—

"(A) such advocate's activities under this section;

"(B) new initiatives required to increase competition; and

"(C) barriers to full and open competition that remain;

"(5) recommend to the senior procurement executive of the executive agency goals and the plans for increasing competition on a fiscal year basis;

"(6) recommend to the senior procurement executive of the executive agency a system of personal and organizational accountability for competition, which may include the use of recognition and awards to motivate program managers, contracting officers, and others in authority to promote competition in procurement programs; and

"(7) describe other ways in which the executive agency has emphasized competition in programs for procurement training and research.

"(c) The advocate for competition for each procuring activity shall be responsible for challenging barriers to and promoting full and open competition in the procuring activity, including unneces-

sarily detailed specifications and unnecessarily restrictive statements of need.

"ANNUAL REPORT ON COMPETITION

"SEC. 21. (a) Not later than January 31 of each of 1986, 1987, 1988, 1989, and 1990, the head of each executive agency shall transmit to each House of Congress a report including the information specified in subsection (b).

"(b) Each report under subsection (a) shall include—

"(1) a specific description of all actions that the head of the executive agency intends to take during the current fiscal year to—

"(A) increase competition for contracts with the executive agency on the basis of cost and other significant factors; and

"(B) reduce the number and dollar value of noncompetitive contracts entered into by the executive agency; and

"(2) a summary of the activities and accomplishments of the advocate for competition of the executive agency during the preceding fiscal year.".

(b)(1) Section 6(e) of such Act (41 U.S.C. 405(e)) is amended by striking out "subsection (c)" and inserting in lieu thereof "subsection (d)".

(2) Section 16(1) of such Act (41 U.S.C. 414(1)) is amended to read as follows:

"(1) increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured;".

Subtitle D—Procurement Protest System

PROCUREMENT PROTEST SYSTEM

SEC. 2741. (a) Chapter 35 of title 31, United States Code, is amended by adding at the end thereof the following new subchapter:

"SUBCHAPTER V—PROCUREMENT PROTEST SYSTEM

"§ 3551. Definitions

"In this subchapter—

"(1) 'protest' means a written objection by an interested party to a solicitation by an executive agency for bids or proposals for a proposed contract for the procurement of property or services or a written objection by an interested party to a proposed award or the award of such a contract;

"(2) 'interested party', with respect to a contract or proposed contract described in paragraph (1), means an actual or prospective bidder or offeror whose direct economic interest would be

affected by the award of the contract or by failure to award the contract; and

"(3) 'Federal agency' has the meaning given such term by section 3 of the Federal Property and Administrative Services Act of 1949 (40 U.S.C. 472).

"§ 3552. Protests by interested parties concerning procurement actions

"A protest concerning an alleged violation of a procurement statute or regulation shall be decided by the Comptroller General if filed in accordance with this subchapter. An interested party who has filed a protest under section 111(h) of the Federal Property and Administrative Services Act of 1949 (40 U.S.C. 759(h)) with respect to a procurement or proposed procurement may not file a protest with respect to that procurement under this subchapter.

"§ 3553. Review of protests; effect on contracts pending decision

"(a) Under procedures prescribed under section 3555 of this title, the Comptroller General shall decide a protest submitted to the Comptroller General by an interested party.

"(b)(1) Within one working day of the receipt of a protest, the Comptroller General shall notify the Federal agency involved of the protest.

"(2) Except as provided in paragraph (3) of this subsection, a Federal agency receiving a notice of a protested procurement under paragraph (1) of this subsection shall submit to the Comptroller General a complete report (including all relevant documents) on the protested procurement—

"(A) within 25 working days from the date of the agency's receipt of that notice;

"(B) if the Comptroller General, upon a showing by the Federal agency, determines (and states the reasons in writing) that the specific circumstances of the protest require a longer period, within the longer period determined by the Comptroller General; or

"(C) in a case determined by the Comptroller General to be suitable for the express option under section 3554(a)(2) of this title, within 10 working days from the date of the Federal agency's receipt of that determination.

"(3) A Federal agency need not submit a report to the Comptroller General pursuant to paragraph (2) of this subsection if the agency is sooner notified by the Comptroller General that the protest concerned has been dismissed under section 3554(a)(3) of this title.

"(c)(1) Except as provided in paragraph (2) of this subsection, a contract may not be awarded in any procurement after the Federal agency has received notice of a protest with respect to such procurement from the Comptroller General and while the protest is pending.

"(2) The head of the procuring activity responsible for award of a contract may authorize the award of the contract (notwithstanding a protest of which the Federal agency has notice under this section)—

"(A) upon a written finding that urgent and compelling circumstances which significantly affect interests of the United

States will not permit waiting for the decision of the Comptroller General under this subchapter; and

"(B) after the Comptroller General is advised of that finding.

"(3) A finding may not be made under paragraph (2)(A) of this subsection unless the award of the contract is otherwise likely to occur within 30 days thereafter.

"(d)(1) If a Federal agency receives notice of a protest under this section after the contract has been awarded but within 10 days of the date of the contract award, the Federal agency (except as provided under paragraph (2)) shall, upon receipt of that notice, immediately direct the contractor to cease performance under the contract and to suspend any related activities that may result in additional obligations being incurred by the United States under that contract. Performance of the contract may not be resumed while the protest is pending.

"(2) The head of the procuring activity responsible for award of a contract may authorize the performance of the contract (notwithstanding a protest of which the Federal agency has notice under this section)—

"(A) upon a written finding—

"(i) that performance of the contract is in the best interests of the United States; or

"(ii) that urgent and compelling circumstances that significantly affect interests of the United States will not permit waiting for the decision of the Comptroller General concerning the protest; and

"(B) after the Comptroller General is notified of that finding.

"(e) The authority of the head of the procuring activity to make findings and to authorize the award and performance of contracts under subsections (c) and (d) of this section may not be delegated.

"(f) Within such deadlines as the Comptroller General prescribes, upon request each Federal agency shall provide to an interested party any document relevant to a protested procurement action (including the report required by subsection (b)(2) of this section) that would not give that party a competitive advantage and that the party is otherwise authorized by law to receive.

"§ 3554. Decisions on protests

"(a)(1) To the maximum extent practicable, the Comptroller General shall provide for the inexpensive and expeditious resolution of protests under this subchapter. Except as provided under paragraph (2) of this subsection, the Comptroller General shall issue a final decision concerning a protest within 90 working days from the date the protest is submitted to the Comptroller General unless the Comptroller General determines and states in writing the reasons that the specific circumstances of the protest require a longer period.

"(2) The Comptroller General shall, by regulation prescribed pursuant to section 3555 of this title, establish an express option for deciding those protests which the Comptroller General determines suitable for resolution within 45 calendar days from the date the protest is submitted.

"(3) The Comptroller General may dismiss a protest that the Comptroller General determines is frivolous or which, on its face, does not state a valid basis for protest.

"(b)(1) With respect to a solicitation for a contract, or a proposed award or the award of a contract, protested under this subchapter, the Comptroller General may determine whether the solicitation, proposed award, or award complies with statute and regulation. If the Comptroller General determines that the solicitation, proposed award, or award does not comply with a statute or regulation, the Comptroller General shall recommend that the Federal agency—

"(A) refrain from exercising any of its options under the contract;

"(B) recompete the contract immediately;

"(C) issue a new solicitation;

"(D) terminate the contract;

"(E) award a contract consistent with the requirements of such statute and regulation;

"(F) implement any combination of recommendations under clauses (A), (B), (C), (D), and (E); or

"(G) implement such other recommendations as the Comptroller General determines to be necessary in order to promote compliance with procurement statutes and regulations.

"(2) If the head of the procuring activity responsible for a contract makes a finding under section 3553(d)(2)(A)(i) of this title, the Comptroller General shall make recommendations under this subsection without regard to any cost or disruption from terminating, recompeting, or reawarding the contract.

"(c)(1) If the Comptroller General determines that a solicitation for a contract or a proposed award or the award of a contract does not comply with a statute or regulation, the Comptroller General may declare an appropriate interested party to be entitled to the costs of—

"(A) filing and pursuing the protest, including reasonable attorneys' fees; and

"(B) bid and proposal preparation.

"(2) Monetary awards to which a party is declared to be entitled under paragraph (1) of this subsection shall be paid promptly by the Federal agency concerned out of funds available to or for the use of the Federal agency for the procurement of property and services.

"(d) Each decision of the Comptroller General under this subchapter shall be signed by the Comptroller General or a designee for that purpose. A copy of the decision shall be made available to the interested parties, the head of the procuring activity responsible for the solicitation, proposed award, or award of the contract, and the senior procurement executive of the Federal agency involved.

"(e)(1) The head of the procuring activity responsible for the solicitation, proposed award, or award of the contract shall report to the Comptroller General, if the Federal agency has not fully implemented those recommendations within 60 days of receipt of the Comptroller General's recommendations under subsection (b) of this section.

"(2) Not later than January 31 of each year, the Comptroller General shall transmit to Congress a report describing each instance in which a Federal agency did not fully implement the Comptroller General's recommendations during the preceding fiscal year.

*"§ 3555. **Regulations; authority of Comptroller General to verify assertions***

"(a) Not later than January 15, 1985, the Comptroller General shall prescribe such procedures as may be necessary to the expeditious decision of protests under this subchapter, including procedures for accelerated resolution of protests under the express option authorized by section 3554(a)(2) of this title. Such procedures shall provide that the protest process may not be delayed by the failure of a party to make a filing within the time provided for the filing.

"(b) The Comptroller General may use any authority available under chapter 7 of this title and this chapter to verify assertions made by parties in protests under this subchapter.

*"§ 3556. **Nonexclusivity of remedies; matters included in agency record***

"This subchapter does not give the Comptroller General exclusive jurisdiction over protests, and nothing contained in this subchapter shall affect the right of any interested party to file a protest with the contracting agency or to file an action in a district court of the United States or the United States Claims Court. In any such action based on a procurement or proposed procurement with respect to which a protest has been filed under this subchapter, the reports required by sections 3553(b)(2) and 3554(e)(1) of this title with respect to such procurement or proposed procurement and any decision or recommendation of the Comptroller General under this subchapter with respect to such procurement or proposed procurement shall be considered to be part of the agency record subject to review.".

(b) The analysis for such chapter is amended by adding at the end thereof the following:

"SUBCHAPTER V—PROCUREMENT PROTEST SYSTEM

"3551. Definitions.
"3552. Protests by interested parties concerning procurement actions.
"3553. Review of protests; effect on contracts pending decision.
"3554. Decisions on protests.
"3555. Regulations; authority of Comptroller General to verify assertions.
"3556. Nonexclusivity of remedies; matters included in agency record.".

Subtitle E—Effective Date; Regulations; Study

EFFECTIVE DATES

SEC. 2751. (a) Except as provided in subsection (b), the amendments made by this title shall apply with respect to any solicitation for bids or proposals issued after March 31, 1985.

(b) The amendments made by section 2713 and subtitle D shall apply with respect to any protest filed after January 14, 1985.

MODIFICATION OF FEDERAL ACQUISITION REGULATIONS

SEC. 2752. Not later than March 31, 1985, the single Government-wide procurement regulation referred to in section 4(4)(A) of the Office of Federal Procurement Policy Act (41 U.S.C. 403(4)(A)) shall be modified to conform to the requirements of this title and the amendments made by this title.

STUDY OF ALTERNATIVES

SEC. 2753. (a) Not later than January 31, 1985, the Administrator of the Office of Federal Procurement Policy, in consultation with the Secretary of Defense, the Administrator of General Services and the Administrator of the National Aeronautics and Space Administration, shall complete a study of alternatives and recommend to the Committee on Governmental Affairs of the Senate and the Committee on Government Operations of the House of Representatives a plan to increase the opportunities to achieve full and open competition on the basis of technical qualifications, quality, and other factors in the procurement of professional, technical, and managerial services.

(b) Such plan shall provide for testing the recommended alternative and be developed in accordance with section 15 of the Office of Federal Procurement Policy Act (41 U.S.C. 413), and be consistent with the policies set forth in section 2 of such Act (41 U.S.C. 401).

TITLE VIII—FEDERAL CREDIT UNION ACT AMENDMENTS

SEC. 2801. Section 201(b)(8) of the Federal Credit Union Act (12 U.S.C. 1781(b)(8)) is amended to read as follows:

"(8) to pay and maintain its deposit and to pay the premium charges for insurance imposed by this title; and".

SEC. 2802. Section 202 (b) of the Federal Credit Union Act (12 U.S.C. 1782(b)) is amended to read as follows:

"(b)(1) For each insurance year, each insured credit union which became insured prior to the beginning of that year shall file with the Board, at such time as the Board prescribes, a certified statement showing the total amount of insured shares in the credit union at the close of the preceding insurance year and both the amount of its deposit or adjustment thereof and the amount of the premium charge for insurance due to the fund for that year, both as computed under subsection (c) of this section.

"(2) The certified statements required to be filed with the Board pursuant to this subsection shall be in such form and shall set forth such supporting information as the Board shall require.

"(3) Each such statement shall be certified by the president of the credit union, or by any officer of the credit union designated by its board of directors, that to the best of his knowledge and belief that statement is true, correct, and complete and in accordance with this title and regulations issued thereunder.".

SEC. 2803. Section 202(c) of the Federal Credit Union Act (12 U.S.C. 1782(c)) is amended—

(1) by striking out paragraph (2);

(2) by redesignating paragraph (1) as paragraph (2);

(3) by striking out "Except as provided in paragraph (2) of this subsection, each" in paragraph (2), as redesignated, and inserting in lieu thereof "Each";

(4) by striking out "on or before January 31 of each insurance year" in paragraph (2), as redesignated, and inserting in lieu thereof "at such time as the Board prescribes";

(5) by striking out "member accounts" in paragraph (2), as redesignated, and inserting in lieu thereof "insured shares"; and

(6) by inserting before paragraph (2) the following:

"(1)(A)(i) Each insured credit union shall pay to and maintain with the National Credit Union Share Insurance Fund a deposit in an amount equaling 1 per centum of the credit union's insured shares.

"(ii) The Board may, in its discretion, authorize insured credit unions to initially fund such deposit over a period of time in excess of one year if necessary to avoid adverse effects on the condition of insured credit unions.

"(iii) The amount of each insured credit union's deposit shall be adjusted annually, in accordance with procedures determined by the Board, to reflect changes in the credit union's insured shares.

"(B)(i) The deposit shall be returned to an insured credit union in the event that its insurance coverage is terminated, it converts to insurance coverage from another source, or in the event the operations of the fund are transferred from the National Credit Union Administration Board.

"(ii) The deposit shall be returned in accordance with procedures and valuation methods determined by the Board, but in no event shall the deposit be returned any later than one year after the final date on which no shares of the credit union are insured by the Board.

"(iii) The deposit shall not be returned in the event of liquidation on account of bankruptcy or insolvency.

"(iv) The deposit funds may be used by the fund if necessary to meets its expenses, in which case the amount so used shall be expensed and shall be replenished by insured credit unions in accordance with procedures established by the Board.".

SEC. 2804. Section 202(c)(3) of the Federal Credit Union Act (12 U.S.C. 1782(c)(3)) is amended to read as follows:

"(3) When, at the end of a given insurance year, any loans to the fund from the Federal Government and the interest thereon have been repaid and the equity of the fund exceeds the normal operating level, the Board shall effect for that insurance year a pro rata distribution to insured credit unions of an amount sufficient to reduce the equity in the fund to its normal operating level.".

SEC. 2805. Section 202(c)(4) of the Federal Credit Union Act (12 U.S.C. 1782(c)(4)) is repealed.

SEC. 2806. (a) Subsections (d) through (f) of section 202 of the Federal Credit Union Act (12 U.S.C. 1782(d) through (f)) are amended—

(1) by inserting "its deposit or" before the words "the premium charge" and "any premium charge" each time they appear, other than in the second sentence of subsection (e) of section 202; and

(2) by striking out "member accounts" and inserting in lieu thereof "insured shares".

(b) Section 202 of the Federal Credit Union Act (12 U.S.C. 1782) is amended—

(1) in the first sentence of subsection (e), by inserting "deposit or" after "the amount of any unpaid";

(2) in the second sentence of subsection (e), by inserting "deposit or" before "premium charge due"; and

(3) in the first sentence of subsection (f), by inserting "deposit or" after "statement or pay any such".

SEC. 2807. Section 202(g) of the Federal Credit Union Act (12 U.S.C. 1782(g)) is amended—

(1) by striking out "statements, and premium charges" and inserting in lieu thereof "statements, and deposit and premium charges";

(2) by striking out "payment of any premium charge" and inserting in lieu thereof "payment of any deposit or adjustment thereof or any premium charge"; and

(3) by striking out "any premium charge for insurance" and inserting in lieu thereof "any deposit or adjustment thereof or any premium charge for insurance".

SEC. 2808. Section 202(h)(1) of the Federal Credit Union Act (12 U.S.C. 1782(h)(1)) is amended by inserting before the semicolon at the end thereof the following: ", unless otherwise prescribed by the Board".

SEC. 2809. Section 202(h)(2) of the Federal Credit Union Act (12 U.S.C. 1782(h)(2)) is amended to read as follows:

"(2) the term 'normal operating level', when applied to the fund, means an amount equal to 1.3 per centum of the aggregate amount of the insured shares in all insured credit unions, or such lower level as the Board may determine; and".

SEC. 2810. Section 202(h)(3) of the Federal Credit Union Act (12 U.S.C. 1782(h)(3)) is amended to read as follows:

"(3) the term 'insured shares' when applied to this section includes share, share draft, share certificate and other similar accounts as determined by the Board, but does not include amounts in excess of the insured account limit set forth in section 207(c)(1).".

SEC. 2811. Section 203(b) of the Federal Credit Union Act (12 U.S.C. 1783(b)) is amended—

(1) by inserting "deposits and" before "premium charges"; and

(2) by adding at the end thereof the following: "The Board shall report annually to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Banking, Finance and Urban Affairs of the House of Representatives with respect to the operating level of the fund. Such report shall also include the results of an independent audit of the fund.".

SEC. 2812. Section 206(d)(1) of the Federal Credit Union Act (12 U.S.C. 1786(d)(1)) is amended—

(1) by inserting "(1)" after "subsection (a)";

(2) by inserting "maintain its deposit with and" before "pay premiums to the Board"; and

(3) by adding at the end thereof the following sentence: "Notwithstanding the above, when an insured credit union's insured status is terminated and the credit union subsequently obtains comparable insurance coverage from another source, insurance of its accounts by the fund may cease immediately upon the effective date of such comparable coverage by mutual consent of the credit union and the Board.".

SEC. 2813. (a) Title III of the Federal Credit Union Act (12 U.S.C. 1795 et seq.) is amended—

(1) in section 303 by inserting ", an instrumentality of the United States," after "Central Liquidity Facility" in the second sentence; and

(2) by adding at the end thereof the following:

"STATE AND LOCAL TAX EXEMPTION

"SEC. 312. (a) The Central Liquidity Facility, and its franchise, activities, capital reserves, surplus, and income, shall be exempt from all State and local taxation now or hereafter imposed, other than taxes on real property held by the Facility (to the same extent, according to its value, as other similar property held by other persons is taxed).

"(b)(1) Except as provided in paragraph (2), the notes, bonds, debentures, and other obligations issued on behalf of the Central Liquidity Facility and the income therefrom shall be exempt from all State and local taxation now or hereafter imposed.

"(2) Any obligation described in paragraph (1) shall not be exempt from State or local gift, estate, inheritance, legacy, succession, or other wealth transfer taxes.

"(c) For purposes of this section—

"(1) the term 'State' includes the District of Columbia; and

"(2) taxes imposed by counties or municipalities, or any territory, dependency, or possession of the United States shall be treated as local taxes.".

(b)(1) Section 501 of the Internal Revenue Code of 1954 (relating to organizations exempt from tax) is amended by redesignating subsection (k) as subsection (l) and by adding subsection (j) the following new subsection:

"(k) GOVERNMENT CORPORATIONS EXEMPT UNDER SUBSECTION (c)(1).—The organization described in this subsection is the Central Liquidity Facility established under title III of the Federal Credit Union Act (12 U.S.C. 1795 et seq.).".

(2) Paragraph (1) of section 501(c) of such Code (listing exempt organizations) is amended to read as follows:

"(1) any corporation organized under Act of Congress which is an instrumentality of the United States but only if such corporation—

"(A) is exempt from Federal income taxes under such Act, as amended and supplemented, or

"(B) is described in subsection (k).".

(c) The amendments made by this section shall take effect on October 1, 1979.

ELIMINATION OF PAYROLL DEDUCTION FEES ON FINANCIAL ORGANIZATIONS; ADMINISTRATION OF DISBURSING FUNCTIONS

SEC. 2814. (a) Section 3332(b) of title 31, United States Code, is amended by inserting "without charge" after "shall be sent".

(b) Section 3332 of title 31, United States Code, is amended by striking out subsection (c) and redesignating subsections (d), (e), (f), and (g) as subsections (c), (d), (e), and (f), respectively.

TITLE IX—MISCELLANEOUS PROVISIONS

COST SAVINGS BY ADMINISTRATIVE ACTION

SEC. 2901. (a) It is the sense of the Congress that—

(1) departments, agencies, and instrumentalities of the executive branch of government can continue to make significant management improvements in—

(A) the travel and transportation of personnel and transportation of things for personnel;

(B) the use of consultant services;

(C) public affairs, public relations, and advertising activities;

(D) publishing, printing, reproduction, and audio visual activities;

(E) identification, recovery, and collection of Federal overpayments, delinquencies, and indebtedness; and

(F) the operation, maintenance, management, leasing, acquisition, and disposal of motor vehicles; and

(2) such improvements can result in better use of funds and reductions in expenditures for such activities.

(b) Within six months after the date of enactment of this Act, the Director of the Office of Management and Budget shall prepare and transmit to the Committees on Appropriations and Budget of the Senate and House of Representatives and the Senate Governmental Affairs and House Government Operations Committees a report describing for each of the categories specified in subparagraphs (A) through (F) of subsection (a)(1)—

(1) the baseline cost (or best estimate thereof) for fiscal year 1984;

(2) the savings (below such baseline cost or estimate) that can reasonably be expected to be achieved for fiscal year 1985 by improved management;

(3) an explanation of how such savings will be achieved; and

(4) if necessary, draft legislation to achieve such savings.

(c) If the expected savings described pursuant to subsection (b)(2) are—

(1) less than $750,000,000 for the category specified in subparagraph (A) of subsection (a)(1),

(2) less than $1,000,000,000 for the category specified in subparagraph (B) of such subsection,

(3) less than $100,000,000 for the category specified in subparagraph (C) of such subsection,

(4) less than $250,000,000 for the category specified in subparagraph (D) of such subsection,

(5) less than $2,100,000,000 for the category specified in subparagraph (E) of such subsection, or

(6) less than $160,000,000 for the category specified in subparagraph (F) of such subsection,

the report shall state the reasons why the amount specified in paragraph (1), (2), (3), (4), (5), or (6) is not achievable.

DISPOSAL OF CERTAIN LANDS AT MONTAUK AIR FORCE BASE

SEC. 2902. (a) The Congress finds that—

(1) the highest and best use of the lands described in subsection (b)(1) of this section is use as a park or recreational area;

(2) the State of New York has indicated a willingness to convey by donation to the United States the fee interest to the lands described in subsection (b)(2);

(3) therefore the Administrator of General Services should assign to the Secretary of the Interior the lands described in subsection (b)(1) for use as a public park or recreational area; and

(4) the Secretary of the Interior should, simultaneous with acceptance of the lands described in subsection (b)(2), convey the property described in subsection (b)(1) to the State of New York for use as a public park or recreational area through a public discount conveyance under section 203(k)(2) of the Federal Property and Administrative Services Act of 1949 (40 U.S.C. 484(k)(2)).

(b)(1) The lands described in this subsection are those portions of the Montauk Air Force Station in East Hampton Township, Suffolk County, New York, totaling approximately 278 acres, that were declared surplus to the needs of the United States Government on December 21, 1981.

(2) The lands described in this subsection are approximately 125 acres of real property owned by the State of New York within the boundaries of the Fire Island National Seashore.

COST SAVINGS REPORT BY THE PRESIDENT

SEC. 2903. The President shall review recent recommendations for management improvement and cost control opportunities including those made by congressional committees, executive and legislative branch agencies, educational and research organizations, and public and private boards, task forces, councils, panels, and study groups, which require administrative or Presidential action. A report on such review shall be submitted with the Budget of the United States Government transmitted in January 1985 under section 1105(a) of title 31, United States Code, and shall contain a list of the recommendations the President has reviewed, the source of those recommendations, the actions which the President proposes to take or has taken, and the amount of cost savings expected to result therefrom in fiscal years 1985, 1986, and 1987.

COST SAVINGS BY COMMITTEE

SEC. 2904. Each authorizing committee of the Senate and House of Representatives shall review the report required under section 1609 and make recommendations from that report to the Budget Committees including any necessary changes in laws to allow for or facilitate the achievement of savings as identified in that report. The resulting recommendations shall be transmitted to the Budget Committee as part of each committee's report submitted pursuant to section 301(c) of Public Law 93-344, on March 15, 1985.

ANALYSES OF BUDGET ASSUMPTIONS

SEC. 2905. (a) The director of the Congressional Budget Office shall conduct a study of the nature and reliability of the assumptions upon which budget estimates are based for concurrent resolutions on the budget adopted by the Congress and make a report to the Committee on the Budget of the House of Representatives and the Committee on the Budget of the Senate by June 1, 1985. Such study shall identify—

(1) the reasons for the differences between actual revenues and outlays and the revenue and outlay estimates used for concurrent resolutions on the budget;

(2) the extent to which any systematic biases exist in the assumptions or methods used for making revenue and outlay estimates for the concurrent resolutions on the budget; and

(3) the extent to which the use of alternative assumptions or estimating methods. This would include time-series analyses of historical budget patterns and economic trends.

(b) On a trial basis, the Congressional Budget Office shall conduct in consultation with the General Accounting Office a review of the budget estimates prepared by the Department of Defense and one civilian agency to determine whether:

(1) there is a systematic underestimation of the costs required to carry out the policies, programs and projects proposed; and

(2) what effects any systematic costing errors may have upon the long-run costs of programs, the mix of programs implemented and the effectiveness of programs in meeting agency missions and goals.

The General Accounting Office component of this review shall look at all phases of budget preparation and program evaluation in the agencies selected, and shall examine historical patterns of funding to determine the effect of cost estimation biases.

FORMULA APPROACH TO FEDERAL BUDGETING

SEC. 2906. The Director of the Congressional Budget Office and the Director of the Office of Management and Budget shall each, in consultation with the Chairman and ranking member of the Committee on the Budget of the House of Representatives and the Committee on the Budget of the Senate, conduct a study of the administrative feasibility and potential impact in terms of effectiveness and equitability of applying alternative formula approaches to the entire Federal budget. These studies may include, but need not be limited to, the following formulas:

(1) a fraction (not necessarily limited to less than 1.0) of historical trends in spending within functions or categories of the budget;

(2) an equal percentage growth rate, or an equal percentage reduction in the growth rate of, each function or category of the budget;

(3) a set of percentage growth rates, whereby the budget is divided into major categories and a different percentage growth rate is then applied to each category;

(4) a fraction (not necessarily limited to less than 1.0) of the growth in the Gross National Product (as calculated by the

Congressional Budget Office or the Office of Management and Budget) applied to each function or category of the budget.
The Congressional Budget Office and the Office of Management and Budget shall each report the findings of such study to the Congress no later than December 31, 1984.

MINING OF NICARAGUAN PORTS

SEC. 2907. It is the sense of the Congress that no funds heretofore or hereafter appropriated in any Act of Congress shall be obligated or expended for the purpose of planning, directing, executing, or supporting the mining of the ports or territorial waters of Nicaragua.

And the House agree to the same.

That the House recede from its disagreement to the amendment of the Senate to the title of the bill and concur therein with an amendment as follows:

Amend the title so as to read: "An Act to provide for tax reform and deficit reduction".

And the Senate agree to the same.

Solely for consideration of titles I through VIII, section 1002, and title XI of the Senate amendment, and division A of the House amendment to the Senate amendment:

From the Committee on Ways and Means:

DAN ROSTENKOWSKI,
SAM GIBBONS,
J.J. PICKLE,
C.B. RANGEL
PETE STARK,
BARBER B. CONABLE, Jr.,
JOHN J. DUNCAN,
BILL ARCHER,
Managers on the Part of the House.

From the Committee on Finance, to consider those matters within its jurisdiction:

BOB DOLE,
BOB PACKWOOD,
W.V. ROTH, Jr.,
JOHN C. DANFORTH,
JOHN H. CHAFEE,
RUSSELL B. LONG,
LLOYD BENTSEN,
SPARK M. MATSUNAGA,
MAX BAUCUS,
Managers on the Part of the Senate.

Solely for consideration of sections 921 through 926, 943, 944, 952, and 958 of the Senate amendment and title III, parts B and C of division B of the House amendment to the Senate amendment:

From the Committee on Energy and Commerce:

JOHN D. DINGELL,
HENRY A. WAXMAN,
JAMES H. SCHEUER,
TOM LUKEN,
DOUG WALGREN,

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BARBARA A. MIKULSKI,
Managers on the Part of the House.

From the Committee on Finance, to consider those matters within its jurisdiction:

BOB DOLE,
BOB PACKWOOD,
W.V. ROTH, Jr.,
JOHN C. DANFORTH,
JOHN H. CHAFEE,
RUSSELL B. LONG,
LLOYD BENTSEN,
SPARK M. MATSUNAGA,
MAX BAUCUS,
Managers on the Part of the Senate.

Solely for consideration of sections 905, 909, 917, 919, 951, 955, 956, 957, subsections (a), (b), and (c) of section 965, 966, 971 through 976, 981 through 985, and 992 through 997 of title IX of the Senate amendment and title III, sections 308 (2308), 339 (2339), 340 (2340), 342 (2342), and title VI (except for sections 650 (2650) and 661 (2661)) of division B of the House amendment to the Senate amendment:

From the Committee on Ways and Means:

DAN ROSTENKOWSKI,
ANDREW JACOBS, Jr.,
C.B. RANGEL,
MARTY RUSSO,
HAROLD FORD,
PETE STARK,
DONALD J. PEASE,
BARBER B. CONABLE,
JOHN J. DUNCAN,
W. HENSON MOORE,
Managers on the Part of the House.

From the Committee on Finance, to consider those matters within its jurisdiction:

BOB DOLE,
BOB PACKWOOD,
W.V. ROTH, Jr.,
JOHN C. DANFORTH,
JOHN H. CHAFEE,
RUSSELL B. LONG,
LLOYD BENTSEN,
SPARK M. MATSUNAGA,
MAX BAUCUS,
Managers on the Part of the Senate.

Solely for consideration of title IX (except for sections 905, 909, 917, 919, 921 through 926, 943, 944, 951, 952, 955 through 958, subsections (a), (b), and (c) of section 965, 966, 971 through 976, 981 through 985, and 992 through 997)) and section 1611 of the Senate amendment and title III (except for sections 308 (2308), 339 (2339), 340 (2340), and 342 (2342)) of division B of the House amendment to the Senate amendment and sections 650 (2650) and 661 (2661) of division B of the House amendment to the Senate amendment:

From the Committee on Energy and Commerce:

JOHN D. DINGELL,
HENRY A. WAXMAN,
JAMES H. SCHEUER,
TOM LUKEN,
DOUG WALGREN,
BARBARA A. MIKULSKI,

From the Committee on Ways and Means:

DAN ROSTENKOWSKI,
ANDREW JACOBS, Jr.,
C.B. RANGEL,
MARTY RUSSO,
HAROLD FORD,
PETE STARK,
DONALD J. PEASE,
BARBER B. CONABLE,
JOHN J. DUNCAN,
W. HENSON MOORE,
Managers on the Part of the House.

From the Committee on Finance, to consider those matters within its jurisdiction:

BOB DOLE,
BOB PACKWOOD,
W.V. ROTH,
JOHN C. DANFORTH,
JOHN H. CHAFEE,
RUSSELL B. LONG,
LLOYD BENTSEN,
SPARK M. MATSUNAGA,
MAX BAUCUS,
Managers on the Part of the Senate.

Solely for consideration of title XIV and section 1606 of the Senate amendment:

From the Committee on Appropriations:

JAMIE L. WHITTEN,
EDWARD P. BOLAND,
SILVIO O. CONTE,
JOSEPH M. MCDADE,

Solely for consideration of title XIV except for section 1401(f) of the Senate amendment:

From the Committee on Rules:

CLAUDE PEPPER,
GILLIS LONG,
ANTHONY C. BEILENSON,
MARTIN FROST,
Managers on the Part of the House.

From the Committee on Appropriations, to consider those matters within its jurisdiction:

MARK O. HATFIELD,
TED STEVENS,

From the Committee on Governmental Affairs, to consider those matters within its jurisdiction:

W.V. ROTH, Jr.,
BILL COHEN,
TOM EAGLETON,

From the Committee on the Budget:

PETE V. DOMENICI,
WILLIAM L. ARMSTRONG,
NANCY LANDON KASSEBAUM,
RUDY BOSCHWITZ,
JOHN TOWER,
Managers on the Part of the Senate.

Solely for consideration of title XII and sections 1604 and 1607 of the Senate amendment, and title II of Division B of the House amendment to the Senate Amendment:

From the Committee on Post Office and Civil Service:

WILLIAM D. FORD,
WILLIAM CLAY,
ROBERT GARCIA,
MICKEY LELAND,
DAN ALBOSTA,
MARY ROSE OAKAR,
GENE TAYLOR,
BENJAMIN A. GILMAN,
TOM CORCORAN,
JIM COURTER,

Solely for consideration of such portions of section 1201 of the Senate amendment and section 201 of division B of the House amendment to the Senate amendment as related to cost-of-living adjustments for military retirees:

From the Committee on Armed Services:

MELVIN PRICE,
BILL NICHOLS,
WM. L. DICKINSON,
ELWOOD HILLIS,

Solely for consideration of section 1604 of the Senate amendment:

From the Committee on the Judiciary:

PETER W. RODINO, Jr.,
JACK BROOKS,
HAMILTON FISH, Jr.,
Managers on the Part of the House.

From the Committee on Governmental Affairs, to consider those matters within its jurisdiction:

W.V. ROTH, Jr.,
CHARLES McC. MATHIAS, Jr.,
BILL COHEN,
TOM EAGLETON,
JEFF BINGAMAN,
Managers on the Part of the Senate.

Solely for consideration of title XV of the House amendment:

From the Committee on Government Operations:

JACK BROOKS,
DON FUQUA,
CARDISS COLLINS,
GLENN ENGLISH,
ELLIOTT H. LEVITAS,
FRANK HORTON,
JOHN N. ERLENBORN,
W. CLINGER,
Managers on the Part of the House.

From the Committee on Armed Services, to consider those matters within its jurisdiction:

BILL COHEN,
DAN QUAYLE,
JEFF BINGAMAN,
CARL LEVIN,

From the Committee on Governmental Affairs, to consider those matters within its jurisdiction:

W.V. ROTH, Jr.,
BILL COHEN,
TOM EAGLETON,
CARL LEVIN,
Managers on the Part of the Senate.

Solely for consideration of sections 1301 through 1314 of the Senate amendment:

From the Committee on Banking, Finance and Urban Affairs:

FERNAND J. ST GERMAIN,
FRANK ANNUNZIO,
CARROLL HUBBARD,
DOUG BARNARD, Jr.,
MARY ROSE OAKAR,
CHALMERS P. WYLIE,
STEWART B. MCKINNEY,
Managers on the Part of the House.

From the Committee on Banking, Housing, and Urban Affairs, to consider those matters within its jurisdiction:

JAKE GARN,
JOHN TOWER,
BILL PROXMIRE,
Managers on the Part of the Senate.

Solely for consideration of title IV of division B of the House amendment to the Senate amendment:

From the Committee on Small Business:

PARREN J. MITCHELL,
JOSEPH P. ADDABBO,
JOSEPH M. MCDADE,
Managers on the Part of the House.

From the Committee on Small Business, solely for consideration of title IV of division B of the House amendment to the Senate amendment:

LOWELL P. WEICKER, Jr.,

SLADE GORTON,
DALE BUMPERS,
Managers on the Part of the Senate.

Solely for consideration of title V of division B of the House amendment to the Senate amendment:

From the Committee on Veterans' Affairs:

G.V. MONTGOMERY,
DON EDWARDS,
BOB EDGAR,
DOUGLAS APPLEGATE,
MARVIN LEATH,
RICHARD SHELBY,
JOHN PAUL HAMMERSCHMIDT,
CHALMERS P. WYLIE,
ELWOOD HILLIS,
Managers on the Part of the House.

From the Committee on Veterans' Affairs, solely for consideration of title V of division B of the House amendment to the Senate amendment:

ALAN K. SIMPSON,
STROM THURMOND,
ALAN CRANSTON,
Managers on the Part of the Senate.

Solely for consideration of sections 1603, 1605, 1609, and subsection (b) of section 1610 of the Senate amendment:

From the Committee on Government Operations:

JACK BROOKS,
DON FUQUA,
CARDISS COLLINS,
GLENN ENGLISH,
ELLIOTT H. LEVITAS,
FRANK HORTON,
JOHN N. ERLENBORN,
W. CLINGER,
Managers on the Part of the House.

From the Committee on Governmental Affairs, to consider those matters within its jurisdiction:

W.V. ROTH, Jr.,
BILL COHEN,
TOM EAGLETON,
CARL LEVIN,

From the Committee on the Budget:

PETE V. DOMENICI,
WILLIAM L. ARMSTRONG,
NANCY LANDON KASSEBAUM,
RUDY BOSCHWITZ,
JOHN TOWER,
Managers on the Part of the Senate.

Solely for consideration of title IX, section 1001, and titles XII through XVI of the Senate amendment, and division B of the House amendment to the Senate amendment:

From the Committee on the Budget:

JAMES JONES,
LEON E. PANETTA,
RICHARD GEPHARDT,
BILL NELSON,
BRIAN DONNELLY,
BUTLER DERRICK,
PAT WILLIAMS,
Managers on the Part of the House.

For consideration of the entire bill:
From the Committee on the Budget:

PETE V. DOMENICI,
WILLLIAM L. ARMSTRONG,
NANCY LANDON KASSEBAUM,
RUDY BOSCHWITZ,
JOHN TOWER,
Managers on the Part of the Senate.

JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendment of the House to the amendments of the Senate to the bill (H.R. 4170) to provide for tax reform, and for other purposes, submit the following joint statements to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

The joint statement of managers which follows was prepared by the committee of jurisdiction and is arranged by title of the conference agreement.

SUMMARY TABLE OF CONTENTS

TABLE OF CONTENTS FOR REVENUE PROVISIONS

1. TAX FREEZE; TAX REFORMS GENERALLY

A. Tax Freeze and Related Provisions

1. Postponement of finance lease provisions

Present law

Overview

The law contains rules (pre-safe harbor lease rules) to determine who owns an item of property for tax purposes when the property is subject to an agreement which the parties characterize as a lease. Such rules are important because the owner of the property is entitled to claim tax benefits including cost recovery deductions and investment tax credits with respect to the property. The pre-safe harbor rules attempt to distinguish between true leases, in which the lessor owns the property for tax purposes, and conditional sales or financing arrangements, in which the user of the property owns the property for tax purposes. These rules generally are not written in the Internal Revenue Code. Instead they evolved over the years through a series of court cases and revenue rulings and revenue procedures issued by the Internal Revenue Service. Essentially, the law is that the economic substance of a transaction, not its form, determines who is the owner of property for tax purposes. Thus, if a transaction is, in substance, simply a financing arrangement, it is treated that way for tax purposes, regardless of how the parties choose to characterize it. Under the pre-safe harbor lease rules, lease transactions cannot be used solely for the purpose of transferring tax benefits. They have to have nontax economic substance.

The Economic Recovery Tax Act of 1981 (ERTA) provided a new set of rules which represented a major departure from the pre-safe harbor rules. These provisions were intended to be a means of transferring tax benefits rather than a means of determining which person is in substance the owner of the property. Under these rules (safe-harbor lease rules), certain transactions involving tangible personal property were treated as leases for Federal income tax purposes regardless of their nontax economic substance. The pre-safe harbor leasing rules continued to apply for transactions not qualifying under the safe-harbor lease rules or when the safe harbor was not elected.

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) generally repealed safe-harbor leasing. In its place, TEFRA substituted a liberalized form of pre-safe harbor leasing called finance leasing. The finance lease rules essentially provide that certain parts of the pre-safe harbor rules are not taken into account in determining whether an agreement with respect to a limited class of property is a lease for tax purposes. Thus, the pre-safe harbor rules apply when finance lease rules are unavailable, and, except to the extent not taken into account under the finance lease rules, they apply when the finance lease rules are available.

Pre-safe harbor leasing rules

Underlying principles

In general, the determination of lease treatment under the pre-safe harbor leasing rules requires a case-by-case analysis based on all the facts and circumstances. Although the determination of whether a transaction is a lease is inherently factual, a series of general principles is embodied in court cases, revenue rulings, and revenue procedures. These principles are used in determining the character of transactions not eligible for the safe-harbor lease rules.

For a transaction to be a lease under these rules, the lessee generally cannot hold title to or have a significant equity interest in the property. However, the fact that the lessor has title does not guarantee that the lessor is the owner for Federal income tax purposes. Both the courts and the IRS look to additional criteria in determining whether a transaction is a lease. These criteria focus on the substance of the transaction rather than its form. The courts do not disregard the form of a transaction simply because tax considerations are a significant motive so long as the transaction also has a bona fide business purpose and the lessor retains sufficient burdens and benefits of ownership.[1]

To be entitled to depreciation deductions as the owner of the property, the lessor has to show that the property is being used by it for a business or other income-producing purpose. To have a business purpose, the person claiming ownership (i.e., the lessor) at least has to have a reasonable expectation that he will derive a profit from the transaction independent of tax benefits.[2] This requirement precludes lease treatment for a transaction intended merely to reduce the user's costs by utilizing the lessor's tax base. For a sale-leaseback, other nontax business motives have been considered in determining the substance of the transaction.

The fact that the lessor in a lease financing transaction can show a profit or business purpose, however, does not automatically result in lease treatment under pre-safe harbor lease rules, since a profit or business motive could also exist in a financing arrangement. In addition, the lessor has to retain meaningful benefits and burdens of ownership.[3] Thus, lease treatment has been denied under pre-safe harbor lease rules if the user has the option to acquire the property at the end of the lease for a price that either is nominal in relation to the value of the property at the time when the option can be exercised (as determined at the time the parties entered into the agreement) or which is relatively small when compared with the total payments required to be made.[4]

Where the residual value of the property to the lessor is nominal, the lessor has been viewed as having transferred full ownership of the property for the rental fee. Where the purchase option

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[1] See, *Hilton* v. *Commissioner*, 74 T.C. 305 (1980), *aff'd*, 671 F.2d 316 (9th Cir. 1982); *Frank Lyon Co.* v. *United States*, 435 U.S. 561 (1978), *rev'g*, 536 F.2d 746 (8th Cir. 1976); and Rev. Rul. 55-540, 1955-2 C.B. 39 (and cases cited therein); See generally, *Gregory* v. *Helvering*, 293 U.S. 465 (1935).

[2] See, *Hilton* v. *Commissioner*, 74 T.C. 305 (1980), *aff'd*, 671 F.2d 316 (9th Cir. 1982).

[3] See, *Frank Lyon Co.* v. *United States*, 435 (U.S. 561 (1978), rev'g 536 F.2d 746 (8th Cir. 1976); and Rev. Rul. 55-540, 1955-2 C.B. 39 (and cases cited therein).

[4] See, Rev. Rul. 55-540, 1955-2 C.B. 39 (and cases cited therein).

is more than nominal but relatively small in comparison with fair market value, the lessor may still be viewed as having transferred full ownership if the likelihood that the lessee will exercise the bargain purchase option is great.[5] Furthermore, if the lessor can force the lessee to purchase the property at the end of the lease (a put), the transaction might also be denied lease treatment under pre-safe harbor lease rules if the put eliminates the risk borne by owners of property that there may be no market for the property at the end of the lease.

Objective guidelines used in structuring transactions

The question of exactly what burdens and benefits of ownership have to be retained by the lessor under pre-safe harbor lease rules created some confusion and difficulty for people trying to structure leases that, at least in part, were motivated by tax considerations. To give taxpayers guidance in structuring leveraged leases (i.e., where the property is financed by a loan from a third party), the Internal Revenue Service in 1975 issued Revenue Procedure 75-21, 1975-1 C.B. 715, and a companion document, Revenue Procedure 75-28, 1975-1 C.B. 752 (the guidelines). If the requirements of the guidelines are met and if the facts and circumstances do not indicate a contrary result, the Service will issue an advance letter ruling that the transaction is a lease and that the lessor is the owner for Federal income tax purposes.

The guidelines generally apply only to leveraged leases of equipment. The general principles described above continue to govern nonleveraged leases and leases of real property. The guidelines are not a definitive statement of legal principles and are not intended for audit purposes. If less than all requirements of the guidelines are met, a transaction might still be considered a lease if, under all the facts and circumstances, the transaction is a lease under the general principles discussed previously. However, in practice, many taxpayers have taken into account the guidelines' requirements in structuring transactions. The guidelines may be viewed as a type of safe harbor.

The specific requirements for obtaining a ruling under the guidelines are as follows:

1. *Minimum investment.*—The lessor must have a minimum 20 percent unconditional at-risk investment in the property. This rule represents an attempt to ensure that the lessor experiences some significant loss if the property declines in value. By limiting the degree of nonrecourse leverage, this guideline also limits the pool of potentially transferable tax benefits from such transactions.

2. *Purchase options.*—In general, the lessee may not have an option to purchase the property at the end of the lease term unless, under the lease agreement, the option can be exercised only at fair market value (determined at the time of exercise). This rule precludes fixed price purchase options, even at a bona fide estimate of the projected fair market value of the property at the option date. In addition, when the property is first placed in service by the lessee, the lessor cannot have a contractual right to require the

[5] See, *M&W Gear Co.* v. *Commissioner*, 446 F.2d 841 (7th Cir. 1971).

lessee or any other party to purchase the property, even at fair market value.

The fair market value purchase option requirement fulfills three purposes related to the determination of the economic substance of the transaction. First, it ensures that the lessor bears the risk implicit in ownership that no market or an unfavorable market will exist at the end of the lease. Second, it ensures that the lessor has retained an equity interest in the property. Any fixed price option represents a limitation on the lessor's right of full enjoyment of the property's value. Third, it limits the ability of the parties to establish an artificial rent structure to avoid the cash flow test (described below). However, several courts have held that the mere existence of a fixed price purchase option does not prevent lease treatment so long as the lessor retains other significant burdens and benefits of ownership.[6]

Safe harbor leasing rules

The safe-harbor leasing provisions of ERTA were intended to permit owners of property who were unable to use depreciation deductions and investment credits to transfer those benefits to persons who were able to use them, without having to meet the pre-safe harbor lease requirements for characterizing the transaction as a lease. The safe-harbor leasing provisions operated by guaranteeing that, for Federal income tax purposes, qualifying transactions were treated as leases and that the nominal lessor was treated as the owner of the property, even though the lessee was in substance the owner of the property and the transaction otherwise would not have been considered a lease.[7]

3. *Lessee investment precluded.*—Neither the lessee nor a party related to the lessee may furnish any part of the cost of the property. The rationale is that a lessee investment may suggest that the lessee is in substance a co-owner of the property.

4. *No lessee loans or guarantees.*—As a corollary to the prior rule, the lessee must not loan to the lessor any of the funds necessary to acquire the property. In addition, the lessee must not guarantee any lessor loan.

5. *Profit and cash flow requirements.*—The lessor must expect to receive a profit from the transaction and have a positive cash flow from the transaction independent of tax benefits. These guidelines are based on the requirement, as previously mentioned, that lease transactions must have a business purpose independent of tax benefits.

6. *Limited use property.*—Under Revenue Procedure 76–30, 1976–2 C.B. 647, property that can be used only by the lessee (limited use property) is not eligible for lease treatment. The rationale is that if the lessee is the only person who could realistically use the property, the lessor has not retained any significant ownership interest.

The Tax Equity and Fiscal Responsibility Act of 1982 generally repealed safe-harbor leasing.

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[6] See, e.g., *Northwest Acceptance Corp.* v. *Commissioner*, 58 T.C. 836 (1972), *aff'd*, 500 F.2d 1222 (9th Cir. 1974).

[7] For a discussion of the safe-harbor lease eligibility requirements, see the General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982, prepared by the Staff of the Joint Committee on Taxation (December 31, 1982).

Finance lease provisions

TEFRA provided rules (finance leasing rules) which in two respects liberalized the pre-safe harbor leasing rules with respect to certain property. Under the finance leasing rules, the fact that (1) the lessee has an option to purchase the property at a fixed price of 10 percent or more of its original cost to the lessor or (2) the property is readily usable only by the lessee (limited use property) is not taken into account in determining whether the agreement is a lease.

A qualified agreement must be a lease determined without taking into account the fact that it contains a 10-percent fixed price purchase option or that the property is limited use property. Thus, the transaction must have economic substance independent of tax benefits. The lessor must reasonably expect to derive a profit independent of tax benefits. In addition, the transaction, without taking into account the fact the agreement contains a fixed price purchase option or that the property is limited use property, must not otherwise be considered a financing arrangement or conditional sale.

The finance lease rules generally apply to agreements entered into after December 31, 1983, but three restrictions apply in 1984 and 1985. First, no more than 40 percent of property placed in service by a lessee during any calendar year beginning before 1986 may qualify for finance lease treatment. Second, a lessor may not use finance lease rules to reduce its tax liability for any taxable year by more than 50 percent. This 50-percent lessor cap does not apply to property placed in service after September 30, 1985 (in taxable years beginning after that date). Third, the investment tax credit for property subject to a finance lease and placed in service on or before September 30, 1985, is only allowable ratably over 5 years, rather than entirely in the year the property is placed in service.

An exception to the general rule is provided for agreements relating to farm property. Finance lease rules are available for up to $150,000 of a lessee's farm property, for agreements entered into after July 1, 1982, and before 1984. Furthermore, the 40-percent lessee cap, 50-percent lessor cap, and 5-year spread of investment credit are inapplicable to this farm property.

No regulations have been issued under the finance lease provisions.

House bill

The House bill postpones for four years the effective dates of the finance lease rules. Thus, these rules generally apply only to agreements entered into after December 31, 1987, and the three restrictions currently scheduled to apply in 1984 and 1985 apply in 1988 and 1989. First, the 40-percent lessee cap is extended to cover property placed in service by a lessee during any calendar year beginning before 1990. Second, the 50-percent lessor cap is extended through September 30, 1989. Third, the 5-year spread of investment credit for property subject to a finance lease is extended to cover property placed in service on or before September 30, 1989. Present law rules relating to the availability of finance leasing for up to

$150,000 of a lessee's farm property are extended to cover agreements entered into before 1988.

The House bill provides transitional rules which exempt certain property from the 4-year postponement described above. Under these rules, the postponement does not apply to property if, before March 2, 1984, (1) a binding contract to acquire or construct the property was entered into by the lessee, (2) the property was acquired by the lessee, or (3) construction of the property was begun by or for the lessee.

The House bill prohibits the Treasury from issuing, before 1988, regulations relating to the determination of whether a transaction is a lease. The prohibition does not apply to regulations which carry out the purposes of the bill with respect to tax-exempt entity leasing or of section 210 of TEFRA (relating to agreements covering certain motor vehicles).

Senate amendment

The Senate amendment is generally the same as the House bill. However, the Senate amendment substitutes March 7, 1984, for March 2, 1984, in the transitional rules, and does not include a provision prohibiting the Treasury from issuing leasing regulations. In addition, the Senate amendment exempts the following property from the 4-year postponement of finance leasing rules: (1) up to $150 million of a qualified lessee's automotive manufacturing property and (2) property that is part of a coal-fired cogeneration facility for which certification and construction permit applications were filed on specified dates.

Conference agreement

The conference agreement generally follows the Senate amendment.

In the Tax Equity and Fiscal Responsibility Act of 1982, Congress permitted lease treatment, beginning in 1984, for agreements which would be appropriately treated as leases under current administrative rules and practices were it not for the fact that the agreement contained a fixed price purchase option or pertained to limited use property. The conference agreement postpones these relaxations of current administrative guidelines, and the conferees intend that those guidelines should not be relaxed by administrative action.

The conference agreement does not include the provision of the House bill which generally would have prohibited the Treasury Department from issuing leasing regulations before 1988. The conferees reached this decision on the basis of an understanding that the Treasury Department does not intend to liberalize significantly current administrative rules and practices for determining whether an agreement is a lease or a financing arrangement. The conferees also took into account the fact that a prohibition could have precluded perfecting modifications that may be shown to be necessary but that would not operate to liberalize current administrative guidelines in this area.

The conferees are concerned that agreements represented as leases are being used to transfer the tax benefits of ownership from persons who cannot utilize them to nominal lessors who can, when in substance the nominal lessor does not have a significant at-risk investment in the property itself. Current administrative rules and procedures are designed to check such tax benefit transfers. Therefore, the primary objective of the conferees is that there be no relaxation of administrative rules and practices that would result in lease treatment for financing transactions in which the purported lessor does not have a significant ownership interest in the property. While recognizing that in some cases special factors may need to be taken into account, the conferees believe that current administrative rules and practices, when applied to the broad range of conventional lease financing transactions, produce a satisfactory and appropriate differentiation between leases and financing arrangements.

2. Postponement of increase in amount of used property eligible for investment tax credit

Present law

The maximum amount of a taxpayer's investment in used property that is eligible for the regular investment tax credit in a taxable year is $125,000. In the case of a married individual who files a separate return, the limit is $62,500. These limits are scheduled to increase to $150,000 and $75,000, respectively, for taxable years beginning after 1984.

House bill

The House bill maintains the maximum amount of used property eligible for the investment credit at its current level of $125,000 per year until taxable years beginning after 1987, when this limit is increased to $150,000.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and Senate amendment.

3. Postponement of increases in amount of property eligible for expensing

Present law

A taxpayer (other than a trust or estate) may elect, in lieu of capital cost recovery under the Accelerated Cost Recovery System, to deduct the cost of qualifying property in the taxable year it is placed in service. In general, qualifying property must be acquired by purchase for use in a trade or business and must otherwise be eligible for the investment tax credit. No investment credit is allowable for the portion of the cost of property expensed under this rule.

For taxable years beginning in 1983, the dollar limitation on the amount that can be expensed is $5,000 a year. This limitation is scheduled to increase to $7,500 for taxable years beginning in 1984 and 1985, and to $10,000 for taxable years beginning after 1985. In each case, the limitation that applies to a married individual who files a separate return is one-half the dollar limitation described above.

House bill

The House bill postpones for four years the scheduled increases in the maximum amount of property that can be expensed. Thus, the dollar limitation on the amount that can be expensed will remain at $5,000 for taxable years beginning before 1988, increase to $7,500 for taxable years beginning in 1988 or 1989, and increase to $10,000 for taxable years beginning after 1989.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and Senate amendment.

4. Net interest exclusion

Present law

The Economic Recovery Tax Act of 1981 provides for an exclusion of 15 percent of net interest received, for up to $3,000 of net interest ($6,000 on a joint return). Net interest is generally interest received by the taxpayer in excess of interest paid (other than mortgage interest or business interest) by the taxpayer for which an income tax deduction is allowed.

The net interest exclusion is scheduled to take effect for taxable years beginning after 1984.

House bill

The House bill repeals the net interest exclusion.

Senate amendment

The Senate amendment postpones the effective date of the net interest exclusion to taxable years beginning after 1987.

Conference agreement

The conference agreement follows the House bill.

5. Postponement of increase in foreign earned income exclusion

Present law

The maximum amount of income earned abroad that is excludible from an individual's taxable income is $80,000 for 1983. This amount is scheduled to increase in $5,000 annual increments to a permanent level of $95,000 in 1986.

House bill

The House bill freezes the maximum amount of the foreign earned income exclusion at $80,000 until 1988 and increases it in $5,000 increments to $95,000 in 1990.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

6. Defer scheduled reductions in maximum gift and estate tax rates

Present law

The Economic Recovery Tax Act of 1981 (ERTA) enacted reductions in the maximum gift and estate tax rates, to take effect over a four-year period. The maximum rates before ERTA were 70 percent. Under ERTA, the maximum rates are 60 percent for gifts made and individuals dying in 1983; 55 percent in 1984, and 50 percent thereafter.

House bill

The House bill retains the 60-percent maximum gift and estate tax rates through 1987. The rate will be reduced to 55 percent in 1988 and 50 percent in 1989 and thereafter.

The provision applies to gifts made, and estates of individuals dying, after December 31, 1983.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with a modification that the maximum tax rate is 55 percent through 1987. The rate will decline to 50 percent for estates of individuals dying, and gifts made, after December 31, 1987.

7. Windfall profit tax rate on newly discovered oil

Present law

Present law imposes an excise tax on the production of domestic crude oil. Differing tax rates and base prices apply to oil, generally depending upon its classification on one of three tiers.

Tier 1 oil (previously controlled oil) generally is taxed at a 70-percent rate; tier 2 oil (stripper oil and naval petroleum oil) generally is taxed at a 60-percent rate. A 50-percent rate applies to up to 1,000 barrels a day of tier 1 oil production by independent producers. In the case of tier 2 stripper oil, production by independent producers generally is exempt from tax.

Tier 3 oil is newly discovered oil, heavy oil, and incremental tertiary oil. Prior to 1982, all tier 3 oil was subject to tax at a 30-percent rate. Starting in 1982, the rate on newly discovered oil was reduced to 27-1/2 percent and to 25 percent in 1983. Under present law, the rate of windfall profit tax on newly discovered oil is 22.5 percent for 1984, 20 percent for 1985, and 15 percent for 1986 and later years.

House bill

Under the House bill, the rate of windfall profit tax on newly discovered oil would not be reduced to 22-1/2 percent in 1984. Instead, the tax rate would remain at 25 percent through 1987 and then be reduced to 22-1/2 percent for 1988, 20 percent for 1989, and 15 percent for 1990 and later years.

The provision applies with respect to domestic crude oil removed from the premises on which it was produced after December 31, 1983.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with an amendment providing that the windfall profit tax rate applicable to newly discovered oil will be 22.5 percent for 1984 through 1987, 20 percent for 1988, and 15 percent for 1989 and subsequent years.

8. Percentage depletion for secondary and tertiary production after 1983

Present law

In the Tax Reduction Act of 1975, Congress retained the percentage depletion allowance for limited quantities of oil and gas production. For oil production, effective January 1, 1984, the rate has declined to a permanent level of 15 percent and is limited to 1,000 barrels per day.

The 1975 amendment continued this percentage depletion allowance for secondary and tertiary production at a 22-percent rate but (because of an error) only through 1983.

Under the 1975 amendments, if an interest in any proven oil or gas property is transferred to another owner after 1974, no percentage depletion allowance applies to the property after the transfer unless one of the exceptions provided for in section 613(c)(9) or (10) applies. The proposed Treasury regulations, published in 1977, stated that the transfer restrictions would not apply to percentage depletion for secondary and tertiary production. This exception to the transfer rule resulted from the same 1975 drafting error that caused termination of that percentage depletion after 1983.

House bill

The House bill corrects the technical errors that occurred in the Tax Reform Act of 1975 with respect to depletion on secondary and tertiary depletion. The bill eliminates the distinction between primary and secondary or tertiary production after 1983. Thus, independent producers may claim percentage depletion in 1984 at a rate of 15 percent on up to 1,000 barrels of all their production. In addition, starting in 1984, percentage depletion on secondary and tertiary production will not be available after 1983 for production from proven properties transferred since 1974 unless one of the exceptions provided for in section 613A(c)(9) applies to the transfer.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

9. Modification of excise tax rates on cigarettes and distilled spirits

a. Cigarette excise tax

Present law

Present law imposes an excise tax on cigarettes manufactured in or imported into the United States. The rate of tax on small cigarettes is 16 cents per pack of 20 cigarettes. Higher rates apply to so-called "large" cigarettes, which are cigarettes weighing more than 3 pounds per thousand. Nearly all taxable cigarettes are small cigarettes. On October 1, 1985, the present tax rates are scheduled to decline by one-half.

House bill

The House bill provides an excise tax equal to 12 cents per pack of 20 cigarettes after September 30, 1985, and before January 1, 1988. A corresponding adjustment to the tax rate for large cigarettes is made.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the Senate amendment.

b. Distilled spirits excise tax

Present law

Present law imposes an excise tax at a rate of $10.50 per proof gallon on distilled spirits produced in or imported into the United States. A proof gallon is a U.S. gallon of liquid one-half of the volume of which consists of ethyl alcohol of a specified gravity.

House bill

The House bill increases the excise tax on distilled spirits by $3.75, to $14.25 per proof gallon, after September 30, 1985, and before January 1, 1988.

Senate amendment

The Senate amendment increases the excise tax on distilled spirits by $2.00, to $12.50 per proof gallon, effective after December 31, 1984.

Conference agreement

The conference agreement follows the House bill and the Senate amendment with modifications. Under the agreement, the increase in the tax rate is $2.00 per proof gallon as under the Senate amendment, and the increase is effective on October 1, 1985, as under the House bill.

The conference agreement clarifies and expands the Treasury Department regulatory authority to prescribe the time for payment of the special imposed on certain floor stocks held for sale on October 1, 1985, and to exempt certain small businesses from that tax. Under the agreement, the floor stocks tax generally will be due on April 1, 1986. Additionally, certain special de minimis provisions are included for small and middle sized wholesale and retail dealers. The de minimis exception provides the following:

(1) All persons holding distilled spirits for sale on October 1, 1985, are required to conduct a wine gallon inventory.

(2) Dealers whose wine gallon volume inventory is less than 500 gallons are exempt from the floor stocks tax.

(3) Dealers with an inventory of 500 liquid gallons or more are required to conduct a proof gallon inventory and to pay floor stocks tax on that inventory, but these dealers will receive a credit against the tax equal to $800 (the approximate tax on 500 wine gallons).

(4) All dealers whose gross sales from all products in the preceding taxable year did not exceed $500,000 are allowed to pay the floor stocks tax in three installments, one-third on each of April 1, 1986, July 1, 1986, and October 1, 1986.

10. Modification of time and manner of paying excise taxes on cigarettes and alcohol products

Present law

Time of payment

Cigarette and alcohol excise taxes generally are paid with respect to semimonthly periods; the taxes are due the following number of days after the last day of the semimonthly period when the taxable product is removed from bonded premises:

Cigarettes	25 days
Domestically produced and bulk imported distilled spirits	30 days
Bottled imported distilled spirits	15 days
Wine and beer	15 days

Method of payment

Present law generally requires payment of the cigarette and alcohol product excise taxes to accompany a return for each semimonthly period. There is no requirement of payment by electronic funds transfer.

House bill

No provision.

Senate amendment

Time of payment

The Senate amendment requires payment of the excise taxes on cigarettes and all alcohol products 14 days after the close of each semimonthly period. If the 14th day is a Saturday, Sunday, or Federal holiday, payment is required on the last preceding business day. This provision is effective with respect to semimonthly periods ending on and after June 30, 1984.

Method of payment

The Senate amendment requires payment of the excise taxes on cigarettes and all alcohol products by means of electronic funds transfer to a Federal reserve bank in the case of taxpayers whose gross tax liability with respect to the product involved was $5 million or more during the preceding calendar year. This provision is effective with respect to payments due on and after June 30, 1984.

Conference agreement

The conference agreement follows the House bill as to the time of payment and the Senate amendment as to the method of payment. The Senate amendment is modified, however, to delay the effective date of the electronic funds transfer provision until September 30, 1984.

11. Extension of excise tax on communications services

Present law

A 3-percent excise tax is imposed on amounts paid for local telephone service, toll (long-distance) telephone service, and teletypewriter exchange service. The tax is scheduled to terminate on January 1, 1986.

House bill

The House bill extends the 3-percent tax on communications services for two years, or through December 31, 1987.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

B. Leasing Provisions

1. Tax-exempt entity leasing

a. General rule

Present law

The rules for determining who is entitled to the tax benefits associated with the ownership of property generally are not written in the Internal Revenue Code. Rather, they are embodied in a series of court cases and in revenue rulings and revenue procedures issued by the IRS. Essentially, these rules focus on the economic substance of a transaction, not its form, for determining who is entitled to the tax benefits of the ownership of property. Thus, in a purported lease or similar arrangement, the person claiming ownership for Federal income tax purposes must show that he has sufficient economic indicia of ownership. The applicable rules are discussed at length in the committee reports.

In general, the tax benefits of ownership of property include depreciation or accelerated cost recovery deductions and investment tax credits. Generally, ACRS or other depreciation deductions and investment credits are allowed only for property used for a business or income-producing purpose. The accelerated cost recovery system generally permits taxpayers to depreciate qualifying property on an accelerated basis over relatively short periods. For most property, the ACRS recovery period is shorter than the actual useful life of the property. Investment credits permit taxpayers to reduce their tax liability by a percentage of their investments in eligible property. Eligible property includes certain depreciable personal property. Special rules apply to certain energy property and to certain rehabilitations of older buildings or certified historic structures.

As a general rule, ACRS or other depreciation deductions and investment credits are not available for property owned by governmental units and tax-exempt organizations since they are not generally taxable. Moreover, no investment credit is allowed for property leased to or otherwise used (though not owned) by a tax-exempt organization in its exempt function or by a governmental unit (nontaxable use restriction). The nontaxable use restriction does not affect the allowance of ACRS deductions and certain other tax benefits. As a result, tax-exempt entities, by leasing property, may indirectly enjoy tax benefits that they could not have enjoyed had they owned the property instead.

Property used by a foreign government or person is not subject to the nontaxable use restriction. However, if the property is used predominantly outside the United States, in general, ACRS deductions are reduced and no investment credit is allowed. There are a number of exceptions to this rule (sec. 48(a)(2)(B) and sec. 168(f)(2)(D)).

House bill

Numerous changes are made in the tax treatment of property leased to or otherwise used by a tax-exempt entity, as defined in the bill. The bill provides rules for determining cases in which property is to be treated as used by a tax-exempt entity for certain purposes, including cases in which property subject to a so-called service contract or other arrangement with or on behalf of a tax-exempt entity is to be treated as leased to that entity. The bill also provides rules for determining the tax treatment of property which is not tax-exempt use property under the general rules of the bill but which is owned by a partnership or other pass-through entity which has a tax-exempt entity as a partner or other beneficiary.

The provision is generally effective with respect to property place in service by the taxpayer after May 23, 1983, and to property placed in service by the taxpayer before May 24, 1983, and used by a tax-exempt entity pursuant to a lease entered into or renewed after May 23, 1983. Numerous transition rules are provided.

Senate amendment

The Senate amendment generally follows the House bill with several exceptions. In addition, the Senate amendment provides that the rules for distinguishing service contracts and other arrangements from leases are applicable for all income tax purposes. The Senate amendment also provides rules for determining the tax treatment of property leased to thrift institutions.

The provision generally has the same effective date as the provision in the House bill. However, the Senate amendment provides different transition rules.

Conference agreement

The conference agreement is discussed below.

b. Definition of tax-exempt entity

Present law

For purposes of the nontaxable use restriction applicable with respect to the investment credit, tax-exempt entities generally include organizations (other than farmers' cooperatives) exempt from income taxes (other than with respect to property used predominantly in an unrelated trade or business the income from which is subject to tax under sec. 511). Tax-exempt entities also include the United States, any State or political subdivision thereof, most international organizations, and any agency or instrumentality of any of the foregoing.

House bill

For all purposes of the bill, the term "tax-exempt entity" includes, in addition, U.S. possessions. The term also includes foreign governments, international organizations, any agency or instrumentality of any of the foregoing, and any person who is not a U.S. person (collectively, "foreign persons or entities"), but only with respect to property 50 percent or less of the gross income from the use of which for the taxable year is subject to U.S. income tax. The term also includes organizations which were tax-exempt at any time during the 5-year period ending on the date such organization first used the property involved.

The House bill also provides that a fully taxable corporate instrumentality of the United States or any State or political subdivision thereof is not to be treated as a tax-exempt entity only if a majority of its board of directors is not selected by the United States or any State or political subdivision thereof.

Senate amendment

The Senate amendment follows the House bill with certain exceptions. First, no foreign person or entity is treated as a tax-exempt entity with respect to property more than 20 percent of the gross income from the use of which is subject to U.S. income tax. For this purpose, income currently included under Subpart F in the income of a U.S. shareholder of a controlled foreign corporation is to be treated as subject to U.S. income tax.

Second, certain organizations (e.g., rural electric cooperatives) formerly exempt from tax under section 501(c)(12) at any time during the 5-year period preceding their first use of the property involved are not treated as tax-exempt entities if they agree to be fully taxable for the period beginning with the taxable year the property involved is placed in service and ending with the close of the 15th taxable year following the last taxable year of the recovery period for the property involved.

And third, fully taxable corporate instrumentalities of the United States or any State or political subdivision thereof are not treated as tax-exempt entities.

Conference agreement

The conference agreement generally follows the Senate amendment. However, the conference agreement follows the House bill with respect to the (1) 50 percent threshold in the case of property used by a foreign person or entity, and (2) the treatment as tax-exempt entities of corporate instrumentalities of the United States or any State or political subdivision thereof. In addition, property leased to the Federal Home Loan Mortgage Corporation (which is made a taxable entity by the bill) is not to be treated as leased to a tax-exempt entity under the 5-year lookback rule.

Finally, under the conference agreement, certain former section 501(c)(12) organizations (e.g., rural electric cooperatives) are not subject to the 5-year lookback rule only if, in addition to complying with the Senate amendment, they comply with a transitional requirement added by the conference agreement. Under that requirement, the organization must elect to pay taxes on the exempt arbitrage profits it earns or has earned on that portion of the proceeds of any tax-exempt obligations associated with financing (e.g., acquisition or construction financing) by the organization of the property ultimately leased. The requirement is imposed because, in general, the conferees do not believe it appropriate that an organization should, as a tax-exempt entity, be able to earn arbitrage profits on tax-exempt obligations issued to finance property and then, after becoming a taxable entity, be entitled to benefit from tax provisions, through leasing property, available to the owner of the property. This is especially true in the case of cooperatives, which tend to have substantial tax planning flexibility.

This requirement applies with respect to all such exempt arbitrage profits, regardless of when earned, but only to the extent they are attributable to a period during which the organization was exempt from taxation. Under the conference agreement, those profits are taxed to the organization for the first taxable year in which it uses the property under the lease. They are treated as a separate basket of taxable income and taxed as such under section 11. No deductions are allowed against that separate basket of income. Neither are any credits allowed with respect to resulting tax liability.

"Exempt arbitrage profits" are the aggregate amount determined under the principles of sections 103(c)(6)(D)(i) and (ii) (relating to certain arbitrage profits), as amended by the bill, except that for this purpose, sections 103(c)(6)(F)(i)(II) (relating to certain earnings on a bona fide debt service fund) and 103(c)(6)(F)(ii) (relating to earnings on certain temporary investments) are disregarded. Furthermore, the principles of section 103(c)(6)(D)(i) are applicable for this purpose regardless of that section's general effective date. (Generally, that section applies to bonds issued after December 31, 1984.)

If new section 103(c)(6)(D)(i) in fact is applicable to the tax-exempt obligations there are, for purposes of this requirement, no exempt arbitrage profits. In general, if new section 103(c)(6)(D)(i) is applicable, certain arbitrage profits must be rebated to the United States. In such a case, taxation of "exempt arbitrage profits" is inappropriate.

c. Tax-exempt use property

Present law

For purposes of the investment credit (other than the rehabilitation credit), property used by a tax-exempt entity is treated as tax-exempt use property.

House bill

Personal property leased to or otherwise used by a tax-exempt entity is treated as tax-exempt use property. This rule applies for all credit purposes and for purposes of the depreciation provisions of the bill. Qualified films (as defined in sec. 48(k)(1)(B)) distributed to foreign persons or entities are not to be treated as used by such persons or entities.

Real property is treated as tax-exempt use property to the extent of disqualified uses, but only if the disqualified uses of the property exceed 20 percent of all uses of the property. A disqualified use is a lease to a tax-exempt entity if (1) the tax-exempt entity participates in financing the property through the issuance of tax-exempt obligations, (2) the use is pursuant to a lease containing a fixed or determinable purchase or sale option or the equivalent thereof, (3) the use is pursuant to a lease having a term exceeding 80 percent of the property's useful life, or (4) the use occurs after a sale by, lease from, or other transfer by the tax-exempt entity of property used by the tax-exempt entity prior to the transfer.

Senate amendment

The Senate amendment follows the House bill with four exceptions. First, real property is not treated as tax-exempt use property unless disqualified uses exceed 50 percent (35 percent in the case of disqualified use by a single tax-exempt entity). Second, the amendment treats real property used by a tax-exempt entity pursuant to a lease as a disqualified use if the lease term exceeds 20 years. Third, property leased by a tax-exempt entity within 3 months of the date it is placed in service by such tax-exempt entity (or a related party) is not treated as used in a disqualified use under the use after transfer rule. And fourth, sound recordings, as well as qualified films, distributed to foreign persons or entities are not treated as leased to them.

Conference agreement

The conference agreement generally follows the Senate amendment. However, under the conference agreement, real property is treated as tax-exempt use property to the extent of disqualified uses, but only if the disqualified uses of the property exceed 35 percent of all uses of the property. Furthermore, under the conference agreement, in the case of personal property, tax-exempt use property generally is only that portion of any tangible property leased to a tax-exempt entity. However, the 35-percent rule is not applicable with respect to personal property.

The conference agreement clarifies that, for purposes of the provision's depreciation rules, property owned by a tax-exempt entity is not to be treated as tax-exempt use property. Rather, only property leased to a tax-exempt entity is to be treated as used by that entity. For this purpose, the term "lease" includes any grant of a right to use property by one person to another. However, the conferees do not intend by this rule to preclude from treatment as tax-exempt use property any property not otherwise tax-exempt use property which is owned by a partnership or other pass-through entity which has a tax-exempt partner or other beneficiary. See the discussion of partnerships and other pass-through entities. Furthermore, property owned and used by a tax-exempt entity (or a related entity) for more than 3 months prior to a transfer of it by the tax-exempt entity (or a related entity) is to be treated as used by that entity before the transfer. (The general rule that only property "leased" to a tax-exempt entity is "used" by that entity for purposes of the bill's depreciation rules is not intended to change the rule of present law that a tax-exempt owner-lessor of property is not able to pass on any credit to a lessee. See Treas. Reg. sec. 1.48-4(a)(1)(i).)

The conference agreement also clarifies that tax-exempt use property does not include any portion of a property if such portion is predominantly used by a tax-exempt entity directly, or for purposes of the bill's partnership rules, through a partnership of which the tax-exempt entity is a partner in an unrelated trade or business the income of which is subject to tax under section 511. For purposes of this rule, the conferees intend that property will not be treated as predominantly used by the tax-exempt entity in an unrelated trade or business the income of which is subject to tax under section 511 merely because the property is debt-financed property under section 514.

The conferees wish to clarify an example in the committee reports. Assume that a U.S. corporation leases equipment to a foreign corporation not subject to U.S. tax and the foreign corporation subleases the equipment to a branch of a U.S. corporation. The property is tax-exempt use property even though all income earned by the U.S. branch with respect to the use of the property is subject to U.S. tax. This result occurs without regard to the business reasons for the initial lease between the U.S. corporation and the foreign corporation. However, this result would not occur if, in view of the economic substance of the overall arrangement, the transaction is properly treated for U.S. tax purposes as a lease directly from the U.S. corporation to the U.S. branch, and not as a lease to and sublease from the foreign corporation.

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d. Tax treatment of tax-exempt use personal property

Present law

No investment credit is allowed with respect to personal property leased to or otherwise used by a tax-exempt entity. Furthermore, in general, no investment tax credit is allowed with respect to personal property used predominantly outside the U.S. However, in general no restrictions are imposed with respect to the depreciation of personal property used by a tax-exempt entity, although restrictions are generally imposed on the depreciation of property used predominantly outside the U.S.

House bill

No investment credit is allowed with respect to personal property used by a tax-exempt entity. In addition, tax-exempt use personal property is to be depreciated on the straight-line method over the greater of (1) the property's ADR midpoint life (12 years if the property has no ADR midpoint life), or (2) the lease term. Under the House bill, investment credit may be recaptured with respect to property which becomes tax-exempt use sometime after having been placed in service. In addition, under the House bill, regulations are to be prescribed for the depreciation of property that either becomes or ceases being tax-exempt use property sometime after having been placed in service by the taxpayer.

Under the House bill, the Treasury is authorized to prescribe midpoint lives for personal property presently having no midpoint lives.

Senate amendment

The Senate amendment follows the House bill except that tax-exempt use personal property is to be depreciated on the straight-line method over the greater of (1) its ADR midpoint life (12 years in the absence of such a life), or (2) 125 percent of the lease term. In addition, no general authority is granted the Treasury to prescribe midpoint lives for property presently having none. Finally, the Senate amendment provides special rules for property used by foreign persons or entities. Under those rules: property placed in service before January 1, 1984, and used by a foreign person or entity under a lease entered into before January 1, 1984, is generally exempt from the provision; property placed in service in 1984, and used by a foreign person or entity under a lease entered into in 1984, is entitled to 50 percent of any investment credit otherwise allowable and may be depreciated under the 175-percent declining balance method over the longer of (1) its ADR midpoint life (12 years in the absence of such a life), or (2) 125 percent of the lease term; and other property used by a foreign person or entity is entitled to no investment credit but may be depreciated under the 150-percent declining balance method over its ADR midpoint life (12 years in the absence of such a life).

Conference agreement

The conference agreement generally follows the House bill except that tax-exempt use personal property cannot be depreciated over a period shorter than 125 percent of the lease term. Furthermore, under the conference agreement, the bill generally does not apply to property placed in service before January 1, 1984, and used by a foreign person or entity under a lease entered into before January 1, 1984, merely because of that lease.

The conferees wish to make it clear that if personal property is used by a tax-exempt entity (and the use is not pursuant to a short-term lease, as defined by the bill), investment credits are not available. This result follows even if the investment credit would be available under present law by virtue of section 48(a)(2)(B) (relating to exceptions from the denial of investment credit for certain property used predominantly outside the U.S.). For example, an aircraft leased to a foreign person or entity does not give rise to any investment credit even if it is operated to and from the U.S., if not more than 50 percent of the income derived by the foreign person or entity from the use of the aircraft is taxable in the U.S. Similarly, the bill's rules with respect to tax-exempt use property override section 168(f)(2) (relating to recovery deductions with respect to property used predominantly outside the U.S.). However, for a special rule for certain leases of aircraft to foreign persons or entities, see below under the discussion of the short-term lease exception.

e. Tax treatment of tax-exempt use real property

Present law

There are no restrictions on the depreciation of real property merely because it may be used by a tax-exempt entity. In addition, no rehabilitation credits are lost merely because such property may be used by a tax-exempt entity.

House bill

To the extent real property is tax-exempt use property, it must be depreciated on the straight-line method over the greater of (1) 40 years, or (2) 125 percent of the lease term. In addition, the rehabilitation credit is denied for tax-exempt use real property, but only to the extent the property is financed with tax-exempt obligations.

Senate amendment

The Senate amendment follows the House bill except that the rehabilitation credit is denied for all tax-exempt use property. For purposes of the rehabilitation credit, property which is reasonably expected to become tax-exempt use property is treated as tax-exempt use property. In addition, the Senate amendment's special rules for personal property used by foreign persons or entities apply to real property used by foreign persons or entities as well, treating the property's ADR midpoint life as 40 years.

Conference agreement

The conference agreement generally follows the House bill, with two exceptions. First, the rehabilitation credit is denied for all tax-exempt use real property (but only such property) subject to the bill's general depreciation provisions. For this purpose, property which is reasonably expected to become tax-exempt use property is treated as tax-exempt use property, as under the Senate amendment. And second, the bill does not apply to real property placed in service before January 1, 1984, and used by a foreign person or entity under a lease entered into before January 1, 1984.

f. Depreciation of certain short-lived property

Present law

No special provision.

House bill

The House bill's depreciation provisions do not apply to certain high-technology property (i.e., computers and peripherals, high-technology telephone station equipment, and high-technology medical equipment) (1) leased to a tax-exempt entity for 5 years or less (if the lease term exceeds 5 years, the property must be depreciated under the straight-line method over 5 years), or (2) used predominantly outside the United States. These rules are not applicable if the property was previously used by the tax-exempt entity (or a related entity), was financed with tax-exempt obligations, or is used by the United States or any agency or instrumentality thereof.

The Treasury is directed to determine whether the present ADR midpoint lives for such property are appropriate and to report its conclusions to Congress by July 1, 1984.

Senate amendment

The Senate amendment's depreciation provisions do not apply to property having an ADR midpoint life of 6 years or less so long as the lease term does not exceed 75 percent of the property's ADR midpoint life (5 years in the case of property having an ADR midpoint life of 6 years). While high-technology medical equipment is treated as having an ADR midpoint life of 6 years for purposes of this provision, the Treasury, prospectively only, may prescribe by regulations that it has a midpoint life of more than 6 years.

Conference agreement

The conference agreement generally follows the House bill except that the provision requiring the Treasury to report regarding ADR midpoint lives is eliminated. Furthermore, under the conference agreement, only property owned and used by a tax-exempt entity (or a related entity) for more than 3 months prior to a transfer of it by the tax-exempt entity (or a related entity) is to be treated as having been used by the tax-exempt entity before the transfer. Finally, in the case of property used predominantly outside the U.S. under a lease with a term of more than 5 years, the bill's general depreciation rules apply. That is, such property is depreciable on a straight-line basis over the longer of its ADR midpoint life or 125 percent of the lease term.

In addition, the conference agreement authorizes the Treasury to provide, by prospective regulations only, that any high-technology telephone station equipment or medical equipment (both as generally defined in the bill) is to be depreciated under the bill's general depreciation rules rather than the special rules for short-lived property. The conferees intend that the Treasury so provide only if it determines that such property cannot reasonably be expected to become technologically obsolete substantially before the expiration of its physical useful life.

g. Short-term lease exception

Present law

Property leased to a tax-exempt entity pursuant to a casual or short-term lease (determined under all the facts and circumstances) is not subject to investment credit denial.

House bill

The House bill makes no change in the regular investment credit rule of present law. However, it provides that no rehabilitation credit is to be denied for property leased to a tax-exempt entity under a lease with a term of less than 1 year.

In addition, the bill's depreciation provision does not apply to personal property when the lease term is less than (1) 1 year, or (2) 30 percent of the property's ADR midpoint life. However, in no case will this exception apply if the lease has a term exceeding three years. For real property, the bill's depreciation provision does not apply if the lease term is less than 3 years.

Senate amendment

The regular investment credit provision of the Senate amendment generally does not apply if the lease term is less than 6 months. However, in the case of certain offshore oil and gas drilling equipment leased for a term not in excess of 2.25 years (1.8 years in the case of certain containers and related equipment), the regular investment credit provision of the amendment does not apply. No rehabilitation credit is to be denied for property used pursuant to a lease having a term not exceeding 3 years.

The depreciation provision does not apply to personal property leased pursuant to a lease having a term not exceeding one year or, if longer, 30 percent of the property's midpoint life. However, in no case will this exception apply if the lease has a term exceeding 3 years. For real property, the depreciation provision does not apply if the use is pursuant to a lease having a term not in excess of 3 years.

Conference agreement

The conference agreement generally follows the House bill except that for purposes of the rehabilitation credit, a lease is a short-term lease only if its term is less than 3 years. Furthermore, the conference agreement generally follows the Senate amendment with respect to investment credits (other than the rehabilitation credit). In addition, the conference agreement adopts the special investment credit rules in the Senate amendment regarding certain offshore oil and gas drilling equipment and containers and related equipment.

The conference agreement provides a special investment credit rule for certain aircraft leased to a foreign person or entity before January 1, 1990. Under section 47(a)(7), use under certain leases predominantly outside the U.S. of certain aircraft will not trigger investment credit recapture until the aircraft has been so used for more than 3½ years. Absent a special rule, under the bill, leases of such aircraft to a foreign person or entity for 6 months or more would generally trigger investment credit recapture. Under the conference agreement, leases described in section 47(a)(7) to a foreign person or entity of aircraft described in section 47(a)(7) will not trigger investment credit recapture if those leases do not exceed three years. However, if such aircraft is thereafter disposed of or otherwise ceases to be section 38 property, investment credit recapture will be determined by disregarding the term of the lease to the foreign person or entity.

h. Lease term

Present law

No special Code provision.

House bill

For purposes of the House bill, the term of a lease includes all options to renew as well as certain successive leases.

Senate amendment

The Senate amendment generally follows the House bill. However, in the case of real property, the lease term does not include renewal options at fair rental values.

Conference agreement

The conference agreement generally follows the Senate amendment. However, the committee report indicates that the length of a lease term is also to be determined under all the facts and circumstances. See, e.g., *Hokanson v. Commissioner*, 84-1 USTC Par. 9217 (9th Cir. 1984). The conferees intend that the *Hokanson* rule and similar rules take precedence over the rule regarding fair rental renewal options with respect to real property so that, under all the facts and circumstances, the term of a fair rental value renewal option may be treated as a part of the original lease term.

The conference agreement also clarifies that successive leases which are part of the same transaction (or a series of related transactions) with respect to the same or substantially similar property are to be treated as one lease.

i. Thrift institutions

Present law

Property owned by a thrift institution is limited to one-half of any investment tax credit (including any rehabilitation credit) otherwise available because special bad debt deductions available to such an institution effectively reduce the rate of tax applicable to its income. There is no special provision regarding credits with respect to property leased to a thrift institution.

House bill

No provision.

Senate amendment

The lessor of property to a thrift institution is entitled to no greater a credit with respect to such property than the thrift institution would have been entitled to had it owned the property.

Conference agreement

The conference agreement generally follows the Senate amendment. (For this purpose, property used by a thrift institution under a short-term lease (as defined in the bill) is not subject to the rule). However, the conference agreement permits a thrift institution to avoid this rule by electing to waive its rights to claim deductions for additions to bad debt reserves under any method other than the experience method. Any such election would be irrevocable and would apply for all taxable years of the electing thrift institution (and any successor engaged in substantially similar activities) beginning with the taxable year for which made.

j. Service contracts

Present law

No special Code provision. However, case law (*Xerox Corp.* v. *U.S.*, 656 F. 2d 659 (Ct. Cl. 1981)), revenue rulings, and private letter rulings (which are not to be cited as precedent) provide guidance in distinguishing leases and other arrangements from service contracts. In general, property subject to a service contract with a tax-exempt entity is not treated as used by that entity in determining eligibility for the investment credit.

House bill

For all purposes of the provision, property subject to a so-called service contract or other arrangement with a tax-exempt entity is treated as leased to that entity if the arrangement more nearly resembles a lease of the property. In determining whether a so-called service contract or other arrangement with a tax-exempt entity more nearly resembles a lease of the property involved, all relevant factors are to be taken into account, including whether (1) the service recipient is in physical possession of the property, (2) the service recipient controls the property, (3) the service recipient has a significant economic or possessory interest in the property, (4) the service provider bears any significant economic risk if there is nonperformance, (5) there is concurrent use of the property by the service provider to provide significant service to others, and (6) the contract price under the service contract or other arrangement substantially exceeds the rental value of the property.

Special rules are provided with respect to certain waste-to-energy property.

Senate amendment

The Senate amendment generally follows the House bill. However, the Senate amendment provides a different set of special rules applicable to contracts for the provision of solid waste, energy, energy conservation or energy management, and clean water facilities. In general, such contracts are not to be treated as leases unless the service recipient (1) bears significant financial burdens if there is nonperformance, (2) operates the facility, (3) receives significant financial benefits if operating costs are less than projected, or (4) has a fixed or determinable purchase price option (other than at fair market value) or may be required to purchase the facilities.

The factors used to distinguish service contracts and other arrangements from leases are applicable for all income tax purposes.

Conference agreement

The conference agreement generally follows the Senate amendment. However, the conference agreement makes it clear that a contract which purports to be a service contract is to be treated as a lease (rather than a conditional sale or similar arrangement) only if such contract is more properly to be treated as a lease under all the facts and circumstances, including those enumerated in the bill. The Senate committee report contains an example regarding applicability of the general service contract rules (i.e., those not applicable with respect to certain facilities) in the case of certain school buses (Example (6)). The conferees agree with that example. Under the conference agreement, the special rules under the Senate amendment relating to certain facilities are not applicable to any contract or arrangement for the provision of energy conservation or energy management services. However in the case of a binding contract with respect to any such services entered into before May 1, 1984, present law (rather than the bill's general services contract rules) applies.

Under the conference agreement, low-income residential property operated by or for an organization described in section 501(c)(3) or section 501(c)(4) is not subject to the service contract or other arrangement rules of the bill. Thus, for example, the leasing of units in such property to occupants is not treated as use by or on behalf of such an organization. For purposes of this rule, low-income residential property means property described in section 1250(a)(1)(B)(i), (ii), (iii), or (iv), but only if 80 percent or more of the units are leased to low-income tenants, determined in a manner consistent with section 167(k)(3)(B).

k. Partnerships and other pass-through entities

Present law

No special Code provision.

House bill

Property which is not used by a tax-exempt entity may be owned by a partnership or other pass-through entity having both taxable and tax-exempt entities as partners or other beneficiaries. Unless all allocations to each tax-exempt entity partner or other beneficiary are qualified allocations, such partner's proportionate share of the pass-through entity's property is treated as tax-exempt use property for all purposes of the provision.

For purposes of this rule, a qualified allocation means any allocation to a tax-exempt entity which is consistent with such entity's being allocated the same percentage share of each item of income, gain, loss, deduction, credit, and basis of the partnership during the period such entity is a partner or beneficiary. Furthermore, no allocation is qualified unless it meets the substantial economic effect test of section 704(b). However, items allocated under section 704(c) (relating to contributed property) are not taken into account.

A tax-exempt entity partner's or other beneficiary's proportionate share of property of a pass-through entity equals such partner's or other beneficiary's share of the pass-through entity's distributions or items of income or gain (excluding gain allocated under section 704(c)), whichever produces the highest result. If the tax-exempt entity partner's or other beneficiary's share of distribution or items of income or gain (excluding gain allocated under section 704(c)) varies during the period it is a partner or other beneficiary, its share of any such item shall be the highest share it may receive.

Senate amendment

The Senate amendment generally follows the House bill.

Conference agreement

The conference agreement generally follows the House bill and the Senate amendment but makes certain clarifications and additions. For example, the conference agreement amends the rule regarding the determination of a tax-exempt entity partner's proportionate share of partnership property to exclude references to such entity's share of partnership distributions.

The conferees wish to clarify that this rule applies notwithstanding any other provision of the bill. For example, assume that a partnership owns a building which is leased to a taxable entity. The partnership has one tax-exempt entity as a partner, and its proportionate share is 10 percent. Unless the partnership's allocations to the tax-exempt entity are qualified, 10 percent of the building is tax-exempt use property, notwithstanding the 35-percent threshold otherwise applicable in the case of real property. However, this rule does not apply to the extent the property is predominantly used by the tax-exempt entity, through the partnership, in an unrelated trade or business the income of which is subject to tax under section 511 (determined without regard to the debt-financed income rules of section 514).

The conferees also wish to clarify the consequences of property being treated as tax-exempt use property under this rule. If a portion of a partnership's depreciable property is tax-exempt use property, allowable depreciation deductions with respect to that property will be reduced. The partnership's total depreciation deductions will be allocated under the partnership agreement among one or more of the partners in accordance with the provisions of section 704(b).

In addition, the conferees wish to clarify that property may be tax-exempt use property under both the general provisions of the bill and the special partnership provision. For example, a tax-exempt entity may be a partner in a partnership owning a building 60 percent of which is leased to a tax-exempt entity under a long-term lease. Sixty percent of the building is tax-exempt use property under the general provisions. The status of the other 40 percent would depend on whether the allocations with respect to it are qualified.

The conferees also wish to clarify that the reference to allocations of basis in determining whether an allocation is a qualified allocation pertains to allocations of basis of oil and gas properties under section 613A(c)(7))(D) and "section 38 property" under the investment credit rules.

The conference agreement authorizes the Treasury to prescribe regulations dealing with the effect of guaranteed payments (as defined in sec. 707(c)) under this rule. Under those regulations, priority cash distributions to partners that constitute guaranteed payments should not disqualify an otherwise qualified allocation so long as the priority cash distributions are reasonable in amount (e.g., equal to the most appropriate Federal rate) and are made to all partners in proportion to their capital in the partnership. On the other hand, the conferees expect that the regulations will prevent partnerships from avoiding the qualified allocation rules by making disproportionately large guaranteed payments to its tax-exempt partners for the use of their capital.

The conference agreement also authorizes the Treasury to prescribe regulations pursuant to which, in appropriate cases, particular items may be excluded or segregated in determining whether there is a qualified allocation. One example that has come to the conferees' attention involves a U.S. corporation and a foreign country are equal partners in a partnership created under the laws of that foreign country. Under those laws, the U.S. corporation's share of the partnership's profits are taxed, but not the foreign government's share. However, the tax is imposed on and paid by the partnership rather than the U.S. corporation partner directly. Under the partnership agreement, all partnership items are allocated equally between the two partners except that the tax expense is allocated to the U.S. corporation, and cash distributions to the partners reflect that allocation. Assuming those allocations possess substantial economic effect, the conferees do not intend that the partnership agreement be treated as containing an unqualified allocation.

Another situation those regulations might address involves a partnership which, in substance, consists of several partnerships formed to explore for, develop, and produce oil and gas. Typically, a partner in such a partnership may select to what extent he wishes to participate in a particular well, and his interest in the income, gain, loss, deduction, credit, and basis may differ from well-to-well. For example, a partner, consistent with the partnership agreement, may contribute 75 percent of the cost of one well and 50 percent of the cost of a second well and be allocated 75 percent of all tax items from the first well and 50 percent of all tax items from the second. If instead of using one partnership to invest in several wells, a separate partnership were used for each well, the allocation formula used for each well could be different from the others and yet each could satisfy the qualified allocation rules. The conferees anticipate that the regulations will grant relief in this and similar non-abusive situations.

Similarly, the conferees expect that the regulations will provide that an allocation will not disqualify an otherwise qualified allocation on the basis that it does not have substantial economic effect in cases where such allocation is not governed by the substantial economic effect rules (e.g., an allocation of basis of an oil and gas property) or cannot, by its nature, satisfy those rules (e.g., an allocation of credits, deductions attributable to nonrecourse debt, and percentage depletion in excess of basis), provided such allocation complies with the relevant section of the Code or the regulations (e.g., section 613A(c)(7)(D) and proposed regulations section 1.704-1(b)(4)).

Furthermore, the regulations might provide a procedure for taxpayers to seek rulings that an allocation will be treated as qualified in cases not specifically addressed by the regulations.

The conference agreement also provides other special rules for partnerships and other pass-through entities. First, property leased to a foreign partnership or other foreign pass-through entity is not, solely by reason of that lease, to be treated as tax-exempt use property. Second, property leased to any partnership or other pass-through entity, domestic or foreign, having as a partner or other beneficiary a tax-exempt entity is to be treated as leased to each such partner or other beneficiary in an amount equal to its proportionate share of such property (as determined under the conference agreement). Unless the taxpayer establishes otherwise, it is to be presumed for purposes of this rule that all partners of a foreign partnership (and all beneficiaries of any other foreign pass-through entity) are foreign persons or entities.

Finally, rules similar to the foregoing are to apply in the case of tiered partnerships and other tiered pass-through entities.

l. International Maritime Organization and International Satellite Communications Organization

Present law

Intelsat and Inmarsat, which, as foreign partnerships, are international organizations, are not treated as international organizations for purposes of the investment credit nontaxable use restriction under section 48(a)(5).

House bill

The House bill contains special rules applicable to Intelsat and Inmarsat.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement eliminates the special rules for Intelsat and Inmarsat. They are unnecessary in view of the general rules regarding partnerships and other pass-through entities described above, which apply to Intelsat and Inmarsat as well as other partnerships or pass-through entities.

The conferees request the Treasury to conduct a study of the satellite industry and to report the findings to Congress by no later than April 1, 1985. The conferees request that the study focus on the following issues. First, whether and to what extent domestic satellite companies are now able to, and in the future may be expected to be able to, compete successfully with foreign satellite operations for both domestic and foreign business. Second, whether domestic satellite companies are now able to, and in the future may be expected to be able to, compete with each other on fair and equitable terms. Third, what role do tax benefits play in permitting satellite companies to compete with each other on fair and equitable terms. And fourth, whether Federal tax laws should be changed, and, if so, in what respect, to assure fair and open competition among all satellite companies.

m. Related parties

Present law

No special Code provision.

House bill

The House bill contains numerous rules relating to the treatment of tax-exempt entities and related parties as one entity for various purposes. The bill also defines related parties.

Senate amendment

The Senate amendment generally is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

n. General effective date

House bill

The bill is generally effective with respect to property placed in service by the taxpayer after May 23, 1983, and to property placed in service by the taxpayer before that date which is leased to a tax-exempt entity pursuant to a lease entered into after that date.

Senate amendment

The Senate amendment follows the House bill except that for property used by the U.S. Postal Service, May 23, 1983, is changed to October 31, 1983.

Conference agreement

The conference agreement follows the Senate amendment. In addition, the conference agreement provides that certain improvements to property are not to be treated as separate property for purposes of the general effective date rules or the transitional rules. Under this provision, if the bill does not apply to the property improved, it will not apply to the improvements either. Improvements covered are those which would not be substantial improvements under section 168(f)(1)(C)(ii) if 20 percent were substituted for 25 percent.

o. Transition rules

(1) Leases, subleases, and renewals

House bill

The provision does not apply if the tax-exempt use is pursuant to (a) a lease entered on or before May 23, 1983 (or a sublease under such a lease), or (b) any renewal or extension of a lease entered into on or before May 23, 1983, pursuant to an option in such a lease exercisable by the tax-exempt entity.

Senate amendment

The Senate amendment is the same as the House bill except that for property used by the U.S. Postal Service, May 23, 1983, is changed to October 31, 1983.

Conference agreement

The conference agreement follows the Senate amendment.

(2) Binding contracts

House bill

The provision does not apply to property leased to a tax-exempt entity if such lease is pursuant to certain binding contracts which, on May 23, 1983, required acquisition, construction, reconstruction, or rehabilitation of the property involved and its use by the tax-exempt entity.

Senate amendment

The Senate amendment follows the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment. The conferees wish to clarify that, for purposes of this rule, a written contract award made by the United States or an agency or instrumentality thereof on or before May 23, 1983, is to be treated as a binding contract.

(3) Binding contracts and firm plans, etc.

House bill

The provision does not apply to certain property acquired or constructed (or subject to a binding contract to acquire or construct) if (a) a contract entered into before January 1, 1984, requires the tax-exempt entity to use the property, or (b) on May 23, 1983, there was a firm written plan for the tax-exempt entity to enter into a contract for its use.

Senate amendment

No provision.

Conference agreement

The conference agreement generally follows the House bill with modifications.

Under the conference agreement, for property used by a tax-exempt entity (other than a foreign person or entity), the provision does not apply to property that (1) the taxpayer (or a predecessor in interest in or under the contract) or the tax-exempt entity was required to acquire, construct, reconstruct, or rehabilitate pursuant to a contract that was binding on May 23, 1983 (or has commenced, but not completed, construction, reconstruction, or rehabilitation by that date), (2) the taxpayer or the tax-exempt entity acquired after June 30, 1982, and before May 24, 1983, or (3) the taxpayer or the tax-exempt entity completed construction, reconstruction, or rehabilitation of which after December 31, 1982, and before May 24, 1983, but only if, in any such case, such tax-exempt entity enters into a binding contract to use the property before January 1, 1985. Requirement (1), above, is not satisfied if the tax-exempt entity used the property before May 24, 1983.

(4) Governmental action, etc.

House bill

The provision does not apply in certain cases where there was certain governmental action with respect to the project involved on or before May 23, 1984, specified sums were spent on the project involved on or before that date, and a contract requiring the tax-exempt entity to use the property was entered into before January 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with modifications.

The provision does not apply in certain cases where there was governmental action with respect to the property involved on or before November 1, 1983, and a contract requiring the tax-exempt entity to use the property is entered into before January 1, 1985.

In determining whether sufficient governmental action occurred on or before November 1, 1983, the conferees intend that this provision be interpreted in a manner consistent with the similar provision in the House bill. However, in addition to the actions that are described in the report of the Committee on Ways and Means, the following actions constitute significant governmental action: the enactment of a State law authorizing the sale, lease, or construction of the property; the appropriation of funds for the property or authorization of a feasibility study or a development services contract with respect to it; the approval of financing arrangements by a regulatory agency; the enactment of a State law designed to provide funding for a project; or the endorsement of the application for a certification of need with respect to a medical facility by a regulatory agency other than the agency empowered to issue such a certificate.

(5) Certain property

House bill

The provision does not apply to certain mass commuting vehicles, certain boilers and turbines of rural electric cooperatives, and certain sewage or solid waste facilities with respect to which a ruling request was filed on or before May 23, 1983.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

(6) Specified projects

House bill

No provision.

Senate amendment

The Senate amendment specifies certain projects with respect to which the provision is not to apply.

Conference agreement

The conference agreement generally follows the House bill with modifications.

Under the conference agreement, transitional rules are provided for specific projects involving (1) substantial rehabilitations or new construction of buildings where a qualifying action occurred before November 1, 1983, and (2) the rehabilitations of certain educational facilities with respect to which there was substantial reliance on present law.

Under the conference agreement, the provision does not apply to property described in section 168(c)(1)(D) (relating to 15-year real property) if:

(a) the property is leased to a university and houses a basketball arena and university offices, and, on June 16, 1983, the Board of Administrators of the university adopted a resolution approving the rehabilitation of the property in connection with an overall campus development program,

(b) the property is leased to a charitable organization, the organization acquired the property on August 21, 1981, and, on June 12, 1982, an arson fire caused substantial damage to the property, delaying the planned rehabilitation,

(c) the property is leased to a corporation described in section 501(c)(3) (relating to certain organizations exempt from tax), pursuant to a contract that was entered into on August 2, 1983, and under which the corporation first occupied the property on December 22, 1983,

(d) the property is leased to an educational institution and used as an arts and humanities center, an architect was engaged to design a planned renovation in November of 1982, a demolition contract was entered into in December of 1983, and a renovation contract was entered into in March of 1984,

(e) the property was acquired by a college in October of 1981 for use as a dormitory, renovation plans were delayed because of a zoning dispute, and, in May of 1982, the court of highest jurisdiction in the State in which the college is located resolved the zoning dispute in favor of the college,

(f) the property is a fraternity house; in August of 1982, the related university retained attorneys to advise the university regarding the rehabilitation of the property; on January 21, 1983, the governing body of the university established a committee to develop rehabilitation plans; on January 10, 1984, the governor of the State in which the university is located approved historic district designation for an area that includes the property; and on February 2, 1984, historic preservation certification applications for the property were filed with an historic landmarks commission,

(g) the property is leased to a retirement community with respect to which, on January 5, 1977, a certificate of incorporation was filed, and on November 22, 1983, the board of trustees of the retirement community adopted a resolution evidencing an intention to begin immediate construction of the property,

(h) the property is used by a university, in July of 1982, the board of trustees of the university adopted a master plan for the financing of the property, and, as of August 1, 1983, at least $60,000 in private expenditures had been expended in respect of the project,

(i) the property is leased by a university for use as a fine arts center, and the board of trustees of such university authorized a sale-leaseback agreement with respect to such property on March 7, 1984,

(j) the property is used as an international trade center and, prior to January 1, 1982, an environmental impact study for such property was completed; on June 24, 1981, a developer made a written commitment to provide one-third of the financing for the development of such property; and on October 20, 1983, such developer was approved by the board of directors of the tax-exempt entity,

(k) the property is leased to a university of osteopathic medicine and health sciences and, on or before December 31, 1983, the board of trustees of such university approved the construction of such property,

(l) with respect to the property, there existed on May 23, 1983, architectural plans and specifications (within the meaning of section 48(g)(1)(C)(ii)); the property is leased to a tax-exempt entity after substantial improvements are made; and prior to May 23, 1983, at least ten percent of the total estimated cost of such improvements was paid or incurred, or

(m) the property is used as a convention center and, on June 2, 1983, the city in which the property is located provided for over $6 million for the project.

(7) Express appropriations

House bill

No provision.

Senate amendment

The provision is not to apply to certain property leased to or used by the United States if, among other things, an express appropriation for rentals was made for the 1983 fiscal year before May 23, 1983.

Conference agreement

The conference agreement follows the Senate amendment.

(8) Containers

House bill

No provision.

Senate amendment

Containers and certain related equipment placed in service before 1984, and used by foreign persons or entities before 1984, are exempted from investment credit recapture by reason of use by foreign persons or entities until 1985.

Conference agreement

The conference agreement follows the Senate amendment.

(9) Partnerships

House bill

Certain partnerships organized before October 21, 1983, are exempted, with respect to certain property, from the rules regarding the treatment of property owned or to be acquired by partnerships having taxable and tax-exempt entities as partners.

Senate amendment

The Senate amendment exempts, with respect to certain property, additional partnerships.

Conference agreement

The conference agreement generally follows the Senate amendment but expands the transitional rules applicable with respect to property owned by a partnership. Thus, for example, the provisions do not apply to property placed in service by a partnership before October 21, 1983.

(10) Service contracts for all income tax purposes; thrift institutions; rehabilitation credits

House bill

No special provision.

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Senate amendment

The provision's service contract rules, insofar as they relate to persons other than tax-exempt entities, are generally not effective for arrangements entered into before November 5, 1983.

Conference agreement

The conference agreement generally follows the Senate amendment. In addition, the rule regarding thrift institutions is made generally effective with respect to leases entered into after November 5, 1983. A special transitional rule is also provided with respect to the rehabilitation credit.

(11) Certain sewage facilities

House bill

A special transition rule applies to certain sewage facilities.

Senate amendment

No provision.

Conference agreement

The conference agreement includes the House bill provision.

(12) Property used by foreign persons or entities

House bill

No special provision.

Senate amendment

No special provision.

Conference agreement

For property used by foreign persons or entities (other than certain aircraft for which a special rule is provided), the provision does not apply to property that (1) the taxpayer or the tax-exempt entity was required to acquire, construct, reconstruct, or rehabilitate pursuant to a contract that was binding on May 23, 1983 (or has commenced but not completed the activity by that date), (2) the taxpayer or the tax-exempt entity acquired after December 31, 1982, and before May 23, 1983, or (3) construction, reconstruction, or rehabilitation of which was completed after December 31, 1982, and before May 24, 1983, but only if in any such case, such foreign person or entity entered into a binding contract to use the property before January 1, 1984. Requirement (1), above, is not satisfied if the foreign person or entity used the property before May 24, 1983.

Under a special rule for wide-body, four-engine, commercial passenger aircraft, the provisions do not apply to aircraft with respect to which the foreign person or entity entered into a written binding contract to acquire the aircraft on or before November 1, 1983, and which is placed in service prior to January 1, 1986.

2. Treatment of certain motor vehicle operating agreements as leases

Present law

Nominal lease agreements covering motor vehicles often contain terminal rental adjustment clauses. A terminal rental adjustment clause generally permits or requires an upward or downward adjustment in rent to make up for any difference between the value of the vehicle at the end of the lease term as projected when the lease was entered into and its actual value at the end of the lease term.

The Internal Revenue Service has taken the position, and one court has agreed, that the presence of a terminal rental adjustment clause in a nominal motor vehicle lease causes the transaction to be treated as a conditional sale, rather than a lease, for tax purposes. If the transaction is a conditional sale, the nominal lessor is entitled to no depreciation deductions or investment tax credits with respect to the vehicle. Nor is the nominal lessee entitled to any rent deductions.

TEFRA prohibits the IRS from denying, with respect to nominal leases entered into before the issuance of regulations, lease treatment for certain nominal motor vehicle leases merely by reason of the fact that those nominal leases contain terminal rental adjustment clauses. In November, 1982, proposed regulations were issued to the effect that nominal leases of motor vehicles would be treated as conditional sales rather than leases if they contained terminal rental adjustment clauses.

House bill

No provision.

Senate amendment

The presence of a terminal rental adjustment clause in a nominal motor vehicle lease shall not be taken into account in determining whether the transaction is to be characterized as a lease for tax purposes. The provision applies whether the lessee uses the motor vehicle for business or personal purposes. However, the provision does not apply if the nominal lessor finances its ownership of the vehicle with nonrecourse debt.

The provision is effective for agreements entered into before, on, or after the date of enactment.

Conference agreement

Under the conference agreement, a qualified motor vehicle operating agreement containing a terminal rental adjustment clause is treated as a lease if, but for that clause, it would be treated as a lease. The provision applies only to qualified agreements with respect to a motor vehicle (including a trailer). No lessee under a qualified agreement is, under the agreement, to be treated as the tax owner of any property for any period during which such agreement is in effect.

To be a qualified agreement, the nominal lessor must be personally liable for the repayment of all amounts borrowed to finance the acquisition of the motor vehicle involved or must pledge property, other than property subject to the agreement or property directly or indirectly financed by indebtedness secured by property subject to the agreement, as security for all amounts borrowed to finance the acquisition of the motor vehicle involved. In addition, the nominal lessee must certify, in a separate written statement separately signed, under the penalties of perjury, that it intends that more than 50 percent of the use of the property involved will be in a trade or business of the nominal lessee. That signed certification must also state, clearly and legibly, that the nominal lessee has been advised that it will not be treated as owner of the property for Federal income tax purposes. Furthermore, the nominal lessor must not know that the nominal lessee's certification is inaccurate in any material respect.

The nominal lessor is treated as the tax owner of the property involved under a qualified agreement so long as the agreement, but for the terminal rental adjustment clause, is properly characterized as a lease for tax purposes, regardless of the actual use of the motor vehicle by the nominal lessee. The nominal lessee is not to be treated as the tax owner of the property involved under a qualified agreement even if under the agreement, but for the terminal rental adjustment clause, the nominal lessee would be treated as the tax owner. As a result, the nominal lessee is not entitled to depreciation or interest deductions under the agreement which might be available to it if it were treated as the tax owner of the property. Any rent deductions for the nominal lessee are determined under general Code provisions, including provisions added by the bill.

A special rule is provided for lessee-dealers.

The provision is effective for leases entered into after 90 days after the date of enactment. The TEFRA provision is made inapplicable to agreements entered into 90 days after the date of enactment. The Treasury is not to issue regulations under the TEFRA provision with respect to leases entered into before 90 days after the date of enactment.

No inference is intended that a motor vehicle operating agreement containing a terminal rental adjustment clause is, merely by reason of the presence of that clause, to be treated as a lease for tax purposes. Nor is any inference intended that any nominal lease agreement, involving property other than a motor vehicle, which contains a provision similar to a terminal rental adjustment clause is to be treated as a lease for tax purposes.

C. Treatment of Bonds and Other Debt Instruments

1. Definitions and technical amendments

Present law

Under present law, the retirement of a debt obligation that is issued by a corporation or governmental unit and is a capital asset is treated as a sale or exchange.

Present law also provides rules requiring the annual inclusion and deduction of original issue discount (OID). OID is defined as the difference between the issue price of an obligation and its stated redemption price at maturity. OID is allocated over the term of an obligation through a series of adjustments to the issue price for each "bond period" (defined below). The adjustment to the issue price for each bond period is determined by multiplying the adjusted issue price (*i.e.*, the issue price as increased by adjustments prior to the beginning of the bond period) by the obligation's yield to maturity, and then subtracting the interest payable during the bond period.

Exception for short-term government obligations

An exception to the rule requiring annual inclusion is provided for acquisition discount with respect to government obligations with a maturity of one year or less. Acquisition discount is defined as the excess of the stated redemption price at maturity over the taxpayer's basis for the obligation. Treasury regulations provide a similar exception for OID with respect to obligations other than government obligations.

Definition of "bond period"

Except as otherwise provided by regulations, the accrual period for determining the amount of OID that is allocable to a period is an annual period ending on each anniversary of the date on which the bond was issued. Thus, the yield to maturity of a bond is determined on the basis of annual compounding.

Acquisition premium

When a taxpayer purchases a bond for a price that exceeds the adjusted issue price, the excess (or premium) is allowed as an offset to the remaining OID on a straight-line basis over the remaining term of the bond. Under this rule, the amount of premium allowable as an offset may exceed the OID accrued in some years.

Definition of "purchase"

The term "purchase" is defined to exclude the purchase of a bond the basis of which is determined by reference to the basis of the bond in the hands of the transferor or under section 1014(a) (relating to property acquired from a decedent).

Definition of "issue price"

The issue price of bonds registered with the Securities and Exchange Commission ("SEC") is the initial price to the public at which a substantial amount of the debt instruments were sold.

Stripped bonds

For purposes of the rules that require the annual inclusion of OID, a stripped bond (*i.e.*, a bond issued with interest coupons where there is a separation in ownership between the bond and any unpaid coupon) or a stripped coupon (any coupon related to a stripped bond) is treated as a bond originally issued by a corporation on the purchase date, and as having OID equal to (i) the stated redemption price at maturity or the amount payable on the due date of such coupon, respectively, over (ii) such bond's or coupon's ratable share of the purchase price (determined by reference to their respective fair market values on the purchase date).

House bill

Various technical amendments are made to the OID provisions. In addition, clarifying amendments are made to specific provisions of present law.

Retirement of a debt obligation

The retirement of a debt obligation is treated as a sale or exchange without regard to whether the instrument is a capital asset.

Short-term obligations

The statutory exception from the periodic inclusion rules for government short-term obligations is extended to nongovernment obligations.

Definition of bond period

The accrual period with respect to which OID is computed and compounded is defined as each six-month period determined by reference to the maturity date of the bond and the date six months before such maturity date (or the shorter period from the date of issue). This treatment corresponds to the prevalent method of calculating yield to maturity in the financial community (based on semiannual compounding).

Acquisition premium

Acquisition premium is amortized by reducing the OID that would otherwise accrue by a constant fraction determined at the time of purchase. The numerator of the fraction is the total amount of premium to be amortized and the denominator is the aggregate amount of unaccrued OID at the time of purchase. This rule is intended to prevent situations in which the amortization of the acquisition premium exceeds accrual of OID and to provide better matching between the two.

Definition of purchase

The acquisition of a bond from a decedent is treated as a purchase for purposes of the OID provisions, including the rules applicable to stripped bonds and stripped coupons.

Definition of issue price

The issue price rule applicable to bonds registered with the SEC is extended to all publicly traded issues (other than bonds issued for property). The bill authorizes the issuance of regulations to require the furnishing of the amount of OID, the issue date, and other appropriate information. A penalty of one percent of the issue price is imposed for failures to comply without reasonable cause; the maximum penalty with respect to any one issue of bonds is not to exceed $50,000.

Stripped bonds

Under a technical amendment, a stripped bond or stripped coupon is treated as originally issued on the purchase date; the statutory reference to issuance by a corporation is deleted.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill, with a technical amendment relating to stripped bonds.

Stripped bonds

The provision that creates OID with respect to stripped bonds applies for all purposes of part V of subchapter P of chapter 1 of the Code (relating to special rules for bonds and other debt instruments, as added by the bill).

2. Market discount

Present law

Capital gain treatment is accorded to the appreciation in value attributable to market discount on an obligation issued by a corporation or governmental unit and held for more than one year. In many cases, interest on indebtedness incurred to purchase or carry a market discount bond is deductible currently against ordinary income, even though the income eventually generated by the investment is taxed on a deferred basis at capital gain rates.

House bill

Accrued market discount characterized as ordinary income

The House bill provides that, generally, gain on disposition of a market discount bond is recognized as interest income. The term "market discount bond" is defined to mean any bond having market discount, subject to exceptions for (1) certain short-term bonds with fixed maturities, (2) bonds the interest on which is exempt from tax without regard to the identity of the holder, and (3) U.S. savings bonds. Market discount is defined as the excess of the stated redemption price of a bond over the adjusted basis immediately after its acquisition by the taxpayer. The interest-characterization provision applies to obligations issued after the date of enactment.

Deferral of interest deductions

The House bill limits a taxpayer's ability to take current deductions for interest on indebtedness incurred or continued to purchase or carry a market discount bond. The taxpayer's net direct interest expense is allowed as a deduction only to the extent that the expense exceeds the amount of market discount allocable to the days during the taxable year on which the taxpayer held the bond. The term "net direct interest expense" is defined as the excess of the interest paid or accrued by the taxpayer over the interest (including OID) included in gross income for the taxable year with respect to a market discount bond. Deferred interest expense is allowed as a deduction for the taxable year in which the taxpayer disposes of the market discount bond. The interest-deferral provision applies to obligations acquired after the date of enactment.

Senate amendment

The Senate amendment includes the same provisions as the House bill, with two modifications.

Accrued market discount characterized as ordinary income

For market discount bonds that are subject to the interest-deferral rule but not the interest-characterization rule (because the bond was issued before the date of enactment but acquired after such date), gain on disposition is recognized as interest income to the extent of the disallowed interest expense that is allowed as a deduction at that time.

Deferral of interest deductions

Under a special rule for financial institutions, the interest-deferral rule is applied by treating a portion of all interest paid or accrued as being attributable to market discount bonds, allocated by reference to the ratio of the basis of market discount bonds to the basis of all assets held by the financial institution.

Conference agreement

The conference agreement follows the Senate amendment with two modifications.

Accrued market discount characterized as ordinary income

Definition of market discount bond.—The conferees intend that regulations to be prescribed by the Secretary will clarify that the term "market discount bond" does not include an obligation that was demand debt when issued.

Deferral of interest deductions

The conferees intend that interest the deduction for which is deferred as interest on indebtedness incurred or continued to purchase or carry market discount bonds will not be taken into account for purposes of computing the disallowance of interest under section 265(2) (relating to interest on indebtedness incurred or continued to purchase or carry tax-exempt securities).

Short sales.—Under the conference agreement, the deduction of short sale expense is deferred where short sales of property are used to generate funds for the purchase of market discount bonds. This rule will apply in the same manner as the new rule that treats short sale expense as interest for purposes of section 265(2).

Election with respect to deferred interest expense.—The conference agreement provides an election under which deferred interest expense with respect to a market discount bond can be deducted in a taxable year prior to the year in which such bond is disposed of in cases where, subsequently, there is net interest income from the bond. If the election is made, any deferred interest expense with respect to a market discount bond is treated as paid or accrued to the extent that interest included in gross income exceeds interest that was actually paid or accrued with respect to the bond for a taxable year. Any deferred interest expense that remains after application of the elective provision is deductible on disposition of the market discount bond. The election is to be made on a bond-by-bond basis.

3. Discount on short-term obligations

Present law

There is a statutory exception to the rule requiring the periodic inclusion of acquisition discount on short-term government obligations payable without interest at a fixed maturity not exceeding one year. A similar exception is provided by Treasury regulations for OID on short-term obligations other than government obligations. In many cases, interest on indebtedness incurred to purchase or carry obligations eligible for an exception can be deducted currently against ordinary income to generate a one-year tax deferral.

House bill

Definition of short-term obligation

The term "short-term obligation" is defined as any bond, debenture, note, certificate, or other evidence of indebtedness that has a fixed maturity date not more than one year from the date of issue.

Mandatory accrual of OID or acquisition discount

Under the House bill, taxpayers are required to accrue OID or acquisition discount currently with respect to short-term obligations that (i) are held by a taxpayer using an accrual method of accounting, (ii) held by a bank, (iii) held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, or (iv) identified by the taxpayer as being part of a hedging transaction. This provision is effective for obligations acquired after the date of enactment.

Short-term obligations other than government obligations

Taxpayers who acquire short-term obligations other than government obligations can elect to apply the rules described above to acquisition discount on such obligations rather than OID.

Deferral of interest deductions

The House bill also limits a taxpayer's ability to take current interest deductions on indebtedness incurred to purchase or carry obligations that are not subject to the rule for mandatory accrual. The interest-deferral rule does not apply if the taxpayer elects to accrue discount currently. The provision is effective for obligations acquired after the date of enactment.

Election

The House bill provides an election to accrue acquisition discount or OID currently for all short-term obligations held during the taxable year that includes the date of enactment. If this election is made, the application of the accrual rule is treated as a change in the taxpayer's method of accounting, subject to the rules of section 481 (relating to adjustments required by changes in method of accounting). Adjustments required by section 481 are to be taken into account over a ten-year period.

Senate amendment

The Senate amendment includes the provision in the House bill that limits the ability to take interest deductions on indebtedness attributable to obligations eligible for an exception. The Senate amendment does not, however, include the provision that requires certain taxpayers to accrue discount currently.

Special rule for certain financial institutions

The Senate amendment also contains a special rule for certain financial institutions, under which a portion of all interest paid or incurred is treated as being attributable to the purchase or carrying of obligations eligible for the exceptions; the portion treated under the special rule is determined by reference to the ratio of the basis of short-term obligations eligible for the exceptions to the basis of all assets held by the financial institution.

Election

The Senate amendment provides an election to apply the interest-deferral rule to all short-term obligations held during the taxable year that includes the date of enactment. If this election is made, taxpayers obtain a five-year pay-in period for additional tax liability attributable to income that was deferred from taxable years prior to the year that includes the date of enactment. Interest is charged on any unpaid installments.

Conference agreement

The conference agreement follows the House bill with several modifications.

Definition of short-term obligation

The conference agreement contemplates that a stripped coupon or a stripped bond may be treated as an evidence of indebtedness within the meaning of the definition of short-term obligation. Thus, because a stripped coupon or stripped bond is treated as originally issued on the purchase date, the mandatory accrual and interest-deferral rules will apply to a stripped coupon or stripped bond that is payable not more than one year from the date of purchase.

Mandatory accrual of OID or acquisition discount

The conference agreement expands the scope of the provision requiring current inclusion of OID or acquisition discount to any short-term obligation held by (i) a regulated investment company ("RIC"), (ii) a common trust fund maintained by a bank, (iii) a partnership, S corporation, trust, or other pass-through entity more than 20 percent of the value of which is owned—for 90 days or more of the entity's taxable year—by taxpayers who are subject to the rule for mandatory accrual, and (iv) any pass-through entity that is formed or availed of to avoid the application of the rule for mandatory accrual. If the more-than-20-percent test is satisfied during any 90-day period of a pass-through entity's taxable year, then the rule for mandatory accrual is applied with respect to obligations acquired on or after the first day of the entity's taxable year.

Taxpayers using a hybrid method of accounting.—The conferees intend that the rule for mandatory accrual will apply to short-term obligations held by any taxpayer who uses an accrual method of accounting in combination with any other method of accounting.

Optional accrual for RICs.—Under a provision of the House bill, RICs are permitted to elect to currently accrue discount with respect to short-term government obligations. This election is available for taxable years beginning after December 31, 1978. Because the conference agreement applies the rule for mandatory accrual to all short-term obligations acquired by RICs after the date of enactment, the optional accrual rules will only apply for taxable years beginning after December 31, 1978, and ending prior to the taxable year that includes the effective date of the rule for mandatory accrual.

Deferral of interest deductions

The conferees intend that interest on indebtedness incurred or continued to purchase or carry short-term obligations subject to the interest deferral rule not be taken into account for purposes of computing the disallowance of interest under section 265(2).

Short-term obligations other than government obligations

The conferees intend that the election to apply the rules described above to acquisition discount rather than OID apply regardless of whether the obligation was acquired after original issue.

Election

The conference agreement provides an election to accrue discount for all short-term obligations held during the taxable year that includes the date of enactment. The election is available only to taxpayers subject to the rule for mandatory accrual of discount on short-term obligations. The conference agreement clarifies that this election is available only with respect to the taxpayer's first taxable year ending after the date of enactment. If the election is made, the application of the accrual rule is treated as a change in the taxpayer's method of accounting. The net adjustments to income required by section 481 are to be made over a five-year period beginning with the year for which the election is made (the "spread period"). The net adjustments will normally be the income that would be included in the taxable year including the date of enactment under cash basis accounting but that is not included under accrual basis accounting.

The amount of the adjustment to be taken into account in the first year of the spread period (the taxable year including the date of enactment) is the sum of (1) one-fifth of the net adjustments, and (2) the excess (if any) of (a) the cash basis income over the accrual basis income over (b) one-fifth of the net adjustments. The term "cash basis income" means the cumulative amount of acquisition discount or OID with respect to short-term obligations that would be includible in gross income for the current taxable year and the preceding taxable years in the spread period if the rule for mandatory accrual were not applicable. "Accrual basis income" is defined as the cumulative amount of acquisition discount or OID includible in gross income for the current taxable year and the preceding taxable years in the spread period under the rule for mandatory accrual. The requirement that the first year income inclusion be no less than the excess of cash basis over accrual basis income prevents the transition rule from producing a tax reduction relative to present law (which would arise where the excess of cash basis income over accrual basis income exceeds one-fifth of the net adjustments). The conferees intend that the 5-year spread be a mitigation of the tax increase provided by the bill, not a tax reduction.

For each year after the first year of the spread period, the amount of the adjustment to be taken into account is the sum of (1) the balance of the net adjustments divided by the number of taxable years remaining in the spread period (including the year for which the determination is being made), and (2) the excess (if any) of (a) the cash basis income over the accrual basis income over (b) one-fifth of the net adjustments, multiplied by five and minus the number of years remaining in the spread period (not including the year for which the determination is being made). In computing the excess of cash basis income over accrual basis income for a year subsequent to the first year of the spread period, such excess is reduced by any amount that gave rise to an income inclusion in excess of the amount of the net adjustment allocable to a prior year of the spread period. This formula is also intended to ensure that the five-year spread does not permit taxpayers to receive a tax reduction relative to present law.

The conferees intend that, in determining the net adjustments required under section 481 to prevent the omission of amounts, the cash basis income (as defined above) is computed as if such income had accrued in the preceding taxable year and, thereby, resulted in an increase in the basis of the related short-term obligations. Absent this treatment, there would be no omission from income to which section 481 could apply.

4. Original issue discount on tax-exempt obligations

Present law

Under Internal Revenue Service rulings, tax-exempt OID is apportioned among the original holder and subsequent holders of an instrument on a straight-line basis over the term of the obligation.

House bill

Tax-exempt OID is accrued in the same manner as that provided for OID on obligations issued by corporations and other juridical entities, under the economic constant interest method.

The provision is effective for obligations issued after September 3, 1982, and acquired after March 1, 1984.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment. In the case of tax-exempt obligations with a maturity of less than one year, interest will be computed in the same manner as for short-term taxable obligations.

D. Corporate Tax Provisions

1. Dividends received deductions for debt-financed portfolio stock

Present law

A corporate shareholder generally can deduct 85 percent of dividends received from other corporations. If the corporate shareholder is financing an investment in stock with borrowed funds, interest on the indebtedness is generally also deductible. Together, these rules permit corporations to deduct amounts paid or incurred to earn tax-favored dividend income.

House bill

The House bill reduces tax benefits with respect to certain dividend-paying stock the ownership of which is financed by debt. Generally, under the House bill, the corporate taxpayer must determine the percentage of the cost of an investment in stock which is financed with borrowed money. The amount of any dividends received deduction with respect to any dividends received on that stock which would otherwise be available is then reduced by that percentage. The rules are intended to determine what portion of the investment is debt-financed and to limit the availability of double deductions accordingly.

Under the House bill, the dividends received deduction is limited to a percentage determined by computing the product of 85 percent, and 100 percent minus the average portfolio indebtedness. Under regulations, the average portfolio indebtedness is the percentage obtained by dividing the average amount of the portfolio indebtedness with respect to the stock by the taxpayer's average adjusted basis in the stock during the base period. A special rule is provided for cases in which the taxpayer does not hold the portfolio stock for the entire base period. Under regulations, any reduction in the amount of the dividends received deduction is not to exceed the amount of any interest deduction (including any deductible short sale expenses) allocable to the dividend involved.

The term "debt-financed portfolio stock" means any stock of a corporation if, (a) as of the beginning of the ex-dividend date for the dividend involved, the taxpayer does not own (1) stock of such corporation possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote, and (2) at least 50 percent of the total number of shares of all other classes of stock of such corporation, and (b) at some time during the "base period" there is portfolio indebtedness with respect to such stock.

The term "base period" means, with respect to any dividend, the shorter of (1) the period between the ex-dividend date for the dividend involved and the ex-dividend date for the immediately preceding dividend, or (2) the one-year period ending on the day before the ex-dividend date for the dividend in question.

The term "portfolio indebtedness" means indebtedness directly attributable to investment in the portfolio stock. For this purpose, proceeds of any short sale are treated as indebtedness for the period between the short sale and the closing of the short sale.

To illustrate these rules, assume that Corporation A pays a dividend of $1 per share each quarter. The ex-dividend dates are January 15, April 15, July 15, and October 15. On January 16, 1985, Corporation B buys 1,000 shares of Corporation A for a total cost of $100,000. Assume further that Corporation B borrows 60 percent, or $60,000, of the purchase price, that the interest rate on the loan is 14 percent per year, and that the stock is portfolio stock. On April 15, 1985, when the $60,000 debt is still outstanding, Corporation B receives dividends on the stock totalling $1,000. Corporation B then sells the stock on April 16, 1985, for $100,000. Under present law, Corporation B would generally be entitled to a dividends received deduction of 85 percent of $1,000, or $850. Under the House bill, since 60 percent of the cost of the stock was debt-financed, 60 percent of the dividends received deduction is disallowed. As a result, Corporation B is entitled to a dividends received deduction of only 40 percent of $850, or $340. Since interest expense allocable to the dividend is $2,100 ($60,000 times 14 percent times 1/4), the special rule limiting the reduction to the amount of interest expense allocable to the dividend is not applicable.

The provision does not apply with respect to dividends eligible for the 100-percent dividends received deduction (generally determined under section 243(b)), or to dividends received by a small business investment company operating under the Small Business Investment Act of 1958.

The provision generally applies to stock the holding period for which commences after the date of enactment.

Senate amendment

The Senate amendment generally follows the House bill. However, proceeds of a short sale are not treated as indebtedness if no deduction is allowed to the party effecting the short sale for payments in lieu of dividends under section 263(h) (as added by the bill).

The provision generally applies to stock the holding period for which commences after the date of enactment. The conference agreement generally follows the House bill, except as noted below. The rule in the Senate amendment regarding proceeds of a short sale is viewed as no different from the rule in the House bill.

Conference agreement

The conference agreement generally follows the House bill, except as noted below. The rule in the Senate amendment regarding proceeds of a short sale is viewed as not different from the rule in the House bill.

Portfolio stock

Under the conference agreement, the term "portfolio stock" is redefined. Stock of a corporation is portfolio stock unless specifically excluded. Under the conference agreement, stock of a corporation is not portfolio stock if, as of the beginning of the ex-dividend date for the dividend involved, the taxpayer owns stock (1) possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote of such corporation, and (2) having a value equal to at least 50 percent of the value of all the stock (disregarding certain preferred stock) of such corporation.

In addition, stock of a corporation is not portfolio stock if, as of the beginning of the ex-dividend date for the dividend involved, (1) the taxpayer owns stock of such corporation possessing at least 20 percent of the voting power and value of all the stock (disregarding certain preferred stock) of such corporation, and (2) five or fewer corporate shareholders own, directly, stock of such corporation possessing at least 50 percent of the voting power and value of all the stock (disregarding certain preferred stock) of such corporation. This rule exempts certain corporate joint ventures from the provision.

Finally, stock of a bank or a bank holding company is not portfolio stock if, as of the beginning of the ex-dividend date for the dividend involved, the taxpayer (1) owns stock having a value equal to at least 80 percent of the value of all the stock (disregarding certain preferred stock) of the corporation, and (2) holds options to acquire stock possessing at least 50 percent of voting power of all classes of stock of such corporation.

Directly attributable

The reports of the House and Senate committees contain examples, which the conferees endorse, of indebtedness which is treated as directly attributable to investment in stock and of indebtedness which is generally not so treated. However, the conferees wish to clarify that indebtedness of a taxpayer is not directly attributable to portfolio stock held by a corporation all or substantially all of the stock of which is acquired by the taxpayer if the portfolio stock is held by the acquired company in the active conduct of a trade or business. This rule applies only in cases in which the practice of making portfolio stock investments is an integral part of the acquired corporation's trade or business. Thus, for example, if the taxpayer makes a 100 percent debt-financed acquisition of all of the stock of a life insurance company, and such company uses its capital and surplus to make investments in portfolio stock of other corporations, the provision is not to apply because the taxpayer is really acquiring an active business, not portfolio stock. In contrast, however, if the taxpayer makes a debt-financed acquisition of 100 percent of the stock of a mere investment company, the provision is applicable.

Also, the conferees wish to clarify that the provision may be applied where indebtedness is directly attributable to the carrying of portfolio stock as well as where the indebtedness is directly attributable to the acquisition of portfolio stock. Thus, assume that an acquisition of stock is entirely equity-financed. Assume also that the purchaser, at a later date, obtains funds through a borrowing secured by the portfolio stock in a case in which the purchaser could reasonably have been expected to sell the portfolio stock rather than incur the indebtedness. The provision is applicable.

Portfolio indebtedness

The conferees wish to clarify that purchase money indebtedness is treated as portfolio indebtedness for purposes of the provision. Thus, if a corporation buys stock, issuing its own debt obligation to the seller, that obligation is portfolio indebtedness.

The provision operates on the dividends received deduction instead of the interest deduction. However, under the conference agreement, the Treasury is granted authority to issue regulations providing, in lieu of reducing the dividends received deduction, for the disallowance of the interest deduction, or other appropriate treatment, where the obligor is a person other than the person receiving the dividend. The conferees anticipate that these regulations, for example, would apply in a case in which two corporations, A and B, acquire all of the stock of a third corporation, C, with A using debt to acquire 30 percent of the C stock and B using equity funds to acquire the remaining 70 percent. If the money borrowed by A is directly attributable to investment in dividend-paying portfolio stock by C, under such regulations, there would be no reduction in C's dividends received deduction. Rather, interest expense paid or accrued by A on the debt incurred to acquire the C stock would be disallowed, or other appropriate treatment (e.g., the equivalent of a recapture of interest deductions) provided. This result is more appropriate than a reduction in C's dividends received deduction because such a reduction would, in effect, penalize both A and B even though B's investment was not debt-financed.

2. Certain dividends from regulated investment companies

Present law

Domestic corporations are generally entitled to an 85-percent dividends received deduction with respect to dividends from other corporations. No similar deduction is available with respect to their interest income. Individuals are generally entitled to exclude from gross income up to $100 of dividend income. No similar rule applies with respect to their interest income.

Mutual funds, or regulated investment companies ("RIC's"), are generally not subject to tax if they distribute their income to their shareholders. That income is generally taxed to the shareholders directly. If less than 75 percent of a RIC's gross income for a taxable year consists of dividends from domestic corporations, then its taxable distributions (other than capital gain distributions) to its shareholders are treated as dividend income in an amount based on the ratio of the RIC's gross income constituting dividend income to all its gross income for the year. However, if 75 percent or more of the RIC's gross income for a taxable year consists of dividends from domestic corporations, then all the RIC's such distributions for the year are treated as dividend income to its shareholders.

For purposes of the foregoing rules, it is not clear whether a dividend received by a RIC is treated as a dividend if the RIC, had it been a regular corporation, would not have been entitled to a dividends received deduction with respect to it. Furthermore, it may be unclear whether a RIC's short-term capital gain income from the sale of stock or securities is treated as gross income for this purpose. See Rev. Rul. 80-345, 1980-2 C.B. 204 (holding that it is to be treated as a part of gross income for this purpose).

House bill

With respect to corporate shareholders of a RIC, 100 percent, rather than 75 percent, of the RIC's gross income must constitute dividend income before all its distributions (other than capital gain distributions) are to be treated as dividend income eligible for the dividends received deduction in the hands of domestic corporate shareholders. Furthermore, for this purpose, no dividend received by a RIC is treated as a dividend unless, had the RIC been a regular corporation, it would have been entitled to a dividends received deduction with respect to it. If less than 100 percent of the RIC's gross income constitutes dividend income, the proration rule of present law applies.

The provision is effective for RIC taxable years beginning after the date of enactment.

Senate amendment

The Senate amendment follows the House bill with certain exceptions. First a 95-percent, rather than a 100-percent, threshold applies. Second, except for the rule requiring that the RIC be entitled to a dividends received deduction, the provision applies for purposes of the dividend exclusion for individuals as well as the dividends received deduction for corporations. Third, the amendment makes it clear that short-term capital gain from the sale of stock or securities is treated as gross income for purposes of the provision. Fourth, if the 95-percent threshold is not met, the amount of the RIC's distributions to be treated as dividends to its corporate shareholders is to be as designated by the RIC. However, the RIC cannot designate as dividends an amount in excess of its aggregate dividends for the taxable year involved which would have been eligible for a dividends received deduction had the RIC been an ordinary corporation.

The provision is effective for RIC taxable years beginning after the date of enactment.

Conference agreement

The conference agreement generally follows the Senate amendment with three exceptions. First, the conference agreement adopts the 100-percent threshold of the House bill for purposes of the dividends-received deduction for corporate shareholders (but accepts the 95-percent threshold of the Senate amendment for purposes of the dividend exclusion for individual shareholders). Second, the conference agreement provides that net short-term capital gains from dispositions of stock or securities in excess of long-term capital losses from dispositions of stock or securities are treated as gross income for purposes of the provision. Third, the basic designation requirement is extended to the dividend exclusion in cases in which less than 95 percent of the RIC's income consists of dividend income. The conferees intend that each share of stock of the RIC outstanding for the entire taxable year (or any portion thereof) have the same designation of income made with respect to it. That is, for example, the RIC cannot designate the same quarterly dividend as being from dividend income for some shareholders and from tax-exempt interest for others.

3. Corporate shareholder's basis in stock reduced by reason of extraordinary dividends

a. Basis

Present law

A corporation owning stock of another corporation generally is allowed a deduction equal to 85 percent of the amount of any distribution received with respect to that stock which qualifies as a dividend. Receipt of the dividend generally has no effect on the shareholder's basis in the stock. Under section 301(c)(2), if the distribution is not a dividend, the shareholder's basis in the stock generally is reduced by the amount of the distribution. To the extent such amount exceeds the shareholder's basis in the stock, the excess is treated as gain from a sale of the stock. For these purposes, if the distribution is of property rather than cash, the amount of the distribution, in the case of certain corporate shareholders, is the lesser of (1) the property's fair market value, or (2) the property's adjusted basis in the hands of the distributing corporation, increased by any gain recognized to it on the distribution.

House bill

A corporate shareholder's basis in any share of stock which is held for one year or less is reduced by the non-taxed portion of any extraordinary dividend received with respect to that stock. Extraordinary dividends which, in amount, equal or exceed 10 percent (5 percent in the case of a share of stock preferred as to dividends) of the corporate shareholder's basis (determined without regard to the provision) in the share of stock with respect to which the dividend is received. All dividends received with respect to a share of stock which have ex-dividend dates within a period of 85 days are treated as one dividend. Furthermore, all dividends received with respect to a share of stock which have ex-dividend dates within a period of 365 days are treated as extraordinary if their amounts exceed 20 percent of the corporate shareholder's basis (determined without regard to the provision) in such share.

Solely for purposes of the provision, the amount of a dividend is, in the case of a distribution of property other than cash, its net fair market value. The non-taxed portion of the dividend is the amount of the dividend, as so determined, less any portion thereof includible in income which is not offset by a dividends received deduction.

A distribution which, had it qualified as a dividend, would have been treated as an extraordinary dividend, is to be treated as an extraordinary dividend even though the distributing corporation has no earnings and profits (or an amount of earnings and profits that is less than the amount of the distribution). In such a case, the amount of the distribution (as determined under the provision) is reduced by the amount of any reduction in stock basis resulting from the application of section 301(c)(2) of present law.

In determining whether the more than one-year holding period requirement has been satisfied, the general holding period suspension rules applicable to the dividends received deduction, as amended by the House bill, are applicable.

The Treasury is authorized to prescribe regulations applying the provision in the case of stock dividends, stock splits, reorganizations, and other similar transactions.

The provision is effective with respect to distributions after March 1, 1984.

Senate amendment

The Senate amendment follows the House bill except that the Senate amendment applies to distributions after the date of enactment.

Conference agreement

The conference agreement follows the House bill. In addition, the conference agreement clarifies that if the amount of the extraordinary dividend (as determined under the provision) exceeds the corporate shareholder's basis in the stock with respect to which the distribution was made, the excess will be taxed to the corporate shareholder under section 301(c)(3)(A). Furthermore, in determining whether the more than one-year holding period is satisfied, the bill makes provision for tolling the running of the holding period in certain instances. Finally, the conferees wish to make clear their intention that if a redemption distribution is treated as a distribution under section 301 rather than a sale or exchange of the redeemed shares under section 302(a), the distribution is treated as made, pro rata, with respect to stock of the shareholder which is not redeemed.

b. Suspension of holding period for dividends -received deduction

Present Law

The 85-percent dividends received deduction is disallowed unless the taxpayer satisfies a 16-day holding period with respect to the dividend-paying stock (91 days in the case of dividends on certain preferred stock). The 16-day and 91-day holding periods do not include periods during which the taxpayer reduces or eliminates the risk of loss on the underlying stock by entering into a short sale of, acquiring an option to sell, or entering into a binding contract to sell substantially identical stock or securities.

House bill

The House bill expands the scope of the provision that suspends the holding period of stock to include (1) any period during which the taxpayer is the grantor of an option to buy substantially identical stock or securities, subject to an exception for a qualified covered call (as defined for purposes of the provisions relating to tax straddles and (2) any period during which the taxpayer holds one or more other positions that substantially diminish the risk of loss from holding the stock.

Senate amendment

The Senate amendment generally is the same as the House bill except that (1) in lieu of the "substantial diminution" standard in the House bill, the holding period of stock is suspended during any period when the taxpayer has reduced the risk of loss from holding the stock by reason of holding one or more positions in substantially similar property, prospectively only, as regulations may provide, and (2) an exception is provided for broker dealers with respect to ordinary income or loss property.

Conference agreement

The conference agreement follows the House bill with several modifications.

Substantially similar or related standard

Under the conference agreement, the 85-percent dividends received deduction is disallowed unless the taxpayer satisfies a 46-day holding period requirement. The 46-day holding period does not include any period when the taxpayer reduces the risk of loss by reason of holding one or more other positions in substantially similar or related property. The conference agreement does not provide an exception for broker dealers.

The following transactions are examples of the types of transactions that are within the scope of the rule for substantially similar or related property: (1) a short sale of common stock when the taxpayer holds convertible preferred stock of the same issuer and the price changes of the convertible preferred stock and the common stock are related (the same result would obtain in the case of a short sale of a convertible debenture while holding convertible preferred stock into which the debenture is convertible or common stock, or a short sale of convertible preferred stock while holding common stock); and (2) the acquisition of a short position in a regulated futures contract ("RFC") on a stock index (or the acquisition of an option to sell the RFC or the stock index itself, or the grant of a deep-in-the-money option to buy the RFC or the stock index) while holding the stock of an investment company whose principal holdings mimic the performance of the stocks included in the stock index (or, alternatively, while holding a portfolio composed of stocks that mimic the performance of the stocks included in the stock index). The conference agreement contemplates that regulations setting forth the application of the rule for substantially similar or related property to the transactions identified above will be generally effective as of the date of enactment of the bill, but that such regulations will be applied to other transactions on a prospective basis. The conferees intend no inference regarding the circumstances under which the dividends received deduction would be disallowed under present law where taxpayers write in-the-money calls with respect to stock they hold. In addition, no inference is intended regarding what situations are covered under the present-law rule applicable to substantially identical stock or securities.

Ordinarily, common stock in one corporation would not be viewed as substantially similar or related to common stock of another corporation. Where stocks of similar companies are involved, however, a short sale of preferred stock of one corporation while holding preferred stock of the other corporation may result in application of the risk reduction rule.

The substantially similar standard is not satisfied merely because the taxpayer (1) holds a single instrument that is designed to insulate the holder from market risks (*e.g.*, adjustable rate preferred stock that is indexed to the Treasury bill rate), or (2) is an investor with diversified holdings and acquires an RFC or option on a stock index to hedge general market risks. The conferees intend that an investment in preferred stock coupled with an option to sell the stock will not be treated as a single instrument, for purposes of applying the substantially similar standard, without regard to whether the option trades separately from the stock.

4. Non-liquidating distributions by corporations of appreciated property

a. Recognition

Present law

A corporation generally does not recognize income on the distribution, with respect to its stock, of appreciated property. There are exceptions to this rule. First, such a distribution will generally trigger recapture income, as under section 1245 (relating to depreciable personal property). Second, the distribution of LIFO inventory generally will generate income in an amount equal to the LIFO reserve with respect to such inventory. Third, if a corporation distributes property which is subject to a liability, or the shareholder assumes a liability in connection with the distribution, gain is generally recognized to the distributing corporation to the extent the liability exceeds the adjusted basis of the distributed property in the hands of the distributing corporation. Fourth, if a corporation distributes property in a redemption to which sections 301 through 307 apply, gain is generally recognized in an amount equal to the excess of the distributed property's value over its adjusted basis in the hands of the distributing corporation. If gain is recognized to a distributing corporation in a redemption distribution, neither the LIFO inventory rule nor the liability rule applies.

However, gain is not always recognized to the distributing corporation with respect to redemption distributions to which sections 301 through 307 apply. For example, gain is not recognized with respect to redemption distributions to certain corporate shareholders. Furthermore, gain is not recognized with respect to redemption distributions to certain noncorporate shareholders if the distribution qualifies as a partial liquidation. Finally, sections 311(d)(2)(C) through (F) provide additional exceptions to the general rule that gain is recognized to the distributing corporation in a redemption distribution.

House bill

Under the House bill, gain (but not loss) is generally recognized to the distributing corporation on any non-liquidating distribution of appreciated property to which sections 301 through 307 apply as if such property had been sold by the corporation for its fair market value rather than distributed. The general rule applies whether or not the distribution qualifies as a dividend.

The general rule also applies whether or not the distribution is a redemption distribution. However, if the distribution is a redemption distribution, the present-law exceptions to gain recognition remain, with two exceptions. First, gain is recognized if the distribution in redemption is to a corporate shareholder unless such shareholder owns, at the time of the distribution, stock possessing at least 80 percent of the total combined voting power and at least 80 percent of the total number of all other classes of stock (disregarding certain preferred stock) of the distributing corporation. However, the corporate shareholder is not to be treated as an 80-percent or more shareholder for this purpose unless its basis in the distributed property is determined with reference to the property's adjusted basis in such property under section 301(d)(2). Second, gain is not recognized if the distribution (1) qualifies as a partial liquidation under section 302(b)(4) and is made to certain noncorporate shareholders, or (2) is a qualified dividend (described below).

If the distribution is not a redemption distribution, gain is recognized in full unless (1) the distribution is to an 80-percent or more corporate shareholder (as determined above), or (2) section 311(d)(2)(C) of present law (relating to certain distributions of stock or obligations of certain controlled corporations) applies.

In the case of a distribution which is not a redemption distribution, gain is not recognized to the distributing corporation with respect to property distributed to certain noncorporate shareholders to the extent the distribution is a qualified dividend. A qualified dividend is a distribution of property which is (1) a dividend, (2) of property used by the distributing corporation immediately before the distribution in the active conduct of a trade or business, and (3) not property described in section 1221(1) (relating to inventory and certain order property) or section 1221(4) (relating to certain accounts and notes receivable). Furthermore, the distribution must be with respect to qualified stock, as defined in section 311(e).

The rules relating to LIFO inventory and liabilities in excess of basis are to be applied before any of the other recognition provisions.

The provision is effective with respect to distributions declared after the date of enactment. A transitional rule is provided for distributions before February 1, 1986, by certain corporations of royalty trust property with respect to which a royalty trust proposal was submitted by certain groups.

Senate amendment

The Senate amendment generally is the same as the House bill. However, it is effective with respect to distributions declared after March 15, 1984. The provision does not apply to any distributions before February 1, 1986, by corporations referred to in the transitional rule under the House bill. Nor does it apply to certain distributions of partnership interests traded on a national securities exchange on March 7, 1984, by certain corporations owning more than 80 percent of such interests on March 7, 1984. Finally, it does not apply to certain distributions declared before the date of enactment of not more than 51 percent of the stock of corporations controlled by certain corporations pursuant to proposals considered before February 15, 1982.

Conference agreement

The conference agreement follows the Senate amendment with some exceptions.

Eighty-percent corporate shareholders

Under the conference agreement, the rule exempting the distributing corporation with respect to distributions to 80-percent corporate shareholders that take a basis in the distributed property determined under section 301(d)(2) is eliminated. Thus, an ordinary, non-liquidating distribution of appreciated property by a 100-percent subsidiary to its corporate parent is a taxable event to the distributing corporation. Generally, the corporate parent takes a fair market value basis in the distributed property (sec. 301(d)(2)).

Under present law, such a distribution would generally not be taxable to the distributing corporation, and the corporate parent would inherit the distributing corporation's adjusted basis in (and holding period for) the property. As a result, when the parent sells the property, gain "accruing" during the period of time the property was held by the subsidiary would be taxed to the parent, rather than the subsidiary, and the character of that gain (as capital or ordinary) would likely be determined with reference to the character of the property in the parent's, rather than the subsidiary's hands. In general, the conferees think that such a shifting of tax liability is inappropriate in the case of ordinary, non-liquidating distributions. Furthermore, the conferees do not believe that such a distribution should permit corporate taxpayers to be able to change the character of the income involved, as present law may permit. Furthermore, the theory of section 311 and the provision is that the distribution of appreciated property to a shareholder is a realization event and, therefore, an appropriate time to impose tax liability. The conferees are not persuaded that a different rule is appropriate merely because the shareholder may be an 80-percent corporate shareholder. If the two corporations are not filing a consolidated return, they should be treated as separate taxpayers, just as they are when one sells property to, or performs services for, the other. The conferees are also aware of cases under present law in which an acquiring corporation can sell, indirectly, built-in-loss assets of an acquired corporation and recognize the loss while selling, indirectly, built-in-gain assets of the acquired corporation without having to take any of that gain into income. Finally, the conferees are aware of transactions in which one corporation buys all the stock of another, has the acquired corporation distribute appreciated property to it, and then sells the stock and recognizes a tax loss. The conference agreement addresses these concerns.

The conferees anticipate that the Treasury will promptly consider what changes, if any, are necessary or appropriate under the consolidated return regulations by reason of this rule.

Effective dates

Under the conference agreement, the provision is generally effective for distributions declared on or after June 14, 1984. However, the rule applying the provision with respect to a distribution to an 80-percent corporate shareholder that takes a basis in the distributed property determined under section 301(d)(2) generally applies only to distributions after December 31, 1984. In addition, the rule applying the provision to such an 80-percent corporate shareholder does not apply to certain distributions before September 1, 1986.

The September 1, 1986, rule applies only in the case of distributions by a corporation (or by any member of a group of corporations, of which such corporation was the common parent, which files a consolidated return for the period which includes June 14, 1986) (1) control of which, as defined in sec. 368(c), is acquired other than in a tax-free reorganization after January 1, 1984, but before January 1, 1985, and (2) a tender offer for the shares of which was commenced on May 23, 1984, and amended on May 24, 1984. Furthermore, the September 1, 1986, rule applies only if the distributing corporation and the distributee corporation are members of the same group filing consolidated returns for the period which includes the date of the distribution. Finally, the September 1, 1986, rule applies only if the distributed property consists of stock of a corporation which on June 14, 1984, was a member of the affiliated group of which the corporation referred to in (1) above was the common parent.

Under the conference agreement, if the distributing corporation and the distributee corporate shareholder are part of the same affiliated group of corporations filing a consolidated return for the period which includes the date of distribution, the aggregation rules of Treas. reg. section 1.1502-34 are applicable in determining whether the 80-percent corporate shareholder exception applies.

The conferees intend that in the case of a redemption distribution to a corporate shareholder, that shareholder is not to be treated as an 80-percent corporate shareholder unless it is an 80-percent corporate shareholder after the distribution, as well as before (applying the rule of Treas. reg. sec. 1.1502–34).

The conference agreement also retains two of the three transitional rules contained in the Senate amendment.

b. Holding period for property distributed by one corporation to another

Present law

Section 301(d)(2) provides rules to determine the basis in the hands of certain corporate shareholders of property distributed to them by a distributing corporation with respect to their stock. That basis is the lesser of (1) the distributed property's fair market value, under section 301(d)(2)(A), or (2) the distributed property's adjusted basis in the hands of the distributing corporation, increased by any gain recognized to the distributing corporation on the distribution, under section 301(d)(2)(B). If section 301(d)(2)(B) applies, then, under section 1223(2), the corporate shareholder's holding period for the property includes the period during which it was held by the distributing corporation. If section 301(d)(2)(A) applies, the corporate shareholder's holding period in the distributed property begins on the date of the distribution.

Under section 1248(f)(1), if certain domestic corporations distribute the stock of certain foreign corporations in a transaction to which section 311 applies, the distributing corporation will have included in its gross income as a dividend an amount equal to certain earnings and profits of the foreign corporation. Under section 1248(f)(2), the rule of section 1248(f)(1) does not apply if, among other things, the distribution is to a domestic corporate shareholder which includes in its holding period for the distributed stock the period such stock was held by the distributing corporation.

House bill

If section 301(d)(2)(B) applies, the House bill provides that the corporate shareholder's holding period for the distributed property begins not earlier than the date the stock with respect to which the distribution was made was acquired.

The provision applies to distributions declared after the date of enactment.

Senate amendment

The Senate amendment generally is the same as the provision in the House bill except that the Senate amendment applies to distributions after the date of enactment.

Conference agreement

The conference agreement generally follows the Senate amendment. However, the conference agreement explicitly clarifies that if the distributing corporation recognizes gain on the distribution under section 311, as amended by the bill, the corporate shareholder's basis in the distributed property is determined under section 301(d)(2)(A) (and not section 301(d)(2)(B)) so that its holding period in the property begins on the date of the distribution. The conferees are aware that under this rule after section 311, as amended by the bill, becomes fully effective, a corporate shareholder's holding period for property distributed to it by another corporation will generally begin on the date of the distribution.

Under the conference agreement, the provision does not apply for purposes of section 1248(f)(2). However, the amendments to section 311 do apply. Thus, the distribution of appreciated stock of a foreign corporation by one domestic corporation to another may trigger gain recognition (some of which may be dividend income under section 1248(a)) to the distributing corporation. On the other hand, the distribution may not trigger gain recognition to the distributing corporation if the distributee shareholder is an 80-percent corporate shareholder and if the distribution occurs before January 1, 1985. If gain recognition is not triggered, and if the conditions of section 1248(f)(2)(B) are satisfied, then section 1248(f)(1) does not apply, and the distributing corporation has no dividend income by reason of the distribution. The conferees are aware that after section 311, as amended by the bill, becomes fully effective, such a distribution will trigger gain recognition (and dividend income under section 1248(a)) to the distributing corporation.

5. Capital gains distributions from regulated investment companies and real estate investment trusts

Present law

Generally, regulated investment companies ("RICs") that distribute their income are not subject to tax. Rather, that income is taxed directly to their shareholders.

RICs frequently realize long-term capital gain income. That income is generally treated as long-term capital gain to the shareholders. If the stock with respect to which a long-term capital gain distribution is made (or treated as having been made) is held by a shareholder for less than 31 days, any loss on the sale or exchange of that stock is treated as a long-term capital loss to the extent of any long-term capital gain distribution by the RIC with respect to such stock.

Similar rules apply with respect to real estate investment trusts ("REITs").

House bill

If stock with respect to which a long-term capital gain distribution is made by a RIC or a REIT is held by a shareholder for 6 months or less, any loss on the sale or exchange of the stock is treated as a long-term capital loss to the extent of the long-term capital gain distribution. An exception is provided for dispositions of stock pursuant to a periodic redemption plan.

The provision is applicable to losses incurred on stock acquired after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment. In determining whether stock has been held for 6 months or less, the bill amends provisions tolling the running of the holding period in certain instances.

6. Certain expenses incurred in connection with short sales

Present law

Treatment of short sales of stock

In a "short sale", the taxpayer sells borrowed property (such as stock or securities) and later closes the short sale by returning identical property to the lender. Gain or loss on the closing of a short sale is considered gain or loss from the sale or exchange of a capital asset if the property used to close the short sale is a capital asset in the hands of the taxpayer. Where the property sold short is stock, and a dividend is distributed with respect to the stock, the taxpayer is required to pay an amount equal to the value of the distribution to the lender of the stock. The Internal Revenue Service has ruled that this payment in lieu of a dividend is deductible currently against ordinary income.

When a dividend is paid with respect to stock, the stock can be expected to decline in value by an amount that approximates the value of the dividend distribution. Taxpayers can effectively convert ordinary income to capital gain by entering into a short sale of stock just before the ex-dividend date, deducting the dividend-substitute payment against ordinary income, and realizing an offsetting capital gain upon closing the short sale.

When a taxpayer borrows property for use in a short sale, the taxpayer may receive a rebate fee—taxable as ordinary income—with respect to short sale proceeds deposited with the lender as collateral. This rebate fee compensates the taxpayer for the lender's use of the short sale proceeds during the period before the short sale is closed and property is returned.

Investment interest limitation

Section 163(d) limits deductions for interest by an individual or other noncorporate taxpayer on indebtedness to purchase or carry an investment. The deduction for investment interest is limited to the taxpayer's net investment income plus $10,000. Disallowed interest deductions are carried over and may be allowed in future years.

Interest related to tax-exempt income

In general, section 265(2) provides that no deduction is allowed for interest on indebtedness incurred or continued to purchase or carry tax-exempt obligations.

In the case of a securities dealer who borrows money for the purpose of conducting a business that includes the holding of tax-exempt obligations, but whose borrowings cannot be traced to the purchase or continued holding of such obligations, section 265(2) is applied on the basis of an allocation. (See Rev. Proc. 72–18, 1971–1 C.B. 1; and *Leslie v. Commissioner*, 413 F.2d 636 (2d Cir. 1969), *cert. denied*, 396 U.S. 1007 (1970).) The amount of interest allocated to tax-exempt obligations is determined by multiplying the taxpayer's total interest expense by a fraction, the numerator of which is the average adjusted basis of the tax-exempt obligations held during the taxable year and the denominator of which is the average adjusted basis of the total assets held during the year. Interest on debt that is traceable entirely to tax-exempt obligations and interest which is not subject to disallowance under section 265(2) is excluded from this computation. The Internal Revenue Service has ruled that section 265(2) does not apply to disallow interest deductions with respect to indebtedness that is collateralized by tax-exempt securities held for the accounts of customers, and that the securities dealer is required to segregate pursuant to rules promulgated under the Securities and Exchange Act of 1934. Rev. Rul. 74–294, 1974–1 C.B. 71.

House bill

Treatment of short sales of stock

Payments in lieu of dividends are not deductible unless the short sale is held open for at least 16 days (more than one year in the case of payments in lieu of extraordinary dividends). The amount disallowed as a deduction is required to be capitalized (*i.e.*, added to the basis of the stock used to close the short sale).

In determining whether the short sale is held open for the required 16-day (or more-than-one-year) holding period, there is not to be included any period during which the taxpayer holds, has an option to buy, or is under a contractual obligation to buy, substantially identical stock or securities, or there is otherwise a substantial diminution of the taxpayer's risk of loss from the short sale by reason of holding one or more other positions.

Investment interest

For purposes of the restriction on the deductibility of investment interest, the definition of interest is expanded to include any amount allowable as a deduction in connection with personal property used in a short sale.

Interest related to tax-exempt income

For purposes of the provision that disallows interest deductions related to tax-exempt income, the definition of interest is expanded to include any amount paid or incurred in connection with personal property used in a short sale.

The provisions of the House bill are effective for short sales entered into after the date of enactment.

Senate amendment

Treatment of short sales of stock

The Senate amendment is similar to the House bill. In applying the risk reduction rule for purposes of determining whether a short sale is held open for the required period, under regulations, there is not to be included any period during which the taxpayer diminishes the risk of loss from the short sale by reason of holding one or more other positions with respect to substantially similar property.

In addition, except with respect to extraordinary dividends, the Senate amendment permits the deduction of dividend-substitute payments to the extent of ordinary income that is received from the person providing the stock used in the short sale as compensation for the use of collateral. Earnings on the collateral establish an appropriate measure of the portion of the dividend-substitute payment that represents a current charge for the use of the property sold short, as distinguished from dividends that had accrued economically prior to the short sale.

Interest related to tax-exempt income

The Senate amendment also includes additional rules for the application of the provision extending the rule that disallows interest deductions related to tax-exempt income. First, section 265(2) does not apply to disallow a deduction for short sale expenses incurred by a taxpayer who acts as a conduit in a short sale transaction executed in a customer's account.

Second, the Senate amendment makes clear that section 265(2) applies to amounts paid by the person providing the personal property used in a short sale as compensation for use of collateral with respect to the property (*e.g.*, a rebate fee).

Third, in applying section 265(2) to a taxpayer whose business includes buying and selling tax-exempt obligations, short sale expenses (and the short sale proceeds) are treated separately, in a manner analogous to the treatment accorded broker loans collateralized with customer securities under present law (the situation covered by Rev. Rul. 74–294, 1974–1 C.B. 71), unless the short sale proceeds can be directly traced to the purchase or carrying of tax-exempt obligations. Thus, section 265(2) would not apply to disallow a deduction for short sale expenses incurred in a transaction in which the short seller did not receive the short sale proceeds (*e.g.*, because the funds were deposited as collateral).

Conference agreement

The conference agreement follows the House bill with several modifications.

Treatment of short sales of stock

Under the conference agreement, payments in lieu of dividends are not deductible unless the short sale is held open for at least 46 days (more than one year in the case of payments in lieu of extraordinary dividends). In applying the risk reduction rule for purposes of determining whether a short sale is held open for the required period, under regulations, there is not to be included any period during which the taxpayer diminishes the risk of loss from the short sale by reason of holding one or more other positions with respect to "substantially similar or related property" (as that term is defined for purposes of the holding period requirements for the dividends-received deduction).

The conference agreement clarifies that, in the case of any short sale, the provision relating to short sale expenses applies before section 263(g) (relating to interest and carrying costs in the case of straddles).

Interest related to tax-exempt income

The conference agreement does not include the provision of the Senate amendment relating to brokers who act as conduits in short sales executed for customers. This result occurs under present law without a statutory provision. Thus, the conference agreement contemplates that the provision expanding the scope of section 265(2) to apply to short sale expense will not apply to a broker who acts as a conduit. The conference agreement does not provide for the separate treatment of short sale expenses and short sale proceeds. Under the conference agreement, section 265(2) will not apply to disallow a deduction for short sale expense if the taxpayer (1) deposits cash as collateral for the property used in the short sale, and (2) does not earn a material return on the cash so deposited.

7. Nonrecognition of gain or loss by corporations on options with respect to their stock (warrants)

Present law

Corporations frequently issue for a consideration options to third parties to acquire from it shares of its own stock (warrants). Sometimes those warrants expire unexercised, or lapse. On other occasions, they may be repurchased by the issuing corporation for more or less than they were originally issued for. The tax consequences to the issuing corporation of a lapse of warrants or of a repurchase of warrants it has issued is unclear.

House bill

Under the House bill, a corporation does not recognize gain or loss on any lapse or repurchase of a warrant it issued to acquire from it shares of its own stock.

The provision applies to warrants repurchased or lapsing after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

8. Accumulated earnings tax

Present law

An accumulated earnings tax is imposed on corporations that are formed or availed of for the purpose of avoiding the income tax with respect to shareholders by permitting earnings and profits of the corporation to accumulate instead of being distributed. Where applicable, the tax is imposed at a rate of 27½ percent of the first $100,000 of accumulated taxable income for the taxable year and at a rate of 38½ percent on accumulated taxable income in excess of $100,000.

The term "accumulated taxable income" means taxable income, with certain adjustments, reduced by a deduction for dividends paid. In determining accumulated taxable income, a corporation is permitted a deduction for net capital losses during the year in question. A corporation is also permitted a deduction for net capital gains during the year, determined without regard to capital loss carryovers or carrybacks, less certain taxes.

The Internal Revenue Service takes the position that the accumulated earnings tax can be imposed on widely-held corporations, even one not controlled by a few shareholders or groups of shareholders. The issue has not been resolved definitely by the courts.

House bill

Under the House bill, the mere fact that a corporation is widely held does not exempt it from the accumulated earnings tax. This rule applies to operating companies, as well as mere holding or investment companies, regardless of how concentrated the ownership of their stock may be.

Changes are also made in the determination of accumulated taxable income. In general, the deduction from accumulated taxable income for net capital gains, less certain taxes, remains. However, in determining net capital gains for this purpose, net capital losses for any taxable year are treated as short-term capital losses during the next taxable year. The deduction for net capital losses also generally remains. However, that deduction is reduced by any deduction from accumulated taxable income for net capital gains, less certain taxes, for preceding years beginning after the date of enactment. No such net capital gains, less certain taxes, are to be used to reduce the deduction for net capital losses more than once.

Certain different rules apply to mere holding or investment companies. For example, they are allowed no deduction from accumulated taxable income for net capital losses. On the other hand, net capital losses are not to be treated as a carryover in determining accumulated taxable income.

The provision applies to all taxable years beginning after the date of enactment.

Senate amendment

The Senate amendment is the same as House bill.

Conference agreement

The conference agreement generally follows the House bill and the Senate amendment.

The conferees agree with the statement in the Senate committee report to the effect that while a section 531 tax avoidance purpose may be inferred in an appropriate case, as a practical matter it may be difficult to establish such a purpose in the case of a widely-held operating company when no individual or small group of individuals has legal or effective control of the company.

The conference agreement clarifies that, in the case of corporations other than mere holding or investment companies, net capital loss carryovers are to be used only once in determining accumulated taxable income. In addition, mere holding or investment companies are allowed a deduction from accumulated taxable income for net short-term capital gains, but only to the extent of any previously unused capital loss carryovers to the year in question.

9. Repeal of stock for debt exception for purposes of determining income from discharge of indebtedness

Present law

Generally, income from discharge of indebtedness is realized when the taxpayer's debts are satisfied at less than their face amount (sec. 61(a)(12)). However, cases have held that a corporation does not realize income from discharge of indebtedness when its debts are satisfied with its own stock, notwithstanding that the value of the stock is less than the amount of the debt. This stock-for-debt rule is subject to two statutory exceptions (sec. 108(e)(8)).

House bill

The House bill provides that a debtor corporation realizes income from discharge of indebtedness when it satisfies its debt with stock having a fair market value less than the principal of the debt. This rule applies where the principal amount of a corporate debt is discharged, including by reason of the exercise of a conversion right by the holder of the debt. It does not apply where payments are simply deferred. (Section 1032 does not prevent the recognition of this income from the discharge of indebtedness.)

The repeal of the stock-for-debt exception does not apply if the discharge occurs pursuant to a title 11 (bankruptcy) case or to the extent the debtor is insolvent; in these cases, present law continues to apply.

The provision applies to transfers after date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement generally follows the House bill, but provides transitional rule exceptions to the general effective date (transfers after the date of enactment) and also makes the provision inapplicable (as of January 1, 1986) to certain "workouts".

Under the first transitional rule, the provision in the bill will not apply to any transfer pursuant to a written binding contract or option (including a convertible debenture) which was in effect at all times on the day of June 7, 1984, and which remains in effect at all times thereafter. Thus, the provision applies to transfers pursuant to contracts or options entered into on or after June 7, 1984, since in such a case, the contract or option will not have been in effect at all times on June 7, 1984. This exception will apply only if the holder of the debt on June 7, 1984, also was the party to the contract or held the option on that date. A transfer pursuant to a written contract must be completed before January 1, 1985. The conversion of debt pursuant to an option or conversion right outstanding at all times on June 7, 1984, and thereafter will be covered by the transitional rule regardless of whether conversion is after 1984. Under the second transitional rule, the provision in the bill will not apply to a transfer of stock before January 1, 1985, to a corporation which owned at least 75 percent of the stock of the debtor corporation on June 7, 1984, and which owns more than 80 percent of the stock of that corporation after the transfer. Finally, a transfer before January 1, 1985, pursuant to a debt restructuring agreement entered into in November, 1983, for which a registration statement was filed with the Securities and Exchange Commission in March, 1984, will not be subject to these new rules.

A stock-for-debt transaction does not give rise to debt discharge income under the "workout" exception if (1) the transfer of stock is made (pursuant to a plan) because of cash flow and credit problems which will cause the debtor corporation difficulty in meeting its liabilities during the next 12 months to such an extent that there is a substantial threat of an involuntary bankruptcy or insolvency proceeding, (2) the corporation notifies its stockholders of this financial difficulty and that it is engaged in a workout, (3) at least 25 percent of the total debt of the corporation is extinguished by transfers of stock pursuant to the plan, and (4) holders of more than 50 percent of the total indebtedness of the debtor corporation outstanding on the date of transfer approve the plan. The workout definition will be satisfied only if it is reasonably related to the objective of avoiding a likely insolvency or bankruptcy proceeding.

The "workout" exception will become effective on the date on which the amendments made to section 382 by the Tax Reform Act of 1976 become effective. Under the bill, this will occur on January 1, 1986. This delayed effective date is adopted to allow the Congress to consider the appropriate treatment of stock-for-debt exchanges in the case of financially troubled corporations while the Congress is reexamining generally the treatment of net operating loss limitations. A stock-for-debt exchange in the case of a financially troubled corporation is a change of ownership event which the Congress may decide is an appropriate occasion for the reduction of net operating losses either under rules of a revised section 382 or by reason of the creation of income from the discharge of indebtedness. It is anticipated that any reconsideration of the exceptions to stock-for-debt rules will include consideration of the rules relating to the use of preferred or limited stock, stock of a parent corporation, and stock of a party to a reorganization, and related technical issues.

10. Affiliated groups

Present law

Includible corporations which are members of an affiliated group of corporations are generally entitled (or required) to file consolidated Federal income tax returns. Section 1504(b) defines the term "includible corporation" to mean any corporation, with several exceptions (e.g., exempt organizations, certain insurance companies, foreign corporations, and regulated investment companies). Certain other tax consequences also depend on whether two corporations are members of the same affiliated group (e.g., the 100-percent dividends received deduction under sec. 243(b)).

Under section 1504, an affiliated group means one or more chains of includible corporations connected through stock ownership with a common parent which is an includible corporation if (1) stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of each includible corporation (except the common parent) is owned directly by one or more other includible corporation, and (2) the common parent owns directly at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of at least one of the other includible corporations. For purposes of the definition, nonvoting stock which is limited and preferred as to dividends is disregarded, as is certain stock held under tax credit employee stock ownership plans or employee stock ownership plans.

Once the above stock ownership requirements cease to be met with respect to any one corporation, it can no longer be included in the consolidated return of its former affiliated group. However, there are generally no restrictions on its rejoining that group or joining any other group.

House bill

Under the House bill, two includible corporations are not eligible to begin filing a consolidated return with respect to any taxable year unless at the beginning of that year one owns stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of the fair market value of all outstanding stock of the other. For purposes of this definition, certain preferred stock is ignored, as is stock held under certain employee stock ownership plans. A similar rule applies in determining whether another corporation may begin being included in the consolidated return of that group.

Once two corporations are properly included in a valid consolidated return, they will continue being an affiliated group for consolidated return purposes unless one ceases to own stock, determined as above, (1) possessing at least 80 percent of the voting power of all classes of stock, or (2) having more than 50 percent of the fair market value of all outstanding stock, of the other. A similar rule applies in determining whether any other corporation continues to be a member of that group. Once a corporation has ceased being a member of an affiliated group filing consolidated returns, restrictions are imposed on its ability to reconsolidate with that group or to consolidate with certain other groups.

The Treasury is granted broad regulatory authority to carry out the purposes of the provision to prevent abuses.

The provision is effective for taxable years beginning after December 31, 1984. A permanent transition rule is provided for corporations which are members of an affiliated group under present law on March 1, 1984.

Senate amendment

The Senate amendment generally is the same as the House bill. However, stock held under tax credit employee stock ownership plans or other employee stock ownership plans is not ignored. In addition, the Treasury, by regulations, is authorized to provide relief in appropriate cases from the rule requiring ownership by one corporation of at least 80 percent of the fair market value of all outstanding stock of another corporation before the two may commence filing a consolidated return. The Senate amendment also clarifies the rule regarding consolidation or reconsolidation after deconsolidation.

The provision is effective for taxable years beginning after December 31, 1984. However, for taxable years beginning before January 1, 1988, the provision is not applicable to corporations filing a valid consolidated return under present law for the taxable year which includes April 11, 1984.

Conference agreement

The conference agreement follows the Senate provision with several exceptions.

All income tax purposes

Under the conference agreement, the definition of affiliated group is to be applied in determining whether an affiliated group exists for all purposes of subtitle A. The conferees see no reason to have a unique definition of affiliated group for consolidated return purposes. Under the definition, one corporation is not part of an affiliated group with another corporation unless one owns stock (1) possessing at least 80 percent of the total combined voting power, and (2) having a value equal to at least 80 percent of the total fair market value of the stock (disregarding certain preferred stock) of the other. Similar rules apply in determining whether any other corporation is also a member of the group.

No inference regarding present law is intended.

Continuation of status

The conference agreement drops the provision in the House bill and the Senate amendment to the effect that once a consolidated return is validly filed by two corporations, affiliated group status is to be treated as continuing so long as one corporation owns stock

(1) possessing at least 80 percent of the total voting power, and (2) having a value equal to more than 50 percent of the total fair market value of the stock (disregarding certain preferred stock) of the other. The conferees believe that such a rule would permit the common parent to dispose of too much of the value of the stock of the other without requiring deconsolidation. As a result, the conference agreement generally treats affiliated group status as continuing only if one corporation continues to own 80 percent of the total voting power and 80 percent of the value of the other. However, nothing in the bill is intended to overturn the position set forth in Rev. Rul. 78-119, 1978-1 C.B. 277 (holding that a corporation which has been a member of a group filing consolidated returns is not deconsolidated merely because its parent has temporarily lost its power to vote such corporation's stock by virtue of a court order issued during the pendency of litigation).

The conferees are also aware that, absent a special rule, the provision would cause affiliated group status to terminate if, merely by reason of changes in relative values of different classes of stock of a corporation, one corporation ceased to own 80 percent in value of the stock of the other corporation. Where the changes in relative value are not large and not intentionally generated, the conferees believe disaffiliation to be inappropriate. Accordingly, under the conference agreement, the Treasury is authorized to prescribe regulations pursuant to which inadvertent changes in relative values of different classes of stock are to be disregarded in determining whether affiliated group status continues.

Preferred stock

The conference agreement also specifies the kind of stock to be ignored in testing for affiliated group status and the continuation thereof. The stock to be ignored is stock which (1) is not entitled to vote, (2) is limited and preferred as to dividends and does not participate in corporate growth to any significant extent, (3) has redemption and liquidation rights that do not exceed the stock's paid-in capital or par value (except for a reasonable redemption premium), and (4) is not convertible into any other class of stock. Thus, for example, preferred stock carrying a dividend rate materially in excess of a market rate when issued would not be ignored.

Consolidation after deconsolidation

The conference agreement amends the rules of the Senate amendment regarding consolidation after deconsolidation. In general, if a corporation is included in a consolidated return filed by an affiliated group for a taxable year which includes any period after December 31, 1984, and such corporation ceases under the bill to be a member of such group for a taxable year beginning after December 31, 1984, then such corporation (and any successor) may not be included in any consolidated return filed by that group or any other group having the same common parent (or a successor) before the 61st month after the cessation.

The Treasury is authorized to waive the rule prohibiting consolidation after deconsolidation for any period subject to such conditions as the Treasury may prescribe. The rule is an anti-abuse rule, and the conferees expect the Treasury to so apply it. For example, assume that operating corporation A owns all the stock of operating corporation X and that the two file a consolidated return. On July 1, 1986, A merges into unrelated operating corporation B in a transaction qualifying under section 368(a)(1)(A). Assume that the transaction is not a reverse acquisition. Absent other factors, X should be able to join in filing a consolidated return with the group of which B is the common parent for the period beginning July 1, 1986, and regulations should so provide.

Regulations

Regulatory authority is granted to the Treasury to disregard transfers of stock within an affiliated group in determining whether affiliated group status is broken. For example, assume that corporation A owns 100 percent of the only class of stock of corporation B, and corporation B owns 100 percent of the only class of stock of corporation C. It is contemplated that a transfer by A of 30 percent of the stock of B to C will not break the status of A, B, and C as an affiliated group. Furthermore, the authority of the Treasury to prescribe regulations permitting affiliated group status to be treated as commencing or continuing if there was reliance on a good faith but erroneous determination of value is clarified.

The conference agreement contains rules similar to those in the House bill and the Senate amendment authorizing the Treasury to prescribe anti-abuse regulations to carry out the purposes of the provision. For example, the Treasury is authorized to prescribe regulations pursuant to which warrants to acquire stock are to be treated as stock and options to acquire stock are to be treated as having been exercised. Thus, assume that corporation A's common stock is worth $40 a share. Assume further that corporation B, the owner of all of A's common stock, grants corporation C an option to acquire that stock for $20 a share at a date beginning 3 years from the date of the grant. The facts indicate that A and C are likely to be loss corporations but that B is profitable. If it can reasonably be expected that C will exercise the option, the regulations may treat the option as having been exercised, for purposes of the new provision.

The Treasury is also authorized to prescribe regulations under which obligations convertible into stock (and similar interests) are treated as stock and stock (like "puttable" stock) is not treated as stock. Finally, the Treasury, by regulations is authorized to disregard changes in voting power to the extent such changes are disproportionate to related changes in value.

Effective date

Except as noted below, the provision is effective for taxable years beginning after December 31, 1984. The provision does not apply to a corporation validly included in a consolidated return of an affiliated group under present law for the taxable year which includes June 22, 1984, until the taxable year beginning after December 31, 1987. However, if (1) at any time after June 22, 1984, more than a de minimis amount of stock of any such corporation is sold or exchanged (including by redemption), or such corporation issues more than a de minimis amount of stock other than in the ordinary course of its business, and (2) thereafter the bill's provision as to ownership of stock of such corporation is not satisfied (even though before December 31, 1984), then the provision will apply to such corporation for its taxable year beginning after December 31, 1984, or if later, the date such stock is sold, exchanged, or issued, as the case may be. For purposes of this rule, generally stock issued to employee stock ownership plans, stock issued upon the exercise of employee stock options, and similar issuances of stock are to be treated as issuance in the ordinary course of the corporation's business.

For example, assume that Corporation B has only 300 shares of class A common stock and 100 shares of class B common stock outstanding. Shares of each class are identical except that each share of class A common stock has three votes whereas each share of class B common stock has one vote. Corporation A owns all the class A common stock, which represents 90 percent of the voting stock and 75 percent of the value of all the stock of Corporation B, at all times during 1984. A and B file a valid consolidated return for calendar year 1984. On June 30, 1985, A sells 20 shares of the class A common stock of B to a third party. After the sale, A owns 84 percent of B's voting stock and 70 percent of the value of all B's stock. B would be disaffiliated under the provision as a result of the sale.

Special and transitional rules are also provided.

11. Earnings and profits

a. General

Present law

Under present law, distributions by corporations to shareholders are included in income by the shareholders as dividends (and taxed at ordinary income rates) only to the extent such distributions are out of current or accumulated earnings and profits. In general, a corporation's earnings and profits are intended to be a measure of the economic income of the corporation available for distribution to its shareholders. However, in many instances earnings and profits are substantially less than the corporation's economic income.

The effect on the earnings and profits of a corporation of a distribution by the corporation in redemption of shares of its own stock is determined by reference to section 312(e). That section provides that the part of a distribution that is "properly chargeable" to capital account does not reduce earnings and profits. Some cases have held, and the IRS has now ruled, that a corporation's capital account is an amount equal to the par value of its stock plus the amount, if any, of paid-in surplus, and that this amount is reduced in proportion to the amount of the corporation's stock that is redeemed. Under this approach, earnings and profits are reduced by an amount equal to the amount of the distribution over the amount charged against capital account. See, e.g., *Jarvis* v. *Commissioner*, 43 B.T.A. 439, *aff'd*, 123 F.2d 742 (4th Cir. 1941); and Rev. Rul. 79-376, 1979-2 C.B. 133.

House bill

No provision.

Senate amendment

The Senate amendment requires that a number of changes be made in the way in which a corporation's earnings and profits are calculated.

Construction period interest, taxes, and carrying charges

For purposes of computing a corporation's earnings and profits, construction period interest, taxes, and carrying charges are required to be capitalized as a part of the asset to which they relate and written off as is the asset itself. This rule applies to all corporations. Further, it applies with respect to both residential and nonresidential real property, and to personal property.

Construction period interest and taxes include property taxes (real and personal), interest paid or accrued on debt incurred or continued to acquire, construct, or carry property, and other carrying charges, but only to the extent such taxes, interest, and other carrying charges are attributable to the construction period for such property.

This provision is applicable to the effect on earnings and profits of amounts paid or accrued in taxable years beginning after date of enactment.

Intangible drilling costs and mine development costs

Intangible drilling costs allowable as a deduction under section 263(c), and mineral exploration and development costs allowable as a deduction under sections 616(a) or 617, are required to be capitalized for purposes of computing earnings and profits, but only if the expenditures give rise to the creation of an asset having an anticipated economic life of more than one year. Intangible drilling costs capitalized under the provision are to be amortized on a straight-line basis over 5 years. The amortization period for mineral exploration and development expenses is 10 years. No amortization is to occur, however, prior to the date the asset is placed in service.

Unamortized intangible drilling expenses incurred in connection with the drilling of a well (or a group of related wells) are to be deducted in computing earnings and profits when it has been determined that the well (or a group of related wells) is dry. For this purpose, a group of wells is to be considered related if they are drilled from a common drilling rig. Unamortized mineral exploration and development expenses incurred in connection with a mineral property are to be deducted in computing earnings and profits when the property is abandoned.

This provision is applicable to the effect on earnings and profits of amounts paid or accrued in taxable years beginning after the date of enactment.

Certain trademark, trade name, and other expenditures

Amounts amortized under sections 173 (relating to circulation expenditures), 177 (relating to trademark and trade name expenditures), and 248 (relating to organizational expenditures) are to be capitalized and treated as part of the basis of the asset to which they relate. Expenditures made in connection with property having a reasonably determinable useful life are to be recovered for earnings and profits purposes over such useful life. Under the Senate amendment, there is no amortization for expenditures made in connection with property which does not have a reasonably determinable limited useful life.

This provision is applicable to the effect on earnings and profits of amounts paid or accrued in taxable years beginning after the date of enactment.

Certain distributions of appreciated property

In the case of a distribution of appreciated property by a corporation to a shareholder with respect to stock, earnings and profits of the distributing corporation are to be increased by the amount of gain on the distributed property that is realized by the distributing corporation on the distribution whether or not such gain is recognized. The provision does not apply to certain distributions.

With certain exceptions, the provision is applicable to the effect on earnings and profits of distributions after the date of enactment.

Changes in LIFO reserves

A corporation's earnings and profits are to be increased by the amount of any increase in the corporation's LIFO reserve for a taxable year. In addition, earnings and profits are to be decreased by the amount of any decrease in the corporation's LIFO reserve for a taxable year. However, decreases in reserve amounts below the LIFO reserve as of the beginning of the taxable year beginning after the date of enactment will not, except as provided by regulations, reduce earnings and profits. For purposes of this provision, the term "LIFO reserve" has the same meaning as that given to the term "LIFO recapture amount" under section 336.

The provision is applicable to the effect on earnings and profits of changes in reserve amounts in taxable years beginning after the date of enactment.

Deferred gain from installment sales

A corporation's earnings and profits for a year in which the corporation sells property on the installment basis are to be increased by the amount of any deferred gain on the installment sale. This is accomplished by treating all principal payments as having been received in the year of the sale.

The provision is applicable to the effect on earnings and profits of sales occurring after March 15, 1984, other than sales pursuant to binding contracts entered into on or prior to such date.

Completed contract method of accounting

A corporation that accounts for income and expenses attributable to a long-term contract on the completed contract method of accounting generally recognizes income and expense in the year in which the contract is completed. Under the Senate amendment, a corporation that accounts for income and expense on this method is required to compute earnings and profits as if it were accounting for income and expense attributable to long-term contracts on a percentage of completion basis.

This provision is applicable to the effect on earnings and profits of contracts entered into after March 15, 1984, other than contracts entered into pursuant to binding contracts entered into on or prior to such date.

ACRS deductions for real property

The amount by which a corporation's earnings and profits are reduced for ACRS deductions with respect to 15-year and 20-year real property is the amount of the deduction that would be allowable if the straight-line method of depreciation had been used and the property had a 40 year recovery period.

This provision is applicable to the effect on earnings and profits of property placed in service in taxable years beginning after the date of enactment.

Redemptions

In the case of a distribution by a corporation in redemption of its own stock, earnings and profits are to be reduced in proportion to the amount of the corporation's outstanding stock that is redeemed. However, the Senate does not intend that earnings and profits be reduced by more than the amount of the redemption.

This provision is applicable with respect to the effect on earnings and profits of distributions in taxable years beginning after the date of enactment.

Conference agreement

The conference agreement generally follows the Senate amendment with several modifications.

Construction period carrying charges

The conference agreement is generally the same as the Senate amendment, with several technical clarifications.

The provision is effective for amounts paid or incurred in taxable years beginning after September 30, 1984.

Intangible drilling costs and mineral exploration and development costs

The conference agreement clarifies the Senate amendment by providing that for purposes of computing a corporation's earnings and profits intangible drilling costs are capitalized and allowed as a deduction ratably over a 60-month period beginning with the month in which the production from the well begins. Also, the conference agreement makes it clear that for this purpose mineral exploration and development costs are capitalized and deducted ratably over a 120-month period beginning with the later of (1) the month in which the production from the deposit begins, or (2) the month in which the amount is paid or accrued.

The provision is generally effective for amounts paid or incurred in taxable years beginning after September 30, 1984.

Certain trademark, trade name, and other expenditures

The conference agreement generally follows the Senate amendment.

The provision is effective for amounts paid or incurred in taxable years beginning after September 30, 1984.

Certain distributions of appreciated property

The conference agreement generally follows the Senate amendment. Certain exceptions to the rule are provided.

The provision is generally effective for distributions after September 30, 1984.

LIFO inventory adjustments

The conference agreement generally follows the Senate amendment with certain technical and clarifying modifications.

In general, earnings and profits shall be increased or decreased by the amount of any increase or decrease in the LIFO recapture amount. The conferees wish to clarify that this provision is designed to eliminate the impact of LIFO on earnings and profits. Thus, under present law, if a corporation's LIFO reserve increases by $10, taxable income and earnings and profits are lower than they would have been had LIFO not been used. Under the new rules, $10 would be added back to earnings and profits.

An exception is to be provided, under regulations, for decreases below the amount of the reserve as of the close of the taxable year of the taxpayer preceding the first taxable year to which the provision applies. Since the cumulative effect of the LIFO reserve has been to keep earnings and profits lower than they otherwise would have been, it is contemplated that the regulations will provide that in the event of a reduction in the LIFO reserve below its level as of the close of such taxable year (the pre-enactment reserve), earnings and profits will be increased as under present law without any offsetting reduction under the new rules. However, because a reduction in the reserve below the pre-enactment reserve results in an increase in taxable income and earnings and profits, any subsequent restoration of the reserve up to the level of the pre-enactment reserve should result in an adjustment under the new rules.

The following example is illustrative.

Assume that a calendar year taxpayer has a LIFO reserve of $100 at the end of 1984. Assume further that the reserve decreases to $95 at the end of 1985 and increases to $105 at the end of 1986. Finally, assume that the reserve decreases to $90 at the end of 1987. The change in the reserve for 1985 results in an increase in taxable income and earnings and profits under present law, with no offsetting adjustment under the new rules. Under present law, the increase in the reserve in 1986 would reduce taxable income and earnings and profits. This reduction is offset by a $10 adjustment to earnings and profits under the new rules.

The $15 reduction in the reserve for 1987 increases taxable income and related earnings and profits by $15. This increase is offset, in part, by a $10 reduction in earnings and profits under the new rules.

The adjustment for 1987 is $10 and not $15 because the provision does not require an adjustment to offset the inclusion in earnings and profits of reserve amounts not previously included in earnings and profits. By the end of 1986, $10 (not $15) of the $100 pre-enactment reserve had been taken into account in determining earnings and profits.

The provision applies to taxable years beginning after September 30, 1984.

Installment sales

The conference agreement generally follows the Senate amendment. The conference agreement makes it clear that a corporation's earnings and profits are computed as if the corporation did not use the installment method to account for the installment sale. Thus, for purposes of computing a corporation's earnings and profits, all principal payments, as determined under general Code principles, are treated as received in the year of the sale. This provision applies to all installment sales, including installment sales of inventory.

The provision applies to sales after September 30, 1984.

Completed contract method of accounting

The conference agreement is generally the same as the Senate amendment except that it applies to contracts entered into after September 30, 1984.

ACRS deductions for real property

The conference agreement is generally the same as the Senate amendment except that the provision applies to property placed in service in taxable years beginning after September 30, 1984.

Redemptions

The conference agreement is generally the same as the Senate amendment.

The conferees wish to clarify that when a corporation has more than one class of stock, its earnings and profits generally should be allocated among the different classes in determining the amount by which a redemption of all or a part of one class of stock reduces the earnings and profits account. However, no earnings and profits generally should be allocable to preferred stock which is not convertible or participating to any significant extent in corporate growth. Therefore, a redemption of such preferred stock should result in a reduction of the capital account only, unless the distribution includes dividend arrearages, which will reduce earnings and profits.

Similarly, priorities legally required as between different classes of stock may be taken into account in allocating earnings and profits between classes. For example, assume that corporation X has 1,000 shares of class A common stock and 1,000 shares of class B common stock. Both classes are $10 par value stock and were issued at the same time at a price of $20. The class A common has a preference as to dividend and liquidating distributions in a 2:1 ratio to the class B common, and only the class B common has voting rights. Assume further that Corporation X holds net assets worth $210,000 and has current and accumulated earnings and profits of $120,000. If X distributes $140,000 in cash in redemption of all of the class A common, earnings and profits should be reduced by $80,000 and the capital account by $60,000.

Special rule for foreign corporations

The amendments made by the conference agreement may affect the earnings and profits of foreign corporations as well as domestic corporations. Application of these amendments to foreign corporations could have an impact on U.S. persons in at least three situations.

First, under section 951, a U.S. person owning 10 percent or more of the stock of a controlled foreign corporation must include in gross income a pro rata share of the corporation's subpart F income for the shareholder's year in which or with which the corporation's taxable year ends. Subpart F income is limited to the earnings and profits, computed according to U.S. tax concepts, of the controlled foreign corporation. Thus, to the extent the conference agreement may require that the earnings and profits of a controlled foreign corporation be computed, for example, by capitalizing and amortizing rather than deducting an item, it could result in an increase in a U.S. shareholder's income.

Second, under section 902, a domestic corporation which owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends is deemed to have paid a proportionate share of any income taxes paid or deemed paid by such corporation to any foreign country or to any possession of the United States on the "accumulated profits" of such foreign corporation from which the dividends were paid. The so-called "deemed paid" credit to which a qualifying U.S. shareholder is entitled equals the foreign taxes paid by the foreign corporation multiplied by the ratio of the dividends to the foreign corporation's accumulated profits. For this purpose, accumulated profits are essentially equivalent to earnings and profits. Because the conference agreement could have the effect of changing the ratio of dividends to accumulated profits, it could change the section 902 deemed paid credit of the corporation's U.S. shareholders.

Third, section 1248 generally treats certain domestic corporations as recognizing dividend income on the sale or exchange, or other disposition, of the stock of certain foreign corporations. That dividend income is measured by certain earnings and profits of the foreign corporation.

Although the conference agreement extends the changes in the earnings and profits provisions to foreign corporations, as well as domestic corporations, the application of the amendments pertaining to LIFO inventory adjustments, installment sales, and the use of the completed contract method of accounting is delayed for certain foreign corporations until taxable years beginning after December 31, 1985. This special effective date applies to foreign corporations deriving less than 20 percent of their gross income from sources within the United States. It is anticipated that this delayed effective date will provide both the Treasury and affected foreign corporations and their shareholders opportunity to consider how those provisions should apply to such foreign corporations.

Distributions to 20-percent corporate shareholders

Under the proposed new earnings and profits rules, a corporation's earnings and profits can exceed its taxable income if its income is deferred for purposes of determining gross income but not for purposes of computing earnings and profits. The conferees are concerned that, without a special rule, if a corporation with earnings and profits in excess of taxable income makes a distribution to a corporate shareholder and the distribution is treated as a dividend qualifying for a dividends received deduction, it may be possible for earnings to be distributed to the corporate shareholder without ever being subject to tax in the hands of the corporate shareholder.

For example, assume that P Corporation owns 100 percent of the stock of X Corporation, that P's basis in such stock is $200, that P and X file separate income tax returns, and that X has no current or accumulated earnings and profits. Assume further that X sells an asset for a $1,000 installment note, realizing an $800 gain. Finally, assume that X borrows $500 secured by the installment note and distributes the $500 to P. In such event, under the provision, absent a special rule, P would include the $500 distribution in income but would likely qualify for a 100-percent dividends received deduction. If P later sells its X stock for $200 (the value of that stock if it is assumed that X will ultimately have a $300 tax liability, in present value terms, on account of the installment sale), it would not recognize gain or loss on the sale. As a result, P would have realized an overall profit of $500.

Under the conference agreement, except as regulations may otherwise provide, the taxable income of a corporate shareholder with a 20-percent or greater interest in the distributing corporation, and such shareholder's basis in the stock of the distributing corporation, are determined as if section 312(n) (as added by the bill) did not apply to the distributing corporation. As a result, in the above example, $200 of the distribution by X to P would be a return of capital, and $300 would be taxed to P under section 301(c)(3). P's basis in the X stock would be reduced to zero, and P would recognize a $200 gain on the sale of the stock. This special rule does not affect the computation of resulting earnings and profits of either the distributing corporation or the corporate shareholder. Thus, for purposes of computing earnings and profits of X and P, $500 of earnings and profits would be treated as having been transferred from X to P. Furthermore, the special rule applies only if the corporate shareholder would, but for the special 20-percent corporate shareholder rule, be entitled to a dividends received deduction with respect to the distribution involved.

Under the rule, a 20-percent corporate shareholder is any corporation owning, directly or indirectly, stock possessing at least 20 percent of the total combined voting power of all classes of stock entitled to vote or at least 20 percent of the total value of all classes of stock (excluding certain preferred stock) of the distributing corporation. Attribution rules apply for purposes of determining stock ownership.

This rule applies to distributions after the date of enactment.

b. Distributions by a corporation of discount obligations

Present law

A corporation may distribute as a dividend its own discount obligations to its shareholders. Only the fair market value of the obligations is includible in the gross income of such shareholders. However, some taxpayers have taken the position that the corporation's earnings and profits are reduced by the entire principal amount of such obligations (sec. 312(a)(2)).

It is unclear whether the original issue discount rules apply to such a discount obligation upon its distribution.

House bill

In the case of a dividend distribution by a corporation of its own discount obligation, the corporation's earnings and profits are reduced only by the issue price of the obligation at the time of the distribution. The issue price is to be determined under the original issue discount rules. Furthermore, the original issue discount rules apply to the holder and the issuer of the obligation upon its distribution.

The provision is effective for distributions after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill except that it applies to distributions declared after March 15, 1984.

Conference agreement

The conference agreement follows the Senate amendment.

12. Net operating loss, etc. carryover rules

Present law

The Tax Reform Act of 1976 substantially revised sections 382 and 383, which relate to the carryover of corporate net operating losses and other corporate tax attributes following acquisitions, including reorganizations. The 1976 Act revisions relating to acquisitions other than reorganizations are generally effective with respect to taxable years beginning after June 30, 1984. Those relating to reorganizations are effective with respect to a reorganization pursuant to a plan of reorganization adopted on or after January 1, 1984. The 1976 Act revisions are not explicitly made applicable to "G" reorganizations (relating to reorganizations of corporations in a title 11 or similar case).

House bill

The 1976 Act revisions relating to acquisitions other than reorganizations are generally effective for taxable years beginning after October 31, 1984. Those relating to reorganizations are effective only with respect to a reorganization pursuant to a plan adopted on or after November 1, 1984.

Senate amendment

The 1976 amendments relating to acquisitions other than reorganizations are generally effective for taxable years beginning after December 31, 1985. Those relating to reorganizations are effective only with respect to a reorganization pursuant to a plan of reorganization adopted on or after January 1, 1986.

Conference agreement

The conference agreement generally follows the Senate amendment. Thus, for example, the revisions of the 1976 Act are not applicable to any reorganization pursuant to a plan of reorganization not adopted on or after January 1, 1986. In addition, the 1976 Act revisions, insofar as they relate to reorganizations, are amended to clarify that, when they become effective, they will apply to "G" reorganizations. This latter amendment is effective as if included in the amendments made by section 4 of the Bankruptcy Tax Act of 1980.

13. Distribution requirement in the case of a "C" reorganization

Present law

A "C" reorganization, as defined by section 368(a)(1)(C), is an acquisition by one corporation (the "acquiring corporation") of substantially all of the properties of another corporation (the "transferor corporation") in exchange solely for voting stock of the acquiring corporation or its parent corporation, or in exchange for such voting stock and a limited amount of money or other property. In determining whether an exchange is solely for voting stock, the assumption by the acquiring corporation of a liability of the transferor corporation, or the fact that the property acquired is subject to a liability, generally is disregarded.

A transaction can qualify as a C reorganization even if the transferor corporation does not distribute to its shareholders the consideration received from the acquiring corporation or assets not transferred by it to the acquiring corporation. Furthermore, the Service has ruled that a transaction can qualify as a C reorganization where the transferor corporation distributes a 25-percent stock interest in the acquiring corporation but retains liquid assets which it intends to use to engage in an active trade or business. (Rev. Rul. 73-552, 1973-2 C.B. 116.)

Under present law, the acquiring corporation in a C reorganization succeeds to, and takes into account, the tax attributes of the transferor corporation described in section 381, subject to limitations contained in that section and section 382. For example, the acquiring corporation generally succeeds to the earnings and profits of the transferor corporation.

Any distribution pursuant to the plan of reorganization by the transferor corporation to its shareholders in exchange for their stock in the transferor corporation is subject to section 354 (or so much of section 356 as it relates to section 354). Thus, no gain or loss is recognized to the shareholders of the transferor corporation on the receipt of qualifying consideration. Gain may be recognized under section 356, however, on the receipt of other property, but not in an amount in excess of the sum of any money and the fair market value of any other property received. If the receipt of such property has the effect of a distribution of a dividend to a shareholder, the shareholder is treated as receiving dividend income in an amount equal to the amount of the gain realized on the exchange but not in excess of the shareholder's ratable share of undistributed earnings and profits of the corporation. The principles of section 302 are applicable in testing for dividend equivalency under section 356. Any gain recognized which is not treated as dividend income is treated as gain from the sale or exchange of property.

For purposes of determining the extent to which a shareholder is to be treated as having received a dividend, the relevant earnings and profits are the accumulated earnings and profits of the transferor corporation. For this purpose, the exchange is generally deemed to occur prior to the time the transferor corporation's earnings and profits are inherited by the acquiring corporation under section 381. Furthermore, the earnings and profits of the transferor corporation inherited by the acquiring corporation under section 381 are reduced by amounts treated as a dividend under section 356.

House bill

No provision.

Senate amendment

Under the Senate amendment, a transaction can qualify as a C reorganization only if the transferor corporation distributes all of its assets (less those retained to meet claims), including consideration received from the acquiring corporation and any retained assets, within 12 months of the acquisition. Authority is provided for the Secretary to prescribe regulations providing exceptions to the distribution requirement.

The Secretary is also directed to prescribe regulations under section 312 providing for the allocation of earnings and profits between the acquiring corporation and the transferor corporation in situations in which, prior to the transaction, 80 percent or more of the stock of the transferor corporation was held by one corporate shareholder and in any other situation described in regulations.

The provision is applicable to transactions pursuant to a plan adopted after the date of enactment.

Conference agreement

The conference agreement generally follows the Senate amendment. However, under the conference agreement, the required distribution must be pursuant to the plan of reorganization rather than within a 12-month period beginning on the date of the acquisition. In addition, the conference agreement makes technical modifications to the Senate amendment.

The provision contained in the Senate amendment that provides that the Secretary may be regulations waive the application of the distribution requirement, subject to any conditions imposed in the regulations, is also retained under the conference agreement. The report of the Senate committee, which the conferees endorse, states that the Senate anticipated that waivers may be granted if a distribution would result in substantial hardship. The conferees also wish to make it clear that as a general rule a waiver is to be granted only on the condition that the transferor corporation and its shareholders be treated as if the retained assests are distributed and then contributed to the capital of a new corporation.

The conference agreement expands a provision contained in the Senate amendment by providing the Secretary with authority to issue regulations allocating the earnings and profits of the transferor corporation between or among such corporation, any corporation in control of the transferor corporation immediately before the reorganization, and the acquiring corporation in the case of a C reorganization. Such authority is extended to D reorganizations as well. The conferees anticipate that under those regulations, generally the consequences of an "A" reorganization (e.g., a merger) preceded by a distribution, on the one hand, and a C (or non-divisive D) reorganization followed by a distribution, on the other hand, will be consistent. In this regard, the Treasury might reconsider its regulations relating to allocations of earnings and profits in transactions under section 355.

The conferees wish to clarify that the provision applies to transactions pursuant to a plan adopted after the date of enactment by any corporation which would be a party to the reorganization if the transaction qualifies as a reorganization.

14. Control requirement in a "D" reorganization

Present law

"D" reorganizations

Under section 368(a)(1)(D), a transfer by a corporation of all or a part of its assets to a corporation controlled immediately after the transfer by the transferor or one or more of its shareholders is generally treated as a "D" reorganization if, among other things, stock or securities of the controlled corporation are distributed in a transaction qualifying under sections 354, 355, or 356. For the transaction to qualify under section 354 (or so much of section 356 as relates to section 354), the acquiring corporation must acquire substantially all the assets of the transferor corporation (a non-divisive D reorganization). For purposes of determining whether a transaction qualifies as a D reorganization, the term "control" is defined in section 368(c) as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. No attribution rules are explicitly made applicable.

Liquidation and contribution to a related corporation

In general, under section 331, amounts distributed to a shareholder in complete liquidation of a corporation are treated as in full payment in exchange for the shareholder's stock. If the stock is a capital asset in the hands of the shareholder, a complete liquidation will result in capital gain or loss. The shareholder's basis in the property received in a taxable liquidation is the fair market value of the property at the time of the distribution. With several exceptions, no gain or loss is recognized to the distributing corporation on a distribution in complete liquidation of such corporation or a liquidating sale by the corporation.

Under section 351, generally no gain or loss is recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and, immediately after the exchange, such person or persons are in control of the corporation. As a general rule, a transferor takes a substitute basis in stock or securities received in the exchange. The corporation's basis in property received from the transferor is generally determined with reference to the basis of such property in the transferor's hands.

House bill

No provision.

Senate amendment

Under the Senate amendment, for purposes of determining whether a non-divisive transaction qualifies as a D reorganization, "control" is defined as ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote and at least 50 percent of the total number of shares of all other classes of stock of the corporation. Further, the constructive ownership of stock rules contained in section 318(a), as modified, are applicable for purposes of determining whether the transferor corporation or its shareholders are in control of the acquiring corporation. The provision is applicable to transactions pursuant to a plan adopted after the date of enactment.

Conference agreement

The conference agreement generally follows the Senate amendment in that under the conference agreement the general definition of "control" contained in section 368(c) does not apply for purposes of determining whether a non-divisive transaction qualifies as a D reorganization. However, the definition substituted for the section 368(c) definition by the Senate amendment is modified under the conference agreement.

Under the conference agreement, control means the ownership, directly or indirectly, of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote, or at least 50 percent of the total value of all shares of all classes of stock. The conferees believe that by taking value into account this definition increases the utility to the Internal Revenue Service of the D reorganization provisions as a means of preventing taxpayers from bailing out earnings and profits at capital gains rates in liquidation-reincorporation transactions.

In addition, the conferees wish to clarify that they do not intend that recharacterization as a D reorganization under this provision be the exclusive means for the Service to challenge liquidation-reincorporation and similar transactions. For example, it is not intended that this provision supercede or otherwise replace the various doctrines that have been developed by the Service and the courts to deal with such transactions. See, e.g., Rev. Rul. 61-156, 1961-2 C.B. 62; *Telephone Answering Service Co.* v. *Commissioner*, 62 T.C. 423 (1974), *aff'd.*, 546 F.2d 423 (4th Cir. 1976), *cert. denied*, 431 U.S. 914 (1977); and *J.E. Smothers* v. *U.S.*, 642 F.2d 894 (5th Cir. 1981).

The conferees wish to clarify that the provision applies to transactions pursuant to a plan adopted after the date of enactment by any corporation which would be a party to the reorganization if the transaction qualifies as a reorganization.

15. Collapsible corporations

Present law

The collapsible corporation rules are designed to prevent the use of a corporation to convert what would be ordinary income in the hands of a shareholder to capital gain. A shareholder's gain on the sale or exchange of stock in a collapsible corporation is generally required to be reported as ordinary income. However, the collapsible corporation rules are inapplicable if the collapsible corporation realizes a "substantial part" of the income to be derived from its collapsible assets. In *Commissioner* v. *Kelley*, 293 F.2d 904 (5th Cir. 1961), the court held that the "substantial part" test is satisfied if the corporation has realized one-third of the income to be derived from its collapsible assets.

Under a second exception, the collapsible corporation rules are inapplicable if 70 percent or less of a shareholder's gain on the disposition of his stock in the corporation is attributable to the collapsible assets (the "70/30" rule).

House bill

The House bill provides that the "substantial part" test requires the realization of at least two-thirds of the income from collapsible assets. In addition, the Secretary is authorized to promulgate regulations to make conforming changes to the 70/30 rule, treating all property described in section 1221(a) as one item of property.

The provision is effective for sales and exchanges made after the date of enactment.

Senate amendment

The Senate amendment is generally the same as the House bill except that the provision is applicable to sales and exchanges made after December 31, 1984. Under a transition rule, the provisions of the bill are inapplicable if, prior to January 1, 1985, a corporation realized a "substantial part" of the income to be derived from any property.

Conference agreement

The conference agreement follows the House bill.

16. Phaseout of graduated rates for large corporations

Present law

Present law provides graduated corporate rates on the first $100,000 of taxable income. These rates provide a maximum tax reduction of $20,250 in tax below the tax which would be imposed if the tax rate on that income were 46 percent.

House bill

No provision.

Senate amendment

The Senate amendment phases out the benefits of the graduated rates on corporations with taxable income in excess of $1 million, by imposing an additional 5 percent tax on the first $400,000 of taxable income over $1 million. This recaptures $20,000 of the graduated rate benefits for corporations with taxable income in excess of $1.4 million.

The provision applies to taxable years beginning after December 31, 1983. (Under Code section 21, the provision will apply on a prorata basis to 1983-1984 fiscal years.)

Conference agreement

The conference agreement generally follows the Senate amendment. However, the full $20,250 of tax benefit from the graduated rates is recaptured. Also, the conference agreement provides that this provision will not apply to any 1983-1984 fiscal years. Thus, the provision applies only to taxable years beginning after December 31, 1984.

17. Golden parachute contracts

Present law

A corporation is allowed a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Reasonable allowances for salaries or other compensation for personal services actually rendered generally qualify as ordinary and necessary trade or business expenses.

House bill

No provision.

Senate amendment

Under the Senate amendment, all payments under a "golden parachute" contract are presumed to be excessive. The presumption is rebuttable, but only by a showing that the payments are a reasonable allowance for salaries or other compensation for personal services actually rendered. It may not be rebutted by a showing that the payments otherwise qualify as an ordinary and necessary trade or business expense.

If any payments under a golden parachute contract are excessive, none of the payments under that contract are deductible, and a nondeductible excise tax of 20 percent is imposed on the recipient with respect to all of the payments.

A golden parachute contract generally is any contract entered into by a corporation with any officer, shareholder, or highly-compensated individual (including any independent contractor) providing, at the time of execution, for contingent payments of cash (or property) which are to be made in the event of a change (or threatened change) in ownership or control of the corporation (or of a significant portion of its assets). Furthermore, the present value of the payments (determined as of the time the contingency occurs) must exceed 200 percent of the highest compensation income of the individual from the corporation includible in his gross income during any of the five taxable years ending with the taxable year preceding the taxable year in which the contract is executed. Present value is determined under section 1274, as added by the bill.

Payments under golden parachute contracts, like any termination pay, are subject to FICA taxes when paid.

To the extent provided by regulations, any contract which the Securities and Exchange Commission classifies as unreasonable in situations involving a threatened takeover will also constitute a golden parachute contract.

The provision is applicable to payments under contracts entered into after March 15, 1984.

Conference agreement

General rule

Under the conference agreement, no deduction is allowed for "excess parachute payments" paid or accrued. Furthermore, a nondeductible 20 percent excise tax is imposed on the recipient of any excess parachute payments.

Parachute payment

A "parachute payment" is any payment in the nature of compensation to (or for the benefit of) a "disqualified individual" if such payment is contingent on a change in the ownership or effective control of a corporation, or in the ownership of a substantial portion of its assets, if the aggregate present value of all such payments made or to be made to (or for the benefit of) the disqualified individual equals or exceeds three times the "base amount". The "base amount" is the average annualized compensation income (including, for example, ordinary income with respect to stock options) from the corporation includible in the disqualified individual's gross income over the five-taxable-year period (or if the individual did not perform services throughout such five-taxable year period for such corporation, the portion of such period during which the individual did perform services for the corporation) preceding the taxable year in which the change of ownership or control occurs.

A "disqualified individual" means any individual who is an employee, independent contractor, or other person specified in regulations who performs personal services for the corporation and who is an officer, shareholder, or highly-compensated individual of such corporation. Personal service corporations and similar entities are treated as individuals for this purpose. Thus, for example, if an individual performs services for a corporation through a personal service corporation, parachute payments to the personal service corporation are treated as made to the individual. Similarly, any office held by the individual is treated as held by his personal service corporation.

To be a parachute payment, the payment must be contingent on a change in ownership or effective control. In general a payment is to be treated as contingent on a change of ownership or control under the provision if such payment would not in fact have been made to the disqualified individual had no change in ownership or control occurred. Furthermore, a payment is to be treated as contingent on a change of ownership or control if the change determines the time such payment in fact is to be made. Finally, a payment may be a parachute payment even if the employment of the individual involved is not voluntarily or involuntarily terminated.

The following examples illustrate the "contingent on a change in ownership or control" concept.

Example (1).—Assume that a contract provides for payments to a disqualified individual if control of the corporate employer changes. Assume that control does change and payments under the contract are made. The payments are contingent on the change in control, even if the individual continues in the employ of the corporation.

Example (2).—Assume that a contract provides for payments to a disqualified individual contingent upon termination of his employment. A change of control occurs, and thereafter, as a result of the change, the employment of the individual is terminated. Payments under the contract are to be treated as contingent on the change in control.

Example (3).—Assume that a contract provides for the acceleration of vesting or a payment of any deferred incentive compensation, for the acceleration of the time for the exercise of stock options, or for payments in cancellation of stock options, contingent on a change in control. Payments resulting from such a contract are treated as contingent on a change in control.

Parachute payment presumption

Under the conference agreement, payments under a contract entered into (or amended in significant relevant respect) within one year before a change in ownership or control are presumed contingent on such a change, even if such payments are not contingent on a change in ownership or control, unless the contrary is established by clear and convincing evidence.

Property transfers

Under the conference agreement, transfers of property (e.g., stock options) are treated as payments for purposes of the provision. Any such property is taken into account at its fair market value, and all such property is to be valued for purposes of the provisions. Under the conference agreement, present values are determined in accordance with the principles of section 1274(b)(2), as added by the bill.

Change in ownership or control

Whether a particular transaction involves a change in the ownership or effective control of a corporation or in the ownership of a substantial portion of its assets is to be determined under all the facts and circumstances.

Excess parachute payments

"Excess parachute payments" are any parachute payments in excess of the base amount which are not reasonable compensation for personal services actually rendered by the disqualified individual. Under the conference agreement, it is presumed that no parachute payment is reasonable compensation for personal services actually rendered. Such presumption may be rebutted, but only by clear and convincing evidence. To the extent that the presumption is rebutted, the provision does not apply. To the extent the taxpayer establishes the amount that is reasonable compensation for services actually rendered, it is first applied against the base amount. The conferees do not intend that services adequately compensated for by payments that are not parachute payments be taken into account in determining whether parachute payments are payments of reasonable compensation.

For example, assume that the disqualified individual's base amount is $100,000. Assume further that a payment totalling $400,000, which is contingent on a change in control, is made on the date of the change. Under the provision, parachute payments total $400,000, and the provision applies because $400,000 exceeds $300,000 (three times the base amount). Excess parachute payments total as much as $300,000 ($400,000 less $100,000, the base amount). Assume that the taxpayer establishes by clear and convincing evidence that reasonable compensation for services compensated for by the parachute payments totals $150,000. Under the conference agreement, excess parachute payments equal $250,000 ($300,000 less ($150,000 less $100,000)).

If, in the above example, parachute payments totalled only $290,000, the provision would not apply. In that case, the parachute payments would not equal or exceed three times the base amount.

Reasonable compensation

The conferees believe that in most large corporations, executives are not under-compensated. As a result, the conferees contemplate that only in rare cases, if any, will any portion of a parachute payment be treated as reasonable compensation in response to an argument that the executive was under-compensated in earlier years. On the other hand, payments of compensation previously earned which are in fact made by reason of a change in ownership or control are generally to be treated as reasonable compensation under the provision. For example, payments under the following agreements are generally to be treated as reasonable compensation under the provision if such payments would have been made in the future in any event, even though the timing of such payments is in fact be triggered by a change in control: (1) payments in cancellation of a normal stock option, or normal stock appreciation right, granted more than one year before the change; (2) exercises after termination of stock options or stock appreciation rights issued as part of a normal compensation package granted more than one year before the change; (3) compensation previously earned and deferred pursuant to a plan of the employer, such as a staggered bonus plan, or at the election of the employee; and (4) amounts paid under a retirement plan that supplements a tax-qualified plan to the extent such amounts are designed to compensate a newly-hired key employee for the loss of retirement benefits attributable to services performed for a prior employer.

Violation of securities laws or regulations

Under the conference agreement, the term "parachute payment" also includes any payments under a contract similar to a contract providing for parachute payments which violates securities law or regulations. However, the rules relating to reasonable compensation are not applicable in determining how much of such parachute payments are excessive.

Withholding

Rules regarding withholding taxes and FICA taxes are also provided.

Application

The provision is to be applied on a pro rata basis with respect to each excess parachute payment paid or accrued by the corporation or received by the disqualified individual in excess of the portion of the base amount allocated to such payment. The conferees intend that any reasonable compensation in excess of the base amount be allocated to the first parachute payments made.

Other

The conference agreement authorizes the Treasury to prescribe regulations necessary to carry out the purposes of the provision (including regulations for the application of the provision in the case of related corporations and personal service corporations). Those regulations are to prescribe rules for the case in which the disqualified individual commences working for the corporation in the year the change in ownership or control occurs.

No inference is intended as to the deductibility under present law of amounts paid or accrued under so-called golden parachute agreements. Nor is any inference intended as to the deductibility of any parachute payments which are not excess parachute payments under the provision.

Effective date

The conference agreement is effective for payments made under contracts entered into or renewed after June 14, 1984. For this purpose, a contract cancellable at will by either party is to be treated as a new contract entered into on the date any such cancellation, if made, would be effective. Payments under agreements in effect on June 14, 1984, are not affected by the provision unless the terms of such agreements are amended in significant relevant respect after that date. The conferees intend that an agreement will be treated as so amended if it is amended (or supplemented) either to add or modify a change in ownership or control trigger (or similar trigger), to increase amounts payable (or, where payment is under a formula, to modify the formula) in the event of such a trigger, or to accelerate the payment of amounts otherwise payable at a later date in the event of such a trigger. Where a golden parachute agreement in effect on June 14, 1984, is so amended or supplemented after that date, all amounts payable under the contract (and any supplement) are subject to the provision.

18. Increase in reduction of certain corporate tax preference items from 15 percent to 20 percent

Present law

TEFRA reduced certain corporate tax preferences by 15 percent. These preferences include real estate, capital gains, percentage depletion for coal and iron ore, bad debt reserves and interest to carry tax-exempt obligations of financial institutions, amortization of pollution control facilities, DISC, intangible drilling expenses of integrated oil companies, and mining exploration and development costs.

The corporate minimum tax was adjusted to prevent a double impact of the two provisions.

House bill

No provision.

Senate amendment

The Senate amendment generally increases the preference cutback from 15 to 20 percent, including a similar adjustment to the new Foreign Sales Corporation provision. The Senate amendment makes a corresponding adjustment to the corporate minimum tax. The cutback in the depletion allowance for coal and iron ore remains unchanged.

The provision applies to taxable years beginning after, and transactions after, December 31, 1984.

Conference agreement

The conference agreement follows the Senate amendment.

E. Partnership Provisions

1. Shifting of income, gain, loss, and deduction when partnership interests change

Present law

Contributions

Under present law (sec. 704(c)), when property is contributed to a partnership, depreciation, depletion, or gain or loss with respect to the contributed property may be shared among the partners so as to take account of the variation between the basis of the property to the partnership and its fair market value at the time of contribution (i.e., the built-in gain or loss on the property). If the partnership does not make allocations on this basis, the allocations are made as if the property had been purchased by the partnership. It generally is thought that a portion of the built-in gain or loss that would have been realized by the contributing partner if he had sold the property may be shifted to the other partners.

Retroactive allocations

The Tax Reform Act of 1976 amended the partnership provisions to preclude a partner who acquires his interest late in the taxable year from taking into account partnership items incurred prior to his entry into the partnership ("retroactive allocations" of partnership losses). The 1976 Act provided that when partners' interests change during the taxable year, each partner's share of various items of partnership income gain, loss, deduction, and credit is to be determined by taking into account each partner's varying interest in the partnership during the taxable year.

Some taxpayers argue that the 1976 Act rule may be avoided in the case of tiered partnership arrangements on the theory that losses sustained by the lower-tier partnership are allocable to the day in the upper-tier partnership's taxable year on which the lower-tier partnership's taxable year closes. Similarly, partnerships using the cash receipts and disbursements method of accounting have avoided the retroactive allocation rules by deferring actual payment of accrued deductions until near the end of the partnership's taxable year.

House bill

Contributions

Under the House bill, depreciation, depletion, and gain or loss with respect to contributed property are to be shared among the partners, pursuant to Treasury regulations, so as to take account of the difference between the partnership's basis for the property and the fair market value of the property at the time of contribution. The report of the House committee anticipates that the regulations under this provision generally will provide for the same result that is achieved under present law when a partnership elects to provide for sharing of depreciation, depletion, and gain or loss among the partners so as to take into account fully the difference between the basis and fair market value of the property contributed to the partnership (at the time of the contribution). Thus, it will not be possible to shift built-in gain or loss from the contributing partner to the other partners.

The provision is effective with respect to property contributed to a partnership after March 31, 1984.

Retroactive allocations

The House bill provides that if any partner's interest in a partnership changes at any time during the partnership's taxable year, each partner's share of each item of partnership income, gain, loss, deduction, and credit is to be determined by using any method prescribed by Treasury regulations which takes into account the varying interests of the partners in the partnership during the taxable year. Unless these regulations provide otherwise, the House bill requires, in the case of cash-method partnerships, that interest, taxes, payments for services or use of property, and any other item specified in regulations be assigned to each day in the period to which it is attributable (i.e., to the day or days in such period to which such item would accrue if such partnership were on the accrual method) and allocated among the partners in proportion to their interests in the partnership at the close of each day.

In the case of tiered partnerships, the bill provides that the upper-tier partnership's share of any item of income, gain, loss, deduction, or credit of the lower-tier partnership will, except as otherwise provided in regulations, be prorated equally over the portion of the taxable year during which the upper-tier partnership had an interest in the subsidiary.

The provision applies to items attributable to periods after, or amounts paid or accrued after, March 31, 1984.

Senate amendment

Contributions

The Senate amendment is the same as the House bill with respect to the partner's share of depreciation, depletion, and gain or loss on property contributed to a partnership.

Retroactive allocations

The Senate amendment generally is the same as the House bill with respect to retroactive allocations of partnership items, except that the amendment explicitly provides that when there is a disposition of less than an entire interest in a partnership by a partner (including entry of a new partner), the partnership may elect (on an annual basis) to determine the varying interests of the partners by using a monthly convention that treats any changes in any partner's interest as occurring on the first day of the month.

Conference agreement

The conference agreement follows the House bill and the Senate amendment with modifications to eliminate gaps in the provisions identified by the conference committee.

Contributions

Under the conference agreement, the Secretary is provided with authority to require items of income, gain, loss, and deduction with respect to contributed property to be shared among the partners to take account of the variation between the basis and fair market value of such property at the time of contribution. By making reference to items of income and deduction, the conferees do not intend for the Treasury to require such variations to be eliminated by allocations of operating income and loss attributable to the contributed property (other than depreciation, depletion, and similar items). Rather, the conference agreement intends to address situations in which a partner on the cash receipts and disbursements method of accounting contributes accounts receivable, accounts payable, or other accrued but unpaid items to a partnership that uses the same method of accounting. Thus, for example, if a cash-method taxpayer contributes accounts payable to a cash-method partnership, the deductions attributable to those items generally will be allocated to the contributing partner if possible, and if not, capitalized (see the discussion of retroactive allocations below). The committee intends that, similar to the amendments recently made to section 357(c) (and contrary to Rev. Rul. 60-345, 1960-2 C.B. 211), these accrued but unpaid items should not be treated as partnership liabilities for purposes of section 752. The conferees expect that the Treasury will provide regulations to cover situations in which the partnership is on the accrual method of accounting. These changes, and the changes contained in new section 724, are not intended to override the anticipatory assignment of income doctrine in those situations in which such doctrine would apply to a cash-method partner's contribution of accrued but unpaid items to a partnership. *See*, e.g., Rev. Rul. 80-198, 1980-2 C.B. 113 and Rev. Rul. 80-199, 1982-2 C.B. 122, and the cases cited therein. These changes compliment, and are consistent with, the modifications to the retroactive allocation provisions adopted by the conferees which prevent a cash-method partnership from shifting its accrued deductions to partners who are admitted to the partnership after such deductions are accrued.

The conferees are concerned with complexities that may arise in applying this new rule to allocations of depreciation and depletion. In this regard, the conferees note that the report of the Senate committee suggests ways in which the Treasury might provide for flexibility in applying the new rule (for example, in the case of small operating partnerships) when no tax avoidance potential exists. The conferees intend that this language be read as illustrative of, rather than as a limitation on, the Secretary's authority to provide reasonable rules as long as no abuse potential is present. For example, the conferees recognize that the Secretary may decide to require taxpayers to allocate only the built-in gain or loss on contributed property under new section 704(c) and permit allocations of depreciation, depletion, or similar items with respect to such property, to be governed by section 704(b), provided this flexibility is not likely to result in the contributing partner avoiding the effect of the allocation of built-in gain or loss (such as when the property is expected to be held by the partnership until it has little, if any fair market value). Although partnerships may continue to rely on the regulations issued under present section 704(c)(2) until new regulations are proposed, the conference agreement provides authority for the Secretary to significantly modify or expand those rules. Those modified regulations may take into account situations not addressed by the current rules, including those involving contributions of (1) more than one item of property with built-in gain or loss by a single partner, (2) property with built-in gain or loss by more than one partner, (3) property with built-in gain that would constitute ordinary income under the various recapture provisions, (4) property which is disposed of by the partnership for "substituted basis" transaction as defined in new section 7701(a)(42), (5) property when there are disproportionate profit and loss sharing arrangements contained in the partnership agreement, and (6) property which is not disposed of prior to the contributing partner's disposition of his partnership interest.

Finally, the conferees wish to clarify the intended effect of this new rule on the allowance for depletion. Under present law, a partnership allocates the adjusted basis of an oil or gas property among those who are partners as of the time the property is acquired and also allocates the amount realized from the taxable disposition of such property among the partners. Each partner uses these items to separately compute his depletion deductions and gain or loss with respect to the property. Thus, the partnership does not actually allocate depletion or gain or loss with respect to such property depletion to its partners. The conferees intend that the Treasury regulations will provide for allocations of adjusted basis and amount realized to account for any built-in gain or loss on the contributed oil and gas properties, but may permit flexibility in allocating adjusted basis in non-abusive cases consistent with the discussion above.

Retroactive allocations

The conference agreement follows the House bill and the Senate amendment, except that (1) the treatment of items attributable to more than one year is modified, (2) the monthly convention rule of the Senate bill is not included, and (3) the treatment of tiered partnerships is clarified.

Under the conference agreement, a technical defect of the House bill and Senate amendment which would have permitted taxpayers to avoid the retroactive allocation rules by delaying payment of deductible cash-method items until the first day of the year following the year of a change in partnership interests is modified. Thus, if any portion of such an item is properly attributable to periods before the beginning of the taxable year, the agreement requires that such portion be allocated to the persons who were partners on the days to which such portion is attributable in proportion to their varying interests in the partnership on those days (determined in a manner consistent with section 704). This determination will require allocation of such items in the manner in which the partners would have borne the corresponding economic cost, even though the cost is actually borne by another partner (typically, a later-admitted partner) in connection with a change in the partners' interests in the partnership (other than a change governed by section 761 rather than section 706). If the persons to whom all or part of such items are allocable are not partners in the partnership on the first day of the partnership taxable year in which the item is taken into account, then their portion must be capitalized by the partnership and allocated to the basis of partnership assets in the manner required by section 755.

With respect to the monthly convention, the conferees understand that the Secretary will provide for a monthly convention by regulation; thus, the statutory provision adopted by the Senate is unnecessary. Under this convention, partners entering after the 15th day of a month will be treated as entering on the first day of the following month and partners entering during the first 15 days of a month will be treated as entering on the first day of the month. Further, the conferees note that the Secretary may provide for other conventions and may deny the use of any convention when the occurrence of significant, discrete events (e.g., a large, unusual gain or loss) would mean that use of a convention could result in significant tax avoidance.

With respect to the treatment of tiered partnerships, the conference agreement provides that when there is a change in the interests of the partners of the upper-tier partnership, items of the subsidiary are (except as otherwise provided by regulations) to be allocated among the partners of the upper-tier partnership (1) by assigning the appropriate portion of each item to the appropriate day in the upper-tier partnership's taxable year on which the upper-tier partnership is a partner in the lower-tier partnership, and (2) by allocating the portion assigned to a day among the partners in proportion to their interests in the upper-tier partnership as of the close of the day (determined in a manner consistent with section 704). For this purpose, items allocable to periods before or after the upper-tier partnership's taxable year will be assigned to the first or last day of that year, respectively. If the persons to whom items are properly allocated are no longer partners in the upper-tier partnership on the firstday of the upper-tier partnership taxable year in which the item is taken into account, then that such persons' portion of such items are capitalized and allocated to the basis of partnership assets in the manner required by section 755.

Effective dates

The provisions of the conference agreement relating to contributions apply to contributions made after March 31, 1984. In the case of allocations with respect to items other than depreciation, depletion, and gain or loss, the conferees expect that the regulations requiring allocation and describing the method of allocation will take effect no earlier than the date those regulations are proposed.

The provisions of the conference agreement relating to retroactive allocations of partnership items apply to amounts attributable to periods before or after March 31, 1984, and in the case of tiered partnerships, amounts paid or accrued by the lower tier partnership after March 31, 1984.

2. Uses of partnerships to change the character and timing of income, gain, loss, or deduction

a. Payments to partners for property or certain services

Present law

The contribution of property to a partnership in return for a partnership interest is generally a tax-free transaction (sec. 721). If, instead of contributing property to a partnership, the taxpayer sells property to the partnership, the taxpayer recognizes gain or loss on the sale and the partnership is generally required to capitalize the amount of the purchase price, which may be deductible over the useful life of the property (or any applicable recovery period). When services are provided to a partnership, the partnership may be permitted to deduct amounts paid or incurred for such services (subject to the rules generally applicable to other taxpayers), and the party providing services must include an equivalent amount in income. However, a partnership, like any taxpayer, is generally required to capitalize (rather than currently deduct) expenditures which relate to the improvement of property or which create an asset the useful life of which extends substantially beyond the end of the taxable year. Present law (sec. 709) also provides specifically that a partnership may not currently deduct amounts paid or incurred to organize the partnership. Instead, the partnership may elect to deduct these amounts ratably over a 5-

year period, or, alternatively, may capitalize these expenses. In addition, neither the partnership nor any partner may even deduct syndication fees. These rules are equally applicable to services provided by third parties and services provided by a partner acting in a capacity other than that of a member of the partnership.

When a partnership allocates income from partnership operations among its partners, the partners generally include these amounts in income for the taxable year of the partner in which the partnership taxable year ends. This is distinct from a distribution of partnership assets, which generally is tax-free to the extent that the amount distributed does not exceed the recipient-partner's basis for his partnership interest. This tax-free treatment is based, in part, on the theory that a partner is entitled to withdraw the adjusted basis of his investment in a partnership (including the constructive investment retained by the partnership that corresponds to the partnership income on which the partner has paid tax) before recognizing gain on the investment.

Although amounts allocated to a partner are not deductible by the partnership, an allocation of taxable income to one partner may have the effect of a deduction for the remaining partners by reducing the amount of taxable income allocated to them.

Under case law, partnerships have been used to circumvent the requirement to capitalize certain expenses and other rules and restrictions concerning various expenses by making allocations of income and corresponding distributions in place of direct payments for property or services. Similarly, taxpayers have deferred or avoided tax on sales of property (including partnership interests) by characterizing sales as contributions of property (including money) followed (or preceded) by a related distribution of partnership property (including money). Although Treasury regulations provide that the substance of the transaction should govern in these latter cases, court decisions have allowed tax-free treatment in cases which are economically indistinguishable from sales of property by the partner to a partnership or to another partner.

House bill

Recharacterization of payments for capital expenses

Under the House bill, if a partner performs services for, or transfers property to, a partnership and receives a related allocation (direct or indirect) of partnership income or gain, the transaction will be treated as a transaction between the partnership and a person who is not a partner. This rule applies only if a direct payment for the property or services would have been a capital expenditure by the partnership. Thus, the amount paid to the partner in consideration for the property or services will be treated as a fee for services or purchase price of property provided to the partnership (as the case may be) and the partnership will be required to capitalize these amounts. The partnership will disregard the purported allocation to the partner performing services or transferring property to the partnership in determining the partners' shares taxable income or loss.

This provision applies to services performed, or property transferred, after March 1, 1984.

Disguised sales

The House bill provides that, when a partner transfers money or other property to a partnership and there is a related direct or indirect transfer of money or other property to that partner or other partner, the transaction is to be treated (as appropriate) as a sale between the partners of property (including partnership interests) or as a partial sale and partial contribution of the property to the partnerships. The selling partner will be required to recognize gain (or loss) on all or part of the amount received in the transaction. This rule is intended to prevent the parties from characterizing a sale or exchange of property as a contribution to the partnership followed by a distribution from the partnership thereby deferring or avoiding tax on the transaction.

This provision applies to property transferred after March 1, 1984.

Definition of partner

For purposes of the preceding rules, the House bill treats partners joining at the end of a series of transactions as partners for the entire series.

Senate amendment

Payments for services or property

The Senate amendment generally is consistent with the House bill with three modifications. First, clarifying amendments explicitly limit the application of the rule to cases in which the performance of services or transfer of property and a related allocation or distribution to a partner are, when viewed together, properly characterized as occurring between the partnership and a partner acting in his nonpartner capacity. Second, the rule is not limited to transactions in which direct partnership payments would have to be capitalized. Third, the provision applies to services performed or property transferred after February 29, 1984.

Disguised sales

The Senate amendment generally is consistent with the House bill with two modifications. First, clarifying amendments explicitly limit the provision to cases in which a transfer of money or property to a partnership and a related transfer of money or property by the partnership are, when viewed together, properly characterized as a sale of property. Second, the provision applies to property transferred after March 31, 1984, except for property transferred before December 31, 1984, if (1) there was a written private placement offering memorandum in existence on February 29, 1984, (2) the partner had expended $250,000 in connection with the offering of February 29, 1984, (3) the partner contributing encumbered property is the sole general partner, and (4) all of the encumbrances incurred in anticipation of the contribution are without recourse.

Definition of partner

The Senate amendment contains no provision relating to the definition is a partner, since Treasury's general regulatory authority will permit it to prescribe rules to prevent abuses.

Conference agreement

The conference agreement follows the Senate amendment.

The conferees wish to note that when a partner of a partnership contributes property to the partnership and that property is borrowed against, pledged as collateral for a loan, or otherwise refinanced, and the proceeds of the loan are distributed to the contributing partner, there will be no disguised sale under the provision to the extent the contributing partner, in substance, retains liability for repayment of the borrowed amounts (i.e., to the extent the other partners have no direct or indirect risk of loss with respect to such amounts) since, in effect, the partner has simply borrowed through the partnership. However, to the extent the other partners directly or indirectly bear the risk of loss with respect to the borrowed amounts, this may constitute a payment to the contributing partner.

Effective dates.—The provision of the conference agreement relating to disguised payments for services or property apply to services performed or property transferred after February 29, 1984. The provision relating to disguised sales of property apply to property transferred after March 31, 1984, with two exceptions. First, the conference agreement includes the transitional rule of the Senate amendment for certain transfers for which there was a written private placement offering in existence on February 29, 1984. Second, the agreement provides a transitional rule, for any transfer of property pursuant to a contract which was a binding contract on March 31, 1984, and at all times thereafter.

b. Character of gain or loss on contributed property

Present law

The character of income or loss from the disposition of property by a partnership is generally determined at the partnership level. Under present law, a contribution of property to a partnership by a partner, followed by a sale of the property, may result in a character of gain or loss different from that which would have resulted from a direct sale by the partner. Thus, taxpayers have contended that ordinary income may be converted into capital gain when dealer status exists at the partner but not at the partnership level and that capital loss may be converted into ordinary loss when dealer status exists at the partnership but not the partner level.

This result can be contrasted with the treatment of certain ordinary income property distributed by a partnership and subsequently sold by the recipient. The character of gain or loss on property in such a case generally is determined by the character of the property in the hands of the distributee with two exceptions. First, in the case of certain inventory items, the ordinary income character of an asset in the hands of the partnership carries over to the partner for a 5-year period. Second, the ordinary income character of certain unrealized trade or business receivables also carries over to the partner on an indefinite basis (sec. 735).

House bill

Under the House bill, if a partnership disposes of property which was inventory property in the hands of a partner immediately before its contribution, then any gain or loss recognized by the partnership on the disposition of the property during a period of 5 years after the date of the contribution will be treated as ordinary income or loss. Gain or loss on a disposition of unrealized receivables contributed by a partner will be treated as ordinary income or loss regardless of the date of disposition. The House bill also provides that built-in losses on capital assets will retain their character as capital losses for a period of 5 years after the date of contribution, but only to the extent of pre-contribution unrealized losses.

The bill further provides that, for purposes of the rules regarding contributed and distributed property (i.e., the new rules and section 735 of present law but not section 751), certain trade or business property which would qualify as a capital asset under section 1231 if held for one year or more by the partner or partnership prior to contribution or distribution (as the case may be) will not be treated as ordinary income property. Also, if property subject to section 724 or section 735 is disposed of in a nonrecognition transaction, the treatment of the transferred property will carry over to any substituted basis property resulting from the transaction (other than stock of a Subchapter C corporation received in a section 351 transfer).

The provisions apply to property contributed (or distributed in the case of section 735) after March 31, 1984.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

c. Transfers of partnership interests by corporations

Present law

The gain or loss on the sale or exchange of a partnership interest is generally a capital gain or loss. However, money or property received by a transferor partner in exchange for all or part of his partnership interest is subject to ordinary income treatment to the extent it is attributable to certain ordinary income assets of the partnership (sec. 751). For purposes of this provision, ordinary income items include the recapture of depreciation deductions previously taken on partnership property.

Also under present law, when a corporation distributes property (or sells property in the course of certain complete liquidations), income attributable to recapture property (and certain installment obligations) is taxed to the corporation, while other gain attributable to appreciation in value of the transferred property generally goes unrecognized.

Some taxpayers have taken the position that the present law recapture provisions can be avoided by the distribution or liquidating sale by a corporation of an interest in a partnership that holds recapture property. The United States Claims Court rejected this position in *Holiday Village* v. *United States*, No. 87-82T (June 6, 1984).

Basis adjustment.—Under present law (secs. 743 and 754), on a sale or exchange of interests in the partnership (or a transfer by reason of death) a partnership may elect to adjust the basis of partnership assets to reflect differences between the basis of partner's interest in the partnership and the partner's share of the basis of the partnership property. The election must apply to all sales or exchanges of partnership interests and may be revoked only for sufficient reason (Treas. Reg. sec. 1.754-1(c)).

House bill

For purposes of determining the amount of gain recognized by a corporation on any distribution, the House bill treats the distribution of a partnership interest as a distribution of the corporation's proportionate share of the recognition property of the partnership. Recognition property is defined as any property with respect to which the corporation would recognize gain if it distributed the property in a distribution (sec. 311 or 336) or sold the property in a liquidation sale (sec. 337).

Basis adjustments.—Under the House bill, when a partnership has an appropriate election in effect, the basis of partnership property may be adjusted following the distribution of an interest in a partnership to reflect differences between the basis of the distributee partner's interest in the partnership and the distributee partner's share of the basis of the partnership property (secs. 743 and 754).

These provisions apply to distributions, sales, and exchanges made after March 1, 1984, in taxable years ending after that date.

Senate amendment

The Senate amendment generally is the same as the House bill, except that the provision applies to distributions, sales, or exchanges made after March 31, 1984, in taxable years ending after that date.

Conference agreement

The conference agreement follows the Senate amendment with technical changes affecting the placement of the new provision within the Internal Revenue Code and providing that for purposes of section 708, section 743, or any other provision of subchapter K specified in regulations (not just section 743 as in the House bill and Senate amendment) a distribution of a partnership interest by a partnership or corporation will be treated as a sale or exchange of the interest. The conference agreement also replaces a specific technical amendment to section 751 in the Senate amendment with a general provision under which, in determining the amount of gain or loss with respect to property, for income tax purposes, fair market value with respect to property shall not be treated as less than the amount of any nonrecourse liability to which the property is subject. Of course, this provision would, have no application to transactions covered by section 751(c). The conferees stress that no inference is intended as to whether or not the results obtained by the provisions of this section differ from those obtained under current law.

These provisions apply to distributions, sales, and exchanges made after March 31, 1984.

d. Use of tiered partnerships to alter character of income on exchanges of partnership interest

Present law

Under present law, some taxpayers have argued that ordinary income treatment of unrealized receivables and substantially appreciated inventory may be avoided when the assets are held in a lower-tier partnership. Thus, if all of the assets held in a lower-tier partnership are section 751 assets, it is not entirely clear whether the ordinary income rules of section 751 should be applied by regarding an exchange of interests in the upper-tier partnership as an exchange of a capital asset (the interest in the lower-tier partnership) or of ordinary income assets (the section 751 assets held by the lower-tier partnership).

House bill

Under the House bill, it is made clear that the ordinary income rules of section 751 require fragmentation of the partnership's section 751 items from the partnership interest. Under this approach, a partner will be treated as disposing of such items independently of the rest of his partnership interest. The rule will apply regardless of how many tiers of partnerships exist between the transferor partner and the ordinary income assets.

The bill also provides that this approach regarding the fragmentation of section 751 items is to apply to interests in trusts in the manner provided for in regulations.

The provision is effective for distributions, sales, and exchanges made after March 31, 1984, in taxable years ending after that date.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

3. Exchanges of like-kind property

Present law

An exchange, like a sale of property, is generally a taxable transaction. However, present law provides that no gain or loss is to be recognized if property held for productive use in the taxpayer's trade or business, or property held for investment purposes, is exchanged solely for property of a like-kind that is also to be held for productive use in a trade or business or for investment. This provision (sec. 1031) specifically does not apply to exchanges of stock in trade or other property held primarily for sale, or to stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest.

Present law does not require specifically that a like-kind exchange be completed within a specified period in order to qualify for tax-free treatment. In *Starker v. United States*, 602 F.2d 1341 (9th Cir. 1979) the United States Court of Appeals for the Ninth Circuit held that an exchange qualified for like-kind treatment even though the property to be exchanged could be designated by the transferor for up to 5 years after the transaction and even though the transferor could have ultimately received cash rather than like-kind property.

Present law does not state specifically whether an interest in one partnership may be exchanged for an interest in another partnership as a tax-free exchange of like-kind property.

House bill

The House bill provides that, for purposes of the like-kind exchange provision, any property received by the taxpayer more than 180 days after the date on which the taxpayer relinquishes property (or after the due date of the taxpayer's tax return) is not to be treated as like-kind property.

Also, the like-kind exchange rules will not apply to any exchange of interests in different partnerships.

The provision relating to deferred like-kind exchanges is effective for transfers after the date of enactment. For transfers on or before date of enactment, any property received after December 31, 1986, will not be treated as like-kind property. The provision relating to partnership exchanges is effective for transfers of property after March 31, 1984, other than exchanges made pursuant to binding contracts entered into on or before March 1, 1984.

Senate amendment

The Senate amendment generally is the same as the House bill, with two modifications. First, property which was not identified as the property to be received by the taxpayer on the date the transferred property was relinquished will not qualify as like-kind property. Second, the provisions apply to transfers after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment except that transferors are permitted 45 days after the transfer to designate the property to be received and that a modified form of the effective date provisions of the House bill are adopted. The conferees note that the designation requirement in the conference agreement may be met by designating the property to be received in the contract between the parties. It is anticipated that the designation requirement will be satisfied if the contract between the parties specifies a limited number of properties that may be transferred and the particular property to be transferred will be determined by contingencies beyond the control of both parties. For example, if A transferred real estate in exchange for a promise by B to transfer property 1 to A if zoning changes are approved and property 2 if they are not, the exchange would qualify for like-kind treatment.

As under present law, these new rules would not permit a taxpayer who receives cash and later purchases the designated property to claim like-kind exchange treatment.

Effective dates.—The provision relating to deferred like-kind exchanges is effective for transfers after the date of enactment. For transfers on or before date of enactment, any property received after December 31, 1986, will not be treated as like-kind property, except if the property to be received was designated in a written binding contract entered into before June 14, 1984, then the property must be received on or before December 31, 1988. The provision relating to partnership exchanges is effective for transfers of property after the date of enactment other than exchanges made pursuant to binding contracts entered into on or before March 1, 1984. In the case of any transfer on or before the date of enactment which the taxpayer treated as part of a like-kind exchange and which is liable as a result of this provision, the period for assessing any deficiency of tax shall not expire prior to January 1, 1988.

The conference agreement also provides that the prohibition on like-kind exchange treatment for transfers of partnership interests is not to apply when general partnerships interests are exchanged pursuant to a plan of reorganization of ownership interests which took effect on March 29, 1984, provided that all of the exchanges contemplated by the reorganization plan are completed on or before December 31, 1984.

4. Use of tiered partnership to achieve step-up in basis of partnership assets

Present law

Under present law, a distribution of property by a partnership to a partner may result in an increase or decrease to the adjusted basis of such property in the hands of the distributee partner. In such cases, present law permits (but does not require) the partnership to adjust the basis of remaining partnership assets to take account of the change in the basis of the distributed property. In addition, when a partnership interest is sold or exchanged, present law permits (but does not require) the basis of partnership assets to be adjusted to reflect the difference between the transferee's adjusted basis in his interest and his share of the basis of all partnership assets. These basis adjustments are permitted only if the partnership makes a valid election which, once made, may be revoked only upon a showing of sufficient reason and applies to al distributions by a partnership and to all transfers of interests in the partnership.

Under present law, it may be possible in a tiered partnership arrangement to manipulate the basis adjustment provisions to inflate artificially the adjusted basis of property held by the partnership, as illustrated by the example contained in the report of the House committee.

House bill

The House bill prohibits an upper-tier partnership from adjusting the basis of its property following a distribution of an interest in a lower-tier partnership if the lower-tier partnership does not have a section 754 election in effect. This provision will prevent taxpayers from achieving a step-up in the basis of assets by means of inconsistent elections under section 754.

This provision is effective for distributions after March 1, 1983, in taxable years ending after that date.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

5. Allocation of liabilities to partners

Present law

A partner may deduct his allocable share of partnership losses to the extent of the adjusted basis of his partnership interest. A partner's basis includes both the amount of any partnership debt for which the partner assumes liability and the amount of the partner's share of partnership liabilities. In the case of partnership debt for which neither the partnership nor any partner has any personal liability (i.e. nonrecourse debt), all partners (including limited partners) increase their basis by a share of the nonrecourse debt (determined in accordance with their respective interests in partnership profits).

In *Raphan* v. *United States* (United States Claims Court, No. 452-78, September 26, 1983) the court held that a general partner who guaranteed repayment of what was otherwise a nonrecourse debt of the partnership was not to be treated as personally liable for such debt. Thus, the debt retained its nonrecourse status, and the limited partners were entitled to take into account a portion of such debt in computing the basis of their partnership interests.

House bill

The House bill directs the Treasury to prescribe regulations concerning the inclusion of partnership liabilities in the basis of the partners' partnership interests, and to take into account, where possible, the manner in which the partners share the economic risk of loss with respect to the borrowed amounts. The report of the House committee anticipates that these regulations will, among other things, reflect the position taken in Rev. Rul. 83-151, 1983-43 I.R.B. 6, and will reject the holding in *Raphan* v. *United States.* Thus, the regulations will specify that a partnership debt for which a partner is primarily or secondarily personally liable, whether in his capacity as a partner or otherwise, is not a nonrecourse debt, and thus generally does not provide limited partners with additional basis for their partnership interests. Similarly, when a limited partner guarantees what is otherwise a nonrecourse debt of the partnership, the regulations will not shift the basis attributable to that debt away from the limited partner as a result of the guarantee.

This grant of regulatory authority will take effect upon enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill in substance with certain modifications. Under the agreement, the decision in the *Raphan* case is not to be followed for purposes of applying section 752 or the regulations thereunder. In addition, the Treasury is to revise and update its regulations under section 752 (as soon as practicable) to take account of current commercial practices and arrangements, such as assumptions, guarantees, indemnities, etc. The conferees intend that the new regulations will reject the holding of the *Raphan* decision effective March 1, 1984, and that other changes in the regulations will apply prospectively from the date new regulations are proposed or some later date specified by the Treasury. The conferees do not intend that any inference should be drawn regarding the validity of the *Raphan* decision for transactions prior to March 1, 1984, and the conferees do to intend to affect in any way the rights of the various parties to that case. Finally, the conferees intend that the revisions to the section 752 regulations will be based largely on the manner in which the partners, and persons related to the partners, share the economic risk of loss with respect to partnership debt (other than bona fide nonrecourse debt, as defined by such regulations). With respect to bona fide nonrecourse debt, the conferees do not expect that such regulations will make major changes to the manner in which the partners' shares are determined, but may attempt to provide more certainty than presently exists.

F. Trust Provisions

1. Trust distributions

Present law

Under present law, beneficiaries are taxed on amounts distributed from a trust or estate to the extent of the trust's or estate's distributable net income. The trust or estate is allowed a deduction for amounts taxed to its beneficiaries. Present Treasury regulations provide that distributions of property are deemed to carry out distributable net income to the extent of the property's value at the time of distribution. In such a case, there is no gain or loss realized by the trust or estate, and the basis of the property in the hands of the beneficiary generally is its value to the extent it carries out distributable net income. (Treas. Reg. sec. 1.661(a)-2(f)).

House bill

Under the House bill, the distribution of property by a trust or estate results in the recognition of gain or loss on the distribution as if the property had been sold to the beneficiary. Alternatively, the bill allows the trustee or executor to elect to treat distributions of property as carrying out distributable net income only to the extent of the lesser of the property's basis or its fair market value at the time of distribution. If the election is made, the basis of the property in the hands of the beneficiary will be the same as the trust's or estate's basis.

The provision does is effective with respect to distributions made after March 1, 1984, in taxable years ending after that date.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment with a technical modification providing that distributions of appreciated property result in gain to the trust only if the trustee elects. If no election is made, such a distribution is treated as carrying out distributable net income only to the extent of the lesser of the property's basis or its fair market value at the time of the distribution. In such a case, the basis of the property in the hands of the beneficiary will be the same as the trust's or estate's basis.

The conference agreement clarifies that this provision does not affect the uniform basis rules of the Code (such as the rule providing a basis adjustment for property received in satisfaction of a pecuniary bequest).

Additionally, the conferees do not intend that this provision will change the present law tax effects of charitable contributions. For example, if a trust beneficiary makes a gift to a charitable organization property received in an in-kind distribution, that transfer is not to be considered a taxable disposition within the meaning of the Code. The present law rules governing gifts of appreciated property will continue to apply to such gifts.

Finally, the conference agreement provides that the provision applies to trust distributions after June 1, 1984, in taxable years ending after that date.

2. Taxation of multiple trusts

Present law

Treasury regulations promulgated following the Tax Reform Act of 1969 provided that multiple trusts are treated as one trust if the trusts had (1) the same grantor and substantially the same beneficiaries, (2) no substantially independent purposes, and (3) as their principal purpose, the avoidance or mitigation of progressive rates of tax or of the alternative minimum tax.

In *Edward L. Stephenson Trust* v. *Commissioner*, 81 T.C. 283 (1983), the Tax Court held that the Treasury regulations were invalid because the regulations were inconsistent with the intent of Congress regarding the tax treatment of multiple trusts.

House bill

The House bill provides that, under Treasury regulations, two or more trusts will be treated as one trust if (1) the trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and (2) a principal purpose for the existence of the trusts is the avoidance of Federal income tax.

This provision is effective for taxable years beginning after March 1, 1984.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

G. Accounting Changes

1. Premature accruals

Present law

Under the accrual method of accounting, an expense is generally deductible in the taxable year in which (1) all the events have occurred that determine the fact of the liability and (2) the amount of the liability can be determined with reasonable accuracy (the so-called "all events test"). Whether an expense involving a future obligation can satisfy the all events test in a year significantly earlier than the year in which the taxpayer must fulfill the obligation has been the subject of controversy under present law. Neither the Internal Revenue Code nor case law requires a taxpayer to account for future expenses on a present value basis.

The Code allows a deduction for contested liabilities if (1) the taxpayer contests the asserted liability, (2) the taxpayer transfers money to provide for the satisfaction of the asserted liability, (3) the contest with respect to the asserted liability exists after the time of the transfer, and (4) but for the fact that the liability is contested, a deduction would be allowed for the taxable year of transfer or for an earlier taxable year (sec. 461(f)).

House bill

In general, the House bill provides that in determining whether an accrual method taxpayer has incurred an amount during the taxable year, all the events which establish the taxpayer's liability for such amount will not be deemed to have occurred any earlier than the time when economic performance occurs. If economic performance has occurred, the amount will be treated as incurred for all purposes of the Code. Amounts incurred are deductible currently only if they are not properly chargeable to a capital account and are not subject to any other provision of the Code that requires the deduction to be taken in a taxable year later than the year when economic performance occurs.

Economic performance

The House bill provides principles for determining when economic performance occurs in the case of two categories of liabilities: (1) liabilities arising from another person's providing of goods or services or the use of property to the taxpayer; and (2) liabilities of the taxpayer to provide property or services. Economic performance occurs with respect to the first category as the property or services are provided to the taxpayer. Economic performance occurs with respect to the second category as the taxpayer provides the property or services.

A special rule is also provided for tort liabilities, liabilities arising under a worker's compensation act, and or employee benefit liabilities. In these situations, economic performance occurs as payments are made in satisfaction of the liability.

In the case of any type of liability not specifically described by the bill, economic performance will occur at the time determined under Treasury regulations.

Exceptions.—The economic performance standard will not apply to a liability of the taxpayer to provide benefits to employees of the taxpayer through a qualified pension, profit-sharing, or stock bonus plan described in section 404 or 404A; to contributions to a funded welfare benefit plan to which section 419 (as added by the bill) applies; or to items the time for deduction of which is determined under other sections of the Code, including additions to a bad debt reserve (sec. 166), vacation pay (sec. 463), qualified discount coupons (sec. 466), and additions to reserves by insurance companies subject to tax under subchapter L.

Net operating loss carrybacks

The House bill provides a 10-year carryback for net operating losses attributable to certain liabilities deferred under these provisions. The bill also provides a special carryback rule for losses incurred in connection with the decommissioning of a nuclear power plants. Such losses may be carried back to each of the taxable years during the period beginning with the taxable year in which the plant was placed in service. No loss, however, may be carried back to a taxable year beginning before January 1, 1984, unless it may be carried back without regard to these rules.

The provisions of the bill apply generally to expenses incurred (without regard to the economic performance requirement) after the date of enactment.

Senate amendment

The Senate amendment is generally the same as the House bill with the following exceptions.

First, if a taxpayer has a liability to provide benefits to employees (other than through a plan to which section 404 or 404A applies), and if payments with respect to such liabilities are made within 2½ months after the end of the taxable year, economic performance is treated as occurring in such taxable year. For contributions to certain trusts, including funded welfare benefit plans, economic performance occurs as payments are made to the plan.

Second, the Senate amendment clarifies that the economic performance standard must be satisfied before a deduction is allowable under section 461(f) (relating to contested liabilities).

The Senate amendment also includes provisions relating to current deductions for certain nuclear power plant decommissioning expenses and mine reclamation and similar costs (see items 2 and 3, infra). A special NOL carryback rule, under which carrybacks would not be limited to taxable years beginning on or after January 1, 1984, is also provided.

The amendment applies to expenses incurred under current law after the date of enactment and to expenses incurred under current law prior to the date of enactment with respect to which economic performance occurs after the date of enactment. The rules of section 481 would apply to require any adjustments necessary to prevent double deductions.

Conference agreement

The conference agreement generally follows the House bill, with modifications. However, the agreement adopts the Senate amendment's provisions relating to nuclear power plant decommissioning costs and to costs associated with the reclamation and closing of mine and solid waste disposal sites, with certain modifications (see Items 2 and 3, infra).

Exception from economic performance requirement for certain recurring items

In many ordinary business transactions, economic performance may not be met until the year following the year in which the all events test is otherwise satisfied. To avoid disrupting normal business and accounting practices and imposing undue burdens on taxpayers, the conference agreement provides an exception under which certain expenses may be treated as incurred in the taxable year in which the all events test is otherwise met even though economic performance has not occurred. This exception applies if four conditions are met: (1) the all events test, without regard to economic performance, is satisfied with respect to the item during the taxable year; (2) economic performance occurs within a reasonable period (but in no event more than 8½ months) after the close of the taxable year; (3) the item is recurring in nature and the taxpayer consistently treats items of that type as incurred in the taxable year in which the all events test is met; and (4) either (a) the item is not material or (b) the accrual of the item in the year in which the all events test is met results in a better matching of the item with the income to which it relates than would result from accruing the item in the year in which economic performance occurs.

This exception does not apply to workers' compensation liabilities, tort liabilities, or deferred compensation that is subject to the rules of section 404 as amended by the conference agreement.

Recurrency and consistency.—In determining whether an item is recurring in nature and is consistently reported by the taxpayer, consideration should be given to the frequency with which the item and similar items are incurred (or expected to be incurred) and the manner in which these items have been reported for Federal income tax purposes. The conferees intend for this exception to be available to taxpayers starting up a trade or business as well as to taxpayers already in a trade or business. In addition, a new type of expense or expense that does not recur every year should not necessarily be excluded from this exception.

Materiality.—The factors taken into account in determining the materiality of an item will include the size of the item, both in absolute terms and in relation to the taxpayer's income and other expenses, and the treatment of the item on the taxpayer's financial statements. If an item is considered material for financial statement purposes, it will also be considered material for tax purposes.

For example, assume that a calendar-year taxpayer enters into a one-year maintenance contract on July 1, 1985. If the amount of the expense is prorated between 1985 and 1986 for financial statement purposes, it also should be prorated for tax purposes. If, however, the full amount is deducted in 1985 for financial statement purposes because it is not material under generally accepted accounting principles, it may (or may not) be considered an immaterial item for purposes of this exception.

In some circumstances, items that are not material for financial accounting purposes will be treated as material items under this provision. For example, an item of expense which is immaterial for purposes of consolidated financial statements that combine a corporate taxpayer's financial data with those of affiliated companies may be material if the taxpayer is viewed separately. The conferees intend that where the item is directly related to an activity, the materiality of the item will be separately determined with respect to that activity. The materiality of overhead expenses that relate to several activities of the taxpayer will be measured against those collective activities.

In the case of any partnership or other pass-through entity, the conferees intend that in appropriate circumstances and to the extent provided in regulations, an item will be considered immaterial only if it is not material when analyzed at both the entity and at the partner (or, in the case of a trust or estate, beneficiary) level. Thus, an item that may not be material at the partnership level may be material at the partner level. Application of this rule may be appropriate, for example, when a partner invests in an accrual method partnership that makes a special allocation to the partner of an item that is not material to the partnership but is material to the partner. The conferees intend this rule to be applied in such a manner that no significant additional reporting requirements be imposed on partnerships and other flow-through entities in nonabusive situations.

Finally, the conferees intend that the above standards for determining whether an item is a material item apply only for purposes of the recurring item exception to the economic performance test. No inference is implied with respect to whether an item is material for purposes of any other Code provision. For example, an item that may not be considered material for purposes of the economic performance test may nevertheless be material for purposes of the fraud and false statement provisions of the Code (sec. 7206(1)). Likewise, an item that is not material under the economic performance exception may be material under the provisions relating to changes in methods of accounting (see Treas. reg. sec. 1.446-1(e)(2)(ii)(a)).

Matching.—In determining whether the accrual of an item in a particular year results in a better matching of the item with the income to which it relates, generally accepted accounting principles will be an important factor, although not necessarily dispositive. Costs directly associated with the revenue of a period are properly allocable to that period.[1] For example, a sales commission agree-

[1] "Basic Features and Basic Elements of Financial Accounting," *AICPA Professional Standards*, AC sec. 1025.19.

ment may require certain collection activities to be performed in a year subsequent to the year in which sales income is reported. In such a case, economic performance with respect to some portion of the liablity to pay the commission may not occur until the following year. Nevertheless, deducting the commission expense in the year in which the sales income is reported results in a better matching of the commission expense with the sales income. Likewise, if income from the sale of goods is recognized in one year, but the goods are not shipped until the following year, the shipping costs are more properly matched to income in the year the goods are sold rather than in the year the goods are shipped.

Expenses such as insurance or rent generally can be allocated to a period. Thus, a calendar year taxpayer with a twelve-month insurance contract entered into on July 1, 1984, generally should allocate one-half the expense to 1984 and one-half to 1985. In appropriate circumstances, however, the expense may be an immaterial item and accruable in its entirety in 1984. Expenses such as advertising costs that cannot practically be associated with income of a particular period may under generally accepted accounting principles be assigned to the period in which the costs are incurred. The conferees intend that, in general, the matching requirement will be satisfied with respect to advertising expenses if the period to which the expenses are assigned for tax and financial reporting purposes is the same.

Modifications and clarifications with respect to economic performance standard

Interest.—In the case of interest, economic performance occurs with the passage of time (that is, as the borrower uses, and the lender foregoes use of, the lender's money) rather than as payments are made. Interest incurred by accrual method taxpayers with respect to debts incurred in transactions occurring after June 8, 1984, the date of conference action, will be deductible only on a constant interest basis. (See sec. 44 of the conference agreement relating to the effective date of the OID and unstated interest rules). Interest on obligations issued on or prior to that date are not subject to the statutory prohibition against noneconomic accruals of interest. However, the conferees intend no inference regarding the propriety of interest accruals with respect such obligations that are inconsistent with the principles stated in Rev. Rul. 83-84.

Payments for nuclear waste disposal.—The conferees anticipate that the Treasury Department will issue regulations providing that economic performance with respect to amounts paid under the Nuclear Waste Disposal Act of 1982 occurs as payments are made to the Federal Government.

Natural gas refunds.—Regulated natural gas utilities may receive refunds from their suppliers for amounts they have been overcharged. Generally, these refunds are made to the utilities pursuant to regulatory commission orders and must be passed through to customers, usually within 8 to 12 months after receipt. Rev. Rul. 63-182, 1963-2 C.B. 194, which interpreted the all events test under existing law, permits a utility to deduct the amount refunded to customers in the year the refunds are received by the utility rather than in the year the refunds are passed through to customers.

The conferees intend that the Treasury Department have authority under the conference agreement to provide that, in the case of natural gas supplier refunds, a utility may deduct such refunds in the year the refund is included in the income of the utility, provided that the refunds are passed through to consumers within a reasonable period of time in the following taxable year and that adequate interest is paid over to and includible in the income of the consumers.

Reliance on other existing rulings and regulations.—The conferees expect that the Treasury Department will review existing regulations and rulings to determine whether they are consistent with the policies and principles set forth herein. Until new regulations are issued under these provisions or the existing rulings are revoked or clarified, taxpayers may continue to rely on these rulings to the extent they are not inconsistent with the general principles of economic performance or the generic exception for recurring items. Likewise, the conferees expect that taxpayers may rely on present law with respect to agreements entered into with the Internal Revenue Service (for example, under section 446 or 7121 of the Code or Rev. Proc. 80-51, 1980-2 C.B. 818), until new regulations are issued.

Contested liabilities.—The conference agreement adopts the Senate amendment's provision requiring economic performance before an amount transferred to a section 461(f) trust may be deducted. In the case of workers' compensation or tort liabilities of the taxpayer requiring payments to another person, economic performance occurs as payments are made to that person. Since payment to a section 461(f) trust is not a payment to the claimant and does not discharge the taxpayer's liability to the claimant, such payment does not satisfy the economic performance test.

Proof of compliance with economic performance standard.—The conferees intend that enforcement of compliance with the economic performance standard be carried out in a manner that does not impose substantial additional recordkeeping burdens on taxpayers. In the absence of unusual circumstances, the existence of a valid contract requiring another person to provide property or services to the taxpayer prior to the end of the taxable year (or 8½ months thereafter in the case of recurring items) would be sufficient to establish compliance with the economic performance standard with respect to the taxpayer's liability for an expense reflected in such contract.

More lenient standards may be warranted where an item is incurred by a foreign corporation.[2] The conferees recognize that information regarding economic performance, which in some cases must be obtained from third parties, may be especially difficult to obtain in this situation, particularly if the U.S. taxpayer owns only a minority interest in the foreign corporation. The conferees expect that regulations to be prescribed by the Treasury Department will provide that economic performance will be treated as having oc-

[2] Even if a corporation is not subject to U.S. tax jurisdiction, its taxable income may be relevant in determining the taxable income of a U.S. shareholder. Taxable income, and thus earnings and profits, of a foreign corporation must be determined according to U.S. tax principles, including the all events and economic performance tests.

curred by a particular date if the best available evidence indicates that it has so occurred.

Compensation for services.—The conference agreement provides that economic performance with respect to a liability to an employee generally occurs as the employee renders his or her services. However, an employer's deduction for compensation or other benefits paid to an an employee in a year subsequent to economic performance is subject to the rules in the Code (as amended elsewhere in the conference agreement) governing deferred compensation, deferred benefits, and funded welfare benefit plans.

Carrybacks of net operating losses

The conference agreement adopts the provision of the House bill that no net operating loss carrybacks resulting from nuclear decommissioning may be carried back to a taxable year before January 1, 1984, unless such loss may be carried back to such year without regard to these rules.

Effective date

The conference agreement follows the House bill with the following modification: Taxpayers may elect (with respect to each type of deductible item) the provisions of the bill to apply (1) to expenses incurred under current law after the date of enactment (as in the House bill), or (2) to expenses incurred under current law prior to after the date of enactment as to which economic performance occurs after the date of enactment (as in the Senate amendment) with the spread of any section 481 adjustment limited to 3 years.

2. Nuclear power plant decommissioning expenses

Present law

An accrual-basis taxpayer may deduct an anticipated expense no sooner than the tax year in which (1) all events necessary for determining the existence of the liability have occurred, and (2) the amount of the liability can be determined with reasonable accuracy.

Generally, under Federal and State laws, utilities that operate nuclear power plants are obligated to decommission the plants at the end of their useful lives.

It is unclear under present law when decommissioning expenses are properly accrued.

House bill

The House bill does not except nuclear decommissioning costs from the general rule, adopted in the bill, of allowing accrual basis taxpayers to deduct future liabilities only when economic performance occurs.

Senate amendment

A taxpayer responsible for nuclear power plant decommissioning (the "taxpayer") may elect to deduct contributions to a qualified decommissioning fund, subject to certain limitations.

A qualified nuclear decommissioning fund (a "fund") is a segregated reserve dedicated exclusively for the payment of nuclear decommissioning costs, taxes on fund income, and management costs of the fund. A fund is a separate taxable entity and is taxed at the maximum corporate income tax rate (46 percent). A fund is also subject to rules which (1) limit its investments to the same assets which may be purchased by a Black Lung Disability Trust Fund, (2) prohibit the purchase of a related party's assets, and (3) prohibit self-dealing.

The taxpayer must obtain a ruling from the Secretary to establish the maximum annual deduction that may be claimed for contributions to the fund. The ruling has two purposes: (1) to prevent accumulation of funds in excess of those required to pay future decommissioning costs (attributable to remaining plant life at the date the fund is established), and (2) to ensure that contributions to the fund are not accelerated (i.e., more rapid than level funding). For example, if two-thirds of a plant's useful life remains when a fund is established, then the taxpayer's deduction would be limited to contributions necessary to pay two-thirds of the estimated future decommissioning cost, on a level funding basis. The Secretary shall review this limit at least once during plant life, or more frequently by petition of the taxpayer.

Contributions to a qualified decommissioning fund are deductible, in the year made, but only to the extent these amounts are added to the cost of service charged to customers and included in the taxpayer's taxable income. Withdrawals from a decommissioning fund, for whatever purpose, except payment of taxes imposed on the fund and fund management costs, are included in the taxpayer's taxable income, in the year withdrawn. Amounts paid for decommissioning expenses are deductible from the taxpayer's gross income, as permitted by the Code, in the year paid.

If a decommissioning fund fails to comply with the qualification requirements, it may be disqualified by determination of the Secretary. In the event of disqualification, the Secretary may require that some or all of the fund balance (i.e., principal plus accumulated interest) be included in the taxpayer's taxable income. No deduction is allowed for contributions to a disqualified fund. In the year that plant decommissioning is substantially completed, the balance of the fund must be included in the taxpayer's taxable income. The Secretary will provide rules for determining when decommissioning is substantially complete.

The Senate amendment also provides that all customer charges for decommissioning expense, whether or not contributed to a qualified fund, must be included in the taxpayer's taxable income in that year.

These provisions are effective for decommissioning fund contributions made after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment with several clarifications.

The conferees intend that where responsibility for decommissioning a nuclear power plant is divided between taxpayers, each taxpayer may establish a fund for their share of the liability.

In the event that a nuclear power plant, or interest therein, is sold or otherwise disposed of prior to completion of decommissioning, the seller's decommissioning fund will be treated as disqualified. A buyer may at the discretion of the Secretary make a one-time deductible deposit, in excess of the annual ruling amount, into a new decommissioning fund. However, the buyer's start-up deposit is limited to the balance of the seller's qualified decommissioning fund.

The conferees recognize the importance of ensuring that utilities comply with nuclear power plant decommissioning requirements. In view of this concern, the conferees believe that it may be appropriate for the tax-writing committees to study further the tax treatment of decommissioning costs, and the merits of providing tax incentives for establishing decommissioning funds.

3. Mine reclamation and similar costs

Present law

An accrual-basis taxpayer may deduct an anticipated expense no sooner than the tax year in which (1) all events necessary for determining the existence of the liability have occurred, and (2) the amount of the liability can be determined with reasonable accuracy.

Federal and State laws (and certain municipal permits and ordinances) require reclamation of surface mines and waste disposal sites. The Internal Revenue Service takes the position that reclamation expenses cannot be accrued until reclamation occurs. Notwithstanding the Service position, the Tax Court in *Ohio River Collieries v. Commissioner* held that surface mining reclamation costs that could be estimated with reasonable accuracy were properly accrued when the overburden was removed.

House bill

The House bill does not except mine reclamation and similar costs from the general rule, adopted in the bill, of allowing accrual basis taxpayers to deduct future liabilities only when economic performance occurs.

Senate amendment

Taxpayers may elect to deduct mine and waste disposal site reclamation and closing costs, required by certain Federal and State statutes, prior to economic performance under a uniform method. Hazardous waste disposal sites, to which the Comprehensive Environmental Compensation and Liability Act of 1980 applies, are excluded from this provision.

Site reclamation costs

Electing taxpayers may deduct certain estimated reclamation costs, in current dollars, for land that is disturbed during the tax year, discounted at a compound rate of 2 percent per annum.

Site closing costs

Electing taxpayers may deduct certain estimated site closing costs, in current dollars, attributable to minerals mined (waste deposited) during the tax year, based on the units of production (capacity) method, discounted at a compound rate of 2 percent per annum.

Sinking funds

All amounts deducted for the cost of reclaiming a parcel of land are deemed deposited in a parcel-specific, tax-exempt sinking fund that is deemed to earn interest at 50 percent of the short-term rate provided in Code section 1274 (i.e., 110 percent of the short-term Federal rate). All amounts deducted for site closing costs are deemed deposited in a tax-exempt sinking fund, on a site by site basis, which earns interest at 50 percent of the long-term section 1274 rate. The balance of each sinking fund includes all deemed deposits and associated interest.

Amounts expended for qualified reclamation and site closing activities, allocable to land disturbed or units of production (capacity) subsequent to the date of election, are deductible in the year paid. Such amounts are deemed withdrawn from the applicable sinking fund, to the extent of its remaining balance, and the withdrawal is included in taxable income in that year.

The balance of each reclamation sinking fund is recaptured (i.e., included in taxable income) when reclamation of the parcel (with respect to which deductions were claimed) is substantially completed, but no later than the end of the third taxable year subsequent to creation of the sinking fund. Similarly, the balance of the site closing sinking fund is recaptured when site closing is substantially completed.

Effective date

The Senate amendment is effective after the date of enactment subject to two transition rules: (1) with respect to fixed price mineral supply contracts, entered into prior to March 1, 1984, taxpayers may continue existing accounting practices provided that deductions are taken on a current dollar cost basis, and (2) the Service may not challenge a taxpayer's entitlement to deductions, taken prior to March 1, 1984, for land disturbed or units produced prior to March 1, 1984, on the basis that the liability has not been incurred, if the deductions were based on current dollar cost estimates. (However, the deductions could be challenged on the basis that costs were not estimated with reasonable accuracy.)

Conference agreement

The conference agreement generally follows the Senate amendment with several clarifications and modifications.

In the case of mining, a site is defined as a "property" within the meaning of Code section 614. The conferees intend that the election to deduct reclamation and closing costs under this provision must be made for a site in its entirety. Where an election is made and responsibility for site reclamation and closing is divided between taxpayers with an interest in the site, each taxpayer may claim deductions (subject to the recapture rules) for their share of the liability. For each site, the election may be revoked by the taxpayer; however, the balance of the site reclamation and closing funds must be included in income in that tax year, and the election may not be reinstated.

Hazardous waste site reclamation and closing costs, incurred pursuant to the requirements of certain Federal and State statutes, are included in the conference agreement, except for sites listed in the National Contingency Plan (established under section 105 of the Comprehensive Environmental Compensation and Liability Act of 1980). Waste disposal site reclamation and closing expenses that arise from compliance with a municipal permit or ordinance, rather than a Federal or State statute, are included in the conference agreement.

The conference agreement simplifies the Senate amendment in several respects. The requirement to discount (at 2 percent per annum) deductions for future reclamation and site closing costs is eliminated. The requirement to account for reclamation sinking fund deductions on a parcel by parcel basis is eliminated. A single reclamation sinking fund is required with respect to each site. The requirement to recapture the balance of a reclamation sinking fund no later than three years after the end of the tax year in which the fund was created is also eliminated.

Amounts expended for qualified reclamation and site closing activities, allocable to land disturbed or units of production (capacity) subsequent to the date of election are deemed withdrawn from the applicable sinking fund in the year paid. Unlike the Senate bill, such withdrawals are not included in taxable income. However, only the excess of the amount paid for reclamation and closing activities over the year-end sinking fund balance (after deemed deposits and interest) is deductible in the year paid.

The deemed interest rate on the site reclamation and closing sinking funds is determined according to the following schedule: 70 percent of the short-term rate provided in Code section 1274 (compounded semiannually) in tax years ending in 1984 and 1985, 85 percent in 1986, and 100 percent in tax years ending on or after January 1, 1987.

The conferees agreed that the balance of the site reclamation and closing sinking funds should be subject to a reasonable limitation in order to prevent abuse of this provision. Amounts in the site reclamation and closing sinking funds in excess of these limits, at the end of each tax year (after deemed deposits, interest, and other withdrawals) are deemed withdrawn and are included in that year's taxable income.

The balance of the site reclamation sinking fund, at the end of each tax year, is limited to the current cost of reclaiming land that has been disturbed, subsequent to the date of election, but not previously reclaimed. For example, if at the end of the first tax year after site opening 20 acres have been disturbed and the per acre cost of reclamation is $10, then $200 (10 x $10) may be deducted in that year and the sinking fund balance is limited to the same amount. If at the end of the second tax year 20 additional acres are disturbed, the per acre cost of reclamation has risen to $11, and no reclamation work has been paid for, then $220 (20 x $11) may be deducted in that year and the sinking fund balance is limited to $440 (40 x $11).

The balance of the site closing sinking fund, at the end of each tax year, is limited to the current cost of closing the portion of the site which has been utilized (based on a units of production or capacity method), subsequent to the date of election. For example, suppose that site capacity is 500 units, 100 units are produced (or utilized) at the end of the first year, and the current cost of closing the entire site is $1,000. In this case, $200 ($1,000 x 100/500) may be deducted in that year and the sinking fund balance is limited to the same amount. If at the end of the second tax year an additional 100 units are produced and the current cost of site closing has risen to $1,100, then $225 may be deducted (i.e., the unrecovered cost of current site closing ($1,100-$200) times the proportion of remaining units produced during the tax year 100/(500–100)) and the fund balance is limited to $440 ($1,100 x 200/500).

In the event that a mine or waste disposal site is sold or otherwise disposed of prior to completion of site reclamation and closing, the conferees intend that the seller will recognize the outstanding balance of site reclamation and closing sinking funds in income. If any portion of the site is disposed of, then this portion of the site's reclamation and closing funds are subject to recapture. Recapture of sinking fund balances is also required at the end of the tax year in which a waste disposal site is listed on the National Contingency Plan.

The conference agreement clarifies that reclamation activities, for purposes of this provision, are limited to those activities performed prior to site closing and in connection with reclaiming land disturbed on the mine (or waste disposal) site.

Effective date

Minerals are considered sold subject to a fixed price agreement if their price is determined strictly in accordance with a formula which was fixed as of March 1, 1984 and does not permit, either directly or indirectly, adjustment for changes in tax liability.

The conference agreement clarifies that the fixed price mineral supply contract transition rule applies on a pro rata basis according to units of production. For example, if site production is 100 tons in a tax year, of which 40 tons is sold pursuant to a fixed price supply contract, then only 40 percent of the site reclamation and closing costs allocable to that year (based on current dollar cost estimates) are deductible in that year. If an election were made, then 60 percent of site reclamation and closing costs would be deductible, under the general rules of this provision.

If deductions are claimed pursuant to the fixed price supply contract transition rule, in connection with a site where the taxpayer has made an election, then amounts expended for qualified site reclamation and closing activities, allocable to land disturbed or units produced subsequent to the date of election, are deemed withdrawn from the applicable sinking fund on a cumulative units of production basis. For example, suppose that as of the end of tax year 1990, 500 tons have been produced from a site subsequent to the date of election, of which 300 tons were sold pursuant to fixed price supply contracts, and deductions were claimed in accordance with the transition rule. If the taxpayer paid $1,000 for site reclamation in 1990, then only $400 (200/500 x $1000) would be deemed withdrawn from the site reclamation sinking fund. Similarly, the limitation applicable to the site reclamation (closing) fund would be equal to 40 percent of the current cost of reclaiming (closing) the site attributable to land disturbed (units produced) subsequent to the date of election.

4. Prepaid expenses

Present law

Except with respect to prepaid interest and prepayments by farm syndicates, the Internal Revenue Code contains no provisions expressly prescribing the proper timing of deductions for prepaid items in the case of cash-method taxpayers. Under the weight of judicial authority and Internal Revenue Service rulings, a prepaid expense is deductible when paid only if (1) the expenditure is a payment and not merely a deposit, (2) there is a business purpose for the prepayment, and (3) deduction of the expense in the year of prepayment does not result in a material distortion of the taxpayer's income.

In the case of interest, deductions are allowed only for the year to which the interest relates. Deductions of certain farm syndicates are also limited to certain periods to which the expenses relate.

Expenditures that result in the creation of an asset having a useful life extending substantially beyond the close of the taxable year may not be deducted in full currently, but must be capitalized.

House bill

A tax shelter computing taxable income under the cash receipts and disbursements method will not be allowed a deduction with respect to any amount earlier than the time at which such amount is treated as incurred (i.e., properly deductible under the accrual method of accounting). An amount will not be treated as incurred at any time earlier than the time at which economic performance occurs. Thus, a cash basis tax shelter may not deduct an amount until both economic performance has occurred and the amount has been paid.

Under the House bill, a tax shelter means (1) a partnership or other enterprise (other than a corporation which is not an S corporation) in which interests have been offered for sale, at any time, in any offering required to be registered with a Federal or State agency; (2) a partnership or other enterprise if more than 35 percent of the losses are allocable to limited partners or limited entrepreneurs (generally investors who do not actively participate in the management of the enterprise); or (3) any partnership, entity, plan, or arrangement which is a tax shelter within the meaning of section 6661(b) (i.e., the principal purpose of which is the avoidance or evasion of Federal income tax.)

Senate amendment

Certain taxpayers engaged in the trade or business of farming who compute taxable income under the cash receipts and disbursements method are not allowed a deduction with respect to any amount paid for feed, seed, fertilizer, and other similar farm supplies earlier than the time when the feed, seed, fertilizer, or other supplies are actually used or consumed.

This provision generally applies to any person engaged in the trade or business of farming if more than 50 percent of such person's farming expenses paid during the taxable year are prepaid expenses.

The Senate amendment provides two exceptions to the 50-percent test. If either of these two exceptions are met, prepaid expenses continue to be deductible as allowed by present law, even though those prepaid expenses are greater than 50 percent of farming expenses for that year. The first exception applies if an eligible farmer fails to satisfy the 50-percent test due to a change in business operations directly attributable to extraordinary circumstances. The second exception applies if over the preceding 3-year period an eligible farmer satisfies the 50-percent test on the basis of the three preceding taxable years. The term "eligible farmer" will include (1) any person whose principal residence is on a farm, (2) any person with a principal occupation of farming, and (3) any family member of persons describe in (1) or (2). The exception applies only to an eligible person's farming activities attributable to the farm on which the residence is located, or to farms included in the "principal occupation" of farming activities.

Conference agreement

The conference agreement generally follows the House bill, precluding a tax shelter computing income using the cash receipts and disbursements method from deducting prepaid expenses any earlier than when economic performance occurs. For this purpose, the recurring item exception to the economic performance requirement (see Item 1, supra) will not apply.

Certain exceptions are provided under which prepaid expenses of a tax shelter will be deductible if economic performance occurs within 90 days after the end of the taxable year in which the prepayment is made. However, the maximum deduction that is allowable for any prepaid expenses under this exception is limited to the cash investment by the taxpayer in the tax shelter. For this purpose, the cash investment in a tax shelter which is a partnership is the taxpayer's basis in the partnership determined without regard to any liabilities of the partnership (with or without recourse) and without regard to any borrowings of the partner that are arranged by the tax shelter. In the case of tax shelters that are not partnerships, similar rules will apply. Thus, in the case of individual tax shelters, cash investment would not include any amounts borrowed by the individual which are arranged by the organizer or promoter or are secured by the investment.

For the purposes of this exception only, in the case of oil and gas activities, economic performance is deemed to occur with respect to all intangible drilling expenses of a well when the well is "spudded." For example, if a taxpayer contributed cash (not out of borrowings arranged by the tax shelter) to an oil drilling tax shelter in late December of a taxable year and the spudding of the well commenced within 90 days after the close of the taxable year, the entire amount of the prepaid intangible drilling expense would be deductible, subject to the limitations of present law requiring that the prepayment not be a deposit, that it be made for a business purpose, and that it not result in a material distortion of income.

To the extent that oil and gas prepayments do not meet the requirements of the 90-day exception, they are subject to the general principle provided in new section 461(h); thus, economic performance will occur as the drilling services are provided to the taxpayer. If drilling is commenced in the year of prepayment, only that portion of the intangible drilling costs attributable to drilling prior to the end of the year will be deductible in that year. Such portion of the costs will be deductible without regard to cash investment limitation.

With respect to expenses incurred in the trade or business of farming, the conference agreement clarifies that section 464 will be applied before the prepaid expense provisions, and that accrual method tax shelters will be subject to the timing rules of section 464. The change with respect to accrual method tax shelters is intended to equalize the treatment of cash and accrual farming tax shelters.

The prepaid expense provisions will apply to individual taxpayers engaged in farming activities with the principal purpose of tax avoidance. The conferees intend that marketed arrangements in which individuals carry on farming activities utiliizing the assistance of a common managerial or administrative service may be presumed under certain circumstances to have the principal purpose of tax avoidance. If under such arrangements, taxpayers prepay a substantial portion of their farming expenses with borrowed funds, they should generally be presumed to have a principal purpose of tax avoidance. This presumption may also be appropriate outside the context of farming.

Neither the general rule requiring economic performance to occur before a deduction is allowable nor the 90-day exception overrides any limitations of present law on the deductibility of prepaid expenses, including the requirement of a payment rather than a deposit, a business purpose for the prepayment, and no material distortion of income.

Effective date.—The conference agreement is effective with respect to prepayments made after March 15, 1984.

5. Deferred payment transactions

Present law

Time for inclusion or deduction of deferred interest

Original issue discount ("OID", or interest not paid currently) on a debt obligation issued for property generally is not taken into income by a cash method lender or deducted by a cash method borrower until received or paid, unless the debt instrument is publicly traded or the property for which it is issued is publicly traded stock or securities. If the lender is not an individual and the instrument is publicly traded or the property is publicly traded stock or securities, the OID provisions of the Code require the lender to recognize a portion of the deferred interest as income annually during the loan period and allow the borrower to deduct a corresponding amount, irrespective of whether the parties report income on the cash method or on the accrual method. The OID provisions also apply to debt instruments issued for cash.

For evidences of indebtedness issued after July 1, 1982, the amount of interest annually includible and deductible under the

OID provisions is determined on a constant interest basis, reflecting the compounding of accrued interest over the term of the instrument.

The OID rules do not apply to (1) obligations issued by individuals; (2) obligations having a maturity of one year or less; (3) as to holders, obligations not held as a capital asset; or (4) obligations the interest on which is exempt from tax under section 103 or any other provision of law.

Measurement of interest and principal

If the parties to a sale or exchange providing for deferred payment fail to state interest at least at a safe-harbor simple interest rate fixed by regulation, interest is imputed at a higher compound rate (sec. 483). Interest imputed under this provision ("the unstated interest rules") is allocated among deferred payments in proportion to the amount of the payments. Exceptions to these rules are provided for transactions in which all payments are due no more than one year after the sale, transactions in which the sales price does not exceed $3,000, certain annuity payments, certain sales of patents, and (as to the seller) sales of ordinary income property. The maximum imputed interest rate applicable to real estate transactions between related parties involving $500,000 or less is 7 percent.

House bill

The House bill extends the OID rules to obligations issued for nontraded property, deferred payments for services and use of property (whether or not evidenced by a formal debt obligation), obligations issued by individuals, and obligations not held as capital assets. The bill incorporates requirements similar to section 483 relating to the adequacy of the stated interest element of a deferred payment transaction involving the sale of nontraded property, the use of property, or the performance of services. The interest element in such transactions is compared to a compound safe-harbor rate that approximates a market rate. If inadequate interest is stated in the obligation, or if adequate interest is stated but is not unconditionally payable on a current basis, interest will be imputed annually at a higher rate (or at the stated rate, if higher than the imputed rate).

Exceptions to these rules are provided for sales of principal residences, certain sales of farms, sales involving total payments of $250,000 or less, certain annuity transactions, and certain sales of patents.

Section 483 will continue to apply only in the case of deferred payment transactions involving sales or exchanges of property that are within one of the exceptions to the OID rules. Where section 483 applies, unstated interest income or expense computed on an economic accrual basis (in accordance with the principles set forth in new section 1272 and Rev. Rul. 83-84, 1983-1 C.B. 9) will be reported and deducted as under present law—when payment is made in the case of a cash method taxpayer, when payment is due in the case of an accrual method taxpayer. The bill retains the exceptions of present law except the exception relating to sellers of ordinary income property. The bill also continues the 7 percent maximum imputed interest rate for certain real estate transactions between related parties.

These provisions generally apply to transactions entered into after December 31, 1984. The provisions relating to the current inclusions of OID income do not apply to obligations of individuals issued before March 2, 1984. The provisions relating to debt-for-nontraded property exchanges do not apply to sales or exchanges occurring after December 31, 1984, if made pursuant to a written contract (including an option contract) on March 1, 1984. Certain limitations relating to the manner in which interest may properly be accrued and the principal amount of debt instruments issued for nontraded property are effective for transactions occurring after March 1, 1984, and before January 1, 1985.

Senate amendment

The Senate amendment generally is the same as the House bill, except that it exempts from the OID and unstated interest rules cash method borrowers who issue discount obligations in connection with the purchase of property substantially all of the use of which will be for purposes other than business or investment. In addition, the Senate amendment exempts from the OID rules loans of $10,000 or less between members of the same family, unless tax avoidance is one of the principal purposes of the loan.

The interest element of deferred payment obligations involving services or use of property is dealt with in a separate Code provision (see new sec. 467, as added by this bill). The special transitional rules relating to the accrual of interest and the principal amount of debt obligations issued for nontraded property apply to transactions occurring after February 28, 1984, and before January 1, 1985.

Conference agreement

The conference agreement follows the Senate amendment, with several modifications, technical amendments, and clarifications.

Exceptions to the OID and unstated interest rules

The exception from the OID rules for loans of $10,000 or less is expanded to include loans between any individuals (not just family members) where the lender is not engaged in the trade or business of lending money. An additional exception is provided in the case of debt-for-nontraded property transactions where all payments under the obligation are due no more than six months after the date of sale.

The periodic deduction rule of section 163(e) will not apply to issuers of short-term obligations reporting income on the cash method.

Under the conference agreement, the OID and unstated interest rules do not apply to any amount which constitutes an annuity to which section 72 applies and the liability for which depends in whole or in substantial part on the life expectancy of any individual. It is not intended that this exception apply if the possibility that the life contingency will determine the amount of the payments is remote; that is, the contingency must be real and significant. In addition, the OID rules do not apply to any annuity (whether or not dependent upon life expectancy) issued by an insurance company subject to tax under subchapter L provided the annuity is issued (1) in a transaction in which only cash or another annuity contract meeting these requirements is involved, (2) upon exercise of an election under a life insurance policy by a beneficiary thereof, or (3) in a transaction involving a qualified pension or employee benefit plan.

The general exception for transactions to which section 267 applies is deleted. Thus, the interest element of a deferred payment sale between related parties will be subject to the OID rules.

The conference agreement clarifies that the exceptions to the OID rules for sales of principal residences, certain sales of farms and sales involving total payments of $250,000 or less apply to both the lender and the borrower in such transactions, not just to the lender.

Other modifications

The agreement modifies both bills to provide that if the stated interest rate in an obligation is 110 percent or more of the applicable Federal rate, but is not paid currently at that rate, interest will be imputed at the stated rate rather than at 120 percent of the applicable Federal rate.

As a corollary to the fair market value rule applicable in potentially abusive situations, the conference agreement makes it clear that the Internal Revenue Service retains the right to challenge a transaction in which the principal amount of an obligation is *less* than the fair market value of the property received in exchange for the obligation. Thus, taxpayers may not intentionally overstate original issue discount in deferred payment sales transactions. Taxpayers might be inclined to overstate the interest element of a transaction where, for example, the property involved in the sale is nondepreciable or the seller-lender is not subject to U.S. tax on its discount interest income.

Finally, the requirement in the effective date provisions that interest must be accrued on a constant interest basis applies to transactions occurring after June 8, 1984, the date of conference action. The conferees intend no inference regarding the propriety of interest accruals with respect to transactions occurring prior to that date that do not comply with the concepts stated in Rev. Rul. 83-84.

Clarifications of intent

The conferees agreed to certain clarifications as to the scope and application of the OID provisions.

First, the conferees do not intend that taxpayers be able to circumvent the 110 percent imputed rate contained in the OID provisions simply by coupling a low-interest loan with a sale of property. Thus, if Seller agrees to lend money to Buyer at an interest rate equal to 100 percent of the applicable Federal rate (thereby complying with the low-interest loan provisions of the bill), and Buyer uses the proceeds of the loan to purchase nontraded property from Seller, the loan will be treated as a purchase money loan subject to the 110 percent test and 120 percent imputed interest rate of the OID rules rather than the 100 percent rate applicable to low-interest loans.

Second, no OID will be deemed to exist in situations where a debt instrument issued for nontraded property bears interest, unconditionally payable at least annually, at a variable rate, provided the stated rate is a floating rate, adjusted at no more than six-month intervals, at least equal to 110 percent of the Federal short-term rate (or other appropriate indices provided under regulations).

Finally, the conferees anticipate that the Commissioner will issue regulations, similar to the regulations under existing section 483, dealing with the tax consequences of debt obligations which are assumed or taken subject to, that is, the transfer of obligations to make or rights to receive deferred payments subject to the OID rules. The conferees intend that such rules apply not only to the assumption of deferred payment obligations, but also to assumptions of obligations to third-party lenders. These rules will apply to sales and exchanges after December 31, 1984, and therefore will apply to debt obligations that are assumed or taken subject to after that date even though such obligations were first issued prior to that date.

6. Deferred payments for use of property and services

Present law

A cash method lessor includes rent in income only when payment is received, while an accrual method lessee deducts a portion of the rent in each year of the lease, irrespective of when rent is paid. Thus, a mismatching of income and deductions may occur in the case of a deferred payment lease involving a cash method lessor and an accrual method lessee.

Where a lease provides for current payments of rents, but at disproportionately higher levels in the later years of the lease term (i.e., the rents are "backloaded" or "stepped"), portions of the true rent allocable to the earlier years are in substance being deferred until later years, when the deferred amounts are repaid with interest. The result is deferral of income by the lessor.

It is unclear under present law under what circumstances uneven rent payments will be treated as resulting in deferral or prepayment of rent. The Internal Revenue Service has issued a revenue procedure stating that the payment of uneven rents in a so-called "leveraged lease" will not be regarded as involving a deferral or prepayment of rent provided the rent payable for any year does not exceed 110 percent of the average annual rent payable over the term of the lease and is not less than 90 percent of this average. Rev. Proc. 75-21, 1975-1 C.B. 715.[3]

House bill

The House bill contains no provision relating to the "principal" element of deferred payment transactions involving the use of property or services. It does, however, provide for annual inclusion and deduction of interest with respect to such transactions in certain circumstances (see item 5, supra).

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[3] The revenue procedure also provides an alternative test based on rents payable over the first two-thirds of the lease term.

Senate amendment

The Senate amendment requires that both the rent element and the interest element of a deferred rent transaction be included in the income of the lessor and deducted by the lessee annually, unless rent is paid before the end of the year following the calendar year in which the property is used. A transaction involving stepped rents is treated as a deferred rent transaction if any periodic increase is not commercially reasonable. In general, whether an increase is commercially reasonable is determined on the basis of all the facts and circumstances.

In the case of a sale-leaseback transaction involving payment of stepped rents, an annual increase will be considered as not commercially reasonable if it exceeds the greatest of (1) the percentage increase in the Consumer Price Index (or other index specified by regulations) during the immediately preceding lease period, (2) the Federal short-term rate in effect at the time the lease is entered into, or (3) the increase in specified costs with respect to the property payable by the lessor to unrelated parties during the period between the payments. Leases providing for even "steps" of up to 5 years, with cumulation and compounding of the permissible increases during the period, will qualify as commercially reasonable.

Similar rules are to be provided by regulations for the interest element in deferred payment transactions involving services and for "front-loaded" payment transactions.

The provisions are generally applicable to agreements entered into after March 15, 1984, other than agreements entered into pursuant to a written binding commitment if effect on March 15, 1984. Under a transitional rule, in the case of leases where there was written evidence of a firm plan on March 15, 1984, to lease property which had not been placed in service before that date, the parties will not be subject to the permanent rules; however, such persons will be required to report rental income and deductions in amounts at least as great as those in a specified schedule, regardless of the actual payments made under the agreement. In addition, an exception is provided for a particular lease that was being negotiated on March 15, 1984.

Conference agreement

The conference agreement adopts the House bill and the Senate amendment with modifications.

Overview

The conference committee believes that the deferred rent provision of the Senate amendment is deficient in two respects. First, commercial reasonableness is too vague a standard by which to determine the tax consequences of a lease agreement. The conferees feel that this standard is unworkable and injects an unacceptable degree of uncertainty into legitimate business transactions. Second, the Federal rate safe harbor provided in the Senate amendment would permit rent increases over the term of a lease that would, in general, significantly exceed the increases that could be justified as an economic matter.

Accordingly, the conference agreement adopts a tax avoidance purpose test, makes this test applicable to a narrower range of lease agreements, and eliminates the safe harbor based on the Federal rate. (As under the Senate amendment, only leases involving total payments in excess of $250,000 and either deferred payments or stepped rents are affected by the conference agreement.) The tax avoidance purpose test will be applied only in the case of certain leasebacks and long-term leases. If this test is satisfied, the rents payable under the lease will be "leveled" for purposes of the tax treatment of the parties to the lease, that is, the parties will take into account annually the constant rental amount and interest on unpaid rental amounts from prior years. The conference agreement provides certain safe harbors under which leases will not be deemed to be motivated by tax avoidance.

In cases not involving leasebacks or long-term leases or in which it has been established that there is no tax avoidance purpose for the backloading, the rents specified in the lease agreement will be recognized for tax purposes. However, the parties will be required to report the rent allocable to the period (and interest on unpaid rents) on an accrual basis, regardless of their method of accounting. Thus, the general rule will be "matching" on an accrual basis by both lessors and lessees.

Finally, lessors who, by virtue of having demonstrated no tax avoidance purpose, are not subject to rent leveling during the term of the lease will be subject to a recapture provision on disposition of the leased property. Under this provision, any gain realized on such a disposition will be treated as ordinary to the extent of the excess of the accruals that would have been taken into account had the lessor been subject to the rent leveling provision over the actual accruals of rents up to the date of transfer. The conferees believe that even in situations where the parties can demonstrate that tax avoidance is not a principal purpose of the stepping of rents, and rents are reported on a consistent basis, there is an opportunity to convert ordinary income into capital gain by selling property subject to an agreement providing for increasing rents. The recapture provision prevents such a conversion.

The conferees emphasize that no inference is intended as to the ability of the Internal Revenue Service to challenge the form of an agreement involving deferred or stepped rents under general accrual or clear reflection of income principles, on the basis that a purported lease constitutes a mere financing transaction, or on other grounds.

Matching requirement in case of "section 467 rental agreements"

The conference agreement affects only those leases that would have been subject to the provision contained in the Senate amendment, that is, leases involving total payments in excess of $250,000 and either (1) increasing (or decreasing) rents, or (2) rents payable beyond the close of the calendar year following the year in which the associated use occurs. Such leases are referred to as section 467 rental agreements.

The parties to a section 467 rental agreement not involving a leaseback or a lease of property for a term in excess of 75 percent of the property's ACRS life will not be subject to the tax avoidance purpose test or the rent leveling provision. Both the lessor and the lessee under such agreements, however, will be required to accrue annually the rent allocable to the taxable year where actual payment of the rent is deferred.[4] The rent allocable to a taxable year will be determined from the terms of the lease. If the lease specifies amounts that are allocable to particular periods but these amounts are not paid until more than one year after the year to which they relate, the amount of rent to be accrued for each period will be an amount determined in accordance with Treasury regulations based on present value concepts. It is anticipated that these regulations could provide different methods for determining the appropriate amount, depending upon the particular type of lease involved. Present values will be determined, and interest will accrue on any accrued but unpaid rent (and any unpaid interest on such interest), at a rate of 110 percent of the applicable Federal rate, compounded semiannually.

Constant rental accrual in certain situations

Rents will be deemed to accrue on a level present value basis in two situations. First, level rents will be imputed if a section 467 rental agreement is silent as to the allocation of rents over the lease period. Second, level rents will be imputed if (1) a section 467 rental agreement provides for increasing rents, (2) one of the principal purposes of providing for increasing rents is the avoidance of taxes, and (3) the lease is either part of a leaseback transaction or for a term in excess of 75 percent of the "statutory recovery period" for the property subject to the lease. A leaseback transaction for this purpose is one that involves a lease of property to any person who had any interest in such property within the two-year period such lease goes into effect (or to a person related person to such person). The conferees do not intend that a de minimis ownership interest be deemed an interest for this purpose.

The statutory recovery period for purposes of the 75 percent test is essentially the period provided under the ACRS provisions of the Code. Property that is not recovery property will be treated as if it were recovery property for purposes of this test.

Regulatory safe harbors.—The Treasury Department is directed to prescribe regulations setting forth circumstances under which rents will not be treated as being stepped for tax avoidance purposes. Among the circumstances for which safe harbors are to be provided are (1) increases in amounts determined by reference to price indices such as the Consumer Price Index, (2) rents based on a percentage of the lessee's receipts or similar amounts, (3) reasonable periods during which rents are forgiven or abated, and (4) changes in amounts paid to unrelated third parties.

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[4] The conferees intend that any rent or interest accrued by the lessor under this provision as well as under the rent leveling provision will be treated in the same manner as a receivable or other debt owed to an accrual basis taxpayer. Thus, if the lessee due to bankruptcy or other circumstance ultimately fails to pay rent or interest imputed under this provision when due, the lessor will be able to claim a bad debt deduction, at the time and to the extent a bad debt deduction is permitted under present law to accrual basis taxpayers. Similarly, a lessee under a section 467 rental agreement will have income under discharge of indebtedness or tax benefit principles to the extent a rental or interest amount previously accrued pursuant to this provision is forgiven or otherwise goes unpaid.

Thus, the conferees intend that the regulations will provide that a lease calling for rents that increase at a variable rate equal to the rate of the increase in the CPI (or other appropriate price index) during the lease period does not have tax avoidance as a principal purpose. Such a lease may limit the increase to a specified maximum percentage and still come within the CPI safe harbor, and increases based on such a formula may be aggregated and made in intervals of five years or less.

Similarly, increases that are based on a fixed percentage of the lessee's gross receipts or similar amounts, or that reflect the lessee's obligation under the lease to bear specified costs (such as real estate taxes, insurance, maintenance, and similar costs) of the lessor will not be considered to be motivated by tax avoidance. Because the amount of increases in the CPI or in third party costs generally is not subject to manipulation by the parties, and it is a common commercial practice to pass such increases on to lessees, such increases should not generally be considered in determining whether rents are stepped to avoid taxes.[5]

In addition, the conferees intend that the regulations will provide a safe harbor for leases under which no rent is payable (or is payable at a reduced rate) for a reasonable period of time after the inception of the lease. Whether the length of a "rent holiday" is reasonable will be determined by commercial practice in the locality where the use of the property will occur at the time the lease is entered into. The conferees expect that, in general, this rent holiday will not exceed twelve months, and in no event shall exceed twenty-four months.

The conferees anticipate that the Treasury Department will issue regulations adopting standards under which leases providing for fluctuations in rents paid by no more than a reasonable percentage above or below the average rent payable over the term of the lease will be deemed not motivated by tax avoidance. The conferees understand that the Internal Revenue Service has taken the position that a 10 percent fluctuation above or below the average rent is permissible in the case of leases involving personal property. Rev. Proc. 75-21, 1975-1 C.B. 715, sec. 5. The conferees note that the standards of Rev. Proc. 75-21 may not be appropriate for real estate leases, and that it may be appropriate in the regulations to provide less restrictive standards for such leases.

Tax avoidance standard.—A section 467 rental agreement involving a leaseback or a term in excess of 75 percent of the property's statutory recovery period will be subject to the rent leveling provision only if a principal purpose of the stepping of rents is tax avoidance. The determination of the existence of a tax avoidance purpose will be made on the basis of all the relevant facts and circumstances. A major factor in this determination will be whether and to what extent the tax brackets of the lessor and the lessee differ at the time the lease is entered into, and the parties' reasonable expectations as to their relative tax brackets over the term of the lease. Where their tax brackets are roughly equal, a natural

[5] The conferees intend no inference as to the effect of a lease clause requiring the lessee to assume the burden of any increases in the lessor's debt service on the property, however, including the effect of such a clause on the status of the lease as a true lease.

tension will normally exist between the lessor and lessee since the lessor will defer recognition of income at the cost to the lessee of a deduction to which it would otherwise be entitled.

On the other hand, where a lessor is in a higher marginal tax bracket than a lessee (e.g., where the lessee is a tax-exempt entity or has substantial NOLs or is otherwise in a low marginal bracket), the motives of the parties in stepping the rents will be closely scrutinized, and taxpayers should be held to a higher standard of proof. They should be required to show that market conditions or other substantial business reasons justify the specified increases. In particular, the conferees believe that so-called "sandwich" lease transactions, whereby a tax-exempt entity is interposed between two taxable parties as a lessee-sublessor to achieve deferral of income for the ultimate lessor without sacrificing the deductions of the sublessee, should generally be suspect.[6] The conferees emphasize that they intend no inference as to the ability of the Internal Revenue Service to challenge these sandwich lease transactions under existing law.

The involvement of tax-exempt organizations or taxpayers in an NOL position or low marginal tax bracket will not, however, create a conclusive presumption of a tax avoidance purpose, even where such person serves as a sublessor. Rather, all the facts and circumstances must be considered in determining the purpose of the transaction. If those facts and circumstances suggest substantial nontax reasons for a particular rent structure, the terms of the lease should be respected for tax purposes, even if a tax-exempt or NOL taxpayer is simultaneously a lessor and lessee.

For example, if a tax-exempt trade association negotiated a long-term lease for office space in excess of its current needs in order to assure the availability of additional space in the future, and temporarily sublets a portion of the space to a taxable third party, the transaction need not be viewed as per se motivated by tax avoidance. Increases in rents under the primary lease and sublease would be respected if it could be demonstrated that tax avoidance was not a principal purpose of the increases. The absence of such a purpose might be shown by the existence of leases containing similar terms between the primary lessor and taxable third parties. The burden of proving the absence of a tax avoidance purpose would, however, be on the taxpayer.

Another factor in determining whether a tax avoidance purpose exists is whether under the lease the lessee has an option to renew at a rental amount significantly less than rental amounts payable during the later years of the lease, particularly where the option rental amount is roughly equal to what the constant rental amount would have been for the primary term of the lease had the rent leveling provision been in effect.

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[6] A variation of the sandwich lease is an arrangement whereby a cash basis taxpayer simultaneously serves as lessee and sublessor under a master lease with an accrual basis lessor and a sublease with an accrual basis sublessee. Although the sublease calls for stepped rental payments, the sublessee may take the position it is entitled to accrue annually a level amount of rent that reflects the average rent payable over the term of the lease. The lessor will accrue annually only the amount of rent actually paid on the ground that it is entitled only to that amount.

The Treasury Department in regulations may prescribe other factors that are indicative of a tax avoidance purpose.

Recapture on disposition of leased property in certain situations

If property subject to a leaseback or a long-term lease is not subject to the rent leveling provision, any gain realized by the lessor on disposition of the property during the term of the agreement will be treated as ordinary income to the extent of the "recapture amount." For this purpose, the gain realized is reduced by the amount of gain treated as ordinary income under other provisions of the Code (e.g., sec. 1245 or 1250).

The recapture amount is the excess of the amount which would have been taken into account by the lessor if the rents had been reported on a constant rental basis over the amount actually taken into income by the lessor under the general matching provision. Only amounts that are fixed and determinable will be taken into account in making this computation. The Treasury Department is to provide regulations under which exceptions similar to the exceptions provided under sections 1245 and 1250 shall apply for purposes of the rent recapture provision, and under which the ordinary income taint on the property will be preserved in cases where the property is transferred and the transferor's basis in the property carries over to the transferee.

Other regulations

The conference agreement provides that the Treasury Department is to issue regulations requiring reporting of the interest elements only of deferred payment transactions involving services, in a manner consistent with the treatment of interst in deferred payment rental transactions. Regulations will also deal with the treatment of front-loaded (i.e., prepaid) agreements. The conferees intend that the provisions relating to deferred payment services agreements and front-loaded agreements and the regulations thereunder be applied prospectively from the date of issuance of regulations.

Effective date and transitional rules

These provisions are effective for agreements entered into after June 8 1984, subject to the transitional rules provided in the Senate amendment.

7. Capitalization of construction period interest and taxes

Present law

In general, no immediate deduction is allowed for real property construction period interest and taxes (Code sec. 189).

This rule does not apply to (1) low-income housing, (2) residential real property (other than low-income housing) acquired, constructed, or carried by a corporation (excluding certain corporations) or (3) real property if the property is not, and cannot reasonably be expected to be, held generally in a trade or business, or in an activity conducted for profit.

The capitalized interest and taxes are amortized generally over a 10-year period.

House bill

No provision.

Senate amendment

The rules under section 189 are extended under the Senate amendment to require corporations (other than corporations currently subject to sec. 189) to capitalize construction period interest and taxes for residential real property (other than low income housing). The definition of construction period is the same as under present law.

This provision will apply to interest or taxes paid or incurred in taxable years beginning after December 31, 1984, for the construction of residential real property begun after March 15, 1984.

Conference agreement

The conference agreement follows the Senate amendment.

8. Start-up expenses

Present law

Generally, expenses incurred prior to the establishment of business are not deductible currently since they are not incurred in carrying on a trade or business or while engaging in a profit-seeking activity. However, some expenses such as interest or taxes are allowed as deductions for nonbusiness purposes, and the Supreme Court held in *Snow* v. *Commissioner*, 416 U.S. 500 (1974) that research and experimental expenses are deductible under section 174 notwithstanding the trade or business requirement.

A taxpayer may elect to treat start-up expenses as deferred expenses that may be deducted ratably over a period of not less than 60 months (sec. 195).

Present law is unclear whether, in the absence of an election under section 195, a specific item should be capitalized or expensed.

House bill

No provision.

Senate amendment

Under the Senate amendment, taxpayers will be required to treat start-up expenditures as deferred expenses. Taxpayers will be allowed to amortize such expenditures over a period of not less than 60 months as may be selected by the taxpayer. The definition of start-up expenditures is intended to be generally the same as under present law but also covers certain pre-opening costs.

The Senate amendment applies to taxable years beginning after June 30, 1984.

Conference agreement

The conference agreement generally follows the Senate amendment with the following modification. Under the conference agreement, start-up expenditures that are allowed as deductions under sections 163, 164, and 174 shall not be treated as deferred expenses.

The conference agreement also clarifies that the definition in the Senate amendment of start-up expenditures covers certain pre-opening costs, but only for periods after the effective date of the provision.

9. LIFO conformity

Present law

The "Last-In-First-Out" (LIFO) method of inventory accounting may not be used for tax purposes unless it is also used in reporting to shareholders, partners, other proprietors, beneficiaries, and for credit purposes. An exception to the conformity requirement is provided for certain differences, including differences that arise because the taxpayer adopts the LIFO method for financial statement purposes beginning with an accounting period other than the taxable year for which the taxpayer first used the LIFO method for tax purposes. (Treas. Reg. sec. 1.472-(2)(1)(viii)(A).) Furthermore, the Internal Revenue Service has issued several rulings which provide limited exceptions to the LIFO conformity rule in other factual situations.

In *Insilco Corp.* v. *Commissioner*, 73 T.C. 589 (1980), *aff'd. in an unreported decision* (2nd Cir. 1980), the Tax Court held that the LIFO conformity rules were met by a subsidiary using the LIFO method to compute its income in its financial reports issued to its parent company, even though the parent company converted the subsidiary's earnings to a non-LIFO basis in the parent's consolidated financial statements.

House bill

The House bill treats all members of the same group of financially related corporations as a single taxpayer for purposes of the LIFO conformity requirement. The term "group of financially related corporations" means (1) any affiliated group as defined in section 1504 determined without regard to the exceptions in sec. 1504(b) and by substituting a 50-percent stock ownership test for an 80-percent stock ownership test, and (2) any other group of corporations which issue consolidated financial statements or reports generally to shareholders and others.

The House bill does not affect the exceptions to the conformity requirements already provided under current law, or Treasury's authority to provide other such exceptions in the future.

The House bill applies to taxable years beginning after the date of enactment.

Senate amendment

The Senate amendment generally is the same as the House bill, except the provision also applies to a group of corporations that issue financial statements on a combined basis.

Conference agreement

The conference agreement follows the Senate amendment with certain clarifications and modifications.

First, the conference agreement clarifies that the conformity requirement applies to the financial statements of a corporation that include under the equity method of accounting the results of operations of a corporation that uses the LIFO method of accounting for tax purposes, but only if that corporation is a member of the affiliated group by applying the 50-percent stock ownership test (described under the House bill).

Second, the conference agreement clarifies the transition rules for taxpayers who accounted for inventories on methods similar to those involved in the *Insilco* decision. The conference agreement provides that a taxpayer who relied on *Insilco* (or a similar interpretation of the law) in prior years may elect to remain on the LIFO method for tax purposes and conform its financial statements to the LIFO method. In such a case, the LIFO cost for financial statement purposes may be different than the LIFO cost for tax purposes because the LIFO method is first used for financial reporting purposes in a different year than it was first used for tax purposes. The conference agreement clarifies that such differences in the LIFO cost are not a violation of the conformity requirement (i.e., Treas. Reg. sec. 1.472-2(e)(1)(viii)(A) would apply).

Under the conference agreement, no inference is implied with respect to the taxpayer's compliance with the conformity requirement under present law. Thus, even a taxpayer who complies with the provisions of this bill may nevertheless be subject to challenge by the Internal Revenue Service for violation of the conformity requirement in prior years. However, in order to prevent unwarranted exposure to subsequent decisions contrary to *Insilco*, the conference agreement provides that for this purpose only the IRS may provide a special procedure for taxpayers who want to continue to use the LIFO method to make a protective LIFO election (consistent in all respects with their existing LIFO election) so that taxable years beginning after the date of enactment are protected. No inference is created as to whether a conditional LIFO election may be valid in other contexts.

Taxpayers who elect to change to the LIFO method for tax purposes will be allowed a spread of any adjustment required under section 481 not to exceed 4 years. (The LIFO method as used prior to the effective date would not be treated as a category A method under Rev. Proc. 80-51, 1980-1 C.B. 816).

Effective date.—The provision applies to taxable years beginning after the date of enactment.

H. Tax straddles

Present Law

Exemption of stock and stock options from straddle rules

Losses incurred in positions in actively traded personal property are deferred to the extent that the taxpayer has unrecognized gain on offsetting positions in a straddle. Positions are offsetting generally if there is a substantial diminution in the risk of loss from holding one position by reason of holding the other position. In addition, interest and carrying costs allocable to personal property which is part of a straddle are required to be capitalized, and present law provides authority for regulations to impose rules as to straddles that are comparable to present law wash sale and short sale rules. Present law excludes from the straddle rules stock and stock options that are traded on domestic exchanges.

Mark-to-market rules

Gains and losses from regulated futures contracts (RFCs) are determined by marking such contracts to market and, if they are capital assets, by treating all resulting gain or loss as 60 percent long-term and 40 percent short-term capital gain or loss (60/40 treatment). This formula results in a maximum tax rate of 32 percent for noncorporate taxpayers. This treatment applies to contracts traded on a domestic board of trade or exchange designated as a contract market by the Commodity Futures Trading Commission (CFTC) and to certain foreign currency contracts.

Hedging exemption

Neither the straddle rules nor the mark-to-market and 60/40 treatment apply to gains and losses from properly identified hedging transactions entered into in the normal course of the taxpayer's trade or business and resulting in ordinary income or loss. The hedging exemption is not applicable to certain syndicates with limited partners or limited entrepreneurs.

Treatment of options

Historically, options market makers on securities exchanges have reported ordinary income or loss from their options transactions as well as from transactions in the property subject to the option. Commodity traders derive capital gain or loss from their RFC transactions and are subject to mark-to-market and 60/40 treatment.

Gain or loss from the sale, exchange or lapse of an option held by an investor is capital gain or loss generally, long-term or short-term depending on the period the option is held by the investor, and short-term in any case to an option grantor. If an option is exercised, the premium paid by the holder or received by the grantor results in additional gain or loss with respect to, or an adjustment to the basis of, the underlying property. Questions have been raised about the applicability of these rules to certain cash settlement options and options on RFCs (commodity options).

Mixed straddles

Mixed straddles are straddles composed in part of RFCs subject to a 32 percent maximum tax rate and in part of other positions subject to a maximum 50 percent tax rate. Taxpayers may elect, if the straddle is properly identified, to exclude the RFC portion of a mixed straddle from the mark-to-market and 60/40 rules. Treasury may prescribe regulations similar to the short sales rules with respect to straddle positions. Present regulatory authority to prescribe rules for mixed straddles may be inadequate to insure effective rules.

Wash sale rule

Under the wash sale rule of present law, losses from the disposition of stock and securities are deferred if substantially identical property is acquired within 30 days before or after such disposition. The wash sale rule does not apply to certain short sales against the box which provide taxpayers with an opportunity to defer income. For taxpayers other than corporations, the wash sale rule does not apply if the loss is in connection with the taxpayer's trade or business, while it is inapplicable to corporate taxpayers only if the loss is incurred in the ordinary course of the corporation's business as a securities dealer.

Identification requirement

The hedging exemption, the mixed straddle election, the present law election of securities dealers to identify securities as held for investment, and the identified straddle rule (which limits the applicability of the loss deferral rule), all require identification by the close of the day during which a position is established. Substantial price movements may occur within the course of a day which give taxpayers an opportunity for unwarranted tax benefits through the use of these provisions.

House bill

Overview

The House bill repeals the blanket exceptions from the straddle rules for stock and exchange-traded stock options. More limited exceptions are provided. In addition, the mark-to-market rule and the 32-percent maximum rate of tax are extended to certain exchange-traded options held by investors and to all listed options held by options market makers. Commodity options are also made subject to the mark-to-market rule and accorded the 32-percent maximum rate of tax.

Repeal of exception for certain stock and stock options

Stock

The House bill repeals the exception from the tax straddle rules for direct positions in stock. A more limited exception is provided for a straddle all of the positions of which consist of the holding of stock or the short sale of stock. However, the exception for positions in stock is inapplicable to stock of a corporation formed or availed of to take positions in personal property that offset positions taken by any shareholder.

Exchange-traded stock options

In general, the straddle rules, including the loss-deferral rule, are extended to straddles involving exchange-traded stock options. An exception is provided for qualified covered call writing transactions.

Qualified covered call options

A covered call option is one that is written with respect to stock that is held by the taxpayer (or acquired by the taxpayer in connection with the granting of the option). The granting of a covered call option substantially reduces a taxpayer's risk of loss with respect to the underlying stock to the extent that the option is deep-in-the-money. The House bill contemplates that taxpayers can continue to write at-the-money and nondeep-in-the-money covered calls (i.e. qualified covered calls), without running afoul of the straddle rules.

In general, a qualified covered call option is an exchange-traded option (1) the gain or loss with respect to which is not ordinary income or loss, (2) the term of which is more than 30 days, and (3) which is not deep-in-the-money. The term "deep-in-the-money option" is defined as an option that has a strike price lower than the lowest qualified benchmark." Generally, the "lowest qualified benchmark" is the highest available strike price that is less than the "applicable stock price" (defined below). In the case of an option with a term of more than 90 days and a strike price exceeding $50, the lowest qualified benchmark is the second highest available strike price that is less than the applicable stock price. However, in any case, the lowest qualified benchmark will not be treated as being less than 85 percent of the applicable stock price.

Exchange rules currently provide for strike prices on options at five-dollar intervals (or "benchmarks") for options on stock trading at prices under $100. For stock trading at prices over $100, there are $10 benchmarks. The lowest strike price currently authorized is $10. Thus, for example, with respect to stock trading at $50, an exchange-traded call option with a strike price of $45 or more and a term exceeding 30 days would qualify for the exception.

The term "applicable stock price" is generally defined as the closing price of the optioned stock on the most recent date on which such stock was traded before the date on which the option was granted. However, if the opening price of the optioned stock on the day the option is granted is greater than 110 percent of the closing price on the last previous trading date, then the opening price of the stock is treated as the applicable stock price.

In general, a qualified covered call option must be written on a national securities exchange registered with the Securities and Exchange Commission (SEC). The Secretary may designate other exchanges as qualifying for this treatment if the exchange has rules adequate to carry out the purposes of the exception to the straddle rules for qualified covered calls. The House bill contemplates that, as a condition of designating an exchange, the Secretary could require that trades on the exchange be subject to information reporting under section 6045 (relating to reports by brokers).

The Secretary is granted broad regulatory authority to modify the provisions of the bill (e.g., to take account of changes in the practices of options exchanges or to prevent tax avoidance). The bill contemplates that the Secretary will prescribe rules for the determination of the applicable strike price if the options exchanges modify their benchmarks.

Treatment of gain or loss where the taxpayer is the grantor of a call option

The House bill provides that, if at any time a taxpayer holds stock and is the grantor of an outstanding option to buy such stock, which option has a strike price that is less than the applicable stock price, then any amount that would otherwise be treated as a long-term capital gain with respect to the stock is treated as a short-term capital gain to the extent of any short-term capital loss recognized on the option. This short-term capital gain character would be preserved where the stock is transferred in a nonrecognition transaction (including a gift).

Extension of mark-to-market rule

The House bill extends the mark-to-market rule (including the 60/40 treatment that results in a 32-percent maximum tax rate) to nonequity listed options and dealers' equity options. Rules are provided to prevent limited partners (or entrepreneurs) of an options dealer from recognizing gain or loss from equity options as 60 percent long-term capital gain or loss and 40 percent short-term capital gain or loss.

Definition of listed option contract

The House bill defines a listed option as any option (other than a right to acquire stock from the issuer) that is traded on (or subject to the rules of) a qualified board of trade or exchange. A qualified board of exchange is a national securities exchange registered with the SEC, a domestic board of trade designated as a contract market by the Commodity Futures Trading Commission, or any other exchange or board of trade that the Secretary determines has rules adequate to carry out the purposes of the relevant statutory provisions. The bill contemplates that, as a condition of designating an exchange or board of trade, the Secretary may require information reporting consistent with the rules of section 6045 (relating to returns of brokers).

Equity listed options

An equity option is defined to mean any option to buy or sell stock, and any other option the value of which is determined by reference to an index of stocks of the type that is ineligible to be traded on a commodity futures exchange (e.g., an option contract on a sub-index based on the price of nine hotel-casino stocks). The definition of equity option excludes options on broad-based stock indexes (such as the Standard & Poor's 500 index) and options on stock index futures; thus, these options fall within the definition of nonequity options (discussed below). Holders of equity options (other than dealers) remain subject to the general rules for the taxation of options, including the loss-deferral rule.

Nonequity listed options

A nonequity option is defined as any listed option that is not an equity option. Under the bill, any holder of a nonequity option (whether an options dealer or an investor) is treated as if the option were disposed of at year-end for a price equal to its fair market value, and any gain or loss is taxed as if it were 60-percent long-term and 40-percent short-term (just as the holders of RFCs are treated). All options on RFCs are, by definition, nonequity options under the bill.

Treatment of dealer options

The House bill changes the claimed present-law treatment of options market makers and codifies present law with respect to professional commodity traders by providing that both categories of traders are treated as buying and selling capital assets, except to the extent that an option or future is acquired to hedge property that would generate ordinary income or loss. An options dealer is defined as any person who is registered with the SEC and an appropriate national securities exchange as a market maker or specialist in listed options. Under the bill, an options dealer would not recognize ordinary income or loss with respect to his stock and securities transactions, unless the taxpayer is a dealer in stock and securities under general Federal income tax rules (determined without regard to whether options in such property produce ordinary income or loss).

In addition to nonequity options, which are marked-to-market in the hands of all holders, equity options held by options dealers are also subject to the mark-to-market rule and 60/40 treatment. To prevent dealers from passing through 60/40 treatment of equity options to limited investors, the bill provides that 60/40 treatment does not apply to gain or loss on dealer equity options that is allocable to limited partners or limited entrepreneurs (regardless of the percentage of such gain or loss that is so allocated).

Hedging exemption

In general, the hedging exemption under present law remains available. However, the House bill limits the ability of certain taxpayers to deduct losses from hedging transactions where the hedging exemption is claimed.

Under the House bill, an options dealer who is a dealer in the underlying property is treated the same as a commodity trader who is a dealer in the cash commodity. Thus neither the loss-deferral rule nor the mark-to-market rule applies to an option or an RFC that is identified as a hedging transaction where gain or loss on both the option or the RFC and the underlying property would be ordinary income or loss (as determined under the bill).

For certain taxpayers, the House bill limits the deductibility of any loss on a hedging transaction to the taxable income (determined without regard to such loss) derived from the conduct of the trade or business to which the hedging transaction relates. This provision is intended to prevent the passthrough of ordinary losses to limited investors from transactions engaged in by traders who qualify as dealers in the underlying property.

The limitations on the deductibility of hedging losses apply to the following taxpayers: (1) any taxpayer who enters into a hedging transaction relating to stock or securities, (2) any individual, and (3) any corporation if at any time during the last half of the taxable year more than 50 percent in value of its outstanding stock is owned by five or fewer individuals. The term "hedging loss" is generally defined as the excess of (1) the allowable deductions for the taxable year attributable to hedging transactions (determined without regard to the rule limiting hedging losses), over (2) income received or accrued by the taxpayer during such taxable year from such transactions. However, an exception to the limitations on losses is provided for economic losses. The bill provides that the limitations do not apply to a hedging loss to the extent that such loss exceeds the aggregate unrecognized gains from hedging transactions (including gains from hedged property) as of the close of the taxable year. The "aggregate unrecognized gain" is defined as that term is used for purposes of the straddle rules: (1) the amount of gain that would be taken into account with respect to property if such property were sold on the last business day of such taxable year at fair market value, plus (2) in the case of any position with respect to which, as of the close of the taxable year, gain has been realized but not recognized, the amount of gain so realized.

Cash-settlement options

For cash-settlement options that are not subject to the mark-to-market rule (e.g., narrow-based options on stock indices), the House bill amends section 1234 to clarify that gain or loss on the sale, exchange, lapse, or exercise of the option is capital gain or loss with respect to grantors or holders. For purposes of the bill, a cash-settlement option is defined as any option which on exercise settles in (or could be settled in) cash or property other than the underlying property. As under present law, the receipt of cash on exercise of a cash-settlement option is a taxable event.

Regulatory authority relating to mixed straddles

The House bill broadens the scope of Treasury's regulatory authority to prescribe rules for mixed straddles. The bill requires the Secretary to prescribe such regulations with respect to gain or loss on straddle positions as may be necessary to carry out the purposes of the loss-deferral rule, within six months from the date of enactment. To the extent consistent with this purpose, the regulations should include rules applying the principles of the wash sale rule and the short-sale rule.

Effective dates

General rules

In general, the provision repealing the exemption from the straddle rules for stock options and stock applies to positions established after October 31, 1983. However, the application of the straddle rules to offsetting position stock is effective for positions established on or after May 23, 1983.

The special rule for the treatment of gain where the taxpayer is the grantor of an option to buy stock applies to positions established after March 1, 1984.

The provisions extending the mark-to-market rule to nonequity options and dealer equity options generally apply to positions established after the date of enactment. However, with respect to commodity options, the amendments made by the bill apply to positions established after October 31, 1983.

The provision clarifying the treatment of cash-settlement options applies to options purchased or acquired after October 31, 1983. The amendments to the hedging exemption apply to taxable years beginning after December 31, 1984.

Elections

The mark-to-market rules may be applied to nonequity options and dealer equity options on or before the general effective dates under either of two elections provided by the bill.

Positions held on the date of enactment.—Taxpayers can elect to apply the mark-to-market rule to nonequity listed options or dealer options that they held on the date of enactment. The election must cover all such positions held by the taxpayer on the date of enactment.

Positions held before the date of enactment.—In lieu of the election described above, taxpayers can elect to apply the mark-to-market rule to all positions held by the taxpayer during the taxable year that includes the date of enactment (the "transition year"). If the taxpayer makes this full-year election, all nonequity listed options and dealer options held at any time during the transition year must be marked-to-market.

With respect to stock options, any tax liability for the transition year which is attributable to appreciation in such options can be paid in two to five equal annual installments. Interest is charged on any unpaid installments of tax that are still outstanding after the due date for the first installment.

Senate amendment

Repeal of exception for certain stock and stock options

Under the Senate amendment, an interest in stock is included within the straddle rules only if (1) it is offset by an option to buy or sell actively traded stock, or (2) it is stock in a corporation formed or availed of to take positions in personal property offsetting positions held by any shareholder. The hedging exemption is applicable, under the Senate amendment, to such offsetting position stock held by a member of the same affiliated group (as defined in sec. 1504(a)) as the taxpayer.

Under the Senate amendment, the two benchmark standard applicable to certain qualified covered calls applies where the strike price is exactly $50 (as distinguished from over $50 in the House bill). The Senate amendment also eliminates the limitation of a qualified covered call to one with a strike price not less than 85 percent of the applicable stock price. The Senate amendment reduces the amount of costs of carrying a position that is part of a straddle that is required to be capitalized by dividends on stock included in a straddle, with respect to positions established after the date of enactment.

The repeal of the exception from the straddle rules for stock (other than offsetting position stock) and exchange traded stock options applies to positions established on or after January 1, 1984, under the Senate amendment. The Senate amendment also defers the application of the identification requirement for hedging transactions applicable to stock and stock options until 60 days after the date of enactment.

Extension of the mark-to-market rule

The Senate amendment defines equity options more broadly than the House bill, to include all options on stock indexes. Thus, investors in options on stock index RFCs do not receive mark-to-market and 60/40 treatment under the Senate amendment.

The Senate amendment extends the election to pay in 2 to 5 annual installments the additional tax for the taxable year including the date of enactment derived from prior year appreciation in stock options. Under the Senate amendment, tax attributable to appreciation in stock offset by a stock option and which under present law would result in ordinary income is subject to the election. Under the Senate amendment, regulations as applied to a position in a mixed straddle are not to be effective with respect to a position established before January 1, 1984.

Limitation on hedging losses

Under the Senate amendment, the limitation of net hedging losses to income from the trade or business in which the hedge was entered into applies only to limited partners or limited entrepreneurs.

Exercise of options on regulated futures contracts

Under the Senate amendment, it is explicitly provided that gain or loss is recognized on the exercise of an option on an RFC. This rule is applicable with respect to options purchased or granted after October 31, 1983.

Short sale against the box

The Senate amendment provides that rules similar to those requiring the deferral of losses from disposing of stock in wash sales (sec. 1091) will apply to require the deferral of losses incurred on closing short sale transactions where the taxpayer sells the stock or enters into a second short sale within the period beginning 30 days before and ending 30 days after the closing of the short sale.

Regulatory authority with respect to identification requirement

The Treasury is authorized under the Senate amendment to impose earlier identification deadlines under certain provisions requiring identification of a position by the close of the day on which the position is acquired. This requirement would be imposed by regulation and would apply to the hedging exemption, the mixed straddle election, identified straddles, and, in the case of securities dealers, the identification of securities held by investment. The Treasury could also provide by regulation for a method of identification other than on the taxpayer's records. It is contemplated that any additional identification requirements for the hedging exemption that may be imposed under the regulations will be consistent with the intended application of the identification rule for the hedging exemption expressed in the report of the Senate Finance Committee in 1981 as follows:

> Taxpayers, such as banks or securities dealers, who may conduct thousands of hedging transactions to hedge property held or to be held in their accounts, may identify such accounts as hedged accounts without marking individual items as hedges or hedged property, provided such ac-

counts deal only with ordinary income (or loss) items. S. Rep. No. 97–144, 97th Cong., 1st Sess. 151 (1981).

Treasury would have the authority to require earlier identification only for particular classes of taxpayers, like tax shelters, or to exempt particular classes of taxpayers, like bona fide government securities dealers.

Conference agreement

The conference agreement follows the House bill with several modifications.

1. Repeal of exception for certain stock and stock options

The conference agreement modifies the definition of a qualified covered call option with respect to the restriction that limits the lowest qualified benchmark to 85 percent of the applicable stock price by making it applicable only to stock with an applicable stock price of $25 or less. With respect to stock with an applicable stock price of $150 or less, the conference agreement adopts an overall limitation restricting the lowest qualified benchmark otherwise determined to the amount which is $10 below the applicable stock price. For purposes of the loss-deferral rule, but not for purposes of the limitations on interest and carrying costs (sec. 263(g)) and the short sale and wash sale rules in section 1092, under the conference agreement a covered call option will not be treated as qualified, if gain from the disposition of the stock to be purchased under such option is included in gross income in a taxable year subsequent to the year in which the option is closed and the stock is not held for more than 30 days following the date on which the option is closed. In determining whether this holding period requirement is satisfied, rules similar to those applicable in determining whether a taxpayer is eligible for the dividend received deduction under section 246(c)(3) and (4) will apply (without regard to the exception to those rules for a qualified covered call option).

The conference agreement modifies the House bill and Senate amendment by excluding options written by options dealers in the ordinary course of their activity of writing options from the definition of a qualified covered call option. The conference agreement also makes a technical amendment pursuant to which a qualified covered call option constitutes a position within the meaning of sec. 1092(d)(2) but a straddle consisting only of stock and a qualified covered call is not treated as a straddle for purposes of sec. 1092 and sec. 263(g).

Offsetting positions, one of which is actively traded stock or an interest in such stock and one of which is a position in substantially similar or related property (other than stock) as determined under regulations, constitute a straddle subject to the loss deferral rule and other straddle rules, under the conference agreement. This rule is in lieu of the House bill's more expansive application of the straddle rules to stock and is in addition to the Senate bill's rule that eliminates the exemption only for a straddle consisting of stock and an option. Application of the straddle rules to actively traded stock and exchange traded stock options applies, as under the Senate amendment, to positions established after December 31,

1983. However, the conferees intend that the regulations defining positions that are substantially similar or related to stock held by the taxpayer will apply to straddles described in the following paragraph only for positions established on or after March 1, 1984, and for positions not described in the following paragraph only on a prospective basis.

A straddle consisting of stock and substantially similar or related property includes offsetting positions consisting of stock and a convertible debenture of the same corporation where the price movements of the two positions are related. It also includes a short position in a stock index RFC (or alternatively an option on such an RFC or an option on the stock index) and stock in an investment company whose principal holdings mimic the performance of the stocks included in the stock index (or alternatively a portfolio of stocks whose performance mimics the performance of the stocks included in the index). Identical results will be applicable under the provision reducing the holding period of stock held by a corporation for purposes of the dividend received deduction where the taxpayer has diminished its risk of loss by holding another position in substantially similar or related property. However, stock offset by another position (other than an option) in substantially similar or related stock, which may result in a reduction in a corporate taxpayer's holding period for purposes of the dividend received deduction, does not constitute a straddle.

The conference agreement adopts the Senate amendment's extension of the hedging exemption to offsetting position stock of a member of the same affiliated group (as defined in section 1504(a)) as the taxpayer.

Under the conference agreement, any loss realized from a qualified covered call option granted by the taxpayer which has a strike price below the applicable stock price will be long-term capital loss if gain from a sale or exchange of the stock at the time such loss is realized would be long-term. In addition, the holding period for the stock subject to such option shall not include any period during which the taxpayer is the grantor of the option. It is anticipated that stock option losses and the holding period of stock will also be subject under regulations to sec. 1233(b) and (d) principles as applied to straddles consisting of stock and stock options. However, straddles consisting of stock and qualified covered call options to which the straddle rules are inapplicable will be affected only by the statutory rules under discussion. These rules are in lieu of the provision in the House bill and Senate amendment which would convert long-term gain from the sale or exchange of stock to short-term, to the extent of short-term losses realized on such options. The conferees believe that these rules reduce record-keeping requirements for taxpayers relative to a provision recharacterizing gain on sale of the stock. These rules are applicable to positions established after June 30, 1984.

The conference agreement extends the identified straddle rules of sec. 1092(a)(2) to straddles consisting entirely of section 1256 contracts. Thus, such a straddle which satisfies the definition of an identified straddle under section 1092 as amended by the bill will not cause sec. 263(g) or sec. 1092(a) to apply to any position by treatment of part or all of such straddle as also including positions not part of the identified straddle.

The identification requirement applicable to the hedging exemption, as under the Senate amendment, will not apply to transactions in stock or stock options until 60 days after the date of enactment.

2. Mark-to-market and 60/40

The conference agreement clarifies the provision disqualifying from capital gain or loss status options and RFCs of options dealers and commodity traders held to hedge ordinary income or loss property, by limiting disqualification to cases where a loss from the property would be an ordinary loss to the taxpayer. Thus, for example, ordinary income resulting solely from application of the new market discount rules added by the bill, will not affect the capital gain or loss status of an offsetting option.

The conference agreement eliminates the reference to registration with the SEC in the definition of "options dealer" as contained in the House bill and Senate amendment since there is no such registration requirement for options dealers. Further, the conferees intend that the capital gain or loss status of options traded in the normal course of an options dealer's activity in trading options is to be determined without regard to the identification requirement of sec. 1236.

The conferees wish to clarify that the hedging exception to the capital asset status of section 1256 contracts in sec. 1256(f)(4)(B), as added by the bill, is not intended to limit the scope of the hedging exemption of present law, so that, a section 1256 contract may hedge property to be acquired or obligations to be incurred to the extent those results are obtained under section 1256(e).

Several stock index options are currently traded for which there has been no designation by the CFTC for futures trading in the same index. These options held by investors are not subject to mark-to-market and 60/40 treatment until the Secretary of the Treasury determines that they meet the requirements of law for such a CFTC designation. The conferees expect such designations will have prospective effect only. Thus, the conferees urge the Treasury Department to take prompt action to determine the status of these options. The conference agreement provides for the extension of mark-to-market and 60/40 treatment, as well as the covered call exception, to options traded on a market other than a board of trade or exchange if the Secretary of the Treasury determines that such market has rules adequate to carry out the purposes of the provisions governing the treatment of section 1256 contracts. The Secretary is also to determine whether persons trading in such market qualify as options dealers.

Under the conference agreement, the rule that makes 60/40 treatment inapplicable to gains and losses with respect to dealer equity options applicable to limited partners and limited entrepreneurs is clarified by providing that such gains and losses are treated as short-term capital gains and losses.

Clarifying and technical corrections are made to the definition of "equity option" under the conference agreement.

For stock option market makers electing mark-to-market and 60/40 treatment for all positions held during the taxable year which includes the date of enactment, the conference agreement adopts the Senate amendment's extension of the election to pay the tax resulting from prior years' appreciation in stock options in 2 to 5 annual installments to the tax resulting from unrealized appreciation in stock, and limits the election to gain from stock and options which would be ordinary income to the taxpayer if the stock and options were disposed of by the taxpayer on the last day of the taxable year preceding the taxable year which includes the date of enactment.

3. Treatment of gains and losses of options and commodities dealers as earned income and for certain subchapter S purposes

Under the conference agreement, gains and losses derived in the ordinary course of trading in section 1256 contracts and property related to such contracts (e.g., stock used to hedge options) are defined as earnings from self-employment for purposes of applying the tax on self-employment income and the rules relating to contributions to self-employment plans. This treatment is extended only to options dealers, and commodity dealers, as defined in the bill. A commodity dealer is any person registered with a domestic board of trade designated as a contract market by the CFTC who buys or sells options or RFCs subject to the rules of such board. This treatment applies to taxable years beginning after the date of enactment except that for options dealers electing 60/40 and mark-to-market rules for the taxable year which includes the date of enactment, it applies for such taxable year. The conferees intend that no inference be made as to whether options dealers and commodity dealers be viewed as engaged in a trade or business in connection with their transactions in section 1256 contracts as a result of the application of self-employment taxes to such persons.

Under present law, a tax is imposed on corporations making a subchapter S election in certain cases where net capital gain exceeds 50 percent of the corporation's taxable income. Further, when an election is made by a corporation which has subchapter C earnings and profits, it may be taxable on a portion of its passive investment income and, in certain cases, the election may be terminated. To facilitate subchapter S elections by options and commodities dealers, the conference agreement excepts gains and losses with respect to section 1256 contracts and related property derived in the normal course of an options or commodities dealer's transactions in options or commodities from net capital gain subject to tax under section 1374 and from passive investment income as defined in section 1362(d)(3).

The conference agreement provides that an election to be an S corporation made by a commodities dealer or options dealer made within 75 days after the date of enactment of the bill will be effective for the taxable year which includes the date of enactment without regard to the requirement in sec. 1362(b) requiring the election to be made by the 15th day of the third month of the year.

4. Capitalization of interest and carrying costs and other rules

Interest and carrying costs of a straddle position that are required to be capitalized are reduced, as under the Senate amendment, by dividends on stock included in a straddle. The conference agreement provides that this reduction is limited to the portion of the dividend included in income after allowance of the dividends received deduction. The conference agreement also provides for additional reductions with respect to market discount and acquisition discount included in income under secs. 1276 and 1281 as added by the bill. New sec. 263(h) added by the bill, which disallows the deduction of short sale expenses in certain cases, section 1277 added by the bill, which requires the deferral of net direct interest on indebtedness with respect to market discount bonds, and section 1282 as added by the bill, which requires the deferral of interest on indebtedness with respect to short-term obligations, are to be applied before the application of the rule requiring the capitalization of costs with respect to straddle positions. The conference agreement amends the provision of present law prescribing capital gain or loss treatment with respect to certain contract terminations to exclude from its application (effective as if such exclusion had been included as part of such provision as adopted in ERTA) the retirement of any debt instrument (whether or not through a trust or other participation arrangement, such as a mortgage pass-through certificate).

5. Mixed straddle regulations

The conference agreement extends the regulatory authority, with respect to mixed straddles, to include as a mixed straddle positions not described as such in present law section 1256(d)(4). In addition the regulatory authority is extended to provide rules governing the application of sec. 263(g).

In addition, the conference agreement prescribes that the regulations will provide rules that will apply in lieu of the application of section 1233(d) principles to mixed straddles if the taxpayer so elects. Under these rules, a taxpayer may either (i) offset gains and losses from positions which are part of mixed straddles by separately identifying each mixed straddle to which such treatment applies or (ii) establish a mixed straddle account with respect to a class of activities for which gains and losses will be recognized and offset on a periodic basis. These two new elections will be in addition to the mixed straddle election of present law. Under either of the new alternatives, 60/40 treatment will apply only to net gain or loss from the straddle transactions and only to the extent attributable to section 1256 contracts. Under the rules applicable to a mixed straddle account, not more than 50 percent of any net gain from the account may be treated as long-term capital gain and not more than 40 percent of any net loss from the account may be treated as short-term capital loss.

It is intended that regulations adopting the principles of section 1233(d), authorized under present law for straddles, will result in recharacterizing short-term losses realized from mixed straddle positions not subject to section 1256 as 60/40 losses in the case of mixed straddles that are not either identified or subject to the account described in the preceding paragraph. Under present law, a mixed straddle may also produce 60/40 losses on the section 1256 contracts and short-term gain on the other positions included in the mixed straddle, effectively converting long-term gain realized from transactions unrelated to the straddle to short-term. Taxpayers can avoid this result under present law by making a mixed straddle election foregoing marking-to-market and 60/40 treatment for their section 1256 contracts included in a mixed straddle.

The regulations prescribed by the conference agreement will permit taxpayers to avoid the loss recharacterization rule that results from applying sec. 1233(d) principles while retaining favorable treatment for mixed straddle net gains derived from section 1256 contracts.

Straddle-by-straddle identification

It is intended that, in applying the regulations to separately identified mixed straddles, the determination by the taxpayer of what constitutes a mixed straddle generally will be accepted by the Internal Revenue Service if the taxpayer has adopted a reasonable and consistently applied method of identifying straddle positions which clearly reflects income in the absence of circumstances indicating that the taxpayer has not properly identified straddles pursuant to such method.

The present law election to exclude section 1256 contracts from 60/40 and mark-to-market treatment may be exercised only if all positions included in a mixed straddle are identified not later than the day on which the first section 1256 contract so included is acquired. It is intended that the offset for gains and losses from mixed straddles under the regulations prescribed under the conference agreement may apply in cases where the taxpayer holds either section 1256 contracts or other positions before a mixed straddle is established. In such cases it is intended that the regulations will require the pre-straddle gains and losses accrued at the time the mixed straddle is created to be recognized at such time. Such gain or loss from positions not subject to sec. 1256 will be short-term or long-term, depending on the taxpayer's holding period when the mixed straddle is created, and gain or loss from pre-existing section 1256 contracts will receive 60/40 treatment. In all such cases, appropriate basis adjustments will be made to exclude such pre-existing gains and losses from the mixed straddle offsetting rules.

If a mixed straddle is terminated without disposing of all positions, it is contemplated that the regulations will require recharacterization of gains and losses from some closed positions. For example, if the taxpayer closes a section 1256 contract at a loss of $10 which is offset by an unrealized gain of $10 on an offsetting position not subject to section 1256, the loss will be recharacterized as short-term and will be deferred under sec. 1092 to the extent there continues to be unrecognized gain on the offsetting position at year-end. Under the offsetting position rules, if the loss on the section 1256 contract in this example were $12, the additional $2 that is not offset by unrealized gain would receive 60/40 treatment and would be recognized, assuming it is not offset by unrecognized gain in the offsetting position at year-end. Similarly, if the taxpayer realized a $12 gain on closing a section 1256 contract offset by an unrealized $10 loss on an open offsetting position not subject to section 1256, the rule would recharacterize $10 of such gain as short-term, which would be recognized currently since section 1092 does not defer gains. The remaining gain of $2 would also be recognized and receive 60/40 treatment. The taxpayer could avoid tax on the $10 gain converted to short-term by closing out the offsetting position at a $10 loss before year-end.

If a mixed straddle is terminated by closing out positions other than the section 1256 contracts, it is contemplated that the gain or loss will be offset by the loss or gain with respect to the section 1256 contracts as of the time such positions are closed and any net gain or loss attributable to the positions other than section 1256 contracts will be short-term. Losses from closing positions other than section 1256 contracts generally will not be deferred by sec. 1092 but instead will be netted against any offsetting gain on the section 1256 contracts included in the mixed straddle to the extent of such gain at the time the loss position is terminated. Adjustments to subsequent gain or loss with respect to section 1256 contracts included in a mixed straddle and retained following its termination will be made as under sec. 1256(a)(2) to reflect the portion of such gain or loss absorbed under the offsetting position rules. For example, if the taxpayer closes a position other than a section 1256 contract at a $12 gain and, on the date of disposition, there is a $10 loss determined by marking-to-market the offsetting section 1256 contract, the taxpayer will have a $2 short-term gain. If the taxpayer retains the section 1256 contract at year-end and it is marked-to-market at the same price that resulted in the offsetting $10 loss, no further gain or loss is recognized.

The holding period of positions other than section 1256 contracts included in a mixed straddle will not commence until the mixed straddle is terminated. In this regard, all post-straddle period gain or loss, as to amount and treatment as short-term or long term, is to be determined without regard to gain and loss attributable to the straddle period.

For mixed straddles with respect to which both section 1256 contracts and offsetting positions remain open at year-end, gain and loss attributable to positions that are not section 1256 contracts are not recognized currently. However, gains on section 1256 contracts are recognized under section 1256 and, to the extent offset by unrecognized losses on positions that are not section 1256 contracts, will be recharacterized as short-term gains under the regulations. Similarly, year-end losses on open section 1256 contracts, to the extent offset by unrecognized gains on positions that are not section 1256 contracts, will be recharacterized as short-term losses and will be deferred under section 1092.

Mixed straddle account election

The mixed straddle account rules will accommodate taxpayers who, with respect to a class of trading activities, have such a large volume of transactions that identification of specific mixed straddles is impractical. The account rules will accommodate, for example, market makers in options on XYZ company stock who also have long and short non-option positions in XYZ company stock in substantial volume. If the taxpayer is also a market maker in options on ABC company stock, it is intended that a second account be established with respect to such options and the underlying stock. The conferees intend that the Treasury have considerable flexibility in determining the nature of these accounts, and in specifying the classes of activities for which separate accounts must be established.

All gains and losses on positions in the account are to be determined and offset on a periodic basis which may be a daily or less frequent basis. Those positions not closed during the period are to be marked to market as of the close of the period. In determining how frequently positions in the account are to be marked-to-market and gains and losses are to be netted, the Secretary is to take account of recordkeeping and other administrative burdens that would be imposed on taxpayers.

Gains and losses from positions that are not section 1256 contracts are to be netted for the period and gains and losses from section 1256 contracts for the period are separately netted. The gain or loss from the positions that are not section 1256 contracts are then offset against the loss or gain from the section 1256 contracts. Overall net gain or loss for the period attributable to positions not subject to section 1256 constitutes short-term gain or loss. Overall net gain or loss for the period attributable to section 1256 contracts constitutes 60/40 gain or loss. Net short-term gain and net long-term loss resulting from applying the rules to any period retain their character without regard to the results derived from applying the rules to other periods within the taxable year. If, as a result of applying these rules, over 50 percent of the aggregate net gain for the taxable year from the account is long-term, the excess over 50 percent will be converted to short-term gain. Similarly, if over 40 percent of the aggregate net loss for the taxable year from the account is short-term, the excess over 40 percent will be recharacterized as long-term loss.

Gains and losses with respect to positions entering the account that have accrued as of the date the account is established will be recognized at that time and treated as long-term or short-term depending on the taxpayer's holding period as of that date, or as 60/40 gain or loss for section 1256 contracts. Appropriate basis adjustments will be made to reflect such gains and losses. Similar rules will apply where positions are transferred to and from the account.

It is intended that, under the regulatory rules prescribed in accordance with the conference agreement, the Treasury will have broad authority to place positions held by the taxpayer in the account and to exclude positions from the account, and otherwise to prescribe standards with respect to the account to insure that income is clearly reflected, and the purpose of the mixed straddle rules is carried out.

Effective date of regulations

The conference agreement adopts with a technical modification the Senate amendment's prohibition against applying the regulations under section 1092(b) to mixed straddles established prior to January 1, 1984. Under the House bill and Senate amendment, regulations under section 1092(b) (including regulations relating to mixed straddles) are to be prescribed within 6 months after the date of enactment of the bill. The conference agreement modifies this requirement so as to apply to the initial regulations. The conferees also intend that the regulations providing for netting of identified mixed straddles and for a mixed straddle account will apply to any taxable year, if the taxpayer elects, to the extent that the amendments applicable to section 1256 contracts under the bill apply for such taxable year under the effective date provisions of section 102 (f) and (g) of the bill.

6. Limitation on losses from hedging transactions

The conference agreement adopts the Senate amendment's restriction on the application of the rule limiting net hedging losses to income from the trade or business in which the hedging transaction was entered into to losses allocable to limited partners and limited entrepreneurs. The taxable income determined without regard to hedging transactions is to be separately computed for partners and S corporation shareholders with such limited interests. The conference agreement adopts a clarifying amendment limiting unrecognized hedging gains resulting in a disallowance of hedging losses to those relating to the trade or business in which the hedging losses were incurred.

7. Options on section 1256 contracts

The conference agreement adopts the Senate amendment providing that gain or loss is recognized on the exercise of an option on a section 1256 contract. Under this provision, if an option on a section 1256 contract is excluded from mark-to-market and 60/40 treatment as a result of a mixed straddle election, the treatment of gain or loss resulting from exercise of the option will be determined under the rules of section 1234(a) and (b). In cases in which an option on a section 1256 contract is not accorded 60/40 treatment (because, for example, a mixed straddle election was made with respect to the option), gain or loss will not be accorded 60/40 treatment to either holders or grantors of the options. Thus, the conferees reject the assertion that the "character" of property underlying an option on a section 1256 contract includes the deemed holding period provided to section 1256 contracts. Similarly, the grantor's obligation under an option on a section 1256 contract will not be treated as a section 1256 contract if the option is not directly accorded section 1256 contract treatment.

8. Wash sale rules to apply to losses on certain short sales and other transactions

The conference agreement adopts the Senate amendment extending the wash sale rule to a loss realized on the closing of a short sale if, within 30 days before or after such closing, the taxpayer sells, or enters into another short sale of, substantially identical stock or securities.

Under present law, the wash sale rule does not apply, in the case of taxpayers other than corporations, if the loss is incurred in a trade or business while, in the case of a corporation, it is inapplicable only if the taxpayer is a dealer in stocks or securities and the loss is sustained in a transaction made in the ordinary course of such business. Under the conference agreement the corporate exclusion is made applicable to all taxpayers so that the wash sale rule is inapplicable only if the taxpayer is a dealer in stocks or securities and the loss is sustained in a transaction made in the ordinary course of the taxpayer's business of dealing in stocks and securities.

These amendments apply to losses sustained on short sales occurring after the date of enactment. The limitation of the exemption to dealers in stocks and securities applies to sales after December 31, 1984.

9. Time for identification by taxpayers of certain transactions

The conference agreement adopts the Senate amendment providing regulatory authority to require identification earlier than the close of the day on which an acquisition is made with respect to identified straddles, mixed straddles, the hedging exemption, and securities held for investment by a dealer. The conference agreement restores the present law requirement applicable to identified straddles that the straddle must be identified on the taxpayer's records. This provision applies to positions entered into after the date of enactment.

10. Treatment of losses from pre-1981 straddles

Present law

Prior to the adoption of rules relating to straddles and marking RFCs to market by the Economic Recovery Tax Act of 1981 (ERTA), it was unclear whether a claimed loss was allowable on the disposition of a position in a straddle where offsetting unrecognized gain on another position or positions included in the straddle was deferred. In Revenue Ruling 77–185, 1977–1 C.B. 48, the Internal Revenue Service ruled that a loss claimed on disposing of legs of a silver futures straddle where the straddle was continued was not deductible because there was no closed and completed transaction and the disposition represented no real economic change. Similar arguments were rejected by the Tax Court in *Smith* v. *Commissioner of Internal Revenue*, 78 T.C. 350 (1982) although the loss found to have been incurred in that case was disallowed because, under the facts of the case, it was not incurred in a transaction entered into for profit. The Internal Revenue Service is continuing to litigate the allowability of pre-1981 straddle losses in accordance with the position adopted in Rev. Ru. 77–185 and is challenging such losses where claimed by commodity dealers as well as by investors with isolated transactions such as those involved in the *Smith* case.

House bill

No provision.

Senate amendment

The Senate amendment requires the Secretary of the Treasury to report to the Committee on Finance and the Ways and Means Committee before October 1, 1984, with respect to progress made in reducing the backlog of cases involving the treatment, prior to ERTA, of regulated futures contracts.

Conference agreement

The conferees believe it is inappropriate to prolong the uncertainty with respect to the treatment of losses claimed with respect to straddle positions for periods prior to 1981. Accordingly, in lieu of the Senate amendment's requirement of a report with respect to pre-1981 cases, the conference agreement provides that a loss on the disposition of a position entered into before 1982 will be allowed, except to the extent nonrecognition is required under any applicable provision, if the position is part of a transaction entered into for profit. This treatment applies where the position is part of a straddle as defined in section 1092 as in effect on the day after the date of enactment of ERTA (as well as a straddle consisting entirely of RFCs), and is one to which the provisions of Title V of ERTA did not apply. The loss generally will be allowed for the taxable years in which the position is disposed of. Rules affecting the period within which the loss is recognized, and its treatment as long-term or short-term, such as sec. 1233 or sec. 1234, are to be applied without regard to the fact that the position is part of a straddle.

The provision does not apply to syndicates, as defined in sec. 1256(e)(3)(B). In determining whether the position is part of a transaction entered into for profit, it is intended that the provision be applied by treating the condition as satisfied if there is a reasonable prospect of any profit from the transaction.

In the case of commodity dealers and persons actively engaged in investing in RFCs, the provision is to be applied by presuming that the position is held as part of a transaction entered into for profit unless the Internal Revenue Service establishes to the contrary. In determining whether a taxpayer is actively engaged in trading in RFCs with an intent to make a profit, a significant factor will be the extent of transaction costs. If they are sufficiently high relatively to the scope of the taxpayer's activities that there is no reasonable possiblity of a profit, the presumption will be unavailable. RFCs for purposes of applying the presumption are regulated futures contracts as defined in section 1256(b) before its amendment by the bill.

For purposes of the provision, the term "commodities dealer" has the same meaning as such term in the amendments by the bill providing for application the self-employment income tax to such persons.

I. Foreign Provisions

1. Maintaining the source of U.S. source income

Present law

All U.S. source income of U.S. persons is subject to U.S. tax. The United States also subjects foreign source income of U.S. persons to U.S. tax, but allows a credit for foreign taxes paid on foreign source income. U.S. taxpayers can convert the source of some U.S. source income by paying interest, insurance premiums, or other amounts to a foreign corporation. When the foreign corporation distributes dividends or pays interest to its U.S. owners, generally the dividends or interest are foreign source income. The U.S. owners may pay no U.S. tax and no foreign tax on this artificially converted foreign source income. The same conversion of U.S. to foreign source income can occur when a controlled foreign corporation earns tax-haven-type income that causes an inclusion in the income of its U.S. shareholders (under subpart F).

House bill

For purposes of the foreign tax credit limitation, when 50-percent U.S.-owned corporations whose U.S. source income (including U.S. business income) is 10 percent or more of gross income over a 3-year period pay interest or dividends to a U.S. taxpayer, the portion of the payment attributable to U.S. source income will be treated as U.S. source income. The same result will apply to inclusions under subpart F. The House bill applies to income earned by paying corporations after the date of enactment, but generally does not apply to interest earned on term obligations held on March 1, 1984.

Senate amendment

The Senate amendment generally is the same as the House bill, but it specifies a pro rata method of calculating amounts attributable to U.S. source income. Its effective date is generally the same as the House bill. However, two transitional rules are provided. First, the amendment exempts interest earned by foreign finance subsidiaries until 1992 if the interest arises from loans whose source of funds is (1) debt outstanding on March 7, 1984 (or outstanding on March 31, 1984, pursuant to a binding commitment on March 7) or (2) its equity on March 31, 1984. Second, for corporations other than foreign finance subsidiaries, the amendment does not apply to interest earned on term obligations held on March 7, 1984.

Conference agreement

The conference agreement generally follows the House bill, with substantial technical modifications. The effective date rules follow the Senate amendment, with technical modifications.

Explanation of rules

The conference agreement expressly extends the provision to foreign personal holding company inclusions (Code sec. 551). The conferees saw no reason to allow conversion of U.S. source income to foreign source income through the use of this class of incorporated pocketbooks.

The conference agreement eliminates the 3-year base period provided in the House bill and the Senate amendment; the provision operates on a year-by-year basis under the conference agreement. The agreement makes this change because the 3-year base period could result in too little or too much U.S. source income.

The conference agreement provides separate rules for application of the provision to (1) subpart F and foreign personal holding company income inclusions, (2) interest, and (3) dividends. The conference agreement provides that subpart F inclusions (Code sec. 951(a)) and foreign personal holding company inclusions will be treated as derived from U.S. sources to the extent attributable to U.S. source income of the U.S.-owned foreign corporation with respect to which the inclusions are required.

In general, interest paid or accrued by a U.S.-owned foreign corporation during a taxable year will be treated as derived from U.S. sources to the extent properly allocable (under regulations prescribed by the Secretary) to U.S. source income of the foreign corporation for that taxable year. Interest is to be allocated for this purpose using the same method used (pursuant to Code section 954(b)(5)) to compute the amount of any subpart F or foreign personal holding company inclusion made with respect to the foreign corporation. The conference agreement applies this rule to interest paid or accrued to a (10-percent) U.S. shareholder of the foreign corporation (Code section 951(b)) or to a person related to such a shareholder (Code section 267(b)). In addition, the Secretary may prescribe regulations providing that interest paid or accrued to any person, whether or not the person is a U.S. shareholder, will be subject to the provision. Such regulations might be necessary in the case of U.S.-owned foreign corporations only some of whose U.S. owners are 10-percent U.S. shareholders.

A portion of any dividend paid or accrued by a U.S.-owned foreign corporation will be treated as derived from U.S. sources on the basis of a U.S. source ratio. The "U.S. source ratio" of a dividend equals the earnings and profits from U.S. sources for the taxable year out of whose earnings and profits the dividend was paid or accrued, divided by the total earnings and profits for that taxable year. Thus, while the conference agreement eliminates the 3-year base period, in determining whether a dividend will be treated as derived from U.S. sources the source of a prior year's earnings and profits will control to the extent that the dividend is paid out of that prior year's earnings and profits.

The provision applies for purposes of the foreign tax credit limitation only. In addition, the conference agreement makes clear that the provision applies only to subpart F and foreign personal holding company inclusions, dividends, and interest that would otherwise be treated as derived from foreign sources.

The conference agreement modifies the exception provided in the House bill for inclusions with respect to, and payments received from, U.S.-owned foreign corporations with small amounts of U.S. source income. Under the conference agreement, the exception will apply to dividends and interest only. It will not apply to subpart F and foreign personal holding company inclusions since these provisions do not operate absent threshold amounts of tax-haven type or passive income. Under the conference agreement, the exception will apply when a U.S.-owned foreign corporation has earnings and profits and less than 10 percent of the earnings and profits are attributable to U.S. sources; under the House bill, by contrast, the exception would have applied when less than 10 percent of a U.S.-owned foreign corporation's gross income was from U.S. sources. The agreement adopts this change because of the possibility that taxpayers could defeat the purpose of the provision if it contained a gross income test by earning U.S. source gross income (such as interest) offset by few expenses and sheltering that income with foreign source gross income fully or nearly offset by expenses. In addition, under the conference agreement, the 10-percent test will be applied to earnings and profits on a year-by-year basis rather than, as under the House bill, to income in a 3-year base period. To prevent manipulation of the 10-percent exception, the conference agreement provides that, for purposes of the exception, earnings and profits will be determined without any reduction for interest paid or accrued by a U.S.-owned foreign corporation to a U.S. shareholder of the foreign corporation or to a related party, whether U.S. or foreign.

The term "U.S.-owned foreign corporation" is defined as in the Senate amendment, with minor technical modifications. The conference agreement specifies that, for purposes of the provision, the term "dividend" includes any gain treated as ordinary income under Code section 1246 or as a dividend under Code section 1248. The conference agreement provides that the provision will apply before the Code's foreign loss recapture rules.

The conference agreement requires the Secretary to prescribe such regulations as may be necessary or appropriate for application of the provision in the case of interest or dividend payments through one or more entities. For example, a U.S.-owned foreign corporation that earns gross U.S. source income but that pays interest to a related foreign party might thereby reduce the amount of income that would otherwise be resourced. The Secretary is to prescribe rules so that an inclusion in income of a U.S. taxpayer on account of the related foreign corporation *will* be subject to resourcing. Such an inclusion could occur, for example, under the rules of subpart F, on a dividend or interest payment by the related foreign corporation, or on an investment by the related foreign corporation in U.S. property. The following example provides a more detailed illustration.

Example 1

A foreign corporation wholly owned by a U.S corporation ("CFC-1") earns $100 of gross U.S. source dividends (that is foreign personal holding company income subject to subpart F) but reduces its current year earnings and profits to zero by a $100 interest payment to another foreign corporation wholly owned by the same U.S. corporation ("CFC-2"). Because of the interest payment, there is no subpart F inclusion by the U.S. parent corporation on account of CFC-1 and no dividend payable for the year by CFC-1. Thus, the U.S. parent has no current income with respect to CFC-1 that could be subjected to resourcing. Absent the special rule under discussion, the $100 of U.S. source dividends received by CFC-1 would not give rise to any resourcing of income from CFC-1 or CFC-2 that is included in the U.S. parent's gross income. To prevent this result, the regulations to be prescribed by the Secretary will, for example, subject to resourcing a subpart F inclusion on account of CFC-2 determined with respect to its current year earnings and profits regardless of whether the 10-percent exception from resourcing would otherwise apply. The regulations will treat as U.S. source income CFC-1's $100 interest payment to CFC-2. The U.S. parent's subpart F inclusion on account of CFC-2 consequently will be resourced to the extent of the $100 interest payment (and any other U.S. source subpart F income of CFC-2).

The application of the resourcing provision is illustrated generally in the following examples:

Example 2

A foreign corporation wholly-owned by a U.S. corporation earns $100 of net income and pays a $20 dividend. Ninety dollars of the net income is attributable to the insurance of U.S. risks and $10 is attributable to the insurance of foreign risks of related parties located in other foreign countries. All of the income is subpart F income to the U.S. parent corporation (under Code section 953, and Code section 954(e) as amended by the conference agreement). Since $90 of this $100 subpart F inclusion is attributable to U.S. source income of the foreign corporation (the $90 of net income attributable to the insurance of U.S. risks), $90 of the inclusion will be treated as U.S. source income of the parent corporation under the provision.

As a result of the $100 subpart F inclusion, the $20 dividend is considered to be paid from previously taxed earnings and profits and is excluded from the parent corporation's gross income under Code section 959. The provision, therefore, has no application to the tax-free $20 dividend.

Example 3

A foreign corporation, 90 percent of the total combined voting power in which is held by a U.S. corporation, earns net income of $95 from the sale of personal property in a second foreign country. The foreign corporation also earns net dividend income (after allocation of expenses) of $5 from a U.S. money market account. All of the foreign corporation's $100 of net income is foreign base company income.

Among the foreign corporation's expenses (deductions from net income) is a $20 interest payment to its U.S. parent. The foreign corporation's $95 of net sales income is from foreign sources. Its $5 of net dividend income is from U.S. sources. Assume, for purposes of this example only, that earnings and profits equal net income and that $19 of the $20 interest payment was allocated to gross foreign sales income and the remaining $1 to gross U.S. dividend income in computing the respective amounts of net income from foreign and U.S. sources.

Under subpart F, the U.S. parent corporation must include its pro rata share of the foreign corporation's $100 of foreign base company income in its gross income for the taxable year. Assume, because the U.S. parent controls 90 percent of the voting power in the foreign corporation, that its pro rata subpart F inclusion is $90.

To determine whether the 10-percent exception from resourcing may apply (i.e., whether less than 10 percent of the foreign corporation's earnings and profits for the year are attributable to U.S. sources), the foreign corporation's earnings and profits are first recomputed without any reduction for the $20 interest payment to its U.S. parent. Earnings and profits recomputed in this manner equal $120. Of this amount, $6, or five percent, is attributable to U.S. sources (the $5 of net U.S. dividend income plus the $1 of the $20 interest payment previously allocated to gross U.S. dividend income in computing the amount of net income from U.S. sources).

While less than 10 percent of the foreign corporation's recomputed earnings and profits for the year are, thus, attributable to U.S. sources, the 10-percent exception does not apply to subpart F income. The portion of the U.S. corporation's $90 subpart F inclusion attributable to U.S. source income of the foreign corporation is 5/100ths of $90, or $4.50. Therefore, $4.50 of the subpart F inclusion will be treated as U.S. source income of the U.S. parent under the provision.

The 10-percent exception does, however, apply to interest payments. Because less than 10 percent of the foreign corporation's recomputed earnings and profits are attributable to U.S. sources, the $20 interest payment made by the foreign corporation to its U.S. parent is not subject to resourcing under the provision.

Example 4

A foreign corporation wholly owned by a U.S. corporation earns $85 of gross income, consisting of $60 of gross income from manufacturing operations in its country of incorporation, $10 of gross U.S. bank interest, and $15 of gross interest on a loan to a U.S. affiliate. The foreign corporation incurs total expenses of $115, consisting of $85 of manufacturing expenses and $30 of interest payments to its U.S. parent. The foreign corporation, thus, has a net loss of $30 for the taxable year. Assuming, for simplicity, that earnings and profits equal net income, the foreign corporation also has a deficit in earnings and profits of $30 for the taxable year. The foreign corporation pays a $20 dividend out of earnings and profits for an earlier taxable year. One hundred percent of the earlier year's earnings and profits were from foreign sources and no interest was paid to U.S. affiliates in the earlier year. The foreign corporation owns assets with a total fair market value of $500, consisting of assets used in its manufacturing operations worth $300, a $100 U.S. bank deposit, and a $100 loan to a U.S. affiliate.

To determine whether the 10-percent exception applies to the $30 of interest paid to the U.S. parent, the foreign corporation's earnings and profits for the current year must first be recomputed without any reduction for this interest paid to a U.S. shareholder. Earnings and profits recomputed in this manner equal zero ($ −30 + $30). The 10-percent exception, therefore, does not apply since a requirement of the exception—that the foreign corporation have earnings and profits for the year—is not satisfied.

To determine how much of the $30 of interest payments will be treated as U.S. source income of the U.S. parent under the provision, the payments must be allocated to gross income of the foreign corporation from U.S. and foreign sources, respectively. The U.S. parent corporation uses the asset method (Treas. Reg. sec. 1.861-8(e)(2)(v)) to allocate interest under the provision. Thus, it allocates $18 of the interest paid ($30 × ($300/$500)) against the foreign corporation's $60 of gross manufacturing income, $6 ($30 × ($100/$500)) against the foreign corporation's $10 of gross U.S. bank interest, and $6 ($30 x ($100/$500)) against the foreign corporation's $15 of gross interest on its U.S. affiliate loan. Since all of the manufacturing income is from foreign sources and of all the interest income from U.S. sources, a total of $12 ($6 + $6) of the interest paid is properly allocable under the provision to U.S. source income of the foreign corporation. Therefore, $12 of the $30 of interest paid by the foreign corporation to its U.S. parent will be treated as U.S. source income of the U.S. parent under the provision.

Because the foreign corporation has no earnings and profits for the current year, the U.S. parent corporation has no subpart F inclusion with respect to any separately computed net U.S. interest income earned by the foreign corporation. Any such income would otherwise be subpart F income and, because wholly attributable to U.S. source income of the foreign corporation in this case, would be treated as U.S. source income of the parent under the provision.

Because the $20 dividend paid to the U.S. parent corporation is paid out earnings and profits for a year for which all earnings and profits were from foreign sources, no portion of the dividend will be treated as U.S. source income of the U.S. parent under the provision.

Effective date

General rule

Under the Senate amendment, the provision generally will take effect on the date of enactment. In the case of a taxable year of a U.S.-owned foreign corporation in which the date of enactment occurs, only income received or accrued by the U.S.-owned foreign corporation during that taxable year after the date of enactment generally will be taken into account for resourcing purposes. However, the conference agreement makes clear that *all* income received or accrued by the U.S.-owned foreign corporation during that taxable year will be taken into account for purposes of applying the exception for corporations with small amounts of U.S. source income (the 10-percent exception).

Transitional rules

The two transitional rules provided in the Senate amendment are retained in the conference agreement, with some liberalizing technical modifications.

Under the first transitional rule, certain interest received or accrued by "applicable CFCs" (controlled foreign corporations) will not be taken into account for resourcing purposes if the interest is allocable to certain CFC obligations outstanding, or certain CFC equity, as of March 31, 1984. Interest received or accrued prior to 1992 on U.S. affiliate obligations held by an applicable CFC and allocable to that CFC's capitalizations on March 31, 1984 qualifies for this treatment. For this purpose, an applicable CFC's capitalization on March 31, 1984 is equal to the sum of the CFC's obligations (issued by the CFC) and equity outstanding on March 31, 1984. Obligations outstanding on March 31, 1984 are not counted for this purpose if they were not issued before March 8, 1984, unless a binding commitment by the CFC to issue them was in effect on March 7, 1984.

Qualified interest in a given taxable year is determined by multiplying the interest received or accrued in that year on an applicable CFC's loans to its U.S. affiliates by a limiting fraction. The limiting fraction is equal to (1) the aggregate principal amount of U.S. affiliate obligations held by the CFC on March 31, 1984 (but not in excess of the CFC's March 31, 1984 capitalization), divided by (2) the average daily principal amount of U.S. affiliate obligations held by the CFC during the taxable year. In no event may the limiting fraction exceed one.

The numerator of the limiting fraction is adjusted downward to reflect (1) retirements in that taxable year of any obligations issued by the CFC that are included in its March 31, 1984 capitalization, and (2) a pro rata portion of the CFC's equity allocable to these retired obligations.

The conference agreement makes technical modifications with respect to the treatment of obligations with original issue discount (OID) under the first transitional rule. It treats the principal amount of CFC and U.S. affiliate obligations with OID as including, as of any day, the aggregate amount of all OID on such obligations previously includible in gross income as of that day. It also specifies that proper adjustments are to be made in the numerator of the limiting fraction for OID accruing after March 31, 1984 on CFC obligations and U.S. affiliate obligations. The latter rule will allow an upward adjustment in the numerator, where necessary, for OID accrued after March 31, 1984 on OID-type CFC obligations. However, to the extent that the proceeds of OID-type CFC obligations included in a CFC's March 31, 1984 capitalization were used, as of March 31, 1984, to finance non-U.S. affiliate obligations, no special adjustment in the numerator will be allowed under this rule.

The conference agreement slightly expands the definition of "applicable CFC." Under the conference agreement, an applicable CFC is any CFC in existence on March 31, 1984, the principal purposes of which on that date consisted of issuing obligations (whether short-term or long-term) and lending the proceeds to affiliates. A corporation will satisfy this principal purpose test if at least half of its liabilities on March 31, 1984, were CFC obligations and if at least half of its assets on that date were loans to affiliates.

The terms "affiliate," "U.S. affiliate," and "U.S. affiliate obligation" are defined in the same manner as under the Senate amendment. The definition of "CFC obligation" is revised under the conference agreement so that otherwise qualified interest on certain obligations issued on or before December 31, 1982 will be covered by the first transitional rule.

The first transitional rule does not apply in determining whether the 10-percent exception applies. Thus, if an applicable CFC has $100 of earnings and profits for a given year, $15 of which is attributable to qualified interest, $5 of which is attributable to other U.S.

source income, and $80 of which is attributable to foreign source income, the 10-percent exception will not apply for that year: For purposes of the exception, 20 percent of the applicable CFC's earnings and profits will be attributable to U.S. sources. However, because, under the transitional rule, qualified interest is not taken into account for resourcing purposes, only 5/100ths (rather 20/100ths) of a dividend paid by the applicable CFC out of that year's earnings and profits will be subject to resourcing.

Under the second transitional rule, interest earned on term obligations held on March 7, 1984 by U.S.-owned foreign corporations that are not applicable CFCs is not taken into account for resourcing purposes. The conference agreement also extends the application of the second transitional rule to certain obligations of applicable CFCs: Interest earned on term obligations of U.S. persons other than U.S. affiliates that are held by applicable CFCs on March 7, 1984 will not be taken into account for resourcing purposes under the rule. The liberalizing of the Senate amendment definition of "applicable CFC" may also alter the applicability of the second transitional rule in certain cases.

The conference agreement provides that the foreign tax credit limitation generally will be computed separately (as it is under present law for certain interest income, for example) for income derived from a U.S.-owned foreign corporation that benefits from either of the two transitional rules, i.e., is not resourced. Thus, foreign taxes paid by the recipient of such income on other income will not be creditable against the U.S. tax on the income that benefits from either transitional rule. This rule will not apply to certain income received or accrued before January 1, 1986.

2. Maintaining the character of interest income

Present law

A U.S. taxpayer's foreign source passive interest income cannot escape both U.S. and foreign tax under the United States' separate foreign tax credit limitation. This separate limitation prevents foreign taxes on non-interest income from offsetting U.S. tax on foreign source interest income. U.S. taxpayers seek to circumvent this rule by having foreign subsidiaries or regulated investment companies (RICs) earn interest income (for example, by depositing money in foreign banks). Under regulations, when the U.S. taxpayer is taxable on the earnings of the foreign subsidiary or RIC, its income may be foreign source dividend income, not interest income. Thus, artificially recharacterized "non-interest" income may escape both U.S. and foreign tax.

House bill

For purposes of applying the separate foreign tax credit limitation on interest, the House bill treats foreign dividends as interest to the extent that the paying corporation's earnings and profits arise from passive interest. This rule applies only if 10 percent or more of the paying corporation's earnings and profits for a 3-year base period arise from passive interest. It applies only to 50-percent U.S.-owned corporations. It does not affect interest paid by subsidiaries. It applies to distributions after the date of enactment except distributions attributable to interest earned on term obligations held on March 1, 1984.

Senate amendment

The Senate amendment is generally the same as the House bill. It applies to any RIC, whether or not 50-percent U.S.-owned. It applies to distributions attributable to interest earned by distributing corporations in taxable years beginning after the date of enactment. Except for foreign finance subsidiaries grandfathered under the resourcing rule, the amendment does not apply to distributions attributable to interest earned on term obligations held on March 7, 1984. All payors get a fresh start for the 3-year base-period test so that the first year that counts under that test is the first taxable year beginning on or after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment, with substantial modifications. In general, the conference agreement subjects income of a U.S. person that is attributable to separate limitation interest income of a U.S. owned foreign corporation (sec. 904(d)(2)) or RIC to the separate foreign tax credit limitation for interest.

For purposes of the foreign tax credit limitation, the conference agreement treats dividends or interest that are paid or accrued by a designated payor corporation (and attributable to any taxable year of such a designated payor corporation) as interest income subject to the separate foreign tax credit limitation for interest to the extent that the aggregate amount of such dividends and interest does not exceed the separate limitation interest of the designated payor corporation for the taxable year. For these purposes, a dividend includes any subpart F (sec. 951) or foreign personal holding company inclusion (sec. 551) and any gain treated as ordinary income under section 1246 or as a dividend under section 1248. The agreement defines the term "separate limitation interest" to mean, with respect to any taxable year, the aggregate amount of the interest income of the type that is subject to the separate limitation which is received or accrued by the designated payor corporation during the taxable year, reduced by the sum of any deductions properly allocable (under regulations prescribed by the Secretary) to such income.

This rule maintaining the character of interest income will not apply to any amount attributable to the taxable year of a designated payor corporation if the designated payor corporation has earnings and profits for such taxable year, and if less than 10 percent of those earnings and profits is attributable to separate limitation interest. The conference agreement eliminates the three-year base period in order to measure interest that should be subject to the separate limitation more accurately.

Interest that a designated payor corporation pays or accrues to any of its U.S. shareholders (a U.S. person who owns or who is considered to own 10 percent or more of its voting power) or to a person related to any of its U.S. shareholders will not reduce separate limitation interest of the designated payor corporation, and will not reduce earnings and profits for the purpose of the exception that applies to designated payor corporations with earnings and profits less than 10 percent of which is attributable to separate limitation interest.

Under the agreement, a "designated payor corporation" is any of three types of corporations (the first two of which were included in the Senate amendment and are defined in the same manner in the agreement): any U.S.-owned foreign corporation, any regulated investment company (RIC), and any other foreign corporation in which the taxpayer is a U.S. shareholder (a U.S. person who owns directly, indirectly, or constructively ten percent or more of the total combined voting power of all classes of stock entitled to vote of the foreign corporation) at any time during the taxable year of such foreign corporation. The last category includes any foreign corporation with a U.S. shareholder whether or not the foreign corporation is a controlled foreign corporation.

The conference agreement specifies rules for treating amounts included in U.S. taxable income as attributable to the taxable year of a designated payor corporation. Foreign personal holding company and Subpart F inclusions with respect to a designated payor corporation are attributable to the year of inclusion; interest paid or accrued by a designated payor corporation is attributable to the year that the designated payor corporation pays or accrues it; and dividends from a designated payor corporation are attributable to the year out of whose earnings and profits they are paid.

The order in which the agreement treats amounts attributable to separate limitation interest as income subject to the separate foreign tax credit limitation for interest is as follows. It first treats foreign personal holding company and Subpart F inclusions on account of a designated payor corporation as income subject to the separate foreign tax credit limitation for interest up to the amount of the separate limitation interest of the designated payor corporation. If the amounts so treated are less than the separate limitation interest of the designated payor, then interest paid or accrued by the designated payor corporation is treated as income subject to the separate foreign tax credit limitation for interest. If the interest so treated plus the amounts previously so treated are less than the separate limitation interest of the designated payor corporation, then any dividend paid out of the earnings and profits of the designated payor corporation for the taxable year is treated as income subject to the separate foreign tax credit limitation for interest. The conference agreement treats amounts paid by a designated payor corporation as first attributable to passive interest under the theory that it would be as easy for the ultimate interest recipient to have received the separate limitation interest directly as to have channeled it through a designated payor corporation. In addition, this "stacking" of interest prevents avoidance of tax through the use of back to back loans.

For example, a designated payor corporation that is also a controlled foreign corporation earns $150 of gross active business income during a year and incurs $125 of expenses in connection with that active business. In that year, it also earns $15 of separate limitation interest. There is no subpart F inclusion in the income of its U.S. shareholders with respect to that year because the foreign corporation's gross base company income ($15) is less than 10 percent of its gross income ($165). The foreign corporation incurs no interest expense or foreign tax during the year. Its earnings and profits ($40) consist of $25 of active business income and the $15 of separate limitation interest. It pays a dividend with respect to the earnings and profits of the year of $16.

In this example, the conference agreement treats the dividend as coming first out of separate limitation interest, so that $15 of the dividend is income subject to the separate foreign tax credit limitation for interest income, while $1 is not subject to the separate foreign tax credit limitation. Any later dividend with respect to that year's earnings will not be subject to the separate foreign tax credit limitation, as the $16 dividend has exhausted the pool of separate limitation interest for that year.

The conference agreement retains the rule of the Senate amendment requiring the Secretary to prescribe such regulations as may be necessary to carry out the purposes of this provision in the case of distributions or payments through one or more entities. For example, a U.S. owned foreign corporation that earns separate limitation interest but that pays interest to a related foreign party would reduce the amount of income subject to characterization as separate limitation interest. The income of the related foreign corporation might not be subject to U.S. tax, so the foreign tax credit limitation would not affect the related foreign person. The Secretary is to prescribe rules so that an inclusion in income of a U.S. taxpayer on account of the related foreign corporation will be subject to recharacterization as separate limitation interest. Such an inclusion could occur, for example, under the rules of Subpart F, on a dividend or interest payment by the related foreign corporation, or on an investment by the related foreign corporation in U.S. property.

For example, if a controlled foreign corporation ("CFC-1") earns $100 of gross separate limitation interest (that is foreign personal holding company income subject to Subpart F) but reduces its current year earnings and profits to zero by a $100 interest payment to a related foreign party ("CFC-2"), there would be no Subpart F inclusion for the year on account of CFC-1. If there were no Subpart F inclusion on account of CFC-2 (for instance, because foreign base company income made up less than 10 percent of the gross income of CFC-2), later dividends from CFC-2 would be subject to recharacterization, whether or not 10 percent of the earnings and profits of CFC-2 for the year at issue were attributable to the separate limitation interest that it received from CFC-1 or to other separate limitation interest.

For purposes of determining whether any interest received or accrued by the designated payor corporation is separate limitation interest, interest from a related party described in section 1504 (whether or not a foreign person) will be treated as separate limitation interest to the extent that the related payor earns (directly or indirectly) income that is separate limitation interest or that is attributable to separate limitation interest.

The application of the conference agreement rules is illustrated in the following example:

A foreign corporation wholly owned by a U.S. corporation owns assets with a total fair market value of $500, consisting of a $150 loan to its parent, a $100 certificate of deposit with a foreign bank, and active business assets worth $250. It earns $100 of gross income, consisting of $75 of gross income from an active business, $15 of gross bank interest that is not related to its active business, and $10 of gross interest on a loan to its wholly owned (2d tier) foreign subsidiary incorporated in another foreign country and engaged solely in active business. It incurs $50 of expenses in connection with its active business. It pays $10 of interest to its U.S. parent corporation and $5 of interest to an unrelated party. Its net income is $35. It pays no dividend out of this income.

The $15 of bank interest in this example is interest described in section 904(d)(2), so that, in the hands of the foreign corporation, it is subject to the separate limitation for interest. To determine that portion of this interest that is "separate limitation interest" for purposes of the provision, the interest decreases to the extent of properly allocable expenses. In determining separate limitation interest in this example, the U.S. owner of the foreign corporation allocates the $5 of interest expense that the foreign corporation paid to an unrelated party. The allocation may occur under any proper method, but the conferees intend that the same method of allocation apply for all purposes for any particular year. The taxpayer chooses the asset method (Reg. sec. 1.861-8(f)(1)(v), Reg. sec. 1.861-8(e)(2)(v).) Thus, it allocates $1.50 ($5x($150/$500)) against its $15 of gross bank interest income. Interest paid to its U.S. shareholder does not, under the conference agreement, reduce separate limitation interest. The conference agreement therefore treats $13.50 ($15 − $1.50) of the income of this foreign corporation as separate limitation interest.

The conference agreement first treats any Subpart F inclusion on account of this designated payor corporation as income subject to the separate foreign tax credit limitation for interest. Because more than 10 percent of the gross income of the foreign corporation in this example is foreign base company income, its U.S. owner, under subpart F, must include the foreign base company income of its foreign subsidiary in its income. In determining its Subpart F income, the U.S. owner of the foreign corporation allocates the $15 of interest expense that the foreign corporation incurred under the asset method, the method it chose for this year for all purposes. Thus, it allocates $7.50 ($15x($250/$500)) against its $25 of gross interest income, and $7.50 ($15x($250/$500)) against its $75 of gross active business income. There remain after the allocation of the $15 of interest expense $17.50 of interest income that is foreign personal holding company income under the Subpart F rules, so the Subpart F income that the U.S. owner of the foreign corporation must include in income for the year is $17.50. The U.S. owner treats $13.50 of the Subpart F inclusion as income subject to the separate foreign tax credit limitation for interest income. The $10 of interest that the designated payor corporation pays to its U.S. parent is not income subject to the separate foreign tax credit limitation for interest income in this example because the full $13.50 of the designated payor corporation's separate limitation interest has already been used in recharacterizing a portion of the subpart F inclusion as separate limitation interest.

Under the conference agreement, dividends and Subpart F inclusions recharacterized as interest for the purpose of the foreign tax credit limitation will retain their character as dividends and Subpart F inclusions for the purpose of determining whether a taxpayer is entitled to a deemed-paid foreign tax credit (secs. 902 and 960). However, the deemed paid taxes attributable to income recharacterized as separate limitation interest will be treated as taxes on separate limitation interest. In addition, any taxes deemed paid on such dividends and Subpart F inclusions and treated as dividends for the purpose of the deemed-paid credit (sec. 78), will be characterized in accordance with the income with respect to which the taxes were paid.

The conference agreement will generally take effect on the date of enactment. Generally, only interest income received or accrued by a designated payor corporation in taxable years beginning after that date will be treated as separate limitation interest. However, interest income earned by a regulated investment company with respect to investments by a taxpayer after the date of conference action, June 22, 1984, will be treated as separate limitation interest. In the case of a designated payor corporation that is not an applicable CFC (as defined in section 131(b)(2)(d) of the conference agreement), the agreement will not apply to any interest that the corporation receives or accrues on a term obligation that it held on March 7, 1984.

3. Income from factoring trade receivables

Present law

A seller who sells goods for the buyer's receivable (promise to pay) may sell that receivable to a third party—a factor—at a discount. If a U.S.-owned factor is in a tax haven, it may earn income free of U.S. tax. That income may be eligible for deferral, and it may be foreign-source income that is sheltered by excess foreign tax credits.

When a foreign subsidiary of a U.S. corporation makes a loan to its U.S. parent (or otherwise invests in "U.S. property"), that investment is taxable as a dividend to the U.S. parent (to the extent of the subsidiary's previously untaxed earnings and profits). It is unclear under present law whether this rule applies to a foreign factoring subsidiary that buys receivables from its U.S. parent. Thus, the foreign factoring subsidiary could transfer untaxed cash to its U.S. parent by buying the parent's receivables.

House bill

The House bill taxes the U.S. owner of a controlled foreign corporation on income earned when the controlled foreign corporation collects a receivable that (1) it bought from a related person, and (2) the related person had taken in exchange for inventory or services. There is no tax if factoring income (and other tax-haven type income) is less than 10 percent of the controlled foreign corporation's gross income.

The House bill treats income from a related U.S. person's receivables (from domestic and foreign sales) as U.S. source income.

The House bill treats payments from a foreign subsidiary to a related U.S. person for receivables (from domestic and foreign sales) as investments in U.S. property.

The bill applies to transfers after March 1, 1984.

Senate amendment

The Senate amendment generally is the same as the House bill. However, it taxes the U.S. owner of a controlled foreign corporation earning factoring income whether or not factoring income and other tax-haven type income are less than 10 percent of the subsidiary's gross income. It also prevents tax-free factoring by companies in U.S. possessions.

Its rule for the source of factoring income is the same as that of the House bill, except that it treats income from factoring a related U.S. person's export receivables (other than export receivables from a sale through a DISC or FSC) as 50 percent U.S. source, 50 percent foreign source.

The Senate amendment contains the investment in U.S. property provision of the House bill, but the Senate amendment does not treat investments in export receivables (other than export receivables from a sale through a DISC or FSC) as investments in U.S. property.

Conference agreement

The conference agreement generally follows the House bill. It follows the Senate amendment, however, in imposing tax on the U.S. owner of a controlled foreign corporation earning factoring income without regard to a 10-percent threshold, and in adopting with modifications the rules of the Senate amendment that prevent tax-free factoring by companies in U.S. possessions.

The agreement treats any income (whether in the form of discount, stated interest, or some other form) arising from a trade or service receivable (defined to mean any account receivable or evidence of indebtedness arising out of the disposition by a related party of inventory or out of the performance of services by a related party) acquired directly or indirectly by a foreign corporation from a related person as if it were interest on a loan to the obligor under the receivable. This rule applies only for purposes of the foreign personal holding company rules, the Subpart F rules, and the foreign tax credit limitation. In applying this rule, the conferees intend that the source rules (Code sec. 861-863) be applied as though the income from a trade or service receivable were interest on a loan to the obligor under the receivable.

The application of the rule treating related person factoring income as interest income also will apply to determine the source of that income upon eventual inclusion of the income in the gross income of a U.S. person pursuant to the provision of the conference agreement that maintains the source of U.S.-source income that flows through a foreign corporation (Code sec. 904(g)). If the obligor under a receivable is a U.S. person, the factoring income will be U.S. source income upon inclusion in the gross income of a U.S. shareholder of the foreign corporation (unless the obligor pays foreign source income under the "80/20" rule (Code sec. 861(a)(1)(B)).

A foreign corporation earning income from a trade or service receivable of a U.S. obligor will not be taxable currently on that income (under Code sec. 881). In addition, the agreement does not allow, for example, the obligor under a receivable to treat any part of the purchase price of a capital asset as deductible interest.

Income from a receivable will be subject to the rules of the conference agreement whenever the receivable or an interest in the receivable is assigned to a foreign corporation by a related party. There will be an acquisition of a receivable, for the purpose of the rule contained in the conference agreement, whether or not the person earning the income from the receivable takes title to or physical possession of the receivable, and whether the related party that transfers the rights to income from a receivable does so with or without recourse.

The agreement includes the definition of "related party" contained in the Senate amendment, but expands that definition to include 10-percent U.S. shareholders and persons related to 10-percent U.S. shareholders. This expansion prevents tax-free related-person factoring by foreign corporations owned by several U.S. persons.

Related person factoring income under the conference agreement will be treated as interest described in section 904(d)(2), and therefore subject to the separate foreign tax credit limitation for interest. The income will be ineligible for any exception to application of the separate limitation. The conferees adopted this treatment so that foreign tax credits on non-interest non-factoring income cannot offset U.S. tax on related person factoring income. Taxpayers can generally arrange to earn factoring income, like other financial income, in tax havens, and the conferees believe that it is appropriate to collect the full U.S. tax, unreduced by foreign tax credits on unrelated income, on factoring income.

The conferees intend to subject related person factoring income to tax in the hands of any controlled foreign corporation with earnings and profits. Therefore, related person factoring income will not benefit from exceptions to the Subpart F rules. As under the Senate amendment, it does not benefit from the 10-percent of gross income exception. In addition, it will not benefit from any banking and financing exceptions (sec. 954(c)(3)(B) and sec. 954(c)(4)(B)) or from the same country interest (and dividend) exception (sec. 954(c)(4)(A)).

The agreement modifies the Senate amendment's rules governing factoring in the U.S. possessions. The possessions tax credit (sec. 936, whose prime beneficiary is Puerto Rico) and rules allowing the U.S. Virgin Islands to reduce its tax rate on certain income (sec. 934) will not apply to factoring income unless the income from the receivable arises within the possession under the rule that treats the income as income from a loan to the obligor of the receivable.

The conference agreement provides that a receivable of a U.S. person that was acquired directly or indirectly from a related person who is a U.S. person constitutes U.S. property for the investment in U.S. property rules. Not only does this transaction makes funds available for use by U.S. shareholders, it is in substance a wholly domestic transaction. The conferees believe that this combination of effective repatriation and U.S. nexus makes this transaction one that should be subject to tax to the extent of untaxed earnings and profits.

For the purpose of this provision, the conferees intend that the substitution of any party for the obligor be disregarded. For example, if a U.S. purchaser of goods pays for the goods by establishing a line of credit with a foreign bank whose note the seller of the goods takes and sells at a discount to its foreign subsidiary, the income from the bank's obligation in the hands of the foreign subsidiary will be U.S. source income, and the acquisition of the bank's obligation will constitute an investment in U.S. property.

The conferees understand that some taxpayers may contend that they will be able to circumvent the investment in U.S. property rule of the conference agreement by (1) directly or indirectly transferring earnings and profits from one foreign subsidiary to another foreign subsidiary, and (2) having the transferee invest those earnings and profits in U.S. property. The conferees recognize that current law imposes tax on the investment in U.S. property by the transferee, whether the transferee makes a direct or indirect loan to the transferor (Rev. Rul. 76–192, 1976–1 C.B. 205) or otherwise shifts earnings and profits to the transferee (such as by a contribution to the capital of a newly formed subsidiary with no earnings and profits).

The agreement requires the Secretary to prescribe regulations to prevent the avoidance of the provision's income inclusion rule and its investment in U.S. property rule. The conferees intend, for instance, that regulations treat a loan by a foreign corporation to a purchaser of goods or services of a related party like the acquisition by the foreign corporation of the purchaser's receivable, where the seller of the goods or services (or a related party) guarantees or secures payment to the foreign corporation.

The conference agreement generally applies to accounts receivable and evidences of indebtedness transferred after March 1, 1984. However, a special transitional rule applies to certain accounts receivable held by a certain type of financing entity.

4. Source of transportation income

Present law

Under present law, in general, the United States taxes all U.S. source income, but not all foreign source income, of U.S. persons. In general, the United States does not tax the foreign source income of foreign persons (such as foreign corporations). Under present law, transportation income can be treated almost entirely as foreign source income even if the transportation is between two U.S. points, if the route of transport lies primarily outside the United States' three mile territorial limit.

House bill

The House bill provides that all transportation income attributable to transportation which begins and ends in the United States (including, for this purpose, in any possession of the United States) is to be treated as U.S. source income. For these purposes, transportation income is defined as any income derived from or in connection with the use, or hiring or leasing for use, of a vessel or aircraft or the performance of services directly related to the use of such vessel or aircraft. The bill states that the term "vessel or aircraft" includes any container used in connection with a vessel or aircraft.

The new sourcing rule is to be applied in accordance with regulations prescribed by the Secretary of the Treasury.

The new sourcing rule for transportation income will apply to transportation beginning after the bill's date of enactment in taxable years ending after that date.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment, with certain modifications. The conferees also agreed to certain clarifications of the new sourcing rule's application.

Transportation involving U.S. possessions

The conference agreement generally treats transportation income attributable to transportation which begins in the United States and ends in a U.S. possession (or which begins in a U.S. possession and ends in the United States) as 50-percent U.S.-source income and 50-percent foreign-source income. Those U.S. possessions whose tax laws "mirror" the Internal Revenue Code will, because of the way the "mirror" Codes operate, treat this transportation income as 50-percent domestic-source and 50-percent foreign source. Thus, transportation income attributable to transportation that begins in the United States and ends in Guam, for example, will in effect be split between the United States and Guam for tax purposes. Each will subject to tax no more than half of the income.

Certain transportation income from United States-U.S. possession (and U.S. possession-United States) routes is not subject to the 50-percent sourcing rule. The agreement treats such transportation income earned from the leasing of aircraft eligible for the investment tax credit to U.S. persons (other than a member of the same controlled group of corporations) who are regularly-scheduled air carriers as wholly U.S.-source income.

Transportation income from transportation between U.S. possessions or within a possession is excluded from the scope of the new sourcing rule under the conference agreement and, thus, is not treated as either wholly U.S.-source income or as 50-percent U.S.-source income by operation of the new rule.

Regulations

The conference agreement makes clear that the new sourcing rule will become effective before regulations are issued, in the event regulations are not issued as of the new rule's effective date.

Clarifications

The conferees agreed to the following clarifications of the new sourcing rule's application: Transportation of cargo will not be considered to begin and end in the United States when it involves transportation from one U.S. point to another intermediate U.S. point before ultimate delivery of the cargo to a point in a foreign country, even where the cargo is transported to its ultimate destination on a different aircraft or vessel from the aircraft or vessel that carried the cargo to the intermediate U.S. point, if two requirements are met. The requirements are that the same taxpayer transport the cargo on both legs of the trip and that the cargo not pass through U.S. customs at the intermediate U.S. point. Similarly, if these requirements are met, transportation of cargo will not be considered to begin and end in the United States when, en route to a delivery point elsewhere in the United States, a stop at an intermediate U.S. point is made by a transporting aircraft or vessel which took on the cargo in a foreign country, even where the cargo is transported to its ultimate destination on a different aircraft or vessel from the aircraft or vessel that carried it to the intermediate U.S. point.

Like other round-trip travel from the United States, round-trip travel by a cruise ship, originating in the United States and calling only on foreign ports, is not transportation which begins and ends in the United States for purposes of the new sourcing rule.

The new source rule also does not apply to income for services performed in a foreign country that are connected indirectly with transportation beginning and ending in the United States. For example, income from the operation of the Panamanian pipeline (through which oil extracted in Alaska and bound for East Coast points may pass) will not be treated as U.S. source income under the new sourcing rule. Income from the operation of foreign storage facilities used to store cargo transported between U.S. points will not be subject to the new source rule. Income from services, such as refueling, performed outside the United States in connection with a trip beginning and ending in the United States also will not be treated as U.S. source income under the new provision.

5. Application of accumulated earnings tax to certain distributions received by U.S.-owned foreign corporations

Present law

The accumulated earnings tax may not apply to foreign corporations forming a two tier structure when the parent corporation is widely held by U.S. persons and the subsidiary corporation (wholly owned by the parent corporation) earns U.S. source income or U.S. business income.

House bill

Under the House bill, if 10 percent or more of the earnings and profits of a foreign corporation has a U.S. source or is effectively connected with a U.S. business, its interest payments and a pro rata portion of its dividends are treated as U.S. source in the hands of a U.S.-owned foreign corporation for the purpose of the accumulated earnings tax. The bill applies to distributions received by a U.S.-owned foreign corporation on or after May 23, 1983. For U.S.-owned foreign corporations in existence on May 23, 1983, the bill applies to taxable years beginning after 1984.

Senate amendment

The Senate amendment is generally the same as the House bill, with technical changes.

Conference agreement

The conference agreement follows the House bill, with technical modifications.

6. Repeal of 30-percent tax on portfolio interest paid to foreign persons

Present law

Payments of passive income (interest, dividends, royalties, etc.) to foreign persons generally are subject to a 30-percent U.S. withholding tax if the payments are not effectively connected with a U.S. trade or business conducted by the foreign person. Exemptions from the tax are provided in certain situations. Some U.S. tax treaties reduce the tax. In the case of interest, some treaties eliminate the tax.

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) requires registration of debt obligations unless they are sold under procedures reasonably designed to prevent sale or resale to U.S. persons, they bear interest payable outside the United States only, and they indicate that U.S. holders are subject to tax penalties.

The U.S. estate tax applies to obligations of U.S. corporations, but not to obligations of foreign corporations.

House bill

No provision.

Senate amendment

The Senate amendment phases out the 30-percent withholding tax on interest paid on portfolio indebtedness by U.S. borrowers to nonresident alien individuals and foreign corporations. The rate of tax will be reduced to five percent for interest received after the date of enactment. The rate of tax will be reduced to four percent in 1985, three percent in 1986, two percent in 1987, and one percent for the period January 1 to June 30, 1988. Effective July 1, 1988, the withholding tax on interest received by nonresident alien individuals and foreign corporations on portfolio indebtedness will be repealed.

The phase-out of tax does not apply to interest paid to banks, controlled foreign corporations, or 10-percent or greater owners of the payor.

U.S. corporations that assume debt of foreign affiliates pay interest that is eligible for the tax phase-out if they meet compliance requirements that the affiliate would have had to meet (without necessarily meeting all the TEFRA requirements that would have applied to the U.S. corporation).

The Senate amendment also repeals the U.S. estate tax on obligations eligible for the reduced withholding tax rates.

These provisions apply to portfolio interest received after the date of enactment (and to estates of decedents dying after the date of enactment).

Conference agreement

The conference agreement repeals the 30-percent withholding tax on interest paid on portfolio indebtedness by U.S. borrowers to nonresident alien individuals and foreign corporations, and otherwise follows the Senate amendment, with the following modifications.

The conference agreement generally repeals the tax, effective on the date of enactment, rather than phasing out the tax over a four-year period as the Senate amendment would have. However, unlike the Senate amendment, the conference agreement repeals the tax only with respect to interest paid on portfolio obligations issued *after* the date of enactment. Thus, the 30-percent tax will continue to apply to existing obligations currently subject to the tax.

The conference agreement does not repeal the 30-percent tax for interest paid on obligations assumed by U.S. corporations from their affiliates or other entities. Since, under the conference agreement, interest on existing obligations is not exempted from the 30-percent tax, existing obligations of foreign or U.S. affiliates that U.S. corporations might wish to assume are not eligible for the repeal in any event.

Like the Senate amendment, the conference agreement provides that interest paid on an obligation not in registered form will be exempt from the 30-percent tax when the obligation is exempt from the TEFRA registration requirements because it is sold under procedures reasonably designed to prevent sale or resale to U.S. persons, bears interest payable outside the United States only, and indicates that U.S. holders are subject to tax penalties. However, the conference agreement authorizes the Secretary to exclude future obligations from this exemption from the TEFRA registration requirements without regard to whether the obligation is determined to be used frequently in avoiding Federal taxes. Thus, the Secretary has discretion to require registration.

Interest paid on an obligation in registered form will be exempt from the 30-percent tax under the conference agreement if the obligation satisfies the requirements for registered obligations set forth in the Senate amendment.

The conference agreement differs from the Senate amendment in exempting from the 30-percent tax interest otherwise eligible for the exemption that is paid to a controlled foreign corporation (unless paid by a related person, within the meaning of new Code section 864(d)(4)). However, such interest paid to a controlled foreign corporation will be includible in the gross income of the controlled foreign corporation's U.S. shareholders under subpart F (Code section 951) without regard to the 10-percent exception or any of the other exceptions otherwise provided under the subpart F rules. The conferees also intend that such interest in the hands of a controlled foreign corporation retain its U.S. source (under Code section 904(g), as amended by the conference agreement) upon Subpart F or other income inclusion, without regard to any exception from the Code section 904(g) rule available for other income.

The conference agreement retains the Senate amendment's rule that imposes tax on interest paid to certain foreign shareholders and banks. The conferees understand that taxpayers may attempt to circumvent the foreign shareholder/bank rule of the agreement by entering into "back to back" loans, wherein a foreign affiliate of a U.S. taxpayer (or a bank) lends money to an unrelated foreign party that relends that money at discount to the U.S. taxpayer. The conferees intend that the Internal Revenue Service, when appropriate, use means at its disposal to determine whether back to back loans exist.

Like the Senate amendment, the conference agreement eliminates any potential U.S. estate tax liability of nonresident alien individuals dying after the date of enactment in the case of obligations the income of which, if received by the decedent at the time of his death, would be exempt from the 30-percent tax under the provision. However, under the conference agreement, only obligations issued after the date of enactment will be eligible for the estate tax exclusion.

In connection with the repeal of the 30-percent tax, the conference agreement provides that, if certain requirements are met, interest paid to an "applicable CFC" (within the meaning of Code section 904(g), as amended by the conference agreement but without regard to the requirement that the CFC be in existence on March 31, 1984) on a U.S. affiliate obligation will be treated for all Code purposes as paid to a resident of the country in which the applicable CFC is incorporated. The requirements are that the payee was an applicable CFC on or before June 22, 1984, the U.S. affiliate obligation on which the interest is paid was issued before June 22, 1984, and on the date the interest is paid, the payee satisfies requirements based upon the principles set forth in four revenue rulings issued in connection with the Interest Equalization Tax (Rev. Rul. 69-377, 69-2 C.B. 231; Rev. Rul. 69-501, 69-2 C.B. 233; Rev. Rul. 70-645, 70-2 C.B. 273; and Rev. Rul. 73-110, 73-1 C.B. 454). No inference should be drawn from this rule regarding the proper resolution of other tax issues. The conferees do not intend this provision to serve as precedent for the U.S. tax treatment of other transactions involving tax treaties or domestic tax law.

7. Original issue discount in the case of foreign investors

Present law

Foreign investors are subject to tax on original issue discount upon receipt of coupon interest or disposition or retirement. Calculation of accrual and treatment of partnership debt and noncapital assets are unclear.

House bill

Under the House bill, foreign investors will calculate accrual of original issue discount like U.S. persons, whoever issued the debt, and whether or not the debt is a capital asset in the foreign investor's hands. The bill generally applies to payments made on or after the 60th day after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill, with technical modifications.

Conference agreement

The conference agreement follows the Senate amendment with a substantial modification. The modification reflects a concern expressed in the reports of the House Committee on Ways and Means and the Senate Committee on Finance: the mismatching of (1) an accrual basis U.S. OID debt issuer's tax deductions and (2) a foreign investor's income inclusion.

The agreement delays the interest deduction for interest accrued, but not paid, to related foreign parties with respect to an original issue discount obligation until actual payment. The conferees believe that there is no justification for mismatching in the case of related party OID debt. Such mismatching allows an economic entity that has divided itself into more than one legal entity to contract with itself at the expense of the U.S. Government.

An example illustrates the operation of the conference agreement. The foreign parent of a U.S. corporation lends the U.S. corporation money in exchange for a noninterest bearing discount bond that the foreign parent holds until maturity. (The conference agreement's repeal of the 30-percent withholding tax on interest paid to certain foreign investors does not apply to interest paid to foreign shareholders of a U.S. corporation.) Under the conference agreement, the U.S. corporation cannot deduct interest on the bond until the foreign parent collects the cash due on the obligation at maturity.

In the case of a discount obligation bearing stated interest, the obligor may deduct in a given year only the amount that is paid to related lender in that year. For example, the foreign parent of a U.S. corporation has lent the U.S. corporation money in exchange for an interest bearing discount bond. In a given year, the stated interest on the bond is $30, while the OID accruing on the bond is $150. The amount subject to U.S. tax in the hands of the foreign parent in that year is $100 (rather than $150), the $30 of stated interest plus $70 of accrued OID, because OID (under the conference agreement) is subject to U.S. tax only to the extent that the tax on the OID does not exceed the interest payment less the 30-percent withholding tax (without reduction on account of any income tax treaty) imposed on the interest payment. The deduction of the U.S. borrower is $30, whether or not the foreign lender benefits from an income tax treaty to which the United States is a party.

The conferees understand that the anti-abuse measure in the conference agreement will not end the abuse of mismatching. For the time being, however, the conferees have limited the deferral of deductions to the case of interest accrued to related parties. The conferees believe that further examination of the deductibility of OID accrued to foreign parties is appropriate. In addition, the conferees understand that taxpayers may attempt to circumvent the related party rule of the agreement by entering into "back to back" loans, wherein a foreign affiliate of a U.S. taxpayer lends money to an unrelated foreign party that relends that money at discount to the U.S. taxpayer. The conferees intend that the Internal Revenue Service, when appropriate, investigate the capitalization of foreign-owned U.S. corporations issuing OID debt to unrelated foreign parties to attempt to determine whether back to back loans exist.

This anti-abuse measure of the conference agreement applies to obligations issued after June 9, 1984.

8. Withholding on dispositions by foreigners of U.S. real property

Present law

Under the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA), foreign investors in U.S. real property interests are taxable by the United States on the gains realized when they dispose of these interests, just as are similarly situated U.S. persons. This rule is to be enforced through information reporting. The legislation overrides certain nonrecognition provisions of the Code to insure U.S. taxation of the gain.

House bill

No provision.

Senate amendment

Under the Senate amendment, the taxation of foreign investors on gains from the disposition of U.S. real property interests generally will be enforced through withholding. Purchasers of U.S. real property interests from foreign persons, certain of the purchasers' agents, and settlement officers will have a duty to withhold, but only if they have actual knowledge or have received formal notice that the seller is foreign. U.S. partnerships, trustees, executors, and certain foreign corporate transferors will have a duty to withhold.

Agents for the transferor of a U.S. real property interest will be required to withhold if they had reason to believe, or notice, that the transferor was a foreigner, and failed to notify the transferee. Transferors' agents have a duty to make reasonable inquiry about the transferor's status, but reliance in good faith on a transferor's representation negates the duty to withhold.

Withholding will not apply to a purchaser buying a principal residence for $200,000 or less, or to a sale of stock on an established U.S. market. Withholding also will not apply to a transferor who obtains a qualifying statement from the Secretary that he is exempt from tax, has provided adequate security for payment of the tax, or has otherwise made arrangements for payment the of tax.

The amount withheld is the lesser of the capital gains rate times the amount realized (price paid) for the transferred U.S. real property interest; the maximum tax liability on the sale (after proof of basis); or the amount that the U.S. withholding agent actually controls.

The Secretary can reduce or eliminate withholding on request in certain cases. The Senate amendment removes current information reporting obligations where withholding is required unless the Secretary specifically requires continued reporting. Tax imposed under FIRPTA that is not collected by withholding remains a liability of the foreign transferor.

The Senate amendment requires withholding for amounts paid on or after 30 days after enactment.

Conference agreement

The conference agreement follows the Senate amendment with substantial modifications.

Duty to withhold generally

Following the Senate amendment, the conference agreement generally imposes a withholding obligation when a U.S. real property interest is acquired from a foreign person. The conference agreement generally imposes the obligation on the transferee. The conference agreement narrows the circumstances in which an agent of the transferor or transferee must withhold and generally eliminates any requirement that settlement officers withhold. It clarifies the withholding obligations of partnerships, trustees, and executors, and domestic U.S. real property holding corporations with respect to certain distributions by these entities.

The conference agreement differs from the Senate amendment in requiring withholding *unless* one of five exemptions applies. The Senate amendment generally would have required withholding only if the would-be withholding agent had actual knowledge or had received formal notice that the seller was foreign. The Senate amendment would have imposed a general requirement on the transferor to notify the transferee (as well as any transferee's agent or settlement officer) if the transferor was a foreign person. It also would have imposed a general requirement on any transferor's agent to make a reasonable inquiry concerning the transferor's status and to notify the transferee if the agent had reason to believe that the transferor might be a foreign person. The conference agreement eliminates these two general requirements.

Under the first of the five of exemptions from withholding provided under the conference agreement, withholding by the transferee generally will not be required if the transferor furnishes to the transferee, under penalty of perjury, an affidavit stating that the transferor is not a foreign person and stating the transferor's taxpayer identification number ("non-foreign affidavit"). The conference agreement authorizes the Internal Revenue Service to prescribe regulations requiring the transferee to furnish a copy of the non-foreign affidavit to the Internal Revenue Service. The conferees anticipate that any regulations requiring filing of the non-foreign affidavit with the Internal Revenue Service will also require filing of such other information as the Secretary deems appropriate (for example, a description of the real property interest transferred and the identity and taxpayer identification number of the buyer).

The receipt of a non-foreign affidavit will not relieve the transferee of withholding responsibility if the transferee has actual knowledge that the affidavit is false or he receives a notice from his agent or an agent of the transferor that the affidavit is false. A transferor's agent or transferee's agent with actual knowledge that the affidavit is false must give the transferee notice to that effect at such time and in such manner as the Secretary shall require by regulations. In the case of a foreign corporate transferor, an agent of the transferor will be deemed to have actual knowledge that any non-foreign affidavit is false. In moving to an actual knowledge test, the conference agreement generally imposes significantly less potential liability on agents than did the Senate amendment. The conferees believe that any agent deriving compensation from a foreign corporate principal in a real estate transaction will know that his or her principal is in fact foreign. The chances of ignorance in such a case are so remote that the conference agreement precludes a claim of ignorance. A transferor's agent or transferee's agent that does not give the required notice will be liable for withholding as if he were the transferee, up to the amount of compensation the agent receives in connection with the transaction. This liability for withholding is in addition to any penalties imposed under other provisions of the Code or other laws (both civil and criminal) in connection with the failure to give notice.

The receipt of a non-foreign affidavit also will not relieve the transferee of withholding responsibility if the Internal Revenue Service by regulations requires the transferee to furnish it with a copy of the non-foreign affidavit and the transferee fails to do so.

The conference agreement defines the term "transferor's agent" as any person who represents the transferor in any negotiation with the transferee or any transferee's agent related to the transaction, or in settling the transaction. The conference agreement defines the term "transferee's agent" as any person who represents the transferee in any negotiation with the transferor or any transferor's agent related to the transaction, or in settling the transaction. A settlement officer will not be treated as a transferor's agent or transferee's agent merely because he receives or disburses any portion of the consideration for the transaction or records any document in connection with the transaction.

As under the Senate amendment, any tax imposed on a foreign investor under FIRPTA in excess of amounts withheld will remain the liability of the foreign investor.

Amount withheld

Under the conference agreement, the amount to be withheld on the sale by a foreign investor of a U.S. real property interest generally is 10 percent of the amount realized (sales price). However, the amount withheld may not exceed the transferor's maximum tax liability, discussed below.

The 10-percent rate replaces the higher capital gains withholding rates provided in the Senate amendment. The 10-percent rate is expected to result in the withholding of an amount of tax that more closely approximates (in many cases) the net tax owed by a foreign investor on his gain (after basis is deducted) on a U.S. real property disposition.

The conference agreement eliminates the Senate amendment provision that limits a withholding agent's withholding liability to the portion of the sales proceeds within his control. Because withholding generally will be at a 10-percent rate only under the conference agreement, transferees will be more likely (than under the Senate amendment) to have sufficient sales proceeds within their control to satisfy the full withholding liability. When the initial cash consideration paid by a transferee in a U.S. real property transaction is *not* high enough to cover this withholding liability, the parties can request a "qualifying statement" from the Internal Revenue Service authorizing the transferee to withhold a lesser amount. A qualifying statement is to be issued in this situation if the requirements for such a statement are otherwise satisfied and no abuse is involved. (Qualifying statements are discussed in more detail below). Thus, on a real estate installment sale, for example, an amount equal to 10 percent of the total sales price (or the maximum tax liability, if less) is to be withheld at the time of the first cash payment unless a qualifying statement authorizing the transferee to withhold a lesser amount is obtained.

The "transferor's maximum tax liability" will be determined by the Secretary in the same manner as under the Senate amendment. The Secretary is to establish the transferor's maximum tax liability upon request. The conference agreement departs from the Senate amendment in permitting such a request to be made by the transferee as well as by the transferor. However, transferees may request a maximum tax liability determination only to cure overwithholding errors. The procedure is not intended to be utilized to relieve transferees from withholding responsibility *before* a transaction occurs. In many cases, the fact that would establish that the transferor's maximum tax liability is less than the tax otherwise required to be withheld (namely, the transferor's basis in the transferred property) will not be known by the transferee unless and until the transferor furnishes the information to the transferee.

Transferees may request a determination of maximum tax liability before or after a disposition.

The conference agreement, unlike the Senate amendment, provides that a transferor may seek and obtain an early refund of any amounts withheld in excess of the transferor's maximum tax liability (subject to such terms and conditions as the Secretary may by regulations prescribe). This provision will allow a transferor to seek a refund before the transferor might otherwise file a federal income tax return. No interest will accrue on the amount of any early refund.

The conference agreement adopts the Senate amendment provision allowing the Secretary to reduce withholding under certain circumstances. A request for reduced withholding may be made by either the transferor or the transferee under the conference agreement.

The conference agreement increases to 90 days the 30-day deadline specified in the Senate amendment for action by the Internal Revenue Service on a request for establishment of the transferor's maximum tax liability or for reduced withholding. The conferees extended the deadline to 90 days because they were informed by the Internal Revenue Service that the 30-day deadline provided in the Senate amendment was unrealistic; Service resources would not permit it to complete action on most requests within 30 days. In some cases, the Service's action in response to these requests may not establish the amount of tax due.

Other exemptions from withholding

Domestic corporation furnishes non-U.S. RPHC affidavit

Withholding is not required on the disposition of an interest (other than an interest solely as a creditor) in a domestic corporation if the corporation furnishes an affidavit to the transferee stating, under penalty of perjury, that the corporation is not and has not been a U.S. real property holding corporation ("U.S. RPHC") during the base period specified in Code section 897(c)(1)(A)(ii) (the shorter of (i) the period after FIRPTA's general effective date during which the transferor held the interest and (ii) the five-year period ending on the date of disposition of the interest) ("non-U.S. RPHC affidavit"). The conference agreement authorizes the Internal Revenue Service to prescribe regulations requiring the transferee to furnish a copy of the non-U.S. RPHC affidavit to the Internal Revenue Service.

The receipt of a non-U.S. RPHC affidavit will not relieve the transferee of withholding responsibility if the transferee has actual knowledge that the affidavit is false or the transferee receives a notice from his agent or an agent of the transferor that the affidavit is false. The rules imposing a duty on agents to give notice in the case of a false affidavit, including the rule imposing withholding liability on agents when they fail to give the notice required, are the same in connection with false non-U.S. RPHC affidavits as they are in connection with false non-foreign affidavits.

The receipt of a non-U.S. RPHC affidavit also will not relieve the transferee of withholding responsibility if the Internal Revenue Service by regulations requires the transferee to furnish it with a copy of the non-U.S. RPHC affidavit and the transferee fails to do so.

This exemption is intended to apply only to dispositions of stock that is not regularly traded on an established securities market ("non-publicly traded stock"). A separate exemption, discussed below, is provided for dispositions of publicly traded stock.

Under the conference agreement and the provisions of FIRPTA, a purchaser of non-publicly traded stock in a domestic corporation is potentially liable for withholding unless he obtains either a non-U.S. RPHC affidavit from the corporation or a non-foreign affidavit from the seller. If the purchaser obtains neither, he will be liable for withholding if the seller is in fact a foreign person, the domestic corporation was in fact a U.S. RPHC during the base period specified in Code sec. 897(c)(1)(A)(ii)), and the purchaser does not receive a qualifying statement.

Transferee receives qualifying statement

The conference agreements, with some modifications, follows the Senate amendment in exempting from withholding transferees who receive a "qualifying statement".

The conference agreement defines a qualifying statement as a statement by the Secretary that the transferor is exempt from tax, that either the transferor or the transferee has provided adequate security for payment of the tax, or that either the transferor or the transferee has made other arrangements for the payment of the tax. The conference agreement differs from the Senate amendment in providing expressly that the *transferee's*, as well as the transferor's, provision of adequate security or making of other arrangements for the payment of the tax may form the basis for issuance of a qualifying statement. The conference agreement increases to 90 days the 30-day deadline specified in the Senate amendment for action by the Internal Revenue Service on a request for a qualifying statement.

Purchase price for residence below designated amount

The conference agreement liberalizes in two respects the exemption from withholding provided in the Senate amendment for sales of certain residences. The conference agreement requires that the amount realized by the transferor from the sale of the property not exceed $300,000; the Senate amendment would have required that the amount realized not exceed $200,000. The conference agreement requires that the property sold be used by the transferee as his residence; the Senate amendment would have required that the property be used by the transferee as his *principal* residence.

Stock transferred on established securities market

Under the conference agreement, no withholding is required on a disposition of shares of a class of stock that is regularly traded on an established securities market. The conference agreement, unlike the Senate amendment, does not limit the exemption to stock regularly traded on established securities markets *located in the United States.*

Partnerships, trusts, estates and corporations

The conference agreement adopts the Senate amendment provisions requiring withholding in certain cases by U.S. partnerships, trustees, and executors, and certain foreign corporate transferors, with the following changes: First, for U.S. partnerships, trustees, and executors, the rate of withholding is reduced to 10 percent under the conference agreement. (For foreign corporate transferors, withholding is at the higher capital gains rate provided in the Senate amendment.) Second, the conference agreement makes minor technical modifications in the Senate amendment provisions.

In addition, as discussed in greater detail below, the conference agreement adds two new provisions clarifying that withholding by domestic U.S. RPHCs and domestic and foreign partnerships, trusts, and estates, respectively, is required in connection with certain distributions to foreign persons. The conference agreement also clarifies that transfers of partnership, trust, and estate interests may be subject to withholding: it specifies that, to the extent provided in regulations, transferees of partnership interests and beneficial interests in trusts and estates will be required to withhold.

As discussed in greater detail below, the conferees intend that foreign corporations be treated as foreign person for withholding purposes regardless of whether they elect to be treated as domestic corporations under Code section 897(i).

Distributions by domestic U.S. RPHCs to foreign shareholders

The conference agreement explicitly requires withholding by a domestic corporation that is (or, at any time during the base period specified in Code section 897(c)(1)(A)(ii), was) a U.S. RPHC when the corporation distributes property to a foreign shareholder in a corporate liquidation or in redemption of its stock. In general, the amount of tax to be withheld is 10 percent of the gross amount of the distribution received by the foreign shareholder. While the conference agreement's general withholding rule technically requires withholding by a domestic corporation in this case, the conferees wished to eliminate any uncertainty on this point.

Withholding by a domestic corporation is appropriate in this case because any earlier corporate-level dispositions of U.S. real property interests by the domestic corporation would have escaped tax under FIRPTA. This is because such dispositions by a *domestic* corporation are not by a "foreign person", even if all the domestic corporation's shareholders are foreign persons.

A qualifying statement granting exemption from withholding may be requested in connection with a liquidating distribution by a domestic corporation of a non-U.S. real property interest when Code section 337 nonrecognition treatment was not elected for related corporate-level dispositions of U.S. real property interests (made during the base period specified in Code section 897(c)(1)(A)(ii)) by the domestic corporation. If the section 337 election was not made, a foreign shareholder's interest in the liquidating corporation may not be a U.S. real property interest (under the FIRPTA rule excluding from the definition of a U.S. real property interest an interest in a corporation that is not currently holding U.S. real property interests and that was fully taxed on previous corporate-level dispositions of such interests during the base period). Thus, the foreign shareholder's surrender of his interest in the corporation may not be a taxable disposition under FIRPTA.

A qualifying statement granting exemption from withholding also may be requested in connection with a distribution by a domestic corporation of a U.S. real property interest where the Code accords the distributee foreign shareholder nonrecognition treatment on the distribution and this nonrecognition treatment is not overridden by FIRPTA (Code sec. 897(e)).

Taxable distributions by partnerships, trusts and estates to foreign persons

The conference agreement also explicitly requires withholding by a foreign or domestic partnership, trust, or estate when it makes a taxable distribution of a U.S. real property interest to a foreign person. In general, the amount of tax to be withheld is 10 percent of the fair market value at the time of the taxable distribution of the distributed U.S. real property interest. While the conference agreement's general withholding rule technically requires withholding in such a case, the conferees wished to eliminate any uncertainty on this point.

Under general Code rules, most distributions by partnerships, trusts, and estates are not taxable. However, FIRPTA authorizes the Secretary to prescribe regulations under which distributions of property by these entities (in exchange for the distributees' interests in these entities) *will* be taxable for FIRPTA purposes to the extent attributable to U.S. real property interests (Code sec. 897(g)).

Corporations making section 897(i) election

The conferees intend that foreign corporations electing under Code section 897(i) to be treated as domestic corporations for purposes of FIRPTA's substantive and reporting provisions continue to be treated as foreign persons for withholding purposes. This will simplify the administration of the withholding system, particularly the exemption procedure for persons who furnish non-foreign affidavits.

By treating a foreign corporation as a foreign person for withholding purposes despite its having elected to be treated as a domestic corporation for purposes of FIRPTA's substantive provisions, a liquidation-related sale of a U.S. real property interest by the foreign corporation may be subject to withholding. Because the corporation is treated as a domestic corporation for substantive FIRPTA purposes, however, it may elect tax-free treatment of the liquidation-related sale under Code section 337. The conferees intend that any tax withheld on such a qualifying section 337 liquidation-related sale be offset by means of a crediting procedure. The Internal Revenue Service is to prescribe regulations allowing foreign shareholders in a foreign corporation electing section 897(i) treatment to credit against their FIRPTA tax liability on a liquidating distribution any tax withheld on a qualifying section 337 liquidation-related sale of a U.S. real property interest.

Information reporting requirements

The conference agreement generally repeals the information reporting requirements of FIRPTA.

However, it authorizes the Secretary to require reporting by foreign persons holding direct investments in U.S. real property interests. For this purpose, a foreign person will be treated as holding direct investments in U.S. real property interests during any calendar year if the foreign person did not engage in a U.S. trade or business at any time during the calendar year and the fair market value of the U.S. real property interests held directly by the person at any time during the calendar year was $50,000 or more. A person "directly" holds a U.S. real property interest only if his disposition of the interest would be taxable under FIRPTA. Thus, persons not subject to FIRPTA may not be subjected to information reporting under the conference agreement. The Internal Revenue Service may not impose look-through or similar rules in connection with reporting, under which "deemed" or "constructive" holders of U.S. real property interests are required to report, except to the extent that those required to report would be subject to tax under FIRPTA.

The conferees do not believe that requiring reporting by foreign persons holding direct U.S. real property investments would be unduly intrusive or burdensome. U.S. law presently requires foreign investors in U.S. real property to furnish their names and countries of residence, as well as certain other information, to the U.S. Government, in certain circumstances. For example, the Agricultural Foreign Investment Disclosure Act of 1978 (7 U.S.C. secs. 3501-08) generally requires foreign persons who acquire U.S. agricultural land (other than certain parcels of one acre or less which generate less than $1,000 in annual gross sales) to file detailed reports on such acquisitions with the Department of Agriculture within 90 days of the transaction. Completed reports are made available for public inspection. Pursuant to the International Investment Survey Act of 1976 (22 U.S.C. secs. 3101-08), the Department of Commerce imposes various reporting requirements on foreign investors in U.S. businesses. For example, on the acquisition by a foreign company of a 10-percent (or more) ownership interest in a U.S. business with 200 or more acres of U.S. land or $1 million or more of either assets, gross sales or net income, the Department generally requires that the name and country of residence of the foreign company be reported and certain information about the U.S. business be provided. Information reported pursuant to the International Investment Survey Act generally may be used for analytical or statistical purposes only.

Effective date

The withholding rules apply to dispositions of U.S. real property interests that occur on or after January 1, 1985. The date on which a foreign transferor originally acquired a U.S. real property interest is irrelevant.

The changes in the information reporting requirements are effective retroactively to calendar year 1980.

9. Excise tax on insurance premiums paid to foreign insurers and reinsurers

Present law

The United States imposes excise taxes on premiums paid to foreign insurers not doing business in the United States. The rates are (per dollar of premium): four cents for casualty contracts, one cent for life contracts, and one cent for all reinsurance. The tax is collected by return. Payments to some insurers are exempt by treaty, but reinsurance premiums paid by treaty-protected insurers are subject to the tax (unless the recipient is exempt by treaty).

House bill

No provision.

Senate amendment

The Senate amendment makes the excise tax rate on casualty reinsurance equal to that on casualty insurance (four percent). In addition, the amendment adopts a new withholding mechanism for collecting the insurance excise taxes.

These provisions will apply to premiums paid after the date of enactment.

Conference agreement

The conference agreement does not include the Senate amendment. The conferees have decided not to restructure the insurance excise tax, to increase the tax on casualty reinsurance premiums, or to establish a new withholding mechanism at this time in the belief that further study of these proposed changes is in order.

In coming to their decision the conferees were not pursuaded by the argument that the Senate amendment would violate the income tax treaty between the United States and the United Kingdom. Rather, it is the conferees' view that the Senate provision would not violate any U.S. income tax treaty. It would have only collected a tax that the United States has the power to impose and collect under any U.S. income tax treaty and thus, would have been fully consistent with all U.S. treaty obligations.

In addition, the conferees are aware of assertions that negotiators for the United States and the United Kingdom, in connection with the negotiation of the existing income tax treaty between the two countries, may have reached an unwrittten understanding that the United States would not impose its insurance excise tax on premiums for the reinsurance of U.S. risks paid by U.K. insurers to reinsurers in other foreign countries. Unwritten understandings do not bind Congress. Only open covenants normally warrant Congressional recognition. The conferees do not agree with the suggestion that understandings unknown to Congress and not part of the public record during the ratification process become law in the United States.

However, the conferees recognize that close ties exist between the United States and the United Kingdom, and the conferees believe that Congress, as a matter of comity, should allow our treaty partner and ally every opportunity to establish that internal U.S. law should remain as it is. This concern is an important reason for the conference agreement's omission of the Senate amendment provision at this time. In light of this incident and other experiences, however, the conferees express concern over waiver of U.S. taxing jurisdiction by treaty. The conferees believe that, while income tax treaties provide benefits to U.S. business and U.S. tax administration, they have also caused substantial problems for our tax system, and they sometimes create opportunities for tax avoidance that Congress—in a spirit of comity—is reluctant to close. Therefore, the conferees urge further study of changes in the insurance excise tax, and urge those who support retention of the current system to develop additional reasons—beyond comity—to support their position.

10. Use of territories to avoid U.S. tax on foreign investors

Present law

Payments of U.S. source interest, dividends, and other passive income to foreign investors are generally subject to a 30-percent U.S. withholding tax. The United States does not tax payments of passive income to corporations organized in Guam, the Northern Mariana Islands, or the U.S. Virgin Islands. Some argue that foreigners who wish to invest in the United States may avoid both U.S. and territorial tax by channeling their investments through conduit corporations in these territories. Temporary Treasury regulations subject dividends and interest paid by territorial conduit corporations to territorial withholding tax. Guam is contesting these regulations in court.

House bill

The House bill (which differs substantially from the provision that the Committee on Ways and Means reported because of a technical Committee amendment to the provision on the House floor) provides that interest, dividends, and other passive income paid from U.S. sources to a corporation organized in Guam, the Marianas, or the Virgin Islands will not be subject to U.S. tax if the recipient corporation meets two requirements: first, that at all times during the taxable year less than 25 percent in value of the stock of the corporation be owned directly or indirectly by foreign persons and second, that at least 20 percent of its gross income be shown to the satisfaction of the Secretary to have been derived from local sources for the three-year period ending with the close of the preceding taxable year of the corporation (or for such part of the three-year period as the corporation has been in existence).

For the purpose of the ownership requirement, the term foreign person means any person other than either a U.S. person or a person who would be a U.S. person if the general Internal Revenue Code definition of the United States included references to the U.S. possessions. That is, residents of the possessions will not be foreign persons for this purpose. In determining whether stock of a corporation that belongs to another corporation is owned indirectly by foreign persons, only foreign persons who own five percent or more in value of the corporate shareholder are considered as owning stock in the underlying corporation. This last rule will allow territorial subsidiaries of publicly traded U.S. corporations many of whose stockholders are nominees (but with less than 25 percent in value of their stock held by foreign persons owning 5 percent or more in value) to meet the ownership requirement for reduced withholding.

The 20-percent of gross income requirement makes it clear that a corporation formed in a possession of the United States is not eligible for reduced U.S. withholding tax on any U.S. source income if it could make payments of interest or dividends that are free of withholding tax in the possession. The purpose of this requirement is to assure collection of one tax on foreigners who invest in the United States. If 20 percent or more of the gross income of a corporation organized in Guam, the Marianas or the Virgin Islands during the applicable period were local source income, payments from its U.S. parent would not be subject to U.S. tax, but its payments to foreign investors would be subject to territorial withholding tax. On the other hand, U.S. withholding tax will apply to payments to a Virgin Islands corporation chartered in such possessions, unless its payments of interest and dividends to foreigners are subject to territorial tax. This rule will apply to payments after March 1, 1984.

The bill makes it clear that the Revised Organic Act of the Virgin Islands does not override its rules.

The House bill contains provisions that allow payment of dividends and interest from territorial corporations to U.S. persons without withholding tax whether or not the U.S. recipient of the payment meets either the ownership test or the gross income test.

The bill applies not only to Guam and to the Virgin Islands, but also to other territories (such as the Marianas) whose tax rules operate by reference to U.S. law or to territorial law.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill, with a technical correction. The correction makes it clear that the imposition of tax on certain Guamanian corporate recipients of U.S. source income does not have any effect on the Guamanian tax liability of U.S. recipients of Guamanian source income.

The conferees do not intend that any interplay of the tax laws of the United States and the territories allow foreign investors not resident in the territories to earn, directly or indirectly, U.S. income that escapes both U.S. and territorial tax. If Congress decides to allow use of the territories as conduits for foreign investors, or to allow other tax avoidance at variance with tax policy that Congress has expressed, Congress will do so specifically, and not by indirect application of U.S. tax rules that apply automatically in the territories.

The conferees believe that the relationship between the tax systems of the United States and those U.S. territories whose tax systems depend on the U.S. tax Code has created great uncertainty and possible opportunities for taxpayers to take positions that, if sustained, would result in tax avoidance. The conferees did not address this problem in the conference report because neither House of Congress addressed the problem in the legislation that the Congress considered. Neither taxpayers nor the courts, however, should construe the action of the conferees with respect to the specific problem of territorial conduit entities as indicating that any other tax avoidance device that depends on the laws of the territories whose tax laws generally depend on U.S. tax law as it changes (from time to time) yields the result that avoidance-seeking taxpayers seek.

11. Taxation of certain transfers of property outside the United States

Present law

Certain transfers of appreciated property to a foreign corporation can be made without recognition of gain to the transferor if the transferor establishes to the satisfaction of the Internal Revenue Service ("IRS") that the transfer did not have the avoidance of Federal income taxes as one of its principal purposes.

Transfers for use in a trade or business

Under IRS ruling guidelines (the "guidelines"), ordinarily, a favorable ruling is issued if the foreign transferee devotes the property to the active conduct of a trade or business, and has need for a substantial investment in fixed assets or will be engaged in the purchase and sale abroad of manufactured goods.

Tainted assets

Transfers of certain "tainted" assets are treated as taxable exchanges, regardless of whether the transfer is made for use in an active trade or business.

Incorporation of foreign loss branches

The guidelines require the recognition of gain on the transfer of the assets of a foreign branch to a foreign corporation, to the extent of previously deducted losses. *See* Rev. Rul. 78-201, 1978-1 C.B. 91. If the losses of the foreign branch contributed to an overall foreign loss that reduced U.S.-source income, a statutory provision may require not only recognition of gain but also recharacterization of the gain as U.S.-source income (sec. 904(f)). In the case of an overall foreign loss, the amount of gain required to be recognized under the guidelines is reduced by the amount of income required to be recognized by the statutory rule.

Declaratory judgment procedure

In the case of an actual controversy involving a determination or a failure to make a determination by the IRS as to whether a transfer had tax avoidance as a principal purpose, a taxpayer can litigate the determination in the Tax Court. In addition, the Tax Court is empowered to review any terms and conditions that the IRS seeks to impose upon a taxpayer in making the determination.

Excise tax on certain transfers not subject to section 367

An excise tax is imposed on certain transfers of property to foreign transferees in transactions that are not described in section 367(a). The excise tax is not imposed if the transferor establishes, before (sec. 1492) or after (sec. 1494) the transfer, to the satisfaction of the IRS that the transfer is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

Treatment of liquidating distributions by a domestic corporation

A liquidating distribution of appreciated property by an 80-percent owned domestic subsidiary into its foreign parent corporation (under sec. 332) is subject to the ruling requirement that is generally applicable to transfers of appreciated property to foreign corporations. The only statutory sanction for the failure to obtain the required ruling is the denial of the exception to the recapture rules (for depreciation, investment credits, and other items) that would otherwise be available.

House bill

The House bill eliminates the ruling requirement for transfers of appreciated assets abroad. Except as otherwise provided, transfers of appreciated property to foreign corporations are subject to tax.

Exception for property transferred for use in an active trade or business

Except as provided in regulations, no gain is recognized on the transfer of property to a foreign corporation for use in the active conduct of a trade or business abroad. The House bill contemplates that, prior to January 1, 1985, the Secretary will issue regulations prescribing the standards to be used in determining whether property is transferred for use in an active trade or business.

Tainted assets

Transfers of "tainted assets" (defined in a manner similar to that of the IRS guidelines) are ineligible for the trade or business exception. The House bill creates a new category of tainted assets: foreign currency or property denominated in a foreign currency.

Treatment of stock or securities

Transfers of stock or securities that fall within the active trade or business exception can be made without the recognition of gain. In the case of other transfers, the House bill contemplates that the present-law exceptions to the treatment of stock or securities as tainted assets will continue to apply.

Partnership interests

Except as provided in regulations, a transfer of an interest in a partnership is treated as a transfer of the transferor's pro rata share of the assets of the partnership.

Special rule for transfers of intangibles

Transfers of intangible assets in transactions that would otherwise qualify for nonrecognition of gain are treated as transfers for payments contingent on productivity, use, or disposition of the property. The transferor is treated as receiving payments over the useful life of the intangible property on an annual basis. Amounts included in gross income by reason of the special rule are treated as ordinary income from sources within the United States.

Incorporation of foreign loss branch

The active trade or business exception is inapplicable to certain transfers in connection with the incorporation of a foreign branch that has operated at a loss. Under the House bill, a tax is imposed on the lesser of (1) the excess of pre-incorporation losses incurred by the foreign branch with respect to which a deduction was allowed to the taxpayer over the amount of such losses recaptured under section 904(f), or (2) the gain on the transfer.

Declaratory judgment procedure

The House bill repeals the declaratory judgment procedure for Tax Court review of section 367 rulings and ruling requests.

Excise tax rules

To preserve consistency between section 367 and the excise tax rules, the House bill provides that the excise tax will not be imposed if the taxpayer establishes to the satisfaction of the IRS that gain should not be recognized on the transfer under principles similar to the principles of section 367.

Treatment of liquidating distributions

To the extent provided in regulations to be prescribed by the Secretary, a domestic corporation recognizes gain on liquidating distributions of appreciated property to foreign persons.

Notification requirement

The House bill provides a notification requirement for section 367(a) transfers and a set of penalties for failures to comply.

The bill also extends the general three-year statute of limitations on assessment and collection of tax with respect to any tax imposed under section 367 where the taxpayer fails to give the required notice.

Effective date

The provisions of the House bill apply to transfers or exchanges made after December 31, 1984.

Senate amendment

The Senate amendment generally is the same as the House bill with technical modifications.

Special rule for transfers of intangibles

If, subsequent to a transfer of an intangible to a foreign corporation, the U.S. transferor disposes of its stock in the foreign-transferee corporation, then part of the gain on disposition of the stock is treated as being U.S.-source ordinary income attributable to the disposition of the intangible. Similarly, if the foreign-transferee corporation disposes of the intangible, the U.S. transferor is deemed to receive a U.S.-source payment of ordinary income with respect to the intangible at that time.

Incorporation of foreign loss branch

The Senate amendment clarifies that, in the case of an overall foreign loss, the amount of gain required to be recognized is reduced by the amount of income required to be recognized by section 904(f)(3) in the current taxable year, but not amounts that were simply recharacterized as U.S.-source income by section 904(f)(1).

Treatment of liquidating distributions

Under the Senate amendment, a domestic corporation recognizes gain on liquidating distributions of appreciated property to foreign persons, except as otherwise provided in regulations to be prescribed by the Secretary.

Effective date

The Senate amendment provides a transition rule for transfers with respect to which a ruling request under section 367(a) was filed with the IRS before March 1, 1984.

Conference agreement

The conference agreement generally follows the Senate amendment with technical modifications.

Transfers for use in a trade or business

The conference agreement generally follows the Senate amendment.

Transfers of appreciated property of a domestic branch.—The conferees intend that regulations to be prescribed by the Secretary will require gain recognition on the transfer of assets that were used in the United States, to the extent of depreciation deductions previously claimed by the taxpayer with respect to the transferred property. This result is consistent with the treatment of transfers of property of a foreign branch that has operated at a loss (discussed below).

Tainted assets

The conference agreement follows the Senate amendment.

Except as provided in regulations, gain is recognized on the transfer of (1) property described in section 1221 (1) or (3) of the Code (relating to inventory, copyrights, etc.), (2) installment obligations, accounts receivable, or similar property, (3) foreign currency or other property denominated in a foreign country, (4) intangible property (as defined for purposes of the special rules relating to intangibles), and (5) property with respect to which the transferor is a lessor at the time of the transfer, except where the transferee is the lessee.

Treatment of stock or securities

The conference agreement follows the Senate amendment.

The conference agreement contemplates that certain transfers of stock or securities will fall within the exception for transfers for use in an active trade or business.

With respect to stock that is transferred to a foreign corporation in a transaction that constitutes a section 351 exchange as well as a type B reorganization, the conferees expect that, in developing regulations, the Secretary will carefully consider whether there are cases where the transfer should be treated as a section 351 exchange.

Treatment of partnership interests

The conference agreement follows the Senate amendment.

Special rules for transfers of intangibles

The conference agreement follows the Senate amendment.

The conferees intend that disposition of (1) the transferred intangible by a transferee corporation, or (2) the transferor's interest in the transferee corporation will result in recognition of U.S.-source ordinary income to the original transferor. The amount of U.S.-source ordinary income will depend on the value of the intangible at the time of the second transfer.

The conferees wish to clarify that, as under present law, gain will generally be recognized under section 367(a) on tranfers of marketing intangibles (such as trademarks or trade names) for use in connection with a U.S. trade or business, or in connection with goods to be manufactured, sold, or consumed in the United States.

Incorporation of foreign loss branch

The conference agreement follows the Senate amendment with two technical modifications. First, in applying the rule requiring gain recognition, a pre-incorporation loss is reduced by taxable income derived by the foreign branch in a taxable year after the taxable year in which the loss was incurred and before the close of the taxable year of the transfer. Second, the conference agreement provides for the characterization of the recognized gain (as ordinary income or capital gain) by reference to the character of the previously incurred losses. For example, if a branch incurred a capital loss (or a foreign oil extraction loss) in an earlier year, its later incorporation would yield capital gain (or foreign oil extraction income). The conferees intend that, on incorporation of a loss branch with appreciated intangibles, the transfer of intangibles will generally be subject to the special rule for intangibles, not the loss branch rule. In all other respects, the conferees intend that the provision for transfers of foreign loss branches be applied in a manner consistent with the IRS's published rulings under present law. Thus, for example, losses that result in gain recognition on incorporation include expenses directly related to a branch's property that was not transferred but abandoned as worthless. *See* Rev. Rul. 80-247, 1980-2 C.B. 127. Similarly, in applying the statutory provision, the profits and losses of divisions that are separate business operations cannot be combined. *See* Rev. Rul. 81-82, 1981-1 C.B. 127. As under current law, the basis of transferred assets will be the same as the basis of the assets in the hands of the transferor immediately prior to the exchange, increased by the amount of gain recognized to the transferor on the exchange. *See* Rev. Rul. 78-201, 1978-1 C.B. 91.

Declaratory judgment procedure

The conference agreement follows the Senate amendment.

Excise tax rules

The conference agreement follows the Senate amendment with modifications. First, the conference agreement clarifies that, as under present law, the taxpayer is to make the showing required under section 1492 before the transfer. Second, the conference agreement makes clear that all of the principles of section 367 (including the special rule for intangibles) are applicable for purposes of the excise tax rules.

Treatment of liquidating distributions

The conference agreement follows the House bill. Present law will continue to apply until regulations are promulgated.

Notification requirement

Under the conference agreement, the notification requirement is extended to liquidating distributions to foreign persons.

Effective date

The conference agreement follows the Senate amendment with two modifications.

Ruling requests under the excise tax rules.—The conference agreement expands the scope of the transition rule for transfers with respect to which a ruling request was filed before March 1, 1984 to cover ruling requests under sections 1492 and 1494 of the Code.

Special rule for certain transfers of intangibles.—The conference agreement provides a special rule for transfers of intangibles that occur after June 6, 1984 (the date of conference action) and before January 1, 1985 (the general effective date). Transfers of intangibles during this period will be treated as made for tax avoidance purposes. Subject to terms and conditions prescribed by the Secretary, however, the Secretary is authorized to waive the application of the special rule. The conferees anticipate that the Secretary will waive application of the rule if taxpayers agree to apply to the transfer the rules applicable to post-December 31, 1984, transfers under the bill. The Secretary may also waive application of the rule in other cases under the existing guidelines. The conferees intend, however, that the Secretary carefully examine transfers of intangibles before giving such a waiver. Transfers of intangibles that are not fully developed or that are not essential to the active conduct of a trade or business should not be given a waiver. This rule will not apply to transfers with respect to which a ruling request was filed before March 1, 1984, or with respect to which a ruling was obtained before June 6, 1984.

12. Amendments relating to foreign personal holding companies

Present law

To determine whether a foreign corporation is a foreign personal holding company, a U.S. person is considered to own the stock of his nonresident alien spouse, blood relative, or partners. Interposition of a foreign entity between a U.S. taxpayer and a foreign personal holding company arguably prevents application of the foreign personal holding company rules.

House bill

The House bill ends attribution of ownership of stock owned by a nonresident alien to the alien's U.S. brothers and sisters (whether by the whole or half blood), ancestors, and lineal descendants ("blood relatives"). It disregards the interposition of foreign partnerships and other foreign entities between U.S. taxpayers and foreign personal holding companies. It generally applies to taxable years beginning after December 31, 1983. It provides a transitional rule to allow certain existing structures until the end of 1984 to unwind.

Senate amendment

The Senate amendment includes the House family attribution provision; it also ends attribution of stock owned by a nonresident alien to the alien's U.S. partners who are not shareholders (or relatives of shareholders) in the foreign corporation. It includes the House provision that disregards the interposition of foreign entities between U.S. taxpayers and foreign personal holding companies. It generally applies to taxable years begining after March 15, 1984, and includes the same transitional rule as the House bill.

Conference agreement

The conference agreement generally follows the Senate amendment with respect to attribution of stock ownership from nonresident alien individuals, but limits the application of the provision ending attribution from nonresident aliens who are blood relatives of U.S. persons. In cases where a U.S. person is a blood relative of the nonresident alien individual who owns stock, the conference agreement will attribute the stock of the nonresident alien to his or her U.S. blood relatives. For example, under the conference agreement, as under current law, a foreign corporation 40 percent of whose shares belong to a U.S. citizen and 60 percent of whose shares belong to the nonresident alien sister of the U.S. citizen may be a foreign personal holding company. The conferees see the possibility of significant abuse in such a case, and whenever a nonresident alien's U.S. blood relative owns stock in a foreign corporation, but do not believe that such a strong possibility exists when none of the nonresident alien's blood relatives owns stock in a foreign corporation. The conference agreement follows the Senate amendment with respect to attribution from nonresident aliens who are partners of U.S. persons.

The conference agreement includes the provision in the House bill and the Senate amendment that disregards the interposition of foreign entities between U.S. taxpayers and foreign personal holding companies. The managers intend that, as under current law, to the extent that the grantor of (or a transferor to) a trust is taxable on its income, then that person (and not a beneficiary of the trust) will be treated as the owner of the trust for the purposes of the foreign personal holding company rules. For example, the grantor of a revocable trust is taxable on its income (sec. 674); the grantor will be considered its owner for the purposes of the foreign personal holding company rules.

These foreign personal holding company provisions apply to taxable years beginning after December 31, 1983, and include the transitional rule contained in the House bill and the Senate amendment.

13. Coordination of Subpart F with foreign personal holding company provisions

Present law

When the foreign personal holding company rules and the controlled foreign corporation rules (of Subpart F) overlap, the foreign personal holding company rules take priority. Taxpayers have contended that being subject to foreign personal holding company tax for a year exempts them from tax under Subpart F that year, even on an investment of (previously untaxed) earnings and profits in U.S. property. Foreign personal holding company income includes dividends and interest from a related corporation that operates a trade or business in the recipient's country, but the controlled foreign corporation rules (of subpart F) do not taint this kind of income.

House bill

The House bill repeals the rule that taxation under the foreign personal holding company rules precludes taxation under the Subpart F rules. It provides a new rule for coordination of the two sets of provisions: a controlled foreign corporation's Subpart F income is taxed under Subpart F—but not under the foreign personal holding company rules—to the extent that it would otherwise be taxable under both Subpart F and the foreign personal holding company rules. This provision of the House bill applies to taxable years of U.S. shareholders beginning after the date of enactment.

Senate amendment

The Senate amendment includes the House provision coordinating the foreign personal holding company rules and the Subpart F rules. In addition, the Senate amendment removes dividends and interest from a related corporation that operates its trade or business in the recipient's country from the foreign personal holding company income calculation. This provision of the Senate amendment applies to taxable years of foreign corporation beginning after March 15, 1984.

Conference agreement

The conference agreement includes the provision in the House bill and the Senate amendment coordinating the foreign personal holding company rules and the Subpart F rules. This provision is effective for taxable years of foreign corporation beginning after date of enactment.

The conference agreement includes the provision in the the Senate amendment that removes dividends and interest from a related corporation that operates a trade or business in the recipient's country from the foreign personal holding company income calculation, but adds a technical amendment. The technical amendment specifies that the provision will not apply to dividends or interest from a corporation that is a foreign personal holding company. This provision is effective for taxable years of foreign corporations beginning after March 15, 1984.

14. Gain from sale or exchange of stock in certain foreign corporations

Present law

Gain recognized on the sale or exchange of stock in a foreign corporation by a U.S. person owning ten percent or more of the corporation's voting stock may be treated as a dividend (sec. 1248(a)). Gain is recharacterized as dividend income to the extent of the corporation's post-1962 earnings and profits attributable to the period the stock sold was held by the shareholder while the corporation was a controlled foreign corporation. Similarly, a U.S. corporation that disposes of stock in a transaction governed by section 311, 336, or 337 (by distributing the stock as a dividend-in-kind or in the course of liquidation) is required to recognize its pro rata share of post-1962 earnings and profits as dividend income. The amount of dividend income required to be included in the U.S. corporation's income is equal to the difference between the fair market value of the stock and its basis, subject to the post-1962 earnings and profits limitation.

House bill

Under the House bill, if shareholders of a U.S. corporation exchange stock in the U.S. corporation for newly issued stock (or treasury stock) of a foreign corporation ten percent or more of the voting stock of which is owned by the U.S. corporation, the transaction is recast. For purposes of applying section 1248, the foreign corporation is viewed as having issued the stock to the U.S. corporation and the U.S. corporation is treated as having distributed that stock to its shareholders. Under the rules of section 1248 provided in present law, the U.S. corporation is thereby required to recognize dividend income. The amount of dividend income is equal to the difference between the fair market value of the stock received by the shareholders of the U.S. corporation and the U.S. corporation's basis for its stock in the foreign corporation, subject to the post-1962 earnings and profits limitation.

Under an amendment to section 959 (relating to the exclusion of gross income of a controlled foreign corporation's previously taxed earnings and profits) in a different section of the House bill, the foreign corporation's earnings and profits that are recognized by the U.S. corporation as dividend income under section 1248 are treated as previously taxed income.

The provision is effective for exchanges after the date of enactment.

Senate amendment

The Senate amendment generally is the same as the House bill, except that no provision is made for the treatment of the earnings and profits of the foreign corporation as previously taxed income.

Conference agreement

The conference agreement follows the House bill.

15. Technical amendments to section 1248 (ordinary income treatment on disposition of stock of certain foreign corporations)

Present law

When a U.S. person disposes of stock of a controlled foreign corporation, some of his gains may be taxed as ordinary income, not as a capital gain (Code section 1248). There may sometimes be double counting of ordinary income and foreign tax credits. There may be different treatment of a U.S. person's indirect ownership of a controlled foreign corporation and a U.S. person's direct ownership.

House bill

The House bill prevents double counting of ordinary income and foreign tax credits on account of the disposition of stock in a foreign corporation. This provision applies to transactions occurring after the date of enactment (or after October 9, 1975, at taxpayer's election). The bill also treats a U.S. person's indirect ownership of a controlled foreign corporation like direct ownership. This provision applies to transactions occurring after the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

16. Foreign investment companies

Present law

More than fifty-percent U.S.-owned foreign companies registered under the Investment Company Act or engaged primarily in investing or trading in securities (with certain exceptions) are defined as foreign investment companies, sales of whose shares are taxed at ordinary income rates.

House bill

The bill redefines foreign investment companies as companies engaged primarily in investing or trading in securities or commodities (or interests in either), and changes the ownership test to 50-percent or more U.S. ownership. This new definition applies to sales and exchanges on or after September 29, 1983. For stock held on that date, it applies to sales and exchanges more than one year after date of enactment.

Senate amendment

The Senate amendment is the same as the House bill except that the Senate amendment has a different effective date. The redefinition of foreign investment companies in the Senate amendment applies to sales and exchanges on or after October 31, 1983. For stock held on that date, it applies to sales and exchanges more than one year after date of enactment.

Conference agreement

The conference agreement follows the House bill.

17. Foreign collapsible corporations

Present law

Overview

The collapsible corporation rules of section 341 are designed to prevent the use of a specific tax-avoidance device: the use of a corporation to convert business profits that would otherwise be taxed as ordinary income to capital gain. Under present law, Congressional intent underlying section 341 may be circumvented in some circumstances by use of a foreign corporation.

Background

The reports of the Committee on Ways and Means and the Committee on Finance that accompanied the 1950 legislation enacting section 341 describe a collapsible corporation as "a device . . . used in an attempt to convert ordinary income into long-term capital gain by use of a temporary corporation." [1]

Because U.S. persons are subject to Federal income tax on their worldwide income, there is an incentive to make use of collapsible corporations to engage in activities conducted abroad, as well as activities conducted within the United States.

Statutory rules and legislative history

General rules.—The efficacy of the collapsible corporation as a tax-avoidance device depends on the combination of two tax results: (1) avoiding a tax at the corporate level and (2) obtaining capital gain treatment at the shareholder level. In 1950, Congress acted to prevent taxpayers from obtaining the combination of tax results that underlies the utility of a collapsible corporation.

Section 341(a) generally treats a shareholder's gain on the sale or exchange of stock in a collapsible corporation as ordinary income. Section 341(b)(1) defines the term collapsible corporation to include a corporation that is formed or availed of principally for the manufacture, construction, or production of property, with a view to a sale or exchange of stock by its shareholders before the realization by the corporation of a substantial part of the taxable income to be derived from the property, and the realization by the shareholders of the gain attributable to the property. Thus, the statutory definition of collapsible corporation looks to whether a corporation can be expected to realize the gain inherent in its property in the normal course of business.

The provisions of section 341 make no distinction between domestic corporations and foreign corporations. Thus, the collapsible corporation rules are applicable to a foreign corporation that is used as the vehicle for the proscribed tax avoidance scheme. Rev. Rul. 56-104, 1956-1 C.B. 178.[2]

Section 341(e) exceptions for nonabusive situations.—In 1958, Congress refined the collapsible corporation rules to provide exceptions for situations that were not intended to be covered by the initial legislation. The report of the Senate Finance Committee acknowledges that "the purpose of [section 341] . . . is to prevent income which would otherwise be taxed at ordinary income rates from being converted into income taxable at capital gain rates merely by use of the corporate entity." [3] The statutory definition of collapsible corporation, however, by its terms and as interpreted, could result in the application of section 341 to tax a shareholder's gain as ordinary income even if the corporation's property would constitute a capital asset in the hands of the shareholder.[4] The 1958 leg-

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[1] H.R. Rept. No. 2319, 81st Cong., 2d Sess. 196 (1950); S. Rept. No. 2375, 81st Cong., 2d Sess. 88 (1950).

[2] Congress has addressed the issue of the extent to which U.S. taxpayers can use foreign corporations to defer U.S. tax on foreign-source income in sections 951–964 ("Subpart F") and 1248 of the Code. Under these provisions, the earnings and profits of certain foreign corporations are taxed as ordinary income to U.S. shareholders who own ten percent or more of the corporation's stock. Because the classic collapsible corporation has insignificant earnings and profits, neither Subpart F nor section 1248 prevents the use of a foreign corporation for the proscribed device.

[3] S. Rept. No. 1983, 85th Cong., 2d Sess., 31 (1958).

[4] *See Braunstein* v. *Commissioner*, 347 U.S. 65 (1963) (holding that there is no implied exception for this situation).

islation, which added section 341(e) to the Code, was designed, in part, to reverse this result.

The facts of Revenue Ruling 72-24, 1972-1 C.B. 103, disclosed that a foreign corporation was a collapsible corporation within the meaning of section 341(b). Section 341 was not applied, however, because of the application of section 341(e). In applying section 341(e), the Internal Revenue Service treated the foreign corporation as if it were a domestic corporation.

Section 341(f) consent to recognize gain at the corporate level.—Section 341(f)(1) permits capital gain treatment on disposition of stock in a collapsible corporation if the corporation consents to recognize gain on the disposition of its "subsection (f) assets" (generally, assets other than capital assets) when realized, even in a transaction that would otherwise qualify for nonrecognition of gain. Section 341(f)(3) provides an exception to the requirement of corporate-level gain recognition for certain tax-free corporate organizations, reorganizations, and liquidations, if the transferee gives a section 341(f)(1) consent.

The theory of section 341(f) is that section 341 should not apply if the corporation continues in existence and realizes the gain on its property.[5] To insure the result on which section 341(f) is premised, the statute mandates recognition of gain on dispositions that would otherwise be tax-free.

Treasury regulations provide that, in the case of a foreign corporation that gives a section 341(f) consent, any gain on the corporation's disposition of a subsection (f) asset is considered gross income that is effectively connected with a U.S. trade or business (Treas. Reg. sec. 1.341-7(e)(3)). A foreign corporation is subject to the regular corporate income tax with respect to income that is effectively connected with a U.S. trade or business. The regulatory provision may have no practical effect, however, where the foreign corporation's income is not subject to U.S. tax (because the corporation has no U.S.-source income and is not engaged in a U.S. trade or business) and the stock is sold to a foreign person.

House bill

Under the House bill, to the extent provided in regulations prescribed by the Secretary, a foreign corporation will be prohibited from making a section 341(f) consent.

The provision is effective on the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill, with a technical modification. Under the Senate amendment, to the extent provided in regulations prescribed by the Secretary, a section 341(f) consent will not be given effect where the consent is given by a foreign corporation.

Conference agreement

The conference agreement follows the Senate amendment with one modification. Under the conference agreement, by statute, a

[5] H.R. Rept. No. 1308, 88th Cong., 2d Sess., 3 (1964).

section 341(f) consent will not be given effect where the consent is given by a foreign corporation.

There is no policy reason to allow the use of the collapsible corporation device by U.S. taxpayers simply because the corporation is organized under the laws of a foreign country to engage in an activity abroad. This result may occur, however, where the stock of a foreign collapsible corporation is sold to a foreign person and the section 341(f) consent procedure is used. The conferees intend that a section 341(f) consent given by a foreign corporation will not be given effect if the consenting corporation is not engaged in a U.S. trade or business and stock in the corporation is sold to a foreign person. The conferees recognize that there may be cases in which a section 341(f) consent given by a foreign corporation should be given effect. Accordingly, the conference agreement authorizes the Secretary to prescribe regulations setting forth circumstances in which it would be appropriate to give effect to a section 341(f) consent given by a foreign corporation.

The conferees are informed that taxpayers have taken the position that section 341 should not apply to a foreign corporation that derives no U.S.-source income, and that section 341(f) properly provides a means to accomplish this result. This position is premised on the notion that the primary purpose of section 341 is to insure the collection of a Federal corporate income tax. To the contrary, the legislative history makes clear that section 341 is designed to prevent the conversion of ordinary income to capital gain by use of a corporation; the avoidance of tax at the corporate level is incidental to the conversion technique. Thus, the fact that the income of a foreign collapsible corporation is not subject to U.S. tax does not present a reason to permit the corporation's shareholders to circumvent section 341 by use of a section 341(f) consent.[6]

18. Stapled stock; stapled entities

Present law

Shares in one corporation may be transferable only in tandem with shares of a "sister" corporation. These shares are "stapled." A U.S. corporation owning a foreign corporation may avoid the controlled foreign corporation rules and the anti-boycott rules by spinning off the foreign corporation. Management may retain control if the stock of the two corporations is stapled. In addition, U.S. corporations may avoid restrictions on RICs and REITs by stapling their stock with stock of other U.S. entities. In addition, U.S. corporations may seek multiple surtax exemptions, accumulated earnings tax credits, etc., by stapling.

House bill

Under the House bill, new rules apply to entities 50 percent or more of which can be transferred only in tandem with interests in another entity. Generally, where a foreign and a domestic corporation are stapled entities, the foreign corporation will be treated as domestic. A foreign entity stapled on June 30, 1983, can elect to be

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[6] The conferees acknowledge that it may be appropriate for Congress to review the relationship between the Subpart F provisions, section 1248, and section 341.

treated as the subsidiary of its U.S. sister rather than as a U.S. corporation; stapled entities cannot claim non-U.S. status by virtue of a treaty unless they were entitled to treaty benefits on June 30, 1983. All stapled entities will be treated as one in determining whether any one is a REIT or RIC.

In determining controlled corporation status or stock ownership, one stapled corporation will be treated as owning the other. In addition, the Secretary may prescribe regulations to prevent tax avoidance or evasion through stapling. Generally, the provision is effective on the date of enactment. However, for interests stapled on June 30, 1983, the provision will not apply until January 1, 1985 (January 1, 1987, in the case of a stapled foreign corporation). This provision will not apply to certain Puerto Rican corporations or REITs whose interests were stapled on June 30, 1983.

Senate amendment

No provision.

Conference agreement

The conference agreement generally follows the House bill, but adds a special effective date for certain purposes for certain stapled mortgage REITs.

19. Insurance of related parties by a controlled foreign corporation

Present law

Income of a controlled foreign corporation from the performance of services for a related person outside the country of its incorporation is currently taxable to its U.S. shareholders. Treasury Regulations may deem the place of performance of insurance services to be the location of the insurance company's office so that income from insuring related parties' risks may not be currently taxable to the insurer's U.S. shareholders.

House bill

No provision.

Senate amendment

The Senate amendment specifies that income from the performance of insurance services by a controlled foreign corporation for a primary insured who is related to the insurer arises in the country where the risk is located. This income will be taxable currently to the corporation's U.S. taxpayers.

This provision will apply to taxable years of controlled foreign corporations beginning after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment but expands the definition of "related party" for purposes of the provision to include 10-percent U.S. shareholders (and persons related to them) of a controlled foreign corporation performing insurance services. The purpose of the expansion is to impose tax on an insurance company owned (directly or indirectly) by a relatively small number of U.S. shareholders that use it in whole or in part to insure their foreign risks or foreign risks of parties related to them.

20. Definition of resident alien

Present law

All individuals who are not U.S. citizens are either resident aliens or nonresident aliens of the United States. Residence depends on an alien's subjective intent. Resident aliens, like U.S. citizens, are subject to U.S. tax on worldwide income (although the foreign tax credit may reduce or eliminate U.S. tax on foreign source income). Nonresident aliens are generally subject to U.S. tax only on income that arises in the United States and on income from U.S. businesses.

When an individual changes his status from resident alien to nonresident alien (or vice versa), his or her taxable year consists of two separate periods. During one period, the United States will tax worldwide income; during the other period, the United States will normally tax only U.S. source income.

House bill

Under the House bill, an alien will be a resident if either (1) he is a lawful permanent resident of the United States (the "green card test"), or (2) the sum of (a) the days present during the current year, (b) one-third times the days present during the preceding year, and (c) one-sixth times the days present during the second preceding year equals or exceeds 183 (the "substantial presence test"). Presence as a commuter from Canada or Mexico will not count. Residence for fewer than 31 days in a year precludes residence under the substantial presence test for that year.

The substantial presence test will not count days of diplomats or certain other representatives of foreign governments (indefinitely), teachers or trainees (generally for 2 years only), or students (generally for 5 years only). The test will not apply to an individual who is unable to leave the United States because of a medical condition that arose while he or she was present in the United States.

There is an exception to the substantial presence test for individuals present for fewer than 183 days during the year who establish closer connections with a foreign country than with the United States and a tax home there for the year. This closer connections/tax home exception will not be available for any applicant for an immigrant visa.

Residence under the green card test will begin on the day the alien entered the United States. *De minimis* presence before start or after termination of substantial presence will generally be disregarded under the substantial presence test.

A taxpayer who has not established a taxable year for any period prior to the time he becomes taxable in the United States will be taxed on a calendar year basis.

The bill applies to taxable years beginning after December 31, 1984. For the substantial presence test, days of presence in 1983 will count only for aliens who had been residents (under existing law) in 1983 and 1984; days of presence in 1984 will count only for residents (under existing law) in 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill, with modifications. First, if an individual is a resident of the United States for three consecutive years under the new statutory definition and is a resident of the United States during one of the next three years, then he or she will be subject to U.S. tax for all intermediate years on the same items of income that would be taxed to a U.S. citizen who renounced U.S. citizenship for the principal purpose of avoiding U.S. tax (sec. 877). This rule will apply regardless of the subjective intent of the alien. The conferees adopted this modification because of a concern that, under the mechanical tests for residence that the conference agreement provides, long-time U.S. residents may leave the United States for a short period, dispose of assets free of U.S. tax, and resume U.S. residence. The conferees have adopted for this purpose the rules that tax certain U.S. citizens who renounce U.S. citizenship because of the clarity of that body of law, although the conferees believe that those rules merit reexamination (especially to the extent that those rules allow disposition of foreign assets held during U.S. citizenship or residence free of U.S. tax).

Second, days that an alien is present in transit without visa for 24 hours or less (for example, in a U.S. airport en route from Canada to South America) would not count as days of U.S. presence for the purpose of the substantial presence test.

Third, the substantial presence test will not count days of an individual who is unable to leave the United States because of a medical condition that arose while he or she was present in the United States.

The conferees do not intend that the conference agreement override treaty obligations of the United States. For example, an alien who is a resident of the United States under the new statutory definition but who is a resident of a treaty partner of the United States (and not a resident of the United States) under a United States income tax treaty will be eligible for the benefits that the treaty extends to residents of the treaty partner. However, notwithstanding the treatment of the alien as a resident of the other country for treaty purposes, the conference agreement will treat the alien as a U.S. resident for purposes of the internal tax laws of the United States. For example, if the alien owns more than 50 percent of the voting power of a foreign corporation, the foreign corporation will be a controlled foreign corporation (sec. 957).

The conferees do not intend that the definitions of resident alien and nonresident alien in the conference agreement affect the determination whether a trust or an estate is a U.S. or a foreign trust or estate (secs. 7701(a)(30) and (31)) except insofar as that determination itself turns on the residence or nonresidence of particular alien individuals.

The conference agreement allows the Secretary to prescribe regulations to carry out the purpose of this subsection. In particular, the conferees understand that regulations may be necessary to coordinate U.S. taxing jurisdiction with the taxing jurisdictions of U.S. possessions the basis of whose tax law is the Internal Revenue Code.

21. Treatment of community property income of nonresident aliens

Present law

A married couple both of whom are nonresident aliens may use foreign community property laws to split the U.S. earned income of one spouse for computing U.S. tax liability. A similar couple residing in a common law country could not split income in this way.

House bill

The House bill ends the ability of nonresident alien individuals to use foreign community property laws to split the U.S. earned income of one spouse.

The bill applies to taxable years beginning after December 31, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

23. Foreign sales corporations

Present law

In general

Present law provides tax deferral for the exporting income of Domestic International Sales Corporations (DISCs) and their shareholders. A DISC typically is a domestic subsidiary of a U.S. company engaged in exporting property produced in the United States.

The amount of the deferral is limited generally to 42.5 percent of DISC income that exceeds the average DISC income in a base period. (Most recent data show that the average DISC deferral for all DISCs is 34 percent of DISC income or 17 percent of the combined taxable income of the DISC and its parent.) Deferral is provided for both export profits and export investment income. The tax on accumulated DISC income may be deferred indefinitely until the income is actually distributed or the DISC fails to qualify as a DISC.

Deferred income

Under the DISC rules, deferral of tax is provided for income from (1) the sale or lease for use outside the United States of export property, (2) services related or subsidiary to the sale or lease of export property, (3) certain engineering and architectural services, (4) certain managerial services, including managerial services provided to unrelated DISCs to aid them in deriving export receipts, provided that at least 50 percent of the gross receipts of the DISC that provides the services are from exporting, (5) interest on any obligation that is a qualified export asset, (6) certain dividends, and (7) the sale of export assets.

Export property

DISC benefits are provided for export property, which generally includes property manufactured, produced, grown, or extracted in the United States. DISC benefits are not allowed, however, for property leased by a DISC for use by any member of a controlled group that includes the DISC, patents or intangibles, subsidized property, property in short supply, or oil, gas, coal, uranium, and other depletable minerals. The amount of the deferral on the sale of military goods is half the amount otherwise allowed.

Transfer pricing

DISC deferral is available on a percentage of income allocated to it under special transfer pricing rules. Transfer prices are based on either special rules or arm's-length pricing under Code section 482. Under the special rules, transfer prices are based on either 50 percent of combined taxable income of the DISC and its related party, or 4 percent of gross receipts from the transaction; in either case, the DISC also earns 10 percent of export promotion expenses.

Amount of benefit

The amount of the DISC benefit depends on the method used to determine transfer prices. If transfer prices are based on 50 percent of combined taxable income, deferral is no more than 21.25 percent of income earned by DISC and parent on the transaction. If transfer prices are based on 4 percent of gross receipts, total deferral is no more than 1.7 percent of gross receipts. If transfer prices are based on arm's-length rules, deferral is no more than 42.5 percent of DISC income.

Incremental rules limit the tax deferral to income attributable to export gross receipts that exceed 67 percent of the average gross receipts in a 4-year base period. The incremental rules do not apply to small DISCs with adjusted taxable income of $100,000 or less.

Qualifications

To qualify for the deferral, a DISC must be incorporated under the laws of any of the States or the District of Columbia, have only one class of stock, have outstanding capital stock with a par or stated value of at least $2,500, elect to be treated as a DISC, and satisfy the gross receipts and gross assets tests.

The gross receipts test requires that at least 95 percent of the corporation's gross receipts consist of qualified export receipts. In general, qualified export receipts are receipts, including commission receipts, derived from the sale or lease for use outside the United States of export property, or from the furnishing of services related or subsidiary to the sale or lease of export property. The gross assets test requires that at least 95 percent of the corporation's assets qualify as export assets. Qualified export assets include inventories, export property, necessary operational equipment and supplies, trade receivables from export sales (including certain commissions receivable), producers' loans, working capital, obligations of domestic corporations organized solely to finance export sales under guaranty agreements with the Export-Import Bank, and obligations issued, guaranteed, or insured by the Export-Import Bank or the Foreign Credit Insurance Association.

A DISC's taxable year need not conform to the taxable year of any of its shareholders. A wholly owned DISC will frequently have a taxable year ending one month after its parent's taxable year ends. This difference in taxable years allows an additional 11 months of deferral of income that is deemed distributed to the parent.

If a DISC fails to meet the qualifications for any reason, the DISC provisions provide for recapture of the DISC benefits received in previous years. Recapture of accumulated DISC earnings (because the DISC has become disqualified) is spread over a period equal to 2 years for each year that the DISC was in existence (up to a maximum of 10 years).

Source of income from export sales

The United States taxes U.S. taxpayers on their U.S. and foreign source income, but allows a foreign tax credit for foreign taxes on foreign source income. The foreign tax credit limitation reflects the principle that the credit cannot exceed U.S. tax on foreign source income. In general, in calculating the limitation, most foreign source income is grouped together in a general category known as the "all other" category; a separate limitation or "basket" applies to certain income from deemed DISC distributions (and, separately, to certain interest). In most cases, an export sale will not attract foreign tax so long as the U.S. seller does not maintain a fixed place of business or perform substantial activities in the country of destination. The separate limitation is designed to prevent taxpayers from reducing U.S. tax on low or untaxed distributions from DISCs by crediting foreign taxes on non-DISC income against the U.S. tax on distributions from DISCs.

Cooperatives

A cooperative is allowed to be a shareholder of a DISC. However, farmers who are members of cooperatives do not generally benefit directly or indirectly from DISC deferral. The farmers do not benefit directly because if the deferred income is distributed to the cooperative, it must be distributed currently (and taxed) to the farmer. Also, the cooperative does not benefit from the deferral because a cooperative must distribute its income to its members and patrons to benefit, under the rules for cooperatives, from the exemption from tax. Thus, deferred DISC income (or other pre-tax income) is generally not available to satisfy the particular working capital requirements of the cooperative.

Export Trade Corporations

Export trade corporations (ETCs) are controlled foreign corporations that are allowed to defer a portion of their income from exporting. In 1971, the ETC provisions were replaced by DISC. Only those ETCs in existence at that time are allowed to continue operating as ETCs.

If an ETC fails to meet the requirements to continue operating as an ETC, the previously untaxed income will continue to be deferred provided the income is invested in export assets.

House bill

No provision.

Senate amendment

In general

The Senate amendment exempts from tax a portion of the export income of a Foreign Sales Corporation (FSC) if certain foreign presence and economic process tests are met. Generally, 17 percent of export income will be exempt from tax if the optional administrative pricing rules are used to allocate income to the FSC, or 34 percent of FSC income if FSC income is based on arm's-length (sec. 482) transfer pricing rules. Exemption is provided for export profits but not for export investment income.

A FSC will generally be a foreign subsidiary (a corporation organized outside the U.S. customs area) that meets certain foreign presence tests.

Exempt income

Exemption from tax is provided on a portion of the income from (1) sale or lease of export property for use outside the United States, (2) services related or subsidiary to the sale or lease of export property, (3) certain engineering and architectural services, and (4) export management services, including services provided to unrelated FSCs or DISCs, even if the FSC providing the services is not itself engaged in exporting.

The Senate amendment does not provide exemption from tax on investment income and carrying charges. Investment income includes dividends, interest, royalties, rents, and certain other passive income. Carrying charges include any amounts in excess of the price for an immediate cash sale and any other unstated interest.

Export property

FSC benefits are provided for property manufactured, produced, grown, or extracted in the United States. Unlike DISC, FSC benefits are allowed for coal and uranium products and other depletable products (other than oil and gas). FSC benefits are not allowed for property leased by a FSC for use by any member of a controlled group of which the FSC is a member, patents or other intangibles, subsidized property, property in short supply, and oil and gas products. The exemption on the sale of military goods is half the amount otherwise allowed (same as DISC).

Transfer pricing

FSC exemption is available for income allocated to it under special transfer pricing rules. Transfer prices are based on either optional administrative rules or arms length pricing under section 482. Under the administrative pricing rules, transfer prices are based on either 23 percent of the combined taxable income of the FSC and its related supplier, or 1.83 percent of gross receipts derived from the transaction.

The administrative pricing rules may be used only if the FSC (or its agent) perform all the activities of the economic processes test.

Amount of benefit

Generally, the Senate amendment provides an exemption of tax on 17 percent of export profits with no exemption on nonexport profits or passive income. The amount of the FSC benefit depends, however, on the method used to determine transfer prices. If transfer prices are based on 23 percent of combined taxable income, the exemption is 17 percent of combined taxable income (17/23 of FSC income). If transfer prices are based on 1.83 percent of gross receipts, the exemption is 1.35 percent of gross receipts (17/23 of FSC income). If transfer prices are based on the arm's length pricing rules (sec. 482), exemption is limited to 34 percent of FSC income.

A FSC's nonexempt export income (generally 6 percent of FSC income) will be subject to U.S. tax unless it is determined without reference to an administrative pricing rule, in which case it will be taxed in the same manner and to the same extent as income earned by a foreign corporation that is not a FSC. Interest, dividends, royalties, other investment income and carrying charges will be subject to U.S. tax.

A FSC will not be allowed an investment tax credit or certain other credits. A foreign tax credit will not be allowed with respect to foreign taxes on export income (other than nonexempt export income determined without reference to an administrative pricing rule), but will be allowed with respect to other foreign taxes.

Qualifications

To qualify as a FSC, the corporation must meet the following requirements: (1) a FSC must be organized outside the U.S. customs area. If a FSC is organized in a foreign country, that country must be either a party to an exchange of information agreement with the United States, or an income tax treaty partner if the Treasury certifies that the exchange of information program under the treaty is satisfactory; (2) a FSC may have no more than 25 shareholders; (3) a FSC may not have preferred stock; (4) a FSC must maintain an office outside U.S. customs territory and maintain a set of the permanent books of account at that office; (5) a FSC must have at least one director who is not a U.S. resident; (6) a FSC may not be a member of a controlled group of which a DISC is a member; (7) a FSC must elect to be a FSC; and (8) the taxable year of a DISC or FSC must conform to the taxable year of the majority shareholder.

A FSC that elects to be a small FSC must also satisfy all these requirements.

Foreign presence and economic processes

FSC benefits are provided only if (1) the management of the corporation takes place outside the United States and (2) if the economic processes with respect to each transaction take place outside the United States.

The management of the corporation is treated as outside the United States if all meetings of the board of directors and shareholders are outside the United States, the principal bank account is outside the United States, and all dividends and certain expenses are paid out of this bank account.

Economic processes are treated as outside the United States if (1) the FSC (or its agent) participates outside the United States in the solicitation, negotiation, or making of the contract, and (2) if the foreign direct costs of the transaction incurred by the FSC equal or exceed 50 percent of the total direct costs (or 85 percent of direct costs of 2 activities). For purposes of this test, the costs of 5 activities are considered: advertising or sales promotion, processing customer orders and arranging for delivery, transportation, determination and transmittal of a final invoice or statement of account and the receipt of payment, and assumption of credit risk.

Burden of proof

The burden of proof that the foreign presence and economic processes tests are satisfied will be shifted to the Secretary of the Treasury if an officer of the corporation signs an affidavit stating that the requirements have been met (and how they have been met). The officer must be a citizen and resident of the United States, and the statement must be made under penalty of perjury.

Distributions to shareholders

A FSC will not be required or deemed to make distributions to its shareholders. Actual distributions to shareholders must be made first out of export income; the FSC may have income that is not export income, for example, investment income. Distributions will be treated as being made first out of earnings and profits attributable to export income, and then out of any other earnings and profits. Any distribution made by a FSC which is made out of earnings and profits attributable to export income to a shareholder which is a foreign corporation or a nonresident alien individual will be treated as a distribution which is effectively connected with the conduct of the trade or business conducted through a permanent establishment of the shareholder within the United States, and as U.S. source income. Thus, such distributions will be subject to Federal income tax.

Export income and investment income of a FSC will not be subject to the rules of subpart F. In addition, the Secretary of the Treasury is authorized to exclude property related to the export activities of the FSC from the subpart F rules relating to investments by controlled foreign corporations in U.S. property.

Dividends received from a FSC

A domestic corporation will generally be allowed a 100 percent dividends-received deduction for amounts distributed from a FSC out of earnings and profits attributable to export income. However, a 100 percent dividends-received deduction will not be allowed for nonexempt export income determined without reference to an administrative pricing rule (sec. 923(a)(2) nonexempt income) or a dividend received by a cooperative with respect to export income that is treated as exempt income.

Source of income from export sales

Income (other than nonexempt export income determined without reference to an administrative pricing rule) will be taken into account under a separate imitation for purposes of determining the foreign tax credit limitation of a FSC.

Foreign taxes on FSC dividends paid to the FSC's shareholders that are attributable to export income (other than nonexempt export income determined without reference to an administrative pricing rule) will be treated as noncreditable foreign taxes. In addition, such dividend income will be taken into account for purposes of the foreign tax credit limitation under a separate limitation.

The bill provides a special rule governing the source of income earned by a person related (within the meaning of sec. 482) to a FSC from transactions giving rise to export gross receipts of a FSC. That related person's foreign source income from such a transaction may not exceed the amount which would be treated as foreign source income earned by that person if the analogous DISC pricing rule applied.

Small business

Small FSC.—FSC benefits are available for the export income (up to $5 million of export gross receipts) of a corporation that elects to be a small FSC. A small FSC must be a foreign corporation that meets the requirements to be a FSC. However, a small FSC is not required to satisfy the foreign presence and economic process tests. A FSC may not elect to be a small FSC if it is a member of a controlled group that includes a FSC (unless the other FSC also elects to be a small FSC).

Small DISC.—A small DISC may continue to defer income attributable to $10 million or less of export gross receipts. The incremental rules would not apply. An interest charge that is tied to the T-bill rate is imposed on the amount of tax deferred.

Deferred DISC income

Under the Senate amendment, tax is forgiven on accumulated DISC income. This forgiveness will apply only to actual distributions made after December 31, 1984, by a DISC (or former DISC) that is a qualified DISC on December 31, 1984.

Export Trade Corporations (ETC's)

Tax is forgiven on the previously untaxed income of an export trade corporation if the company elects to discontinue operating as an ETC. Tax is not forgiven on the previously untaxed income of an ETC that does not qualify as an ETC on December 31, 1984, even though the income is invested in qualified assets.

Cooperatives

The Senate amendment provides indirect benefits to farmers who are members of cooperatives that export agricultural products. Farmers will not be taxed on exempt income until it is actually distributed. Thus, the cooperative may use the exempt income as working capital. (Normally, a cooperative must use income that has been taxed (at the farmer level), but not distributed, as working capital). Farmers will be taxed currently, however, on the nonexempt income (generally 6 percent of FSC income).

Special rules

A FSC may not claim benefits under an income tax treaty between the United States and a foreign country. No tax may be imposed on foreign trade income by a possession of the United States.

Transition rules

The taxable year of any DISC which includes January 1, 1985, will close on December 31, 1984, at which time there will be a deemed distribution of DISC income that normally would be deemed distributed at the end of the DISC's taxable year. Thus, shareholders may be including in income almost 2 years of DISC earnings in the current year. These distributions will be spread over 4 years. Special transition rules are provided for taxpayers with long-term contracts. Assets of a DISC (or ETC) generally may be transferred tax-free to a FSC.

Effective date

The provisions generally apply to transactions after December 31, 1984.

Conference agreement

The conference agreement follows the Senate amendment, with modifications. The conferees agreed to reduce the percentage of export income which will be exempt from tax and to clarify (in connection with the factoring provision) that income of a controlled foreign corporation from loans to finance the purchase of its related party's goods is Subpart F income subject to the separate foreign tax credit limitation for interest.

The conference agreement does not contain the Senate amendment's provision expanding the benefits for managerial services beyond those available under DISC. Thus, the agreement requires that a FSC or DISC have at least 50 percent of its income from exporting before income from managerial services provided to an unrelated party will be accorded beneficial treatment.

The exemption for the combined taxable income method under the conference agreement is 16 percent of combined taxable income. The exemption for the gross receipts method is 16/23ds of 1.83 percent, or approximately 1.27 percent of gross receipts (not to exceed 32 percent of FSC income). The limit on the exemption using sec. 482 rules is 32 percent of FSC income. The provision of the conference agreement that decreases the benefits for certain corporate preference items reduces the exemption by an additional 1/17th for corporate shareholders.

The conference agreement adopts the Senate amendment's special rules for small businesses which allow exporting companies with relatively small export gross receipts to elect to be a small DISC with an interest charge or a small FSC. The conferees wish to express concern that without a special effort by the Administration many small businesses which wish to export property will avoid making an election to become a FSC or a small DISC because they fear that such an election will lead to undue complexity and a large administrative burden. Consequently, the conferees hope that small business will be given special encouragement and assistance by the Commerce Department in establishing and operating small FSCs and small DISCs.

The agreement requires tax records (including invoices) to be kept in an office in a country which is either a party to an exchange of information agreement with the United States or an income tax treaty partner, which the Treasury certifies as having an acceptable exchange of information program under the treaty. The conferees intend that a foreign country, to qualify for this treatment, not be a country that has a statute (or other stated policy) which denies the IRS access to the home office of the FSC for audit purposes. Therefore, the conferees intend that the Treasury assure itself of access to the home office of a FSC before certifying a treaty partner or before entering into an exchange of information agreement.

The agreement requires any DISC established after Senate committee action to conform its taxable year to that of its majority shareholder.

The agreement deletes the rule of the Senate amendment that shifts the burden of proof to the IRS on certain issues upon a taxpayer affidavit. The conference agreement does not include the Senate provision shifting the burden of proof to the IRS in connection with enforcement of the foreign presence requirements. The conferees agree with the Senate's rationale for this provision which is to avoid uncertain application of the detailed and technical foreign presence rules thereby reducing administrative burdens on both the IRS and taxpayers. Nevertheless, the conferees believe that the Senate provision created an undesirable precedent. The conferees, however, intend for the IRS to administer the foreign presence provisions of FSC in a manner which facilitate the establishment of FSC and carry out the objectives of the statute.

The agreement modifies the rule governing benefits for sales of military property and services related to such sales to conform to the DISC rule and allow such income one-half of the benefits otherwise allowable.

The conferees agreed to ask the Treasury Department for a study on services. Neither the present DISC provisions nor the FSC benefits allowed under the conference agreement give special tax benefits for the export of services performed in the United States. The conferees think that this policy should be reviewed so that an informed decision can be made regarding the appropriate treatment of income from the export of services in the future. In particular, the conferees expect the study to consider the revenue impact of FSC benfits for services. The conferees direct the Secretary of the Treasury, in consultation with the office of the United States Trade Representative, to undertake a study of the advisability of providing the benefits allowed under the FSC election for profits from services performed in the United States and sold outside the United States. The Treasury Department is to report on the results of this study to the Senate Committee on Finance and the House Committee Ways and Means no later than six months after enactment.

The conference deletes the present law requirement for DISC reports after 1984 and substitutes a requirement for FSC reports.

The conference agreement will allow U.S. territories to impose tax on income of FSCs that arises after January 1, 1987, and includes a technical correction that would prevent FSCs established in the U.S. Virgin Islands from arguably escaping all tax on nonexempt income. The agreement makes it clear that the so-called "mirror Code" tax rules in place in certain U.S. possessions will not apply for purposes of denying the United States taxing jurisdiction under the FSC legislation.

The agreement contains a technical amendment that insures that the provision forgiving the tax on accumulated DISC income will not allow forgiveness of tax on accumulated DISC income that was subject to tax because of a revocation or disqualification prior to requalification and prior to the earning of income that is eligible for forgiveness.

The agreement contains a technical amendment conforming the treatment of second-tier Export Trade Corporations for purposes of the transition rule to that of first-tier Export Trade Corporations.

In view of the rule that a FSC cannot be a member of a controlled group of corporations of which a DISC is a member, the agreement contains a provision that, under regulations to be prescribed by the Secretary, a FSC election will automatically terminate an inconsistent DISC election.

The agreement treats deemed distributions for taxable years of DISCs that begin in 1984 as occurring over 10 years rather than over four years as contemplated in the Senate amendment. The conferees expect that regulations will allow taxpayers to accelerate this inclusion if taxpayers elect to do so.

The provision that clarifies present law to make it clear that a resident of a treaty partner country cannot avoid tax (under sec. 996(g)) on DISC distributions is effective on June 22, 1984.

The provision allows regulatory authority to extend rules allowing waiver of foreign presence requirements in the case of certain contracts entered into before January 1, 1985.

J. Compliance Provisions

1. Provisions relating to tax shelters

a. Registration of tax shelters

Present law

There is no requirement that tax shelters register with the Internal Revenue Service. As a result, the Internal Revenue Service lacks complete and systematic information on which to base its decisions about which shelters should be audited.

House bill

No provision.

Senate amendment

The Senate amendment provides that anyone who organizes a tax shelter must register the shelter with the Internal Revenue

Service by supplying information that briefly describes the investment and identifies the promoter. A tax shelter is defined as any investment with respect to which representations are made that the investment will result in deductions in excess of income, or credits in excess of half the income attributable to the investment, in any of the first 5 years. The shelter also must either be required to register with a Federal or State agency or be offered to "sophisticated investors" (i.e., when the aggregate amount invested exceeds $200,000 and there are 10 or more investors). The Secretary can prescribe regulations to provide exemptions from the registration requirement. The registration form must be filed with the Internal Revenue Service by the earlier of 15 days after the shelter is first offered for sale or December 31 of the year it is first offered for sale.

Once the tax shelter registration form is filed with the Internal Revenue Service, the Internal Revenue Service will provide a tax shelter identification number to the promoter. The promoter must furnish the number to each investor, and the investor must furnish the number on its tax return.

The penalty for failure to register is $500 plus 1 percent of the amount invested that exceeds $1 million. The penalty for each failure by the promoter to furnish the number to investors is $100. The penalty for each failure by the investor to furnish the number on its tax return is $50, unless the failure is due to reasonable cause.

The provision is generally effective on September 1, 1984, with respect to interests sold on or after that date. The Secretary may postpone the date these provisions take effect by regulations.

Conference agreement

The conference agreement follows the Senate amendment with modifications. Under the agreement, anyone who organizes a tax shelter must register the shelter by completing a registration form prescribed by the Internal Revenue Service, on which information that briefly describes the investment and identifies the promoter must be supplied. A tax shelter is considered registered when the registration form is mailed to or otherwise filed with the Internal Revenue Service in the manner required. This must be done not later than the day on which the first offering for sale of interests in the tax shelter occurs.

A tax shelter is required to be registered by the person having principal responsibility for organizing the tax shelter. In many cases, the tax shelter organizer will be the tax shelter promoter. The tax shelter organizer need not, however, be the promoter or general partner. For example, if a person structures or develops a series of related schemes from which he or a related party will benefit through service contracts or asset purchases, that person will be treated as the tax shelter organizer, even though each of the different arrangements is managed or promoted by a different individual.

If the person principally responsible for organizing the tax shelter fails to register the shelter as required, then any person who participates in the organization of the shelter must register the shelter. Such a person who is secondarily liable for registering the shelter must do so not later than the day on which the first offering for sale of any interest in the shelter is made. Requiring registration before this date will enable State securities regulators to prohibit offerings of unregistered shelters in their States. In the event that persons who are principally and secondarily liable for registering a shelter fail to do so, any person participating in the management or sale of the investment must register the shelter. Registration by the manager or seller does not relieve the organizer or promoter of liability for the penalties for failure to register.

Ordinarily, the rendition of professional advice by an unrelated attorney or accountant would not constitute the organization of a tax shelter. However, if, for example, the attorney's or accountant's fee is based, either in part or in whole, upon the number or value of units sold, the Internal Revenue Service might reasonably conclude that the attorney or accountant is an organizer, promoter, or seller of a tax shelter, since he participates in the entrepreneurial risk borne by other promoters.

A tax shelter is defined as any investment (including service contracts and leasing contracts) with respect to which a person could reasonably infer from the representations made or to be made in connection with any offer for sale of any interest that, as of the close of any of the first 5 years, the ratio with respect to any investor of (A) the aggregate of deductions and 200 percent of the credits potentially allowable to (B) the aggregate of the cash invested and the adjusted basis of other property contributed by the investor (reduced by any liability to which that property is subject) is greater than 2 to 1. For purposes of computing this ratio, amounts borrowed from a participant in the organization, sale, or management of the shelter or a related person to a participant are not considered to be cash invested. The Secretary is given authority to prescribe regulations that include or exclude amounts in the aggregate of cash invested and the adjusted basis of contributed property. In addition, for registration to be required, a tax shelter must be (1) required to register under a Federal or State law regulating the offering or sale of securities, (2) offered for sale pursuant to an exemption from registration requiring the filing of a notice with a Federal or State agency regulating securities, or (3) a substantial investment.

An investment is a substantial investment if the aggregate nominal amount that may be offered for sale to all investors exceeds $250,000 and 5 or more investors are expected. The aggregate nominal amount offered for sale includes all cash, all contributions of property, and all loans, whether recourse or nonrecourse. The aggregate nominal amount offered for sale is not the same as the investment amount used to compute the tax shelter ratio.

For purposes of this definition, similar investments organized by the same person are aggregated. For example, assume a sponsor of tax shelters develops generally similar investment plans or arrangements involving 8 different partnerships, each investing in a different item (such as a separate master recording or film), each with a different general partner, and each with 3 limited partners. If each partner invests $1,000 cash and $10,000 in nonrecourse obligations, there will be 32 investors (1 general partner plus 3 limited partners times 8 partnerships) and an aggregate investment of

$352,000 (32 partners times $11,000). Thus, each partnership will constitute part of a substantial investment. If, in this example, representations are made that $1,000 in tax credits and $3,000 in deductions are available to each limited partner in the first year, the sponsor will be required to register all of the partnerships.

The Secretary is given authority to issue regulations to provide exemptions from registration. The conferees intend that this authority be exercised to exclude only transactions with respect to which registration would not be useful to the Internal Revenue Service. The Secretary is also given authority to provide necessary and appropriate rules to carry out the purposes of this provision with respect to foreign tax shelters.

The conferees emphasize that none of the terms used in this new provision is intended necessarily to be limited to the meaning ascribed to it under Federal or State laws regulating securities. For example, the term "offered" as used in this provision refers to any representation, whether oral or written, relating to the tax shelter; it includes any advertisement relating to the tax shelter. An act may constitute an offer for sale under this provision which does not constitute an offer under Federal or State securities laws. Similarly, the term "filing of a notice" refers to any provision of a document to any Federal or State agency regulating securities in connection with offerings or sales of investments even if provision of the document is not required by the agency.

The conferees anticipate that the Internal Revenue Service will provide for registration using a form which will require that information such as the following be provided: identifying information relating to the tax shelter and the organizer, the type of business organization of the shelter and its accounting method, information concerning the business activities and principal asset of the shelter, the form and source of financing, information regarding Federal or State securities registration, the tax shelter ratio, the number and cost of investment units available, the acquisition cost per unit, and the date the first unit may be offered for sale. The conferees anticipate that the Secretary will require this form to be filed in machine-readable format under his present law authority to require that returns be filed on magnetic media or in another machine-readable format. The conferees believe that registration will become a routine task during the organization of tax shelters.

The conference agreement also provides that the Secretary may require that, when a promoter discloses to potential investors the fact of registration with the Internal Revenue Service, the promoter and seller must also indicate that this registration does not imply approval of the investment or of the claimed tax benefits by the Internal Revenue Service.

Any person who claims any deduction, credit, or other tax benefit by reason of a tax shelter that is required to register must include the tax shelter identification number on the return claiming the benefit in the manner the Secretary requires. This could be done, for example, by requiring that the number be included next to the location on the return where the benefit was claimed, or by requiring that it be included on a separate form to be attached to the return. It can also be required to be attached to an application for a tentative refund ("quickie refund").

The penalty for failure to register is the greater of $500 or 1 percent of the aggregate amount invested in the shelter, up to a maximum of $10,000 with respect to any one shelter. The maximum does not apply in cases of intentional disregard of the registration requirement. No penalty is imposed if the failure to register is due to reasonable cause. Reasonable cause for failure to register not later than the day on which the first offering for sale of interests in the shelter occurs would generally exist with respect to a person who participates in the sale of an investment and who is required to register the investment under new section 6111(d)(1)(C) if this person registered the shelter as soon as practicable after discovering that the investment had not been registered under new section 6111(d)(1)(A) or (B). Persons (such as promoters) required to furnish an identification number and who fail to do so are subject to a penalty of $100. The penalty for each failure by the investor to furnish the number on its tax return is $50, unless the failure is due to reasonable cause.

Registration is required for any tax shelter with respect to which any interest is first sold to an investor on or after September 1, 1984. Only the aggregate of interests which may be offered for sale on or after September 1, 1984, must be considered in determining whether a substantial investment would be required to register. This will occur when there are expected to be 5 or more investors on or after September 1, 1984, and the aggregate amount which may be offered for sale on or after September 1, 1984, exceeds $250,000. If a shelter is required to be registered, the tax shelter identification number must be furnished to all investors, regardless of whether they invested before, on, or after September 1, 1984. With respect to interests sold before September 1, 1984, however, the number must be furnished by December 31, 1984. The Secretary would not have authority to postpone the effective date.

b. Promoter lists

Present law

There is no specific requirement that promoters and sellers of tax shelters maintain lists of investors that are available for inspection by the Internal Revenue Service. Thus, when the Internal Revenue Service identifies an abusive tax shelter, it may be able to identify taxpayers who invested in the shelter only through enforcement of summonses or not at all.

House bill

The House bill provides that anyone who organizes or sells an interest in a tax shelter must keep a list, in the manner and to the extent provided in regulations, of each person who was sold an interest in the shelter. A tax shelter is defined as any plan or arrangement that the Secretary determines (by regulations) has the potential for tax avoidance or evasion. The organizer or seller of the shelter is subject to a penalty of $50 for each failure to include a person on a list, up to a maximum of $50,000 in any calendar year. The provision is effective on the date of enactment.

Senate amendment

The Senate amendment provides that tax shelter promoters must maintain lists of investors in each separate promotion. Exceptions are provided from the listing requirement for promotions of partnerships or S corporations. Also, the Secretary is to provide regulations to eliminate duplicative lists. A tax shelter is defined as any plan or arrangement with respect to which representations of tax benefits are made. The penalty provision is the same as that of the House bill. The provision is effective with respect to sales and organizations occurring after December 31, 1984.

Conference agreement

The conference agreement contains a modified form of the House bill and the Senate amendment. Thus, any person who organizes any potentially abusive tax shelter or who sells any interest in such a shelter must maintain lists of purchasers. The list will include the name, address, and taxpayer identification number of the purchaser, as well as any other information that the Secretary may, by regulations, require.

In particular, the conference agreement requires that any promoter or seller of a tax shelter for which registration is required must maintain lists of the persons purchasing an interest in the tax shelter and must make these lists available to the Internal Revenue Service when requested. The agreement also permits the Secretary to require (by regulations) that organizers and sellers of other tax shelter arrangements that have a tax avoidance potential maintain customer lists, regardless of whether the Secretary also extends the registration requirement. In designating these other arrangements, the Secretary may, for example, specifically identify types of investments, or he may provide that any investment falling within a modified form of the definition of tax shelter for registration purposes is subject to the listing requirement. The Secretary may exercise this authority by requiring, for example, that any plan or arrangement that would be subject to tax shelter registration if the tax shelter ratio were 1 to 1 rather than 2 to 1 must maintain lists of investors.

If a potentially abusive tax shelter is sold in a series of transactions, a list of customers must be maintained at each level in the series. For example, if a tax shelter organizer develops several types of tax shelters which he sells to several promoters, the organizer must maintain lists identifying the promoters. When the promoters sell the tax shelters to investors, the promoters must similarly maintain lists identifying the investors. If an investor sells his interest to another investor, the selling investor must maintain information identifying the purchasing investor. The Secretary may provide that the selling investor may obtain less identifying information than would otherwise be required on the buying investor or may maintain that information for a shorter period of time than 7 years, so long as those rules also prevent abuse by taxpayers attempting to avoid the purpose of this provision, which is to facilitate clear identification of all purchasers of potentially abusive tax shelters.

The provision is effective with respect to any interest sold for the first time to an investor on or after September 1, 1984. Thus, if an investor sells an interest he bought before September 1, 1984, to another investor on or after September 1, 1984, the seller is not required to maintain lists. If a promoter sells some interests to investors before September 1, 1984, and other interests on or after that date, the promoter must maintain lists of all sales occurring on or after September 1, 1984. The sale of an entity by an organizer to another organizer or promoter is not considered to be a first sale. Thus, if an organizer sells an entity before September 1, 1984, to another organizer or promoter ("the buyer"), and the buyer sells interests in the entity on or after September 1, 1984, the buyer must maintain lists of customers.

No inference should be drawn from the conference action that there is any restriction placed on the authority of the Secretary under present law to require that books and records be kept, to prescribe the form in which those books and records must be kept, or to obtain customer lists through use of administrative summonses.

c. Increase in penalty for promoting abusive tax shelters

Present law

A promoter who, in connection with the organization or sale of a tax shelter, makes false or fraudulent statements or gross valuation overstatements is liable for a penalty of the greater of $1,000 or 10 percent of the income derived or to be derived from the organization or sale.

House bill

The House bill increases the penalty from 10 percent to 20 percent of the income derived or to be derived from the organization or sale. The increase is effective on the date of enactment.

Senate amendment

The Senate amendment increases the penalty to the greater of $2,000 or 20 percent of the income derived or to be derived from the activity. It also provides that making or furnishing a statement or a gross valuation overstatement incidental to the activities or operation of an abusive tax shelter is subject to this penalty. This change will make these activities subject to injunction under section 7408. These changes are effective for actions occurring after the date of enactment.

Conference agreement

The conference agreement follows the House bill with respect to the increase in the penalty from 10 to 20 percent. With respect to statements incidental to the operation of an abusive tax shelter, the conference agreement provides that activities subject to the penalty for aiding the understatement of tax liability under section 6701 will be subject to injunction under section 7408. The conferees believe that this more directly accomplishes the intention of the Senate amendment without limiting injunctive relief solely to promoter activities. Injunctive relief can be granted with respect to activities subject to penalty under either section 6700 or section 6701, or both, as appropriate. Both amendments take effect on the day after the date of enactment.

No inference should be drawn that the general injunctive power of the district courts under section 7402(a) is, in any way, limited by the action to enjoin promoters of abusive tax shelters (sec. 7408) or the action to enjoin income tax return preparers (sec. 7407). This is in accordance with *U.S.* v. *Landsberger*, 692 F.2d 501 (8th Cir., 1982).

d. Increased rate of interest for tax shelter cases

Present law

Interest must be paid by the taxpayer on underpayments of tax and by the United States on overpayments of tax at the statutory rate (generally, the prime rate, compounded daily). There is no different interest rate for tax shelter cases.

House bill

No provision.

Senate amendment

In the case of tax shelter items, the rate of interest paid to taxpayers on refunds or due the IRS on underpayments is 150 percent of the statutory rate (generally, the prime rate, compounded daily). This rule applies to items arising from any plan or arrangement the principal purpose of which is the avoidance or evasion of tax in which more than 34 persons participate. The provision is effective for interest accruing after December 31, 1984.

Conference agreement

The conference agreement contains a modified form of the Senate amendment, which increases the interest rate on tax shelter underpayments to 120 percent of the otherwise applicable rate and modifies the definition of tax shelter in the Senate amendment.

The increased interest rate applies to an underpayment of tax attributable to one or more tax motivated transactions, if the amount of the underpayment exceeds $1,000. A tax motivated transaction is (1) any valuation overstatement of 150 percent or more, (2) any activity with respect to which a loss or an investment tax credit is disallowed by reason of the at-risk rules, (3) any tax straddle, or (4) any use of any accounting method specified in regulations as potentially resulting in a substantial distortion of income. The conferees anticipate that the following deductions and other claimed tax benefits might be considered by the Secretary to arise from accounting methods that may result in a substantial distortion of income:

(1) Deductions disallowed under section 464, relating to farming syndicates;

(2) In the case of a cash method taxpayer, interest deductions disallowed under section 461(g), relating to prepaid interest;

(3) Interest deductions disallowed because they exceed the effective rate of interest, such as under the rule of 78's;

(4) Improper deductions for syndication expenditures;

(5) Deductions disallowed under section 267(a)(2), relating to transactions between related taxpayers with different accounting methods;

(6) Failure to take into account deferred rental payments in accordance with the principles section 467, as added by this Act; and

(7) Deductions disallowed under the principles of section 461(i), as added by this Act, relating to prepayments of expenses by tax shelters.

In addition, the Secretary is given regulatory authority to specify other types of transactions that will be treated as tax motivated. He shall take into account the ratio of tax benefits to cash invested, the method of promoting this type of transaction, as well as other factors he considers relevant.

The provision is effective with respect to interest accruing after December 31, 1984, regardless of the date the return was filed.

The conferees note that a number of the provisions of recent legislation have been designed, in whole or in part, to deal with the Tax Court backlog. Examples of these provisions are the increased damages assessable for instituting or maintaining Tax Court proceedings primarily for delay or that are frivolous or groundless (sec. 6673), the adjustment of interest rates (sec. 6621), the valuation overstatement and substantial understatement penalties (secs. 6659 and 6661), and the tax straddle rules (secs. 1092 and 1256). Additionally, the conference agreement did not follow the provision of the House bill permitting certified public accountants and enrolled agents to represent a taxpayer in a small tax case because the Tax Court stated that permitting this would jeopardize the integrity of the small tax case process, which is working well.

The conferees believe that, with this amendment, the Congress has given the Tax Court sufficient tools to manage its docket, and that the responsibility for effectively managing that docket and reducing the backlog now lies with the Tax Court. The positive response that the Court has made to several recent GAO recommendations is encouraging and the conferees expect the Court to implement swiftly these and other appropriate management initiatives. The conferees also note favorably the steps the Court has begun to take in consolidating similar tax shelter cases and dispensing with lengthy opinions in routine tax protester cases. The Court should take further action in these two areas, as well as to assert, without hesitancy in appropriate instances, the penalties that the Congress has provided.

The Internal Revenue Service also has significant responsibilities in reducing the Tax Court backlog. The Service's settlement policy should be fair and flexible, and only appropriate cases should be litigated. Although in the recent past the Service has offered to settle many tax shelter cases by permitting taxpayers to deduct out of pocket expenses, the Service no longer routinely offers this as a settlement. This is a constructive change in policy, in that a taxpayer should not expect to be able to deduct out of pocket expenses regardless of the circumstances of his case. The Service should assert, without hesitancy in appropriate circumstances, the penalties that the Congress has provided. In particular, the negligence and fraud penalties are not currently being applied in a large number of cases where their application is fully justified. The conferees note with approval the steps the Service has recently taken to eliminate the backlog in the Appeals Division.

2. Information reporting provisions

a. Returns relating to mortgage interest received in a trade or business

Present law

There is no requirement that recipients of mortgage interest report interest received to the Internal Revenue Service.

House bill

A person who, in the course of his trade or business, or a governmental agency that receives interest on obligations secured by real property must report to the Internal Revenue Service payments from a payor aggregating $600 or more and provide a copy of that report to the payor. Present law penalties for other failures to file information returns and furnish statements apply (generally, $50 per failure except in cases of intentional disregard). The provision is effective with respect to amounts received after December 31, 1984, except that no penalty is imposed on persons reporting for failure to furnish identification numbers with respect to an obligation in existence on December 31, 1984, for amounts received before January 1, 1986.

Senate amendment

The Senate amendment generally is the same as the House bill, except that the reporting threshold is $2,300 and the provision is effective with respect to amounts received after December 31, 1984, and except for technical differences.

Conference agreement

The conference agreement follows the House bill, with modifications. Thus, recipients of $600 or more of mortgage interest with respect to any obligation secured by real property will be required to report that interest to the Internal Revenue Service. The conferees choose the lower reporting threshold of the House bill because more complete reporting reduces the likelihood that the Internal Revenue Service will have to contact a taxpayer concerning claimed deductions.

At the same time, the agreement seeks to eliminate any unnecessary burden to interest recipients. The agreement provides that reporting is required only on payments received from an individual. Under the agreement, the $600 aggregate annual reporting threshold will apply on an obligation by obligation basis. Interest received on two different obligations secured by the same real property does not have to be aggregated into one report; thus, interest on each obligation may be reported separately. The agreement also provides that the Secretary may provide exceptions from this reporting requirement where such exceptions are consistent with effective reporting of mortgage interest and the matching of these reports with a specific line on the tax return. Therefore, the Secretary may, if he considers it appropriate, provide for an exception from reporting for interest paid on credit cards that are secured by real property. This exception would be appropriate if the Secretary determines that such interest is most likely to show on returns as interest on credit cards rather than home mortgage interest. The conferees do not intend that the Secretary except from reporting interest that is reported on Schedule A as home mortgage interest. The agreement also provides the Secretary with authority to issue regulations to eliminate duplicative reports.

The conferees anticipate that recipients of mortgage interest will require the payor to furnish his taxpayer identification number as part of the mortgage loan approval or closing process for mortgage loans entered into after December 31, 1984.

With respect to mortgage loans in existence on December 31, 1984, the conferees anticipate that the Secretary will require recipients of mortgage interest to request, at least once a year, from each payor the payor's taxpayer identification number, unless the recipient already has the payor's number in its accounting system. The conferees anticipate that the Secretary will permit these requests for a payor's taxpayer identification number to be included in the recipient's regular mailings of either payment coupon booklets or annual statements to the payor. Recipients will not be required to make separate mailings of these requests, unless the recipient does not otherwise contact the payor at least once each calendar year. The conferees anticipate that the first request will be made as soon as practicable, but in no event later than with the first mailing by the recipient to the payor in 1985. The conferees also anticipate that recipients will notify payors that the Internal Revenue Service requires the payor to furnish its taxpayer identification number in order to verify the payor's deduction for mortgage interest and that the payor is subject to a $50 penalty by the Internal Revenue Service if the payor fails to furnish its taxpayer identification number. If the interest recipient makes the annual requests described above, and properly and promptly processes the responses, it will not be subject to any penalty for failure to include a TIN on its information return to the Internal Revenue Service because the payor's failure to supply the requested number will constitute reasonable cause for failure to supply the number to the Internal Revenue Service.

The conferees intend that the Secretary coordinate the requirement that a statement be furnished to the payor under this provision with other requirements, such as those of Federal mortgage programs, that similar statements be furnished, so that duplicative reporting is minimized.

b. Returns relating to cash received in a trade or business

Present law

Under the Bank Secrecy Act, certain banks and other financial institutions are required to report cash transactions of more than $10,000.

House bill

No provision.

Senate amendment

A person engaged in a trade or business who receives, in the course of the trade or business, $10,000 or more in cash or foreign currency in one or more related transactions must report it to the Internal Revenue Service and provide a statement to the payor. Amounts required to be reported under the Bank Secrecy Act are excepted from this reporting requirement. Present law penalties for other failures to file information returns and statements apply (generally, $50 per failure except in cases of intentional disregard). The provision is effective for amounts received after December 31, 1984.

Conference agreement

The conference agreement generally follows the Senate amendment. Thus, reporting is required only for payments of more than $10,000 that are received by a person in the course of his trade or business. Reporting is not required on payments (a) that are received in a transaction reported under the Bank Secrecy Act if the Secretary determines that the report under this provision would duplicate the report under Bank Secrecy, or (b) that are received by certain specified financial institutions within the meaning of the Bank Secrecy Act.

With respect to these specified financial institutions, the conferees do not intend to affect the detailed reporting rules and exceptions which Treasury has developed. The other categories of financial institutions that are not specified as exempt from reporting under this provision have generally been exempted by Treasury from Bank Secrecy reporting. Examples of these other entities are certain dealers in precious metals, stones, or jewels, pawnbrokers, loan or finance companies, insurance companies, and travel agencies. These entities are required to report under this new provision. To the extent that Treasury also requires that they report transactions under Bank Secrecy, the Secretary can provide that duplicative reports that would be made on those transactions pursuant to this provision need not be made.

The conferees understand that the Treasury is considering extending certain Bank Secrecy Act reporting to casinos and other establishments. To avoid duplicative reporting requirements, the Secretary has discretion under the conference agreement and the Bank Secrecy Act to review the obligations imposed under the Bank Secrecy Act and to eliminate any reporting required under the conference agreement if the Bank Secrecy reporting, in substance, provides for the reporting of transactions required to be reported under the conference agreement with respect to the information that must be provided to the Treasury.

Under this provision, any taxpayer required to report under this provision who is in a trade or business and who, in the course of the trade or business, receives more than $10,000 in cash in one or more related transactions must report those transactions. For example, assume that an individual purchases a $8,000 item and a $1,500 item at an auction. The auction house adds a 10% buyer's premium and the local sales tax, at a 5% rate. The taxpayer pays his $10,972.50 bill in cash. The auction house must report on that transaction. The auction house could not avoid the reporting requirement by presenting two separate bills of $9,240 and $1,732.50.

c. Provisions relating to individual retirement accounts

Present law

The trustee of an IRA is required to report to the IRS and to the owner of the IRA on contributions or withdrawals made. Each failure to provide a report on a contribution or withdrawal is subject to a $10 penalty. Contributions must be made by the due date (including extensions) of the return for the year to which the contributions relate.

House bill

The report must identify the years to which IRA contributions relate, effective for contributions made after April 15, 1984, relating to years beginning after December 31, 1983. The penalty is increased to $50 for each failure to provide a report on contributions or withdrawals, effective on the date of enactment.

Senate amendment

The report must identify the years to which IRA contributions relate effective for contributions made after 30 days after enactment for taxable years beginning after December 31, 1983. The penalty is increased to $50 for each failure to provide a report on contributions or withdrawals, effective on the date of enactment. Contributions must be made by the due date of the return (without extensions), effective for contributions made more than 30 days after the date of enactment, for taxable years beginning after December 31, 1983.

Conference agreement

The conference agreement follows the Senate amendment, except that the provision is effective for contributions made after December 31, 1984. The conferees wish to clarify that the trustee may require that the owner of the IRA certify as to which year a contribution relates and that, except in unusual circumstances, the trustee may rely on that certification.

The date by which this report must be provided to the Internal Revenue Service and the periods to which the report relates are to be specified by the Secretary in regulations. The conferees intend that generally trustees will be required to report only once a year on the cumulative total of contributions relating to a particular taxable year. The Secretary may, however, provide for more frequent reporting if he determines that it is appropriate to do so. As to the date by which the report must be provided to the Internal Revenue Service, the Secretary could, for example, require reporting by the end of May on all IRA contributions relating to the taxable year with respect to which the individual's tax return was due on the preceding April 15.

d. Returns relating to foreclosures and abandonments of security

Present law

There is no specific requirement of reporting on foreclosures and abandonments of security.

House bill

Under the House bill, any person who, in connection with a trade or business, or any government agency that acquires in full or partial satisfaction of indebtedness any interest in property that is security for the indebtedness or has reason to know that the property that is security for the indebtedness is abandoned, must report the foreclosure or abandonment to the IRS and the payor. No reporting is required if the indebtedness is less than $15,000 or arises from consumer loans for personal property. Present law penalties for other failures to file information returns and statements apply (generally, $50 per failure except in cases of intentional disregard). The provision is effective for foreclosures and abandonments after December 31, 1984.

Senate amendment

The Senate amendment is generally the same as the House bill, except that there are no exceptions for consumer loans or loans of less than $15,000. Additionally, the Senate amendment requires that a taxpayer allowed a bad debt deduction or an addition to a reserve for bad debt must report the deduction or addition to the Internal Revenue Service and to the payor.

Conference agreement

The conference agreement follows the House bill, except that the exception from reporting for indebtedness of less than $15,000 is removed. The exception for consumer loans is retained.

e. Returns relating to exchanges of partnership interests

Present law

A sale or exchange of a partnership interest generally is treated as a sale or exchange of a capital asset. However, sales or exchanges of partnership interests involving unrealized receivables or appreciated inventory will result in ordinary income (to the extent of the receivables and inventory) to the transferor. There is no reporting required on exchanges of partnership interests.

House bill

The transferor partner must notify the partnership of the sale or exchange of a partnership interest involving unrealized receivables or appreciated inventory. Once the partnership has been so notified, it must report to the IRS, the transferor, and the transferee on the sale or exchange. Present law penalties for other failures to file information returns with the IRS and to furnish statements to taxpayers apply to failures by the transferor partner to report to the partnership and to failures by the partnership to report to the IRS, the transferor, and transferee. The provision is effective for exchanges after December 31, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

f. Statements required in the case of certain substitute payments

Present law

There is no reporting required on substitute payments if a broker lends securities of a customer held in street name in connection with a short sale. If in a short sale there is a payment of interest or dividends on the borrowed obligation, the borrower generally is required to make a payment to the lender of the obligation in lieu of the interest or dividends (a "substitute payment"). Absent reporting, the dividends received deduction or an interest exclusion may be claimed twice, even though only the purchaser in the short sale is entitled to the deduction or exclusion.

House bill

A broker is required to furnish a statement to the taxpayer if the broker lends securities for use in a short sale and the broker receives a dividend payment relating to the securities on behalf of the customer. The provision is effective for payments made after December 31, 1984.

Senate amendment

A broker is required to furnish a statement to the taxpayer if the broker lends securities for use in a short sale or similar transaction and the broker receives a dividend payment, tax-exempt interest, or other items that the Secretary prescribes by regulations, relating to the securities on behalf of the customer. The Secretary is given regulatory authority to require that a copy of the statement be furnished to the Secretary. The conferees expect the Secretary to exercise this authority for all types of payments with respect to which such a copy could be useful to the Secretary. The Secretary should also provide that no return regarding payments of dividends (sec. 6042(b)(1)(B)) need be made if it unnecessarily duplicates any return required to be made under this provision. This provision is effective for payments after December 31, 1984.

Conference agreement

The conference agreement follows the Senate amendment.

g. Reporting of State and local tax refunds

Present law

State and local governments must report to the IRS all tax refunds greater than $10. In addition, they must furnish a statement reporting the amount of the refund to the taxpayer in January of the year following the year of the refund.

House bill

The House bill codifies existing regulations by providing that no reporting to the Internal Revenue Service or the taxpayer is required if the taxpayer did not itemize deductions. Reports relating to itemizers must be furnished in January of the year following the year of the refund. The provision is effective for payments of refunds made after December 31, 1982.

Senate amendment

The Senate amendment provides that statements to taxpayers can be provided with the payment of the refund rather than in January of the year following the year of the refund and maintains the present law requirement of reporting to the Internal Revenue Service and the taxpayer of all tax refunds. It also provides penalties parallel to present law penalties for failures to furnish other statements to taxpayers (generally, $50 per failure except in cases of intentional disregard). The provision is effective for payments of refunds made after the date of enactment.

Conference agreement

The conference agreement follows the House bill, with a technical modification providing that no statement is required to be furnished to the taxpayer if the taxpayer did not itemize deductions. All refunds, whether made to itemizers or non-itemizers, however, still must be reported to the Internal Revenue Service. The conferees anticipate that reporting to the Internal Revenue Service will not be burdensome on the States since most States have entered into exchange of information agreements that already provide that this information is to be furnished to the Internal Revenue Service. The conferees emphasize their belief that reporting by the State and local governments to the taxpayer in January is a significant compliance tool. The conferees anticipate that the Secretary would seriously consider terminating any exchange of returns or return information under section 6103 with a State that does not report refunds to the taxpayer.

The provision is effective with respect to payments of refunds, and credits and offsets made, after December 31, 1982. However, the conferees expect that no punative action will be taken against any State or local government or any officer or employee of a State or local government who failed to provide, before January 1, 1985, to taxpayers a statement required to be made under this provision.

h. Furnishing of TIN under backup withholding

Present law

Under the Interest and Dividend Tax Compliance Act of 1983, backup withholding applies unless a taxpayer's identification number is supplied "in the manner required."

House bill

No provision.

Senate amendment

The Senate amendment codifies existing regulations by providing that the Secretary's authority to require that a TIN be furnished under penalties of perjury is restricted to interest, dividends, patronage dividends, and amounts subject to broker reporting. The provision is effective on the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

3. Other compliance provisions

a. Modifications to charitable contribution rules and incorrect valuation penalties

Present law

Substantiation requirements

Present law provides expressly that a charitable contribution is deductible only if verified in the manner required by Treasury regulations (sec. 170(a)(1)). There are no specific statutory requirements that donors must obtain appraisals to verify the fair market value of donations of property, or that donees which resell donated property must furnish information reports to the IRS and the donor.

Overvaluation penalties

Present law imposes a graduated penalty for valuation overstatements on income tax returns (sec. 6659), including overvaluations of charitable donations, as follows—

(1) for claimed valuations of 150 percent or more, but not more than 200 percent, of the correct value, 10 percent of the tax liability understatement;

(2) for claimed valuations of 200 percent or more, but not more than 250 percent, of the correct value, 20 percent of the tax liability understatement; and

(3) for claimed valuations exceeding 250 percent of the correct value, 30 percent of the tax liability understatement.

The penalty does not apply if the tax liability underpayment is less than $1,000, or if the overvalued property had been held by the taxpayer for more than five years. (The penalty does apply in instances where a value is claimed for a charitable donation of property but in fact no property was actually contributed.) The IRS may waive the penalty for good faith valuations having a reasonable basis. The penalty does not apply to undervaluations for estate and gift tax purposes.

House bill

No provision.

Senate amendment

Substantiation requirements

Section 170 is amended to provide that individual (and certain corporate) donors must obtain an independent appraisal, and attach a summary of the appraisal to the return, where the claimed value of donated property exceeds $2,000 ($5,000 under an aggregation rule). The appraisal requirement does not apply for donations of securities for which market quotations are readily available on an established securities market.

For failure to comply with the appraisal requirements, the taxpayer's deduction is reduced under the Senate amendment by the greater of (i) the amount of appreciation or (ii) 10 percent of the deduction otherwise allowable. However, the IRS, in its discretion, could waive this disallowance if the taxpayer establishes that there was reasonable cause for failure to comply.

If the donee charity sells property for which an appraisal is required within two years after receipt, the donee must file an information report on such sale with the IRS and provide a copy to the donor.

These provisions are effective for contributions made after 1984.

Modifications to incorrect valuation penalty

The section 6659 penalty is modified by deleting the exception for property held for more than five years, and by extending the penalty to incorrect valuations for estate and gift tax purposes, effective for returns filed after 1984.

The penalty is extended to undervaluations for estate and gift tax purposes by providing that if the claimed value of any property is 66⅔ or less of the correct value, a graduated penalty applies as follows—

(1) For claimed valuations of 66⅔ or less, but not less than 50 percent, of the correct value, 10 percent of the tax liability understatement;

(2) For claimed valuations of less than 50 percent but not less than 40 percent of the correct value, 20 percent of the tax liability understatement;

(3) For claimed valuation of less than 40 percent of the correct value, 30 percent of the tax liability understatement. The penalty does not apply if the tax liability underpayment is less than $1,000. The IRS may waive the penalty for good faith valuations having a reasonable basis.

Disallowance rule for charitable deduction overvaluations

Under the Senate amendment, a sliding-scale charitable deduction disallowance rule applies (in addition to the overvaluation penalty) if the claimed value of donated property that is subject to the appraisal requirement exceeds the correct value by at least 50 percent, as follows—

(1) for claimed overvaluations of 150–175 percent of the correct value, one-half of the appreciation is disallowed;

(2) for claimed overvaluations of 175–200 percent of the correct value, all the appreciation is disallowed; and

(3) for claimed overvaluations exceeding 200 percent of the correct value, no deduction is allowed.

This provision applies to returns filed after 1984.

Conference agreement

Substantiation requirements

The conference agreement follows the Senate amendment, with the following modifications:

(1) In lieu of amending section 170 to set forth therein the substantiation requirements and to provide a special sanction for failure to comply, the conference agreement requires (by statutory provision outside the Code) that the Treasury Department must issue temporary or final regulations under section 170 before January 1, 1985 incorporating the substantiation requirements as set forth in this section of the conference agreement. Accordingly, pursuant to present law (sec. 170(a)(1)), which expressly allows a charitable deduction only if the contribution is verified in the manner specified by Treasury regulations, no deduction is allowed for a contribution of property for which an appraisal is required under the conference agreement unless the appraisal requirements are satisfied.

(2) The conference agreement increases the dollar threshold for the appraisal requirements from $2,000 to $5,000 for a single item of property ($10,000 in the case of stock), and deletes the aggregation rule in determining dollar thresholds except for similar items of property donated to one or more charities.

(3) The conference agreement limits applicability of the donee reporting requirement to dispositions of donated property where the claimed value of such property (or of all similar items of donated property) exceeds $5,000, whether donated to one or more charities.

Under the conference agreement, the substantiation requirements which must be set forth in Treasury regulations are as follows. These requirements apply to charitable contributions made after December 31, 1984.

General rule

The statute imposes appraisal and information reporting requirements where the amount claimed as a charitable deduction exceeds certain dollar amounts for a charitable contribution of property, other than contributions of securities for which (as of the date of the contribution) market quotations are readily available on an established securities market (referred to as "publicly traded securities"). These requirements apply to charitable deductions claimed under section 170 by an individual, a closely held corporation, or a personal service corporation. In the case of partnerships or S corporations, the requirements apply where a partner or S corporation shareholder includes a deduction on his or her return on account of a charitable contribution of such property by the partnership or S corporation.

The donor appraisal requirements apply if the amount claimed as a charitable deduction by the taxpayer on his or her return for a year exceeds $5,000 for any single item of such property ($10,000 in the case of a donation of stock other than publicly traded securities), or in the aggregate for similar items of property (such as a group or number of stamps or coins, lithographs, or books), whether donated to one or more donees. For example, the substantiation requirements apply if the taxpayer claims on his or her return for the year a deduction of $2,000 for rare books given to College *A*, $2,500 for rare books given to College *B*, and $900 for rare books given to College *C*. The donee information reporting requirements apply if the amount claimed as a charitable deduction by the taxpayer on his or her return for a year exceeds $5,000 for any single item of such property (with no higher amount in the case of donations of stock) or in the aggregate for similar items of property donated to one or more donees.

Deductions for cash donations or for donations of property not subject to the substantiation rules of the bill remain subject to any substantiation requirements prescribed pursuant to regulations under section 170.

Appraisal

For donations of property as to which the donor appraisal requirements apply, the donor must obtain and retain a qualified written appraisal by a qualified appraiser for the property contributed and must attach a signed appraisal summary to the return on which the deduction is first claimed (with such other information as prescribed by regulations).

The appraisal must be made by a person who is qualified to make appraisals of the type of property donated. (The conferees expect that in developing the substantiation regulations, the Treasury will consult, to the extent practicable, with charitable organizations, appraisers and appraisal associations, and others.) The appraisal cannot be made by the taxpayer, a party to the transaction in which the taxpayer acquired the property, the donee, or any person related to or regularly employed by any of the foregoing. Thus, for example, a taxpayer who acquired a painting from an art dealer could not use an appraisal from that dealer, persons regularly employed by the dealer, or related persons (within the meaning of sec. 267(b)). In appropriate circumstances, an appraiser who is regularly retained by a party could be considered, pursuant to Treasury regulations, as an employee of that party for purposes of this appraisal requirement where a longstanding relationship with the appraiser would cause a reasonable person to question the independence of the appraiser.

Appraisals for which the fee is based on a percentage of the appraised value cannot qualify. However, appraisals are not disqualified where all or a portion of the fee is based on a sliding scale if the portion of the fee based on a sliding scale is paid to a generally recognized association which regulates appraisers. This exception applies only if no persons have a beneficial interest in the association.

The appraisal must include a description of the donated property, the fair market value of the property on the date of contribution, the specific basis for the valuation (e.g., comparable sales), and the qualifications of the appraiser. Also, the appraisal must state that it is being prepared for tax purposes, and must be signed by the appraiser, whose tax identification number must be listed. Accordingly, the appraiser is a person to whom the civil tax penalty for aiding and abetting an understatement of tax liability (sec. 6701) could apply.

The appraisal must be received by the donor before the due date (including extensions) of the return on which the deduction is claimed. The donor must attach to the return on which the deduction is claimed a summary of the written appraisal, with such information and in a form prescribed by the Treasury Department. The appraisal summary must be signed by the appraiser and list the appraiser's tax identification number, and must be acknowledged by the donee (see discussion below under "Information report by donee on disposition"). The donor must retain the appraisal itself.

In addition, the donor must include in the return statements of the cost basis and the acquisition date of the donated property, and any other information to the extent required by Treasury regulations. If there is reasonable cause why the donor does not have information on the cost basis or acquisition date, the donor may substitute an explanatory statement, pursuant to Treasury regulations, with the return.

Under the conference agreement, the IRS is authorized and directed by the Congress to revise the individual income tax return for 1985 to add a separate line for claiming deductions for donations of property as to which a qualified appraisal is required. The instructions for the return are to include instructions as to the appraisal requirement. If the IRS, in processing returns as filed, finds that the taxpayer claimed deductions on the separate line relating to donations of property for which a qualified appraisal is required but failed to attach the summary appraisal, then the IRS (to the extent administratively practicable) is to so notify the taxpayer and request the filing of the summary. The deduction is not disallowed for a good faith failure to comply with the substantiation requirements if the taxpayer in fact had timely obtained a qualified appraisal and furnishes the IRS with an appraisal summary.

Information report by donee on disposition

If the donee charity sells, exchanges, or otherwise transfers within two years of the date of receipt certain donated property, the donee must furnish an information report to the IRS (with a copy to the donor) setting forth the donor's name, address, and tax identification number, a description of the property, the date of contribution, the amount received on the disposition, and the date of disposition.

The donee information reporting requirements apply if the amount for which a deduction was claimed under section 170 by the taxpayer on his or her return for a contribution of property (other than publicly traded securities) exceeds $5,000 for any single item of such property or in the aggregate for similar items of such property donated to one or more donees. (There is no higher threshold with respect to stock donations.) Penalties under section 6678 apply for failure to comply with the information reporting requirements.

To facilitate the donee's carrying out of the information reporting requirement, which is based on the amount claimed by the donor on his or her return for donations of property, the regulations are to provide that the donor (as part of the donor appraisal requirements) must (1) submit the appraisal summary to the donee for the donee's acknowledgment signature and (2) inform the donee of any donations of similar items made during the same year. The donee's acknowledgment signature on the summary appraisal solely represents acknowledgment of receipt of the items described in the summary appraisal, and in no way is to be construed as indicating the donee's agreement with or acceptance of the amount claimed for the donated property on the appraisal summary. The regulations are to provide appropriate rules for situations where the donor is unable to obtain acknowledgment by the donee.

Modifications to incorrect valuation penalty

The conference agreement follows the House bill, with two further modifications (in addition to deletion of the five-year exception, and extension of the penalty to incorrect valuations for estate and gift tax purposes). The additional modifications (unlike the general modifications adopted by the conference agreement) apply only in the case of an underpayment attributable to overvaluing any property for which a deduction is claimed under section 170 other than securities for which (as of the date of the contribution) market quotations are readily available on an established securities market.

Under the first additional modification, the section 6659 penalty is increased to a flat 30 percent of the tax liability understatement where the claimed valuation is 150 percent or more of the correct value.

Under the second additional modification, the IRS may not waive any portion of the penalty unless (1) the taxpayer shows (as required under the present-law waiver provision) that there was a reasonable basis for the claimed valuation and that the claim was made in good faith, and (2) the IRS determines both that the claimed value of the property was based on a qualified appraisal made by a qualified appraiser and that, in addition to obtaining such appraisal, the taxpayer made a good faith investigation of the value of the contributed property.

Disallowance rule for charitable deduction overvaluations

The conference agreement does not include the special disallowance rule in section 154(b) of the Senate amendment.

The conferees understand that the Treasury Department remains concerned whether the substantiation and penalty provisions of the bill will prove sufficient to preclude taxpayers from overvaluing charitable donations of property. This concern relates both to tax shelter promotions which exploit the deductibility of appreciation in capital-gain assets, and to other situations where individuals buy items on their own initiative specifically for contribution after expiration of the capital gains holding period, or overvalue items which they have held for long periods before donating them to a charity.

The conferees expect the Treasury and IRS to monitor the effectiveness of the new provisions and to notify the tax-writing committees if there are any continuing valuation problems which should be addressed by legislation. In this connection, the conferees note that the Treasury has authority under section 170(a)(1) to specify by regulations the manner in which charitable contributions must be substantiated in order to be deductible. The conferees encourage the Treasury and IRS to utilize fully the compliance tools available under present law with respect to improper or overvalued claims of charitable deductions, such as negligence and fraud penalties, and other administrative procedures such as the findings of the Art Advisory Panel. Also, the conferees expect the Treasury and IRS to call the attention of the tax-writing committees to any other compliance problems relating to charitable deductions—for example, where the taxpayer or return preparers may claim a deduction based on records of checks drawn in the name of a charity, but where in fact the checks represented payments for goods (purchased directly from the charitable organization or at a fund-raising auction or bazaar) rather than charitable contributions—and to recommend any appropriate legislative solutions.

b. Authorization to disregard appraisals of persons penalized for aiding in understatements of tax liability

Present law

The Secretary of the Treasury may prescribe rules governing the admission of lawyers and accountants to practice before the Internal Revenue Service and may bar individuals from practice if he finds them to be incompetent, disreputable, or grossly negligent. Present law does not provide any comparable authority with respect to the appearance of professional appraisers in proceedings before the Internal Revenue Service.

House bill

The Secretary of the Treasury is authorized to bar from appearing before the Internal Revenue Service or the Treasury Department, for the purpose of offering opinion evidence on the value of property or other assets, any individual against whom a civil penalty for aiding and abetting the understatement of tax (sec. 6701) has been assessed. Thus, an appraiser who aids or assists in the preparation or presentation of an appraisal in connection with the tax laws will be subject to disciplinary action if the appraiser knows that the appraisal will be used in connection with the tax laws and will result in an understatement of the tax liability of another person. The Secretary is also given authority to provide that the appraisals of an appraiser who has been disciplined have no probative effect in any administrative proceeding before the Department of the Treasury or the Internal Revenue Service. The provision applies to appraisers with respect to whom penalties are assessed under section 6701 after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

c. Mailing of deposits of taxes

Present law

Employers are required to deposit taxes in any designated financial institution. They may treat a deposit as timely made if it is mailed as required 2 days prior to the due date. The mailing of deposits to remote depositories by certified or registered mail can result in delays in depositing of up to 2 weeks.

House bill

No provision.

Senate amendment

Deposits in excess of $20,000 by large employers must be made by the due date, regardless of the method of delivery. A large employer is any employer required to deposit tax more than once a month. The Senate amendment is effective for deposits required to be made after June 30, 1984.

Conference agreement

The conference agreement follows the Senate amendment, effective for deposits required to be made after July 31, 1984.

d. Interest on certain additions to tax

Present law

Interest on penalties and additions to tax is generally imposed only for the period from the date of notice and demand to the date of payment. An interest-like element is added to the negligence and fraud penalties for the period from the last day prescribed for payment of the tax to the date of assessment (or payment, if earlier). No comparable element is added to the failure to file, gross valuation overstatement, and substantial understatement penalties.

House bill

No provision.

Senate amendment

Interest is imposed on the amount of the following penalties as of the due date of the return:

(1) failure to file (sec. 6651(a)(1));

(2) gross valuation overstatement (sec. 6659);

(3) valuation understatement for purposes of the estate or gift taxes (sec. 6660); and

(4) substantial understatement (sec. 6661).

The Senate amendment is effective for interest accrued after the date of enactment with respect to penalties assessed after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

e. Penalty for fraudulent withholding exemption certificate or failure to supply information

Present law

An individual who supplies false or fraudulent withholding information or willfully fails to supply information is subject to a criminal penalty, which is in lieu of any other penalty (except a civil fine).

House bill

No provision.

Senate amendment

The Senate amendment provides that the criminal penalty for supplying false or fraudulent withholding information or willfully failing to supply information is in addition to any other penalty. Thus, for example, prosecution for willful evasion (sec. 7201) is not barred where prosecution for a false certificate (sec. 7205) is also possible. The Senate amendment is effective for acts and failures to act occurring after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment. No inference should be drawn with respect to the correct interpretation of prior law on this issue; however, to the extent that *United States v. Williams*, 644 F. 2d 696 (8th Cir., 1981)) might be considered authority to the contrary, the rationale of that decision no longer applies.

f. Penalty for frivolous proceedings before the Tax Court

Present law

Prior to the enactment of TEFRA, the Tax Court had discretionary authority to award damages of up to $500 for proceedings instituted merely for delay. TEFRA raised the maximum to $5,000 and expanded the basis of the award to include proceedings maintained for delay. These changes were not effective for cases pending in the Tax Court at the time of TEFRA's enactment.

House bill

No provision.

Senate amendment

The Senate amendment provides that expanded damages can also be awarded against taxpayers with proceedings pending before the Tax Court as of 120 days after the date of enactment, regardless of when instituted.

Conference agreement

The conference agreement follows the Senate amendment.

g. Failure to request change of method of accounting

Present law

A taxpayer is not permitted to change its accounting method without the consent of the Secretary. Some taxpayers using an improper method argue there is no requirement to request permission to change from an improper to a proper method. They assert the failure of the Secretary to consent to a change in method as a defense to any penalty arising from use of the improper method.

House bill

No provision.

Senate amendment

The Senate amendment provides that if the taxpayer does not request a change in accounting method, the absence of the Secretary's consent cannot be asserted as a defense to any penalty or addition to tax. The provision is effective for taxable years beginning after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment. No inference should be drawn with respect to the validity of the defense asserted by some taxpayers under present law.

The conferees understand that the Internal Revenue Service's general practice is to permit a taxpayer who has not been notified that its return is going to be examined and who wishes to change from an improper method of accounting to a proper method for its taxable year that includes the date of enactment, but is precluded from doing so because the deadline for requesting a change in accounting method for its current taxable year has passed, is generally not subject to a penalty arising from use of the improper method in the current taxable year, provided that the taxpayer files a request for permission to change methods as soon as practicable, but in no event later than the due date (with extensions) of the taxpayer's return for its current taxable year.

h. Clarification of change of venue for certain tax offenses

Present law

There is a conflict among the United States courts of appeal regarding the availability of transfer of venue when the mails are used as part of the offense being prosecuted. Some hold that transfer is required only when the sole basis for venue in a particular district is receipt by the Internal Revenue Service of mailed materials. Others hold that transfer is permitted when the mails are used as part of the offense, even though venue is not based on the mailing.

House bill

No provision.

Senate amendment

The Senate amendment provides that transfer of venue is required only when the sole basis for venue in a particular district is receipt by the Internal Revenue Service of mailed materials. The provision is effective on the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment. Thus, defendants will not be able to force transfer of venue to an inconvenient forum solely because the mails were used as part of the alleged offense. The conferees note that the Internal Revenue Service and the Department of Justice generally attempt to establish venue for a criminal tax prosecution in the judicial district of the taxpayer's residence or principal place of business, because prosecution in that judicial district usually has the most significant deterrent effect. The conferees do not intend a change in that general policy. The conferees also note, however, that the Service and the Department may have valid reasons for bringing a prosecution in another district. Examples of this are multiple defendant cases or cases where venue for non-tax charges is established in a district other than the place of residence or business. The conferees do not intend to restrict the Service and the Department in instances such as these.

i. Statute of limitations relating to contributions to the capital of a corporation

Present law

A contribution in aid of construction to a regulated public utility that is not included in the utility's rate base, and that is expended before the end of the second taxable year following the year of receipt, is not included in the utility's gross income. If it is not expended by the end of the second year, it is includible in the utility's income in the year of receipt. The statute of limitations is 3 years (absent fraud) from the filing of the return.

House bill

No provision.

Senate amendment

The Senate amendment extends the statute of limitations for the year of receipt with respect to the issue of the inclusion of the contribution in income and related adjustments to 3 years from the end of the second year following the year of receipt. The provision is effective for failures to meet the expenditure rule occurring after December 31, 1984.

Conference agreement

The conference agreement follows the Senate amendment with modifications. It provides that the statute of limitations for the assessment of any deficiency (and any ancillary adjustments) attributable to any contribution to the capital of a corporation does not expire before the expiration of 3 years from the date the Secretary is notified by the taxpayer that the contribution has been expended in the required manner, that the taxpayer intends not to make the required expenditure, or that the taxpayer has failed to make the required expenditure. This provision is similar to the rule that applies in the case of rollovers of gain on the sale of a principal residence (sec. 1034(j)).

j. Disclosure of returns and return information to certain cities

Present law

Disclosure of returns and return information can be made to States for tax administration purposes provided that appropriate safeguards against disclosure are provided. Disclosures to cities are not permitted.

House bill

No provision.

Senate amendment

The Senate amendment provides that any city with a population in excess of 2,000,000 that imposes a wage or income tax may, if the Secretary in his sole discretion so provides, receive returns and return information for the same purposes for which States may obtain information under present law, subject to the same safeguards as apply to States under present law. Cities that receive information must reimburse the Internal Revenue Service for its costs in the same manner as a State must under present law. Population is determined on the basis of the most recent decennial United States census data available. The Senate amendment is effective on the date of enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

k. Tax shelter study

Present law

There is no specific provision in present law requiring the Secretary to study various aspects of tax shelters.

House bill

No provision.

Senate amendment

The Senate amendment requires the Secretary to submit a report to Congress by December 1, 1984, on various aspects of tax shelters, including a minimum tax imposed on investments, at-risk and recapture rules, basis adjustment for tax credits, and deductibility of artificial accounting losses.

Conference agreement

The conference agreement does not include the Senate amendment. The conference agreement provides that the Secretary will include the substance of the Senate amendment's report in the Treasury study of alternative tax systems. (See also item XI.1. "Study of alternate tax systems.")

K. Depreciation and Related Provisions

1. Depreciation of real property

Present law

With certain exceptions, most real property placed in service by the taxpayer after 1980, can be depreciated under ACRS over as short as 15 years. In general, components of a building qualifying as recovery property must be depreciated in the same manner as the building itself. However, under section 168(e)(4), certain buildings placed in service by taxpayers after 1980, do not qualify as recovery property.

House bill

No provision.

Senate amendment

The minimum recovery period for real property (other than low-income housing) eligible for a 15-year recovery period under present law is increased. For recovery property placed in service by the taxpayer after March 15, 1984, and before January 1, 1985, the minimum recovery period is 20 years. For recovery property placed in service by the taxpayer after December 31, 1984, and before January 1, 1986, the minimum recovery period is 19 years. For recovery property placed in service by the taxpayer after December 31, 1985, the minimum recovery period is 18 years. Recovery allowances are to be determined in accordance with tables to be prescribed by the Treasury. Any property covered by the provision can also be recovered on the straight-line method over the minimum recovery period.

Numerous conforming changes are made. In addition, rules are provided relating to the depreciation of components added to buildings previously placed in service.

The provision is effective for property placed in service by the taxpayer after March 15, 1984. However, the provision does not apply to property the construction of which was commenced by the taxpayer on or before March 15, 1984. Nor does the provision apply to property that the taxpayer was under a binding contract, entered into before March 16, 1984, to construct or acquire. Furthermore, if the taxpayer transfers his rights in any such property under construction or such contract to construct or acquire property to another taxpayer, the provision does not apply to the property in the hands of the transferee-taxpayer so long as the property was not placed in service before the transfer by the transferor-taxpayer. None of the transitional rules applies unless the property is placed in service before January 1, 1987.

Conference agreement

The conference agreement generally follows the Senate amendment except that for all real property subject to the conference agreement, the minimum recovery period is 18 years. In addition, technical amendments are made in the rules regarding new components added to buildings previously placed in service.

Under the conference agreement, the recovery allowance tables to be prescribed by the Treasury under the provision are to adopt a mid-month convention. That is, real property placed in service by the taxpayer during a month is to be treated as placed in service in the middle of such month. A similar convention is to be applied for the month of disposition.

The conferees wish to clarify certain transitional rules of the Senate amendment. Assume, for example, that taxpayer A signed a binding contract on March 10, 1984 to have a building constructed. On December 1, 1984, A assigns the contract to B. On March 15, 1985, B assigns the contract to C. The building is originally placed in service by C, on November 1, 1985. It is the conferees' intent that, since neither A nor B placed the property in service, the provision not apply to the building in C's hands. Furthermore, the conferees intend that demolition is to be treated as commencement of construction if both the demolition and the formally approved plan of construction are consistent with the recommendations of a feasibility study evidenced by internal documents of the taxpayer in existence when demolition commenced.

A partnership may have commenced construction of, or signed a binding contract to acquire or construct, real property on or before March 15, 1984. Subsequently, but prior to the time the property is placed in service, interests in the partnership may be sold or exchanged. If, by reason of such sales or exchanges, there is a termination of the partnership and the creation of a new partnership under section 708(b)(1)(B) (relating to sales or exchanges of 50 percent or more of the total interests in a partnership's capital and profits), the partnership is to be treated as having transferred its rights in its contract or the property to the new partnership (through its partners) for purposes of the transitional rule.

In addition, the conferees anticipate that the Treasury will promulgate regulations applying the provision in the case of transfers of partnership interests after a partnership has placed property in service. It is contemplated that, in the case of a termination of the partnership under section 708(1)(B), the regulations will provide that the new 18-year recovery period applies to the property in the hands of the new partnership. If there is no such termination but the partnership has a section 754 election (relating to optional basis adjustments) in effect, it is contemplated that the regulations will provide that any increase in the basis of the partnership's real property will be subject to the new 18-year recovery period (other than in cases where the anti-churning rules of section 168(e)(4) apply).

Under the conference agreement, for purposes of the transitional rules, property will not be treated as placed in by a taxpayer holding such real property as section 1221(1) property (relating to inventory and similar property) merely because the property is held for rental or rented for a short period prior to the time it is sold. However, that rule will cease applying under the provision to any such property of the taxpayer held by it on January 1, 1985. No such taxpayer is entitled to take depreciation deductions with respect to such property. No inference is intended as to whether property held by a taxpayer as section 1221(1) property depreciated by the taxpayer.

The conferees also intend that, for purposes of the transitional rules, a contract with respect to the property is to be treated as binding only if it is enforceable under State law and does not limit damages to a specified amount that is relatively minor. A contract that limits damages to an amount equal to at least 5.0 percent of the total contract price will not be treated as limiting damages in an amount that is relatively small. A contract is binding even if subject to a condition, so long as the condition is not within the control of either party. For purposes of the transitional rule, a contract will not be treated as ceasing to be binding merely because any term is to be determined by a standard beyond the control of either party or there is a bilateral agreement to reduce the purchase price of the property by no more than 20 percent or change the financing terms.

Under the conference agreement, property contracted for by the taxpayer before May 1, 1984, will not be subject to the provision if bonds to finance the property were issued before 1984, and an architectural contract with respect to such property was executed before March 15, 1984.

2. Rehabilitation tax credits

Present law

Tax credits are allowed with respect to qualified rehabilitation expenditures incurred in the substantial rehabilitation of certain buildings. In the case of a building which is at least 30 years old, but not 40 years old (and not a certified historic structure), a 15-percent credit is allowed, and depreciable basis is reduced by the full amount of the credit. In the case of a building which is at least 40 years old (and not a certified historic structure), a 20-percent credit is allowed, and depreciable basis is reduced by the full amount of the credit. In the case of a certified historic structure, a 25-percent credit is allowed, and depreciable basis is reduced by only one-half of the credit.

House bill

No provision.

Senate amendment

In the case of a building which is at least 30 years old but not 40 years old (and not a certified historic structure), the credit is reduced to 10 percent (and a full basis adjustment continues to be required). In the case of a building which is at least 40 years old (and not a certified historic structure), the credit is reduced to 15 percent (and a full basis adjustment continues to be required). No change is made in the amount of the credit with respect to a certified historic building, but a full basis adjustment is required for depreciation purposes. It is clarified that the credit applies only in the case of expenditures for real property (or additions or improvements to real property).

The provision has the same effective date as the Senate amendment regarding depreciation of real property.

Conference agreement

The conference agreement does not include the provision in the Senate amendment.

3. Depreciation recapture and installment sales

Present law

In a disposition of depreciable real or personal property, some or all of the gain may be taxed at the time of the disposition as ordinary income under the depreciation recapture rules of sections 1245 and 1250. The ordinary income will equal all or a part of prior depreciation deductions taken with respect to the property involved. For example, in the case of a sale of personal property, all recognized gain generally is taxed as ordinary income under the depreciation recapture rules of section 1245 to the extent of all prior depreciation deductions with respect to the property.

If the disposition is an installment sale, generally no gain or depreciation recapture income is taxed currently if no principal payments are made or deemed made on the installment obligation currently. Depreciation recapture income is taxed only as principal payments are made on the installment obligation. Typically, a portion of each principal payment will be treated as a recovery of basis and not taxed. Generally, the portion of each principal payment not so taxed equals the amount of the payment times a fraction the numerator of which is the taxpayer's adjusted basis in the property sold and the denominator of which is the total purchase price.

Under section 453(i), relating to certain depreciable property with respect to which the taxpayer elected first year expensing, depreciation recapture income is recognized in the year of an installment sale.

House bill

No provision.

Senate amendment

In any disposition of depreciable real or personal property, all depreciation recapture income under sections 1245 and 1250 generally is recognized currently, even if the transaction is an installment sale. In determining how much of any principal payment constitutes a recovery of basis gain, the taxpayer's adjusted basis in the property disposed of is treated as including the amount of the depreciation recapture income.

The provision is effective with respect to dispositions made after March 15, 1984 (April 13, 1984, in the case of a disposition of personal property). However, the provision does not apply to dispositions pursuant to contracts which were binding on March 22, 1984 (April 12, 1984, in the case of personal property). Nor does the provision apply to dispositions pursuant to an agreement in principal before March 23, 1984.

Conference agreement

The conference agreement generally follows the Senate amendment. In addition, section 453(i) is repealed, since, with the new provision, it is no longer needed. Finally, under the conference agreement, the provision is effective with respect to dispositions after June 6, 1984.

4. Movies

Present law

Present law contemplates that qualified movies (i.e., motion picture films and video tapes created primarily for use as public entertainment or for educational purposes) are generally (1) to be depreciated under the income forecast method or a similar method, and (2) entitled, with respect to certain costs, to a 6⅔ percent investment credit under section 48(k). Present law also contemplates that other movies are generally (1) to be depreciated under the income forecast method or a similar method, and (2) entitled to no investment credit.

Existing Code language may be inconsistent with the foregoing. Some taxpayers are depreciating movies under ACRS, and some, including some who are depreciating them under an income forecast method or a similar method, are claiming regular investment credits.

House bill

No provision.

Senate amendment

Movies are not recovery property and so do not qualify for either ACRS depreciation or, except as is provided in section 48(k), the regular investment credit. These rules are effective as of the effective date of section 168. However, these rules do not apply to qualified movies placed in service before December 31, 1984, for which at least 20 percent of the costs of production were incurred prior to March 16, 1984, and for which ACRS was claimed.

The Senate amendment also provides that the general basis adjustment rules of section 48(q) apply to qualified movies but that the general at-risk rules of sections 46(c)(8) and (9) do not. These rules have the same effective dates as section 48(q) and sections 46(c)(8) and (9), respectively.

Conference agreement

The conference agreement generally follows the Senate amendment. However, the rule to the effect that movies are not recovery property does not apply to any qualified movie placed in service before March 15, 1984, if ACRS was claimed with respect to such movie on a return filed before March 16, 1984. Therefore, the provision does not itself operate to disallow investment credits with respect to any such movie. Furthermore, the rule to the effect that movies are not recovery property does not apply to any qualified movies placed in service before 1985, so long as (1) ACRS is claimed with respect to such movie, and (2) 20 percent of the production costs for such movie were incurred prior to March 16, 1984. However, investment credit with respect to any such movie is to be determined solely under the rules of section 48(k).

No inference is intended as to the proper treatment of movies under present law.

5. Sound recordings

Present law

It is unclear whether sound recordings and similar property are eligible for depreciation under the accelerated cost recovery system or for the investment tax credit. It is also unclear whether the distribution of sound recordings and similar property outside the United States causes the property to be treated as used predominantly outside the United States for depreciation or investment credit purposes.

House bill

No provision.

Senate amendment

Taxpayers are provided with two options with respect to each sound recording, generally as defined in section 280(c)(2). First, taxpayers can elect to depreciate a sound recording under the 3-year property ACRS rules and take a 6-percent investment credit (if the property is otherwise eligible for the credit), or second, they can depreciate it under the income forecast method or a similar method and take no investment credit. Unless all taxpayers with an ownership interest in the sound recording elect the first option, the second option will apply.

If the first option is elected, all capital costs, including all non-U.S. production costs, and all contingent amounts (e.g., royalties to songwriters) incurred in the year the property is placed in service or the year thereafter, are to be recovered under the rules applicable to 3-year recovery property (except that contingent amounts incurred in the second year are to be recovered over 3 years beginning with that year). Contingent amounts incurred in other years are not to be treated as 3-year property for depreciation purposes. For purposes of determining any investment credit, basis or cost includes only production costs (including contingent amounts) allocable to the United States (including possessions of the United States). However, basis or cost does not include any contingent amounts which are not eligible for treatment as 3-year property for depreciation purposes.

The rules of section 48(q) (relating to adjustments in the depreciable basis of property on account of the investment credit) apply to sound recordings, but not the general investment credit at-risk rules.

The distribution of a sound recording outside the U.S. is not to be treated as a use of the property outside the U.S.

The provision applies to sound recordings placed in service after March 15, 1984.

Conference agreement

The conference agreement follows the Senate amendment.

No inference is intended as to the proper treatment of sound recordings under present law.

L. Miscellaneous Reform Provisions

1. Tax benefit rule

Present law

Present law excludes from income amounts recovered which previously were deducted but did not produce a tax benefit. The exclusion fails to properly reflect economic reality in certain cases.

House bill

The House bill clarifies the application of the tax benefit rule with respect to the recovery of amounts previously deducted. The bill also provides for an increase in tax when amounts relating to credits are recovered. This rule does not apply to the investment tax credit or the foreign tax credit since specific rules are applicable to those credits.

The provision applies to amounts recovered after December 31, 1983.

Senate amendment

The Senate amendment is the same as the House bill, except that it does not contain the provision relating to credits.

Conference agreement

The provision generally follows the House bill. An increase in tax with respect to credits will arise only where an amount was paid or incurred, and there is a subsequent price adjustment, or similar adjustment, with respect to that amount.

No change is made to the present law rules relating to what constitutes the recovery of an item previously deducted and no inference is intended as to the scope of those rules under present law.

2. Interest-free and below-market interest rate loans

Present law

Under present law, an interest-free or below-market interest rate loan without consideration, such as a loan to a family member, results in a gift from the lender to the borrower for Federal gift tax purposes. *Dickman* v. *Commissioner*, 465 U.S. , 52 U.S.L.W. 4222 (Feb. 22, 1984). There are no cases that have directly held that such a loan also has any income tax consequences. To date, the courts have only addressed the gift tax consequences.

The Internal Revenue Service has taken the position that, in the case of an interest-free or below-market interest rate loan to an employee or shareholder (other than a loan to which section 482 applies), the borrower derives an economic benefit that should be included in income for Federal income tax purposes. Notwithstanding the Internal Revenue Service's position, the Tax Court has consistently held that these non-family interest-free or below-market interest rate loans do not result in taxable income. *J. Simpson Dean* v. *Commissioner*, 35 T.C. 1083 (1961); *Greenspun* v. *Commissioner*, 72 T.C. 931, *aff'd*, 670 F. 2d 123 (9th Cir. 1982).

House bill

Overview

Under the House bill, an interest-free or below-market interest rate loan (referred to herein as a "below-market loan") is recharacterized as an arms-length transaction in which the lender (1) made a loan to the borrower in exchange for a note requiring the payment of interest at a statutory rate, and (2) made a payment to the borrower. The payment by the lender to the borrower is treated as a gift, dividend, contribution to capital, payment of compensation or other payment depending on the substance of the transaction. The bill is generally applicable to any below-market loan unless, under regulations, it is established to the satisfaction of the Secretary that the loan does not have as one of its principal purposes the avoidance of Federal taxes. Under the bill, a demand loan is treated as a below-market loan if no interest is payable on the loan, or interest is payable at a rate less than the applicable Federal rate. A term loan is treated as a below-market loan if the amount of the loan exceeds the present value of all payments due under the loan. A demand loan is any loan which is payable in full at any time upon the demand of the lender. A term loan is any loan that is not a demand loan.

The provision applies to family loans and other below-market loans. A family loan is any below-market loan with respect to which the deemed payment by the lender to the borrower is in the nature of a gift.

Timing and amount of transfers

Loans other than family loans and demand loans

Under the House bill, in the case of any below-market loan other than a family loan or a demand loan, the lender is treated as transferring to the borrower and the borrower is treated as receiving from the lender an amount equal to the excess of the amount of the loan over the present value of all principal and interest payments due under the loan. This transfer is treated as occurring on the date the loan is made. In addition, the excess of the amount of the loan over the present value of the payments due is treated as original issue discount. As a result, the lender is treated as receiving interest income at a constant interest rate over the life of the loan. Similarly, the borrower is treated as paying the same amount of interest. The interest which the borrower is treated as paying would be deductible to the same extent as interest actually due on the loan from the borrower. Thus, no deduction would be allowed for interest if the borrower does not itemize his or her deductions for the relevant year or his or her deductions would be disallowed under other provisions of the code (e.g., sections 163(d) or 265).

Family loans and non-family demand loans

In the case of a below-market family loan or a below-market demand loan that is not a family loan, the borrower is treated as transferring to the lender and the lender is treated as receiving from the borrower an amount equal to the foregone interest on an annual basis. This foregone interest is included in income by the lender and deductible by the borrower to the same extent as interest actually due on the loan from the borrower.

In addition, in the case of a demand loan, the lender is generally treated as transferring to the borrower, and the borrower is treated as receiving from the lender, an amount equal to the foregone interest on an annual basis. In the case of a family term loan, the lender is treated as transferring to the borrower on the date the loan is made the excess of the issue price of the loan over the present value of all principal and interest payments due under the loan. The deemed transfer by the lender to the borrower is treated as a gift, a payment of compensation, a dividend, contribution to capital, or some other payment depending on the substance of the transaction. Thus, in the case of a below-market loan from one family member to another in a transaction in which the lender does not receive any other consideration for the use of its money, the transfer from the lender to the borrower would be a taxable gift. In the case of a demand loan from a closely held corporation to a controlling shareholder, the transfer would be treated as a distribution with respect to the stock of the distributing corporation and be taxed to the shareholder as a dividend to the extent of the distributing corporation's earnings and profits under section 301.

Under the House bill, the term foregone interest means, with respect to any period during which a loan is outstanding, the excess of (1) the amount of interest which would have accrued on the loan during the period if interest accrued on the loan at the applicable Federal rate, over (2) any interest actually due on the loan properly allocable to such period.

Applicable Federal rate

Under the House bill, the applicable Federal rate is a rate determined by reference to the term of the loan, as set forth below.

Term	Applicable Federal Rate
Less than 3 years	The Federal short-term rate.
Over 3 years but not over 9 years	The Federal mid-term rate.
Over 9 years	The Federal long-term rate.

The Federal rates are determined by the Secretary within 15 days after the close of 6-month periods ending on September 30 and March 31, respectively, and reflect the average market yield during such 6-month periods on outstanding marketable obligations of the United States with comparable maturities. The applicable Federal rate is compounded semiannually.

The determination reflecting the average yield for a 6-month period ending on September 30 is applicable during the 6-month period beginning on January 1 of the succeeding calendar year. The determination reflecting the average yield for the period ending on March 31 is applicable during the 6-month period beginning on the following July 1.

Under the House bill, the applicable Federal rate that is used to compute amounts of foregone interest is the rate for the day on which the loan is made. For purposes of computing amounts of foregone interest, a demand loan is treated as a series of one-day term loans. Thus, in the case of a demand loan, foregone interest must be computed on a daily basis. Further, in the case of a demand loan, the applicable Federal rate is always the Federal short-term rate.

Exceptions and limitations

Exceptions for non-tax motivated transactions

The House bill provides that, under regulations to be prescribed by the Treasury, the provision does not apply to a loan if it is established to the satisfaction of the Secretary that the loan does not have as one of its principal purposes the avoidance of any Federal taxes.

Special limitations for family loans

Under the House bill, in the case of a family loan, the amount treated as transferred by the borrower to the lender is limited to the amount of income, if any, realized by the borrower which is attributable to the loan.

Other exceptions

The bill provides that the provision does not apply to any loan to which sections 483 or 1274 apply.[7]

Regulations

Under the House bill, the Treasury is directed to prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including (but not limited to) regulations providing for adjustments to the provisions for cases in which, by reason of varying rates of interest, conditional interest payments, waivers of interest, or other circumstances, the provisions of this section do not carry out its purposes.

Effective dates

In general, the provisions of this section apply to term loans made after March 1, 1984, and to amounts outstanding on demand loans after such date. However, a demand loan outstanding prior to March 1, 1984, will not be subject to the provision if it is repaid prior to the 60th day after the date of enactment. Any renegotiation, extension, revision or modification of any of the terms of a loan after March 1, 1984, is treated under the bill as the issuance of a new loan.

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[7] Below-market loans that are made in connection with transactions to which sections 483 or 1274 apply are to be governed by those sections.

Senate amendment

Overview

Generally, the Senate amendment follows the approach of the House bill in that under the Senate amendment a below-market loan is recharacterized as an arms-length transaction in which the lender (1) made a loan to the borrower in exchange for a note requiring the payment of interest at a statutory rate, and (2) made a gift, distributed a dividend, made a contribution to capital, paid compensation, or made another payment to the borrower which, in turn, is used by the borrower to pay the interest. The Senate amendment, however, applies to gratuitous transactions (referred to as "gift loans"), certain specifically enumerated categories of non-gratuitous transactions,[8] and other transactions only under regulations. Further, the Senate amendment provides specific exceptions for certain loans. Under the Senate amendment any loan described in one of the enumerated categories or in regulations is subject to the provision unless one of the specific exceptions is applicable.

Timing and amount of transfers

Gift loans

With respect to gift loans, the Senate amendment generally adopts the approach of the House bill to family loans and demand loans.

Non-gift loans

For non-gift loans that are term loans, the Senate amendment generally adopts the approach of the House bill for loans other than family loans and demand loans. For non-gift loans that are demand loans, the Senate amendment generally adopts the House bill approach to family loans and demand loans.

Designated market interest rate

The designated market interest rate under the Senate amendment is the same as the applicable Federal rate under the House bill.

Exceptions and limitations

Special exceptions and limitations for gift loans

Under the Senate amendment, a number of limitations and exceptions are provided for certain gift loans made directly between natural persons. For purposes of these exceptions and limitations, a husband and a wife are treated as one person.

Minimum outstanding balance.—As a general rule, under the Senate amendment, no amount is treated as transferred from the lender to the borrower, or retransferred from the borrower to the lender, for any day during which the aggregate amount owed by

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[8] The enumerated non-gratuitous transactions are (1) loans by corporations to shareholders of such corporations, and loans by shareholders to their corporations, (2) loans by employers to employees, and (3) loans made to independent contractors by persons for whom such contractors perform services.

the borrower to the lender does not exceed $10,000 (taking into account all loans by the lender to the borrower regardless of the rate of interest).

Net investment income limitations.—As a general rule, under the Senate amendment, no amount is treated as retransferred from the borrower to the lender for any day if (1) the borrower's net investment income for the year in which the day falls does not exceed $1,000, and (2) the aggregate outstanding balance on all loans from the lender to the borrower on such day does not exceed $100,000 (taking into account all loans by the lender to the borrower regardless of the rate of interest).

In addition, if the borrower has net investment income for the year in excess of $1,000, the maximum amount that can be treated as retransferred from the borrower to the lender for any day during a year in which the aggregate of all amounts owed by the borrower to the lender does not exceed $100,000, is limited to the borrower's net investment income for the year. Except as otherwise provided in regulations, determinations made under these provisions are to be made on the basis of the borrower's taxable year.

Under the Senate amendment, net investment income is the excess of investment income over investment expenses. The term investment income is defined, in general, by reference to section 163(d). Thus, investment income is the sum of: (1) gross income from interest, dividends, rents and royalties; (2) net short-term capital gain attributable to the disposition of property held for investment; and (3) amounts treated under section 1245 (relating to dispositions of certain depreciable property), 1250 (relating to dispositions of certain depreciable realty) and 1254 (relating to dispositions of interests in oil, gas and geothermal property) as ordinary income. In addition, net investment income includes any amount included in income under the original issue discount provisions of the Code, and any amount that would be included if such provisions were applicable to all "deferred payment obligations." The term "deferred payment obligations" is defined to include bonds with market discount, short-term government obligations, annuities and any similar obligations producing a determinable investment return which economically accrues currently but is not recognized until a subsequent year. Any income, gain or other amount derived from the active conduct of a trade or business, however, is not treated as investment income. Generally, investment expenses include amounts allowable as deductions under sections 162 (relating to trade or business expenses), 164(a) (1) or (2) (relating to bad debts), 167 (relating to depreciation), 171 (relating to amortizable bond premium), 212 (relating to expenses incurred in connection with the production of income), and 611 (relating to cost depletion).

Except as otherwise provided in regulations, determinations made under these provisions are to be made on the basis of the borrower's taxable year.

Tax avoidance transactions.—The minimum balance exception and the net investment income limitations do not apply if a principal purpose of a loan is the avoidance of Federal taxes. Second, the exception and limitations do not apply to the extent that the proceeds of a loan are used to purchase or carry marketable securities other than bonds or other evidences of indebtedness. Third, the minimum balance exception and the rule that provides that no amount is treated as retransferred from the borrower to the lender in cases in which the borrower has less than $1,000 of investment income do not apply to the extent that the proceeds of a loan are used to purchase or carry passive income-producing assets, unless the Secretary determines that there is no tax avoidance purpose.

Also, the Senate amendment provides that the Secretary will prescribe regulations to prevent abuse of the net investment income limitation through the deferral or other distortion of a borrower's net investment income.

Special exception for employment-related loans

Generally, under the Senate amendment, no amounts are treated as transferred by the lender to the borrower, or retransferred by the borrower to the lender, with respect to any term loan to a person providing services (including independent contractors) if the aggregate amount of loans outstanding between the borrower and the lender on the date on which the loan is made is $10,000 or less. Further, in general, no amount is treated as transferred by the lender to the borrower, or as retransferred by the borrower to the lender, with respect to a demand loan for any day on which the aggregate amount of loans outstanding between the borrower and the lender is $10,000 or less. For this purpose, the aggregate amount of loans outstanding includes all loans by the borrower to the lender regardless of the rate of interest.

Other exceptions

The Senate amendment is the same as the House bill.

Regulations

The Senate amendment follows the House bill. The Senate amendment, however, provides authority to issue certain regulations under the Federal estate tax.

Effective date

In general, the provisions of the Senate amendment apply to term loans made after February 1, 1984, and to amounts outstanding on demand loans after the date of enactment.

Conference agreement

Overview

The conference agreement generally follows the approach of the Senate amendment. Thus, the conference agreement applies to certain enumerated categories of transactions and others under regulations. Further, specific exceptions and limitations are provided. The distinction between term loans and demand loans contained in the House bill and the Senate amendment is retained, as is the rule treating term gift loans as demand loans for income tax purposes. Payments deemed made under this provision are treated as if actually made for all purposes of the Code.

The conference agreement contains a number of technical modifications to the Senate amendment.

Loans subject to the provisions

The conference agreement generally applies to term or demand below-market loans that are gift loans, compensation-related loans, corporation-shareholder loans, and tax-avoidance loans. In addition, under regulations, the conference agreement applies to other transactions that are, in substance, below-market loans if the interest arrangements have a significant effect on the tax liability of either the borrower or the lender. It is intended that the term "loan" be interpreted broadly in light of the purposes of the provision. Thus, any transfer of money that provides the transferor with a right to repayment may be a loan. For example, advances or deposits of all kinds may be treated as loans.

Gift loans.—A gift loan is any below-market loan where the foregone interest is in the nature of a gift. In general, there is a gift if property (including foregone interest) is transferred for less than full and adequate consideration under circumstances where the transfer is a gift for gift tax purposes. A sale, exchange, or other transfer made in the ordinary course of business (i.e., a transaction which is bona fide, at arms length and free from any donative intent) generally is considered as made for and full and adequate consideration. A loan between unrelated persons can qualify as a gift loan.

The conferees wish to clarify that if a taxpayer makes a below-market demand loan to a trust and the loan is treated as a revocable transfer of property for purposes of subpart E, the provisions of subpart E govern.[9] The conferees anticipate that regulations may be issued describing the circumstances under which a loan to a trust will be treated as a revocable transfer.

Compensation-related loans.—A compensation-related loan is any below-market loan made in connection with the performance of services directly or indirectly between (1) an employer and an employee, or (2) an independent contractor and a person for whom such independent contractor provides services.

For purposes of determining the timing and amount of the transfers deemed made under the provision, a compensation-related term loan is treated as a demand loan if the benefit derived by the employee from the interest arrangement is (1) non-transferable and (2) conditioned on the future performance of substantial services by the employee. A benefit is treated as non-transferable and conditioned on future performance under this provision if it would be treated as non-transferable and conditioned on future performance under section 83, if that section were applicable. For example, a benefit is conditioned on the future performance of substantial services if, on the termination, for any reason, of the employee's employment, the interest rate is increased so that the rate for the remaining term of the loan equals or exceeds the applicable Federal rate.

The conferees wish to clarify that an arrangement will be treated as a compensation-related loan only if, in substance, there is a debtor-creditor relationship between the employee and the employ-

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[9] This result is required because it would be anomalous to give effect for tax purposes to a loan made by a taxpayer to himself or herself.

er at the time the loan is made. For example, if an employer makes a payment to an unrelated third-party lender to buy-down a mortgage loan for an employee, and taking into account all the facts and circumstances, the transaction is, in substance, a loan by a third-party lender to the employee, and a payment by the employer to secure a valuable benefit for the employee, the payment by the employer to the lender is to be treated as compensation under generally applicable principles of tax law. To that extent, the below-market loan rules do not apply. However, if the transaction is, in substance, a loan by the employer made with the aid of services provided by the third-party lender acting as an agent of the employer, there is a compensation-related loan subject to this provision.

Also, under the conference agreement, if an employee receives payment from a customer for services rendered on behalf of an employer, and is permitted to retain the money for a period without paying interest at a rate equal to or greater than the applicable Federal rate, there is generally a compensation-related loan. For example, if an investment banker is permitted by an issuer to retain the proceeds from a public offering of stock or debt for a period without paying interest, there is a below-market loan from the issuer to the banker. To the extent the benefit is in lieu of a fee for services, the loan is a compensation-related loan.[10]

The conferees also wish to clarify that, in the case of a compensation-related loan, the deemed payment by the lender to the borrower is treated as wages for purposes of chapter 21, chapter 22 and chapter 23. Further, unless otherwise provided in regulations, a payment must be included in gross income by the borrower, even if the borrower is likely to be entitled to an offsetting deduction. Finally, even though there is no requirement that there be wage withholding for purposes of chapter 24, a payment must be reported under the appropriate information reporting provision.

Corporation-shareholder loans.—A corporation-shareholder loan is any below-market loan made directly or indirectly between a corporation and any shareholder of such corporation.

Tax avoidance loans.—A below-market loan is a tax-avoidance loan if one of the principal purposes of the interest arrangement is the avoidance of any Federal tax by either the borrower or the lender. Tax-avoidance is a principal purpose of the interest arrangement if it is a principal factor in the decision to structure the transaction as a below-market loan, rather than a loan requiring the payment of interest at a rate that equals or exceeds the applicable Federal rate and a payment by the lender to the borrower.

Other below-market loans.—A loan that is not a gift loan, compensation-related loan, corporation-shareholder loan or tax avoidance loan may be subject to these provisions under regulations if the interest arrangement has a significant effect on the tax liability of the borrower or the lender.

The interest arrangement of a below-market loan has an effect on the tax liability of the borrower or the lender if, among other

[10] To the extent the benefit is not in lieu of a fee for services, such an arrangement nevertheless may have a significant effect on the tax liability of the lender or the borrower. If so, the loan may be treated under regulations as a loan subject to the provision.

things, it results in the conversion of a non-deductible expense into the equivalent of a deductible expense. For example, if a member of a club makes a non-interest bearing refundable deposit to the club in lieu of part or all of his or her membership fee, the member is paying the fee with money that has not been included in his income (i.e., the investment income from the proceeds of the deposit), and has, in effect, converted the fee into the equivalent of a deductible expense.

The conferees anticipate that in determining whether an effect is significant, the Treasury will consider all the facts and circumstances including (1) whether items of income and deduction generated by the loan offset each other, (2) the amount of such items, (3) the cost to the taxpayer of complying with the provision and (4) any non-tax reasons for deciding to structure the transaction as a below-market loan rather than a loan with interest at a rate equal to or greater than the applicable Federal rate and a payment by the lender to the borrower.

Timing and amount of transfers

Loans other than gift loans and demand loans

The conference agreement generally adopts the approach of the House bill to loans other than family loans and demand loans.

Gift loans and non-gift demand loans

The conference agreement generally adopts the approach of the House bill to family loans and non-family demand loans.

For purposes of determining the timing and amount of the deemed transfers by the borrower to the lender, term gift loans are treated as demand loans.[11] Thus, the borrower is treated as transferring to the lender, and the lender is treated as receiving from the borrower, an amount equal to the foregone interest on an annual basis. For example, assume that on January 1, P, a calendar year taxpayer, makes a $200,000 loan to S, a calendar year taxpayer, for two years at 5 percent simple interest payable annually. If the applicable Federal rate is 12 percent compounded semiannually, the amount treated as transferred by the lender to the borrower for gift tax purposes would be $24,760 (i.e., the excess of $200,000 over the present value of all payments due under the loan discounted at the applicable Federal rate). The amount treated as retransferred by the borrower to the lender on the last day of each of the two calendar years would be $14,720 (i.e. the excess of interest computed at the applicable Federal rate (compounded semiannually) over interest actually payable on the loan). This amount, which would be included in income by the lender and, subject to the rules governing the deductibility of interest, deductible by the borrower, would be in addition to the $10,000 actually due each year under the terms of the loan.

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[11] Term gift loans are treated as demand loans for income tax purposes because, in light of the underlying familial or other personal relationship that is likely to exist between the borrower and the lender, the technical provisions of the loan, such as the maturity of the loan, may not be viewed as being binding by the parties. In addition, an original issue discount analysis is required to determine the income tax consequences of a term loan. By treating term gift loans as demand loans for income tax purposes, such analysis is avoided.

The conferees wish to clarify that a term loan with deferred interest at a rate equal to or greater than the applicable Federal rate, and a related gift to defray all or a part of the interest payable on the loan, may be the economic equivalent of an interest-free (or below-market) loan with a principal amount equal to the sum of the actual stated amount of the loan and the amount of the gift. The conferees anticipate that under regulations such a transaction will be treated in accordance with its substance.

Foregone interest

The conference agreement clarifies the meaning of the term "foregone interest." Under the conference agreement, the term means, with respect to any period during which the loan is outstanding, the excess of (1) the amount of interest which would have been payable on the loan for the period if interest accrued at the applicable Federal rate and were payable annually on the last day of the calendar year, over (2) any interest payable on the loan properly allocable to such period.

Applicable Federal rate

The conference agreement follows the House bill and the Senate amendment.

Applicable Federal rates are to be announced on or before September 30, 1984, and are to apply as of January 1, 1985. Neither the House bill nor the Senate amendment specify the rate that is to apply to days prior to January 1, 1985. The conference agreement provides that for periods prior to January 1, 1985, the applicable Federal rate is ten percent compounded semiannually.

Exceptions and limitations

The conference agreement provides specific de minimis rules. Generally, these rules are based on those contained in the Senate amendment.

De minimis exceptions

De minimis exception for gift loans between individuals.—As a general rule, no amount is treated as transferred by the lender to the borrower, or retransferred by the borrower to the lender, for any day during which the aggregate outstanding amount of loans does not exceed $10,000. For this purpose, the aggregate outstanding amount of loans includes all loans between the lender and the borrower regardless of the rate of interest.

This de minimis rule does not apply, however, if the loan is directly attributable to the purchase or carrying of income producing assets. Although a "directly attributable" test requires that there be some direct link between the loan and the borrower's purchase or continued ownership of income-producing assets, the conferees wish to emphasize that this is an anti-abuse provision, and should be interpreted in light of its purpose of preventing the avoidance of the assignment of income rules and the grantor trust rules.

The conference agreement makes it clear that, because a term gift loan is treated as a demand loan for income tax purposes, generally no amount is deemed retransferred by the borrower to the lender for any day on which the aggregate amount owed is $10,000 or less. Thus, if the balance of a term gift loan fluctuates, there may be income tax consequences for some days but not for other days.

De minimis exception for compensation related loans and corporation shareholder loans.—A de minimis exception is provided for loans between (1) an employer and an employee, or an independent contractor and a person for whom such independent contractor provides services, or (2) a corporation and a shareholder of such corporation. Under these rules, no amounts are treated as transferred by the lender to the borrower and retransferred by the borrower to the lender for any day during which the aggregate outstanding amount of loans between the borrower and the lender does not exceed $10,000. This *de minimis* rule does not apply, however, if a principal purpose of the interest arrangement is the avoidance of any Federal tax.

The conference agreement makes it clear that, for purposes of applying the exceptions and limitations, all loans between the same parties are aggregated. Further, in the case of non-gift term loans, the deemed transfers from the lender to the borrower are treated as occurring on the latter of the dates on which the loans are made or the first date on which the loans are subject to the provision. Thus, for example, if there are no other outstanding loans between an employer and an employee, and the employer makes $9,000 compensation-related term loan to an employee on April 1, and a $2,000 compensation-related term loan to the same employee on April 10, the parties are treated as if the employer made a $11,000 compensation-related term loan to the employee on April 10.

Finally, the conference agreement clarifies that in the event of a reduction in the outstanding balance of a non-gift term loan below $10,000, the provision continues to apply. Thus, the borrower is treated as transferring to the lender, and the lender is treated as receiving from the borrower, foregone interest on the remaining outstanding balance.

Special rules for gift loans

The amount treated as retransferred by the borrower to the lender for any day on which the aggregate outstanding amount of loans between the lender and the borrower does not exceed $100,000 is limited to the borrower's net investment income for the year. If the borrower has outstanding two or more gift loans, net investment income is allocated among such loans in proportion to the respective amounts that would be treated as retransferred by the borrower without regard to this limitation.

In addition, the conference agreement provides that if a borrower has less than $1,000 of net investment income for the year, such borrower's net investment income for the year is deemed to be zero. Thus, if the aggregate outstanding amount of loans from the lender to the borrower does not exceed $100,000 on any day during a year, and the borrower has less than $1,000 of net investment income for the year, no amount is treated as retransferred by the borrower to the lender for such year.

The definition of net investment income in the conference agreement is generally the same as in the Senate amendment. However, the conference agreement makes it clear that United States Savings Bonds are deferred payment obligations.

It is anticipated that the Secretary will prescribe regulations to prevent the abuse of these rules through the deferral or other distortion of a borrower's net investment income. These regulations are to apply to situations in which a party can control the timing of the receipt of investment income (e.g. where the borrower can control the timing of dividends paid by a closely-held corporation) or has engaged in any activities a principal purpose of which is to defer receipt of net investment income. Further, it is anticipated that regulations will provide for determinations under these provisions in cases in which either the borrower or lender computes taxable income on the basis of a fiscal year.

These special rules for gift loans do not apply if a principal purpose of the interest arrangement is the avoidance of Federal taxes.

Other exceptions

The conference agreement is the same as the House bill and the Senate amendment.

Regulations

The conference agreement generally follows the House bill and the Senate amendment.

Under the conference agreement, authority is provided to issue regulations exempting from these provisions any class of transactions if the interest arrangements do not have a significant effect on the tax liability of the borrower or the lender. The conferees anticipate that, in appropriate circumstances, compensation-related loans, including employee-relocation loans, may be exempted by these regulations. The term "significant effect" has the same meaning for this purpose as it does for purposes of determining whether loans not otherwise covered by the provision should be subject to it under regulations.

Authority is also provided to issue regulations for the purpose of assuring that borrowers and lenders take consistent positions under this provision. In appropriate cases, these regulations may condition a deduction for imputed interest on adequate identification of the lender.

In addition, authority is provided to issue regulations concerning the tax consequences of a disposition by a lender or a borrower of his or her interest in a below-market loan, or the acquisition of an interest in such a loan.

Effective dates

In general, under the conference agreement, the provision applies to term loans made after June 6, 1984, and to amounts outstanding on demand loans after such date. Amounts outstanding on demand loans on June 6, 1984, will not be subject to the provision if repaid prior to 60 days after the date of enactment. No inference is intended with respect to the application of present law to any below-market loan outstanding prior to the effective date.

Compensation-related term loans that are otherwise treated as demand loans for purposes of determining the timing and amount of the deemed transfers under the provision are treated as term loans for purposes of this effective date provision. In addition, advances to continuing-care facilities by residents of such facilities made prior to June 6, 1984, are not subject to the provision. No inference is intended regarding the application of the provision to advances to continuing-care facilities made after that date.

3. Limitations with respect to property which is partially used for personal purposes and luxury automobiles

Present law

The portion of the cost of an asset attributable to business use is eligible for the investment tax credit (generally 6 percent on automobiles) and ACRS (automobiles are 3-year property), or, alternatively, for expensing (up to a specified dollar limit). Business use is any use in a trade or business (sec. 162) or in connection with the production of income (sec. 212).

A portion of the investment tax credit and expensing deduction may be recaptured if the portion of the asset attributable to business use declines after the first year it is placed in service. No such recapture rule applies to ACRS deductions.

a. Percentage of personal use presumption for automobiles

House bill

At least 50 percent of use is treated as personal unless the taxpayer establishes otherwise, effective for taxable years beginning after December 31, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the Senate amendment.

b. Limitation on investment tax credit and depreciation for automobiles

House bill

For purposes of tax credits, ACRS, and expensing, the basis of a passenger automobile is limited to $21,000, adjusted for inflation, effective for property placed in service after March 1, 1984.

Senate amendment

The Senate amendment generally is the same as the House bill, except that basis is limited to $15,000 and the provision is effective for property placed in service after March 15, 1984.

Conference agreement

The conference agreement generally follows the House bill, with modifications. The maximum investment tax credit that can be claimed with respect to any passenger automobile is $1,000, indexed for automobile price inflation and rounded to the nearest $100. If the taxpayer elects a reduced investment credit in lieu of a basis adjustment for half the credit under section 48(q), then the credit is two-thirds of maximum credit that can be claimed. The maximum allowance for depreciation that can be claimed with respect to any passenger automobile is $4,000 in the year the automobile is placed in service by the taxpayer, and $6,000 in any subsequent year. Both figures are indexed for automobile price inflation and rounded to the nearest $100. In computing the allowable credit, the general rules for the credit are applied first; the limitation is then imposed. The credit as limited is then reduced to reflect any personal use. If business use is less than 100 percent, the taxpayer is entitled to claim the portion of the maximum investment tax credit and depreciation deductions allowable which corresponds to the taxpayer's business use percentage (as described below).

The limits do not apply to an automobile leased or held for leasing by any person regularly engaged in the business of leasing automobiles. Rather, the limits are applied to the lessee by denying a deduction for the percentage of the lease payments that is substantially equivalent to the effect as if these restrictions were placed on the lessor. This percentage is to be determined under tables prescribed by the Secretary. If the lessor passes through the credit to the lessee, the limit on the investment credit allowable applies to the lessee.

The limits are effective for property placed in service or leases entered into after June 18, 1984, except that property acquired pursuant to a binding contract in effect on or before June 18, 1984, that is placed in service before January 1, 1985, is not affected by these limits.

c. Personal use property

House bill

No provision.

Senate amendment

Under the Senate amendment, at least 90 percent of the use of an automobile (based on mileage) must be for business purposes for the taxpayer to claim ITC, ACRS, or expensing. If the 90 percent test is not met, the taxpayer must use standard mileage to determine his allowable deductions in lieu of ITC, ACRS, expensing, and actual operating expenses. An automobile kept at the taxpayer's residence more than 14 nights a year is automatically on standard mileage, unless the residence is the principal place of the taxpayer's principal business or the taxpayer is an outside salesman.

With respect to property used for transportation (except automobiles), entertainment and recreation property, computers, and other property listed in regulations, at least 90 percent of the use must be for business purposes in order for the property to be eligible for ITC, ACRS, and expensing. If the 90-percent test is not met, the taxpayer must use 12-year straight-line depreciation.

The taxpayer must meet the 90-percent test for both of the first two years to claim ITC, ACRS, and expensing, and if business use falls below 90 percent after the first two years, ITC, ACRS, and expensing are recaptured. Use by another person is not counted as for a business purpose unless (1) the use is directly connected with the taxpayer's trade or business, (2) the use gives rise to income to the other person, or (3) fair rent is paid to the taxpayer for the use.

The provision is effective for property placed in service after March 15, 1984.

Conference agreement

For automobiles and other transportation equipment, entertainment, recreation, or amusement property, computers, or other property specified in regulations, the investment credit and use of the accelerated percentages under ACRS are not allowed for property not used predominantly (i.e., more than 50 percent) on an annual basis in a trade or business. Use of this specified property for the production of income, but not in a trade or business, does not count in determining whether the 50-percent test is met. If the 50-percent test is otherwise met, however, use for the production of income may be considered in determining the amount of the investment credit and ACRS that may properly be claimed. For example, if a specified asset is used 30 percent in a trade or business and 30 percent for the production of income, the taxpayer may not claim the investment credit or ACRS and must instead compute depreciation under the rules described below. If, however, an asset is used 70 percent in a trade or business and 20 percent for the production of income, the taxpayer may claim the investment credit and ACRS based on 90 percent business use. As is required under present law, the taxpayer may properly claim the credit and deduction only with respect to the portion of the use of the asset that represents business use. Moreover, as is provided under present law, a taxpayer is entitled to no depreciation deduction with respect to an entertainment, recreation, or amusement facility.

If the taxpayer's automobile is used by another person, any use of the automobile by that other person is not treated, for purposes of this provision, as business use, if that use (A) is not directly connected with the business of the taxpayer, (B) does not give rise to income to the other person (which, in the case of an employee, must also be treated as wages for withholding purposes), or (C) does not result in a payment of fair market rent.

Provision of the use of listed property merely as compensation to 5-percent owners and related taxpayers or leasing to such individuals is not treated as use in a trade or business. However, for airplanes and helicopters, such compensation or leasing to such individuals can be considered business use, provided that business use without consideration of those activities is at least 25 percent of total use.

Listed property does not include any computer exclusively located at a regular business establishment (including a qualifying home office) of the employer or proprietor and owned by the employer or proprietor. However, present law rules permitting the credit and deduction only with respect to the business use of these computers would still apply.

If the 50-percent test is not met, the portion for which depreciation deductions are allowed must be depreciated on a straight-line basis (using a half-year convention (except for 15 year real property) and without regard to salvage value) using earnings and profits lives (see sec. 312(k)(3)(A)). With respect to 3-year property (such as automobiles), this is a 5-year period. With respect to 5-year property (such as computers or transportation equipment other than automobiles), it is a 12-year period. With respect to real property, it is a 35-year period.

Listed property which an individual owns in connection with his employment is eligible for the investment credit and ACRS deductions only if such property is required for the convenience of the employer and as a condition of employment. The conferees intend the terms "convenience of the employer" and "condition of employment" to have the same meaning with respect to this provision as it does with respect to the exclusion from gross income for lodging furnished to an employee. In order to satisfy the condition of employment requirement, the property must be required in order for an employee to properly perform the duties of his employment. This requirement is not satisfied merely by an employer's statement that the property is required as a condition of employment. The conferees intend that the principles of *Dole* v. *Commissioner*, 43 T.C. 697, *aff'd.*, 351 F.2d 308, (1st Cir. 1965) apply.

With respect to recapture of the investment credit, any property (or portion thereof) which ceases to be section 38 property during a taxable year, other than because of a disposition, is considered to be disposed of on the first day of the taxable year (Treas. reg. secs. 1.47-1(c), 1.47-2(e)). These regulations accomplish the objective of the provision in the Senate amendment denying the investment credit if business use falls below 90 percent in the first two years the property is in service. Accordingly, the 2-year rule of the Senate amendment has not been adopted. The conferees expect that these regulations will be strictly enforced. The conferees note that the Secretary can provide, as has been done in other areas, a rule that a *de minimis* reduction in the portion of property that continues to be section 38 property will not trigger any recapture.

For listed property, recapture rules for depreciation will apply. A reduction in the business use portion from above 50 percent to 50 percent or below will trigger recapture of the excess depreciation. Excess depreciation is the excess of depreciation actually claimed over depreciation that would have been claimed on the basis of earnings and profits lives on the straight-line method.

Reduction or denial, due to personal use by the lessee, of the investment tax credit, ACRS, and expensing will not apply to lessors. Personal use by the lessor will, however, cause a reduction in the available investment credit and depreciation. Lessees will be denied a deduction for a percentage of the lease payment equivalent to the value of the portion of the investment tax credit and depreciation and expensing deductions which would have been denied due to personal use. This percentage is to be prescribed in tables issued by the Secretary. These tables may be coordinated with the tables to be prescribed denying a deduction for a percentage of the lease payment attributable to the effect of the caps on the investment credit and depreciation.

Under ACRS, taxpayers may elect, in lieu of the prescribed accelerated percentages, an optional recovery method. The taxpayer may elect either percentages based on the straight line method for the regular recovery period or one of the two optional longer recovery periods. Generally, an election to use an optional recovery method must be made in the year the property is placed in service by the taxpayer. Additionally, except in the case of 15-year real property, a taxpayer who elects to use an optional recovery method must elect the same recovery method for all property of that class placed in service in the year for which the election is made. The mandatory use of the straight line method under this new provision is not intended to have a binding effect on all other recovery property of that class placed in service in the same year by the taxpayer. Thus, a taxpayer who owns a car that is subject to this provision which must be recovered over a 5-year recovery period has not made a binding election with respect to all other 3-year recovery property placed in service in the same taxable year.

In lieu of any investment tax credit and any depreciation or expensing deduction, the taxpayer may elect, as under present law, to compute his deduction for the business use of his automobile at the standard mileage rate. This rate is currently 20.5 cents a mile for the first 15,000 miles of business use per year, up to a maximum of 60,000 miles. Beyond those limits, the rate is 11 cents per mile.

The conference agreement provides the Secretary with authority to prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section. These regulations should, among other things, ensure that taxpayers do not attempt to evade the restrictions on the investment credit and depreciation by, for example, separating an automobile into its component parts.

The conferees also expect that the Secretary will issue regulations that provide explicit methods for allocating basis between business and personal use. With respect to automobiles, the regulations could provide that the proportion of business use is not to be greater than the proportion of total mileage which is driven for business purposes. The Secretary may also provide alternate means to determine the business use percentage for automobiles. For example, regulations could provide that if an automobile is used 5 days a week for business purposes and is available 2 days a week for personal purposes, in no event may the taxpayer consider more than five-sevenths of the use to be allocable to business purposes. An allocation based on different factors, such as time, may be more appropriate for other types of property as well.

Commuting is not business use, regardless of whether work is performed during the trip. Thus, for example, a business telephone call made on a telephone installed in an automobile while the taxpayer is commuting to work does not transform the character of the trip from commuting to business. This is also true for a business meeting held in a car while the taxpayer is commuting to work. Similarly, a business telephone call made on an otherwise personal trip does not transform the character of the trip from personal to business. In a likewise manner, the fact that an automobile is used to display material that advertises the owner's or user's trade or business does not convert an otherwise personal use into business use.

These provisions are effective for property placed in service after June 18, 1984, except that property acquired pursuant to a binding contract in effect on or before such date which is placed in service before January 1, 1985 (or January 1, 1987, in the case of real property) is not affected by these provisions.

The following examples illustrate the operation of this provision:

Example 1. On July 1, 1984, A purchases for $35,000 and places in service a passenger automobile which is 3-year recovery property under section 168. The automobile is used exclusively in A's business. The amount of A's investment tax credit is limited to $1,000. A's unadjusted basis for ACRS purposes is $34,500 (i.e., $35,000 reduced by the one-half basis adjustment). A selects the use of the accelerated recovery percentages under ACRS. A's recovery deductions for the years during his recovery period (i.e., 1984 through 1986) are limited to $4,000, $6,000, and $6,000, respectively. A continues to use his car exclusively in his business during taxable years 1987 through 1990. For those years, A is limited to a recovery deduction of $6,000 per year. In 1990, A's recovery deduction is $500 (i.e., his remaining depreciable basis).

Example 2. On August 1, 1984, B corporation purchases for $25,000 and places in service a passenger automobile which is 3-year recovery property under section 168. C owns 100 percent of B corporation. The automobile is used 25 percent in B's business and 75 percent for C's personal use for years 1984 through 1989. Because business use does not exceed 50 percent, B may not claim the investment tax credit and must use either the straight-line method over 5 years or the longer recovery period of 12 years, which B may elect under section 168(b)(3). B uses the 5-year period. In 1984, B's recovery deduction is $625 (*i.e.*, .25 (business use) x $25,000 x .10 (depreciation on a straight line basis with a half-year convention)). In 1985 through 1988, B's recovery deduction is $1,250 (*i.e.*, .25 x $25,000 x .20). In 1989, B's recovery deduction is $625 (*i.e.*, .25 x $25,000 x .10). No further recovery deductions are available to B. This is because the amount with respect to which recovery deductions are available is reduced each year by the amount that could have been deducted if business use had been 100 percent.

Example 3. On December 1, 1984, A purchases for $30,000 and places in service a passenger automobile which is 3-year recovery property under section 168. A owns 100 percent of his business. In 1984, A uses his car 40 percent in his business, 20 percent in an investment activity, and 40 percent for personal purposes. Because A does not use his car more than 50 percent in his business, A may not claim an investment tax credit with respect to the car. A's unadjusted basis is $30,000. Also, because A does not use the car more than 50 percent in his trade or business (*i.e.*, in a "qualified business use"), the deduction allowed under section 168 must be determined by use of the straight-line method over a 5-year recovery period (or, if A so elects, over a 12-year period). A's business use percentage, for purposes of determining the allowable portion of the recovery deduction, is 60 percent for 1984 (that is, 40 percent trade or business use plus 20 percent investment activity use). Thus, A's allowable deduction for 1984 is $1,800 (that is, the allowable depreciation of $3,000 ($30,000 x 10% depreciation) (which is less than the $4,000 cap) times the 60 percent business use percentage).

Example 4. On July 1, 1984, A purchases for $18,000 and placed in service a passenger automobile which is 3-year recovery property under section 168. A's 1984 business use percentage is 80 percent. A elects to take a reduced investment tax credit in lieu of a basis adjustment. The amount of A's investment tax credit is limited to $536 (*i.e.*, $1,000 x .67 (which is less than .4 x $18,000) times 80% business use). A selects the use of the accelerated recovery percentages under ACRS. A's unadjusted basis for ACRS purposes is $18,000. A's 1984 recovery deduction is $3,200 (*i.e.* $4,000 (which is less than $18,000 x .25) times 80% business use). In 1985, A's business use percentage is 80 percent. A's 1985 recovery deduction is $4,800 (*i.e.* $6,000 (which is less than $18,000 x .38) times 80% business use). In 1986, A's business use is 45 percent. As a result of the decline in business use percentage, A, for investment tax credit purposes, is treated as having disposed of the portion of the automobile converted to personal use and must recapture a portion of the investment tax credit claimed previously (pursuant to Treas. reg. secs. 1.47-1(c), 1.47-2(e)). A's investment credit recapture is $123.82 (*i.e.* $536 x .35 (which is .80 − .45) x .66 (the percentage specified in sec. 47(a)(5))). Since A's business use is not greater than 50 percent, A must recompute (for recapture purposes) his recovery deductions for the preceding recovery years using the straight line method over 5 years. A's recomputed recovery deductions for 1984 and 1985 are $1,440 (*i.e.*, .10 x $18,000 x .80), and $2,880 (*i.e.*, .20 x $18,000 x .80), respectively. A must recapture $3,680 (*i.e.*, (3,200 + 4,800) − (1,440 + 2,880)) and include that amount in gross income as ordinary income for 1986. A's recovery deduction for 1986 is $1,620 (*i.e.* $18,000 x .20 (which is less than $6,000) times 45% business use). A's business use for 1987 and 1988 is 45 percent and his recovery deduction for each year is $1,620. In 1989, A's business use is 45 percent and his recovery deduction is $810 (*i.e.*, $1,800 x .45). A may not recover any additional amounts, because had he used the automobile solely for business purposes, he would have recovered his entire unadjusted basis (*i.e.*, $18,000) by 1989.

d. Recordkeeping

Present law

The taxpayer must substantiate any travel expenses by adequate records or other evidence corroborating his own statements. These records must show the amount, time, place, and business purpose of the travel expenses.

House bill

No provision.

Senate amendment

The Senate amendment extends present law substantiation requirements to all business use of an automobile and to the other property described above (i.e., property used for transportation, entertainment and recreation property, computers, and other property listed in regulations). The Senate amendment requires the maintenance of contemporaneous records.

The Senate amendment also requires that return preparers verify that adequate contemporaneous records have been kept supporting deductions before signing returns. The provision is effective with respect to property placed in service after March 15, 1984.

Conference agreement

The conference agreement follows the Senate amendment with modifications. Thus, taxpayers are required to substantiate by adequate contemporaneous records any investment tax credit or deduction with respect to the business use of listed property, traveling expenses (including meals and lodging while away from home as well as local travel) that are trade or business expenses or expenses for the production of income, for entertainment expenses, and for gifts. If the taxpayer does not have adequate contemporaneous records, no credit or deduction is allowed with respect to that item. If, however, these records are lost due to circumstances beyond the taxpayer's control, such as in a fire, flood, or earthquake, the conferees intend that taxpayers continue to have the ability, as they do under present law, to substantiate a deduction by reasonable reconstruction of expenditures (see Treas. reg. 1.274-5(c)(5)).

The conferees expect that these records will reflect with substantial accuracy the business use of the property. The records must indicate the business purpose of the expense or use, unless the business purpose is clear from the surrounding circumstances. With respect to automobiles, logs recording the date of the trip and the mileage driven for business purposes must be kept.

The requirement of the Senate amendment that return preparers verify that adequate records supporting all of these deductions have been kept before signing the return has been deleted. In place of that requirement, a return preparer must properly and fully advise the taxpayer of these contemporaneous recordkeeping requirements and obtain written confirmation from the taxpayer certifying that adequate contemporaneous records supporting these deductions and credits exist. If the return preparer does not obtain this written certification, the preparer may not sign the return. The conferees anticipate either that the content of this certification will be specified by the Secretary or that the Secretary will prescribe a form for this certification. The conferees expect that the Secretary will amend Form 2106 or any other appropriate form to require that the taxpayer directly indicate on his return whether the required records have been kept. This could be done, for example, by providing a box to check on the return.

The conference agreement also provides that any portion of an underpayment of tax attributable to a failure to comply with these contemporaneous recordkeeping requirements is treated as due to negligence in the absence of clear and convincing evidence to the contrary. Claiming a deduction or credit without the support of the required records is also potentially fraud. This is in addition to the loss of the credit and deduction which would occur under present law.

The conferees anticipate that the Secretary will draw the attention of taxpayers to these new recordkeeping requirements in the appropriate regularly issued Internal Revenue Service publications.

To accomplish this, for example, the Service could describe these new recordkeeping requirements in the section of the instructions to the 1984 Form 1040 that highlights important tax law changes.

The compliance provisions are effective with respect to taxable years beginning after 1984.

4. Transfers of depreciable property between related parties

Present law

Transfers of depreciable property between related parties are denied capital gains and installment sales treatment. Related parties include (1) husband and wife, and (2) partnerships and corporations which are 80 percent controlled by one taxpayer.

House bill

For purposes of this rule, the House bill (1) treats a patent application as depreciable property, and (2) treats a person and a trust in which the person has a beneficial interest (other than a remote contingent interest) as related.

The provision is effective for transactions after March 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

5. Treatment of certain related party transactions

Present law

Present law denies a deduction for business expenses and interest by an accrual basis taxpayer owed to a related cash basis taxpayer if payment is not made within 2½ months after the close of the taxable year.

Present law does not apply to transactions between a partner and a partnership, and does not apply to transactions between related corporations.

House bill

The House bill provides that a deduction for expenses of an accrual basis taxpayer owed to a related cash basis taxpayer is allowed only when the amount is paid. The bill applies the new accrual rule to amounts accrued by a partnership to its partners and persons related to its partners (and vice versa). It also applies the present law rules denying losses between related parties as well as the new accrual rules to transactions between controlled corporations (using a 50-percent control test). It does not apply to sales to a controlled DISC.

The provision applies the accrual rules to taxable years beginning after December 31, 1983, unless pursuant to a binding contract in effect on September 29, 1983.

The expansion of the related party rules will apply to transactions after September 29, 1983, unless it is pursuant to a contract binding on that date. In the case of sales to a controlled foreign corporation, the provision will apply March 1, 1984.

Senate amendment

The Senate amendment generally is the same as the House bill, except (1) the partnership provision does not apply to certain cases involving resyndications of low-income housing, and (2) losses from sales and exchanges between controlled corporations will result in deferral (rather than denial) of losses until the related corporation disposes of the property outside the group in a recognition transaction. No DISC exception is provided.

The effective date generally is the same as the House bill except (1) the expansion of the related party rules will apply to taxable years beginning after December 31, 1983, and (2) no special rule applies to controlled foreign corporations.

Conference agreement

The provision generally follows the Senate amendment with the following modifications:

(1) There will be no attribution of partnership interests held by a subchapter C corporation to any shareholder owning less than 5 percent of the stock of the corporation.

(2) Except as provided in regulations, sales of inventory in the ordinary course of business between two corporations at least one of which is a foreign corporation will not be subject to the loss deferral rule. This exception will only apply if the sales are made for bona fide business purposes. The IRS may apply the loss deferral rule where sales are made for the purpose of accelerating losses. An abnormally large volume of sales near the end of the year would be an indication of a purpose to accelerate losses, absent evidence to the contrary.

(3) The operation of the loss deferral rule is clarified to provide that any loss sustained shall be deferred until the property is transferred outside the group, or until such other time as is provided by regulations. These rules will apply to taxpayers who have elected not to apply the deferral intercompany transactions rules, except to the extent regulations provide otherwise.

The Secretary may prescribe exceptions from these principles, for example, where necessary to properly reflect the net amount of income on a transaction. For example, it is intended that where any income is properly taken into account by the controlled group with respect to the face amount of a note receivable (for example, the income is accruable in accordance with the principles set forth in Rev. Rul. 71-365) at any time prior to the transfer of the property outside the group, any loss due to the discount in the note or receivable (to the extent of such income previously recognized) shall be allowed no later than the time that both the income has been taken into account and that loss has been sustained.

(4) Any loss sustained on the repayment of a loan to another member of the controlled group will not be disallowed if the loan is payable or denominated in a foreign currency and the loss is attributable to a reduction in value of the foreign currency.

(5) The DISC provision in the House bill is contained in the conference agreement.

(6) In the case of sales to a controlled foreign corporation the effective date will be March 1, 1984.

6. Losses on sales and exchanges of property used in a trade or business

Present law

Generally, gains and losses on the sale or exchange of business property plus the gains and losses on the involuntary conversion of business property and capital assets are treated as long-term capital gains and losses if there are net gains for the taxable year and they are treated as ordinary losses if there are net losses for the taxable year.

House bill

No provision.

Senate amendment

Under the Senate amendment, net losses from the sale or exchange of business assets will be treated as capital losses to the extent of net section 1231 gains for the prior three years and will be carried back to offset these gains. Also net gains will be treated as ordinary to the extent of net section 1231 losses for the prior three years.

The provision applies to taxable years beginning after December 31, 1984.

Conference agreement

Under the conference agreement, net section 1231 gains will be treated as ordinary income to the extent of unrecaptured net section 1231 losses of the taxpayer (or predecessor taxpayer) for the 5 most recent prior years beginning after December 31, 1981. Losses will be deemed recaptured in the chronological order they arose.

The provision applies to taxable years beginning after December 31, 1984.

7. Disallowance of certain expenses where taxpayer uses property similar to property owned by taxpayer

Present law

Deductions for personal expenses are disallowed. Deductions are allowed for expenses incurred in a trade or business or in connection with the production of income. In addition, an investment tax credit is allowed for depreciable property used in a trade or business or for the production of income.

House bill

No provision.

Senate amendment

The Senate amendment clarifies the application of present law where a taxpayer uses property owned by another person for personal purposes and such person (or a third person) uses similar property owned by the taxpayer for personal purposes, or, under regulations, where the taxpayer has an interest in a partnership or other entity, the principal purpose of which is to permit its owners to obtain personal use of property while claiming tax benefits with respect to similar property. If this provision applies, the taxpayer is treated as using the property with respect to which tax benefits are claimed for personal purposes, to the extent of the expenses attributable to the similar property that is actually used by the taxpayer for personal purposes.

The provision applies to the use of property after February 22, 1984.

Conference agreement

The conference agreement follows the House bill.

The conferees concluded that present law is adequate to prevent the abuse addressed by the Senate amendment.

8. Use of multicompany structure to reduce tax on coal operations

Present law

Present law (sec. 631(c)) provides that, subject to certain special limits, royalties received on the disposition of coal or iron ore qualify for capital gain treatment. For capital gain treatment to apply, the coal or iron ore must have been held for more than one year before mining. Capital gain treatment does not apply to income realized by an owner as a co-adventurer, partner, or principal in the mining of the coal or iron ore. In the case of iron ore (but not coal), capital gain treatment is also not applicable to a disposal to a related person or to a person owned or controlled directly or indirectly by the same interests which own or control the person disposing of the ore. If capital gain treatment is allowed for coal or iron ore royalties, the royalty owner is not entitled to percentage depletion with respect to the coal or iron ore disposed of.

Under present law, it is possible to reduce the overall tax on coal mining operations by having a separate land-holding company acquire coal reserves and lease them for a retained arm's-length royalty to the company which actually conducts mining operations. Under such an arrangement, the royalties are deductible by the operating company, and the amount of the royalties received by the land company (after subtracting cost depletion and certain expenses) qualify for capital gain treatment. If the benefits of capital gain treatment exceed the loss from foregoing percentage depletion on the coal in question, the overall tax on the operation will be reduced. The Code specifically prohibits this result in the case of iron ore by denying capital gains treatment for dispositions to related persons.

House bill

No provision.

Senate amendment

Section 631(c) is amended to specify that capital gain treatment does not apply to any disposal of coal to a related person or to a person owned or controlled directly or indirectly by the same interests which own or control the person disposing of the coal.

The provision is effective for coal disposed of (i.e., mined) after September 30, 1985.

Conference agreement

The conference agreement follows the Senate amendment, except that the amendment does not apply to coal sold under a fixed contract in effect on June 15, 1984, and at all times thereafter, before for such sale, under which the price for such coal cannot be adjusted to reflect to any extent the increased liabilities of the selling royalty owner for income tax by reason of the amendment. This exception for fixed contracts terminates on January 1, 1990. For purposes of this effective date rule, if an operator sells coal under both fixed contracts and other contracts, unless the contract otherwise provide, the royalty subject to the new rules will be treated as paid first out of the proceeds from the fixed contracts.

9. Public utility dividend reinvestment plans

Present law

Under present law, shareholders may exclude from income up to $750 ($1,500 in the case of a joint return) of stock distributions from public utility corporations under qualified dividend reinvestment plans. This provision expires for distributions made after 1985.

House bill

No provision.

Senate amendment

The Senate amendment repeals this provision effective for distributions made after December 31, 1984.

Conference agreement

The conference agreement does not contain the Senate amendment.

10. Modification of income averaging

Present law

Income averaging is presently available to taxpayers with "averageable income." Averageable income is current year taxable income in excess of 120 percent of average taxable income in the four preceding years. In effect, income averaging widens the tax brackets by a factor of five with respect to averageable income.

House bill

The House bill increases the 120-percent threshold to 140 percent and provides that only the three preceding years are to be taken into account. The bill modifies income averaging so that it, in effect, widens the tax brackets by a factor of four, not five, with respect to averageable income.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The Conference agreement follows the House bill and the Senate amendment.

11. Taxation of the Federal Home Loan Mortgage Corporation

Present law

Tax exemption of the Federal Home Loan Mortgage Corporation ("Freddie Mac")

Under a non-Code provision, the Federal Home Loan Mortgage Corporation ("Freddie Mac") is exempt from all Federal, State, and local taxation. Real property held by Freddie Mac remains subject to State and local tax.

Net operating loss carrybacks

Corporations are generally allowed to carry net operating losses back 3 years and forward 15 years. Under a special rule, the Federal National Mortgage Association (Fannie Mae) is allowed to carry net operating losses arising in 1982 or later back 10 years and forward 5 years, other than losses resulting from mortgage dispositions. Losses resulting from mortgage dispositions are subject to the general corporate rules (i.e., a 3-year carryback and 15-year carryforward).

Dividends received deduction

Corporations are allowed a deducation for a portion (generally, 85 percent) of dividends received from a domestic corporation. This deduction is not allowed for dividends received from a tax-exempt entity. Thus, dividends received by savings institutions from a Federal Home Loan Bank (which is tax-exempt under a non-Code provision) do not qualify for a dividends received deduction.

For dividends received by thrift institutions (including savings and loans and mutual savings banks), present law reduces the amount of the otherwise allowable dividends received deduction by 40 percent.

House bill

No provision.

Senate amendment

Repeal of Freddie Mac tax exemption

The Senate amendment repeals the Federal tax exemption for Freddie Mac, effective January 1, 1985. The State or local tax treatment of Freddie Mac is not affected.

Net operating loss carrybacks

The Senate amendment provides Freddie Mac with treatment equivalent to that provided under present law to Fannie Mae, i.e., a 10-year carryback and 5-year carryforward of net operating losses (except losses resulting from mortgage dispositions).

Dividends received deduction

The Senate amendment allows a dividends received deduction for dividends received from a Home Loan Bank which are allocable to dividends paid by Freddie Mac out of current earnings profits or earnings and profits accumulated after December 31, 1984. For dividends paid out of current earnings and profits of a Home Loan Bank, the amount of any dividend which qualifies for a deduction is that amount which bears the same ratio to the total dividend as the ratio of (a) dividends received by the Home Loan Bank from Freddie Mac during the Home Loan Bank's current taxable year, to (b) the total earnings and profits of the Home Loan Bank for the year.

If the amount of the dividends paid by a Home Loan Bank to its shareholders exceeds the bank's earnings and profits for the current taxable year, then, under the Senate amendment, a deduction is allowed for that portion of any dividend paid out of accumulated earnings and profits of Freddie Mac which is equivalent to the ratio of (a) the amount of dividends received by the Home Loan Bank from Freddie Mac out of Freddie Mac earnings and profits for taxable years ending after December 31, 1984, which have not been accounted for under the rules described in the preceding paragraph, to (b) the sum of (i) the retained earnings of the Home Loan Bank as of January 1, 1985, and (ii) the accumulated earnings and profits of the Home Loan Bank at the time the dividend is paid which are attributable to periods after December 31, 1984. For purposes of his rule, the Home Loan Banks are permitted to treat retained earnings for financial accounting purposes as of January 1, 1985, as accumulated earnings and profits for years before 1985. No deduction is allowed for dividends paid by Home Loan Banks allocable to dividends paid by Freddie Mac out of earnings and profits it accumulated before January 1, 1985 (ie., prior to the date of taxability).

Effective date and transition rules

Under the Senate amendment, the repeal of the Freddie Mac tax exemption is effective on January 1, 1985. Additionally, Freddie Mac is to be treated as having no accumulated earnings and profits as of January 1, 1985.

The Senate amendment includes special basis rules designed to ensure that, to the extent possible, pre-1985 appreciation or decline in the value of Freddie Mac assets will not be taken into account for tax purposes. Under these rules, for purposes of determining gain, the basis of any asset held on January 1, 1985, is to be the higher of (1) the regular adjusted basis of the asset in the hands of Freddie Mac, or (2) the fair market value of the asset on January 1, 1985. For purposes of determining loss, the basis of any asset held on January 1, 1985, is to be the lower of these two figures. Where the amount realized on the disposition of an asset is greater than the lower of these figures, but less than the higher figure, no gain or loss is to be recognized by Freddie Mac on the disposition.

The Senate amendment provides specifically that, for purposes of the basis rules above, rights to income retained by Freddie Mac under participation certificates (PCs) and similar interests in mortgages (including guaranteed mortgage certificates and collateralized mortgage obligations) which Freddie Mac sold prior to January 1, 1985, are not to be considered to have a built-in income component on January 1, 1985, which could be treated as an asset held by Freddie Mac as of the date of taxability. Under a special rule, if Freddie Mac realizes gain on the sale of its interests in a PC or similar interest in mortgages between March 15, 1984, and January 1, 1985, such income is to be recognized on January 1, 1985 (and therefore subject to tax).

Conference agreement

The conference agreement follows the Senate amendment with the following modifications.

Net operating loss carrybacks

The conference agreement follows the Senate amendment in providing Freddie Mac with treatment equivalent to that provided to Fannie Mae under present law, i.e., a 10-year carryback and 5-year carryforward of net operating losses (other than losses from mortgage dispositions). However, the conference agreement provides that no net operating loss, capital loss, or excess credit of Freddie Mac for any taxable year beginning after December 31, 1984, shall be allowed as a carryback to any taxable year beginning before January 1, 1985. This adjustment prevents Freddie Mac from being required to carry back losses or credits to years in which the corporation was not taxable (and in which the losses or credits are therefore without value to Freddie Mac), and allows such losses or credits to instead be carried forward to later taxable years.

Dividends received deduction

The conference agreement clarifies that, in determining the amount of the deduction for dividends paid out of accumulated earnings and profits of a Home Loan Bank, the total accumulated earnings and profits of the Home Loan Bank at the time the dividend is paid are to be taken into account. Thus, a deduction is to be allowed for that portion of such a dividend which bears the same ratio to the total dividend as the ratio of (a) the amount of dividends received by the Home Loan Bank from Freddie Mac which are out of Freddie Mac earnings and profits for taxable years ending after December 31, 1984, and which have not been taken into account in determining the deduction for dividends paid out of current earnings and profits of the Home Loan Bank, to (b) the total accumulated earnings and profits of the Home Loan Bank at the time the dividend is paid. For purposes of this rule, the retained earnings and profits of the Home Loan Bank as of January 1, 1985, are to be treated as its accumulated earnings and profits as of that date.

Effective date and transition rules

Basis of Freddie Mac assets

The conference agreement follows the rules of the Senate amendment regarding the basis of Freddie Mac assets held by the corporation on January 1, 1985. However, the conference agreement pro-

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vides an exception to these general rules in the case of tangible depreciable property held by Freddie Mac on January 1, 1985. For such property, the adjusted basis, for purposes of both gain or loss, is to be equal to the lesser of (1) the regular adjusted basis of the property in the hands of Freddie Mac, or (2) the fair market value of the property as of January 1, 1985. This rule is primarily intended to prevent Freddie Mac from claiming deductions based on pre-1985 depreciation of tangible property (e.g., buildings or office equipment) held by the corporation as of the date of taxability.

Treatment of participation certificates (PCs)

The conference agreement follows the Senate amendment with regard to the treatment of income rights under mortgage pool participation certificates (PCs) or other similar interests in mortgages sold prior to January 1, 1985, with certain technical adjustments. Under the conference agreement, Freddie Mac is to be treated as having no basis in its income rights with respect to PCs or similar interests in mortgages, under the basis provisions of the conference agreement, where the PC, similar interest, or any related security was sold or issued by Freddie Mac prior to January 1, 1985. The conferees intend that this provision will apply in the case of collateralized mortgage obligations (CMOs) sold or issued by Freddie Mac prior to January 1, 1985. Thus, income received by Freddie Mac which is attributable to PCs, CMOs, or similar obligations sold prior to January 1, 1985, is to be taxable in the year received, regardless of whether such income is attributable to services performed by Freddie Mac prior to January 1, 1985, to guarantees provided by Freddie Mac, or to a built-in income or profit component which may be considered to exist as of January 1, 1985. Additionally, Freddie Mac is not to be entitled to a deduction for depreciation or amortization with respect to its income rights in these obligations and is to have no basis in such income rights, under the basis provisions of the conference agreement, for purposes of determining gain or loss on the sale or disposition of such income rights.

The conference agreement follows the special rule of the Senate amendment under which gain realized by Freddie Mac on the sale of its income rights in PCs or similar interests in mortgages after March 15, 1984, and before January 1, 1985, is recognized on January 1, 1985.

Treatment of certain replacement obligations

The conference agreement adds a special rule under which Freddie Mac is denied a deduction for interest accruing after December 31, 1984, on any replacement obligation. For this purpose, a replacement obligation means any obligation created after March 15, 1984, which the Treasury Department determines to replace any equity or debt interest of a Federal Home Loan Bank (or of any other person) in Freddie Mac which existed on March 15, 1984. This provision is intended to prevent any rearrangement of the existing capital structure of Freddie Mac (e.g., replacement of equity or low-interest debt with high-interest debt) from resulting in an unintended tax benefit. The provision does not apply to any obligation with respect to which Freddie Mac establishes that there is no tax avoidance effect.

12. Interest on debt used to purchase or carry tax-exempt obligations of related parties

Present law

Present law (sec. 265(2)) disallows a deduction for interest on debt used to purchase or carry tax-exempt obligations. The application of this rule to related parties is unclear.

House bill

No provision.

Senate amendment

The Senate amendment disallows a deduction under section 265(2) for interest on debt which is used to purchase or carry tax-exempt obligations owned by (1) the taxpayer's spouse or (2) an 80-percent owned entity with respect to the taxpayer.

This provision is effective for term obligations incurred after the date of enactment and demand obligations outstanding 60 days after enactment.

Conference agreement

The conference agreement provides that the Treasury Department is to prescribe such regulations as may be necessary or appropriate to prevent the avoidance of tax provisions which deal with (1) the linking of borrowing to investment, or (2) diminishing risks, through the use of related persons, pass-through entities, or other intermediaries. The conferees specifically intend that this provision will be applied (but will not be limited to) the disallowance of interest deductions under section 265(2).

The conferees intend that, for purposes of section 265(2), related persons will include related persons as defined under section 1239, i.e., (1) a husband and wife, and (2) a person and certain 80-percent entities with respect to such person. Additionally, in appropriate instances, related persons for purposes of section 265(2) will include a person and any minor children of such person.

The conferees intend that this provision will not alter the present law rule which disallows an interest deduction under section 265(2) only if the purpose of borrowing is to purchase or carry tax-exempt obligations.[12] In particular, the conferees are aware that certain corporations engaged in banking, writing insurance, or issuing travelers checks, hold large investment portfolios, including tax-exempt securities, that are required to be held to satisfy obligations to or for their customers in the ordinary course of business. Often these corporations do not have significant amounts of interest-bearing debt. In addition, these corporations are often affiliates of other corporations which have large amounts of interest-bearing debt. The conferees intend that this provision will not cause interest on borrowings by an affiliated company to be disallowed in any case where such interest would not be disallowed under present law if the operations of the corporations were carried on as separate divisions of a single corporation.

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[12] See, e.g., *Leslie* v. *Commissioner,* 413 F. 2d 636 (2d Cir. 1969); *Wisconsin Cheeseman, Inc.* v. *United States,* 388 F. 2d 420 (7th Cir. 1968); Rev. Proc. 72-18, 72-1 C.B. 740.

The Code, as amended by the conference agreement, contains certain provisions other than sec. 265(2) which apply specific rules in cases in which indebtedness is linked to certain kinds of investments. The Code, as amended by the conference agreement, also contains many provisions (e.g., sec. 243) applying specific rules in cases in which a taxpayer reduces his risk of loss with respect to certain kinds of investments. Under the conference agreement, the Treasury regulations regarding related parties, pass-through entities, or other intermediaries are to be applied to all of these provisions. No inference is intended that any other Code provision may be circumvented by the use of related parties, pass-through entities, or other intermediaries. Nor is any inference intended that any particular provision under present law or as amended by the conference agreement (e.g., sec. 265(2) or sec. 246A), by its own terms, is not applicable in the case of related parties, pass-through entities, or other intermediaries.

The provision regarding related parties, pass-through entities, and other intermediaries is generally effective on the date of enactment. However, for purposes of section 265(2) only, this provision is to be effective with respect to (1) term obligations incurred after the date of enactment, and (2) demand obligations outstanding 60 days after the date of enactment.

II. LIFE INSURANCE TAX PROVISIONS

A. Tax Treatment of Life Insurance Companies

1. Definition of a life insurance company

Present law

A company is taxed as a life insurance company if (1) it is an insurance company; (2) it is engaged in the business of issuing life insurance and annuity contracts (either separately or in combination with accident and health insurance), or noncancellable accident and health insurance contracts; and (3) more than 50 percent of its total reserves are life insurance reserves or unearned premiums and unpaid losses (whether or not ascertained) on noncancellable life, accident or health policies not included in life insurance reserves. Life insurance reserves and total reserves do not include deficiency reserves.

Under present law, there is no statutory definition of an insurance company. Treasury regulations, however, provide that an insurance company is a company "whose primary and predominant business activity during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies." (Treas. Reg. sec. 1.801-3(a)).

House bill

The House bill generally adopts the present-law test for determining whether an insurance company is a life insurance company and, for this purpose, continues to look to properly computed statutory reserves. However, for purposes of qualifying as a life insurance company, the House bill adopts a statutory definition of an insurance company. Specifically, for purposes of qualifying as a life insurance company, a company must be one for which more than half of the business activity during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies.

The House bill adopts the same definition of a life insurance reserve as under present law. In doing so, the treatment of noncancellable accident and health insurance contracts in the 1959 Act as being comparable to life insurance contracts because of their long-term rate commitments is continued. Also, generally, the bill adopts the present-law definition of total reserves.

Senate amendment

The Senate amendment is generally the same as the House bill with two modifications. First, because of a general change in State law, as well as new rules for computing tax reserves, the present-law provision that excludes deficiency reserves from the definition of life insurance reserves and total reserves is eliminated. Rather, the new rules for computing tax reserves prohibit a company from taking into account any State requirements for "deficiency reserves" caused by a premium undercharge for purposes of computing the company's increase in reserves deduction.

Second, an insurance company may make a permanent election to treat individual noncancellable (or guaranteed renewable) accident and health contracts as cancellable for purposes of determining the qualification fraction. Thus, a company with large amounts of individual noncancellable accident and health business may elect to be taxed as a property and casualty insurance company, forfeiting the special and small life insurance company deductions.

Conference agreement

The conference agreement follows the Senate amendment, with the modification that the election to treat noncancellable accident and health contracts as cancellable must be made on the return filed for the first taxable year beginning after 1983.

2. Computation of life insurance company taxable income

Present law

A life insurance company currently is subject to a three-phase taxable income computation under Federal tax law. Under the three-phase system, a company is taxed currently on the lesser of its gain from operations or its taxable investment income (Phase I) and, if its gain from operations exceeds its taxable investment income, 50 percent of such excess (Phase II). The other 50 percent of the gain from operations is accounted for as part of a policy holders' surplus account and, subject to certain limitations, is taxed only when distributed to stockholders or upon corporate dissolution (Phase III). Thus, although life insurance companies are taxed at the normal corporate rates under present law, special accounting rules are provided for computing taxable income. Consistent with the taxation of other taxpayers, net capital gain that is taxable to the company may be subject to an alternative tax.

a. Life insurance company taxable income

House bill

Under the House bill, a life insurance company is to be taxed at corporate rates, under a single-phase system, on its life insurance company taxable income (LICTI), plus any distribution from a policyholders' surplus account. LICTI is life insurance gross income reduced by life insurance deductions which include generally available business deductions (with modifications) and special life insurance deductions. As under present law, net capital gain that is taxable to the company may be subject to an alternative tax. A stock life insurance company is to be taxed, at full corporate rates, on any distributions from a pre-1984 policyholders' surplus account.

Senate amendment

The Senate amendment is generally the same as the House bill with the exception of the specific differences described below.

Conference agreement

The conference agreement follows the House bill and the Senate amendment with the specific differences between the two resolved as described below.

b. Deduction for intercorporate dividends

House bill

With respect to the deduction for intercorporate dividends received by a life insurance company, in general, the House bill continues a present-law rule for prorating the deduction between the company and the policyholders as the items of investment income are allocated between the company and the policyholders. However, "100-percent dividends" (i.e., dividends that would be allowed a 100-percent deduction under sections 243 or 244, and certain dividends received by foreign corporations that would be 100-percent dividends but for the foreign recipient) are not subject to proration except to the extent they are funded with tax-exempt interest or with dividends that would not qualify as 100-percent dividends in the hands of the taxpayer.

Senate amendment

The Senate amendment is the same as the House bill except for a provision that allows 100-percent dividend treatment for dividends received from life subsidiaries and certain nonlife insurance subsidiaries if certain conditions are met. One-hundred percent dividends from a life insurance subsidiary will not be prorated if all the affiliated life insurance companies apply proration on a consolidated basis. Dividends from nonlife insurance subsidiaries (e.g., property and casualty insurance companies) will not be prorated if the subsidiary's surplus does not exceed 30 percent of assets and if its tax-advantaged investments (e.g., tax-exempt bonds or common stocks) do not exceed 60 percent of assets. One-hundred percent dividends from reinsurance subsidiaries may be excluded from the general proration rule under regulations. Dividends paid out of pre-1984 earnings by subsidiaries falling under these special rules for exclusion from or application of proration will not be taken into account in computing statement gains from operations under the ownership differential provision (new sec. 809). The special rules for exclusion from proration will terminate and not apply after 1986.

Conference agreement

The conference agreement follows the House bill. Thus, 100-percent dividends received by a life insurance company are not subject to proration except to the extent they are funded either with tax-exempt interest or with dividends that would not qualify as 100-percent dividends in the hands of the taxpayer. The conferees wish to clarify that in determining how much of a dividend has been paid out of tax-exempt interest, or dividends other than 100-percent dividends, or out of other taxable income items, a comparison should be made between the amount that previously undistributed tax-exempt interest and dividends other than 100-percent dividends have contributed to a company's current and post-1983 accumulated earnings and profits and all such earnings and profits immediately prior to the distribution. The conferees believe that this interpretation of the dividends-received proration provision is consistent with the definition of a dividend as a distribution out of earnings and profits (and not out of other amounts). Any other interpretation either would require the establishment of a unique set of earnings and profits accounting provisions, or would result potentially in year-to-year distortions because of annual variations in the proration formula.

c. The special life insurance company deduction

House bill

A life insurance company is allowed a deduction for any taxable year of 25 percent of its "tentative life insurance company taxable income" (tentative LICTI) over the amount of the company's small life insurance company deduction. Generally, a company's tentative LICTI is its life insurance company taxable income determined without regard to (1) the special life insurance company and small life insurance company deductions, and (2) any items (income or loss) attributable to any noninsurance business.

Under this provision, the special life insurance company deduction applies only with respect to income resulting from a company's insurance business. For these purposes, noninsurance business means any business which is not an insurance business. Generally, insurance business refers to the business activity of issuing insurance and annuity contracts and the resinsuring of risks underwritten by insurance companies, together with investment activities and administrative services that are required to support or are substantially related to the contracts issued or reinsured by the taxpayer. Any business that is not an insurance business but is of a type traditionally carried on by life insurance companies for investment purposes is to be treated as insurance business.

The House bill limits the amount of the special life insurance company deduction by treating all life insurance companies that are members of the same controlled group as one company whether such companies join in the filing of a consolidate return or file separate returns. Thus, the gain or loss of any life insurance company member will be reflected in the computation of the affiliated group's tentative life insurance company income, even if that particular member is not allowed to join in the consolidated return because it has not been a member of the affiliated group for the required time or is a foreign corporation. The bill gives Treasury authority to prescribe proper adjustments to eliminate a double reduction of tentative LICTI under such circumstances.

Senate amendment

The Senate amendment is generally the same as the House bill, except that the special deduction is 20 percent of tentative LICTI.

The Senate amendment modifies the computation of tentative LICTI if a company has both insurance and noninsurance business. Noninsurance business means any activity that is not an insurance business; however, an activity is treated as insurance business if it has been traditionally carried on by insurance companies and is carried on for investment purposes, but only if the activity (except for investment in real estate) does not constitute the active conduct of a trade or business. In addition, the performance of administrative services in connection with any plans providing life insurance, pension, or accident and health benefits is treated as insurance business. Also, for purposes of computing LICTI, any gain or loss from the noninsurance business of a life insurance company is treated as if it were the gain or loss of a noninusrance member that joined in the filing of a consolidated return with that life insurance company. Thus, a company's noninsurance losses will be subject to the 35-percent limitation of section 1503(c).

The Senate amendment has the same general rule as the House bill for computing tentative LICTI of a controlled group. However, the Senate amendment provides broader regulatory authority for Treasury to prescribe proper adjustments to be made in the application of the general provision for computing tentative LICTI of a controlled group in order to eliminate any excessive detriment or benefit (from year to year) arising from the operation of that provision.

Also, in lieu of the general rule for computing tentative LICTI of a controlled group, the Senate amendment permits a common parent to elect to compute the special life insurance company deduction separately for each "affiliated group" (as defined by sec. 1504) within the controlled group and for companies that are not members of an affiliated group. Where this election is made, a limitation is imposed on an affiliated group's ability to utilize life company members' losses against nonlife company members' income.

Conference agreement

The conference agreement generally follows the Senate amendment.

In following the Senate amendment with regard to the distinction made between insurance business and noninsurance business, the conferees believe that the distinction drawn between passive investment activities and an active conduct of a trade or business will be more administrable and provide more guidance and certainty for the industry as it further refines the "traditional investment" standard of the House bill. The general insurance-noninsurance distinction that is made for purposes of computing the amount of the special deduction will prevent a company from obtaining a tax rate on income from noninsurance activities that is lower (through the operation of the special deduction) than would be applied if the activities were carried on in a separate nonlife insurance company. At the same time, the conferees recognize that a life insurance company should not be allowed a greater advantage by carrying on, within the company, noninsurance activities that result in losses than would result if those same activities were carried on in a separate company. Thus, the conference agreement adopts the provision that a loss from noninsurnace activities will be treated as a gain or loss of a noninsurance subsidiary of the life insurance company that joined in the filing of a consolidated return with that life insurance company. This results from the application of the general principles of life-nonlife consolidation (sec. 1503(c)) for purposes of combining income and losses from insurance and noninsurance business activities in computing the LICTI of a life insurance company.

For example, noninsurance losses taken into account for purposes of computing LICTI (after the special deduction and small life insurance company deduction) for a taxable year will be limited to 35 percent of the lesser of the noninsurance loss or LICTI (without regard to the noninsurance loss). It is anticipated that regulations under section 1503(c) will develop rules for the treatment of such noninsurance income or losses within a life-nonlife consolidated group that are consistent with the treatment of such items for purposes of computing LICTI of a single life insurance company.

Whether an activity will be treated as insurance business or noninsurance business depends on the nature of the activity itself, regardless of whether the assets and income related to the activity are financially supportive of the insurance business operation. Thus, for example, even though a company might choose to invest premium receipts in an oil or gas joint venture and use the investment return therefrom to meet policy obligations, gain or loss arising from the joint venture will be treated as a noninsurance gain or loss if the company's participation in the joint venture constitutes the conduct of a trade or business. However, the conference agreement provides that certain existing investments in oil and gas through will be treated as insurance business for purposes of computing tentative LICTI. On the other hand, participation in an oil and gas venture solely as a limited partner will ordinarily be treated as a passive investment activity, income and expenses of which will be treated as part of the insurance business. By the same token, the ownership of stock will always be treated as insurance business because it is essentially a passive investment activity, even when the stock ownership results in the life insurance company having control of another company.

This characterization of an activity as insurance or noninsurance business, based on whether it is a passive investment or an active trade or business, is to apply only with respect to the determination of the amount of the special life insurance company deduction (and small life insurance company deduction) and the computation of LICTI, and is not intended to be used for purposes of determining whether a company is a life insurance company for tax purposes. Qualification as a life insurance company will be determined under rules similar to those of present law.

d. The small life insurance company deduction

House bill

Under the House bill, small life insurance companies are allowed an additional special deduction that is not available to other taxpayers. This deduction also is based on tentative LICTI, and applies before the special life insurance company deduction. The amount of the deduction is 60 percent of so much of tentative LICTI for such taxable year as does not exceed $3 million, reduced by 15 percent of the excess of tentative LICTI over $3 million.

As in the case of the special life insurance company deduction, the small life insurance company deduction is computed by treating all life insurance companies that are members of the same controlled group as one company whether those companies join in the filing of a consolidated return or file separate returns.

The small life insurance company deduction is only allowable to companies with gross assets of less than $500 million. The asset qualification for the small company deduction is determined on the basis of a controlled group as defined in section 1563.

Senate amendment

The Senate amendment is the same as the House bill, except that for 1984, only the assets of controlled group members that can be classified as financial intermediaries (e.g., insurance companies, banks, savings and loans, finance companies, securities brokers, and similar institutions), will be aggregated for purposes of the $500 million asset test if certain requirements are met. Also, the modifications to the definition of tentative LICTI described above (item **d.**) apply for purposes of the small life insurance company deduction.

Conference agreement

The conference agreement follows the Senate amendment.

e. The alternative life insurance company deduction

House bill

No provision.

Senate amendment

In lieu of both the special life insurance company deduction and the small life insurance company deduction, a company can elect (subject to certain special rules), for 1984 through 1987, to claim the alternative life insurance company deduction. The amount of the alternative deduction for any year is determined in part as a percentage of the combined special and small life insurance company deductions and in part a percentage of the qualified first-year premium amount. The amount of the alternative deduction will converge over five years to the sole use of the special and small life insurance company deductions. After 1987, there will be no alternative deduction.

The qualified first-year premium amount means 20 percent of premiums for certain newly issued ordinary life and individual accident and health insurance contracts. Also, the amount of qualified premiums must be reduced by the amount of premiums for reinsurance ceded.

Conference agreement

The conference agreement follows the House bill.

3. Policyholders' surplus accounts

Present law

Present law permits stock life insurance companies to defer the tax on 50 percent of their gain from operations in excess of their taxable investment income. The deferred income is added to a policyholder's surplus account, along with amounts deducted for nonparticipating contracts and group life and accident and health insurance contracts. Amounts in the policyholders' surplus account are taxed only when distributed by the company to its shareholders. To determine whether amounts have been distributed, a company must maintain a shareholder's surplus account which generally includes the company's previously taxed income and certain nontaxable items that would be available for distribution to shareholders. Distributions to shareholders are treated as being first out of the shareholders' surplus account, then out of the policyholders' surplus account and finally out of other accounts.

House bill

In general, the House bill eliminates any further deferral with regard to income for 1984 and later years. Although companies will not be able to enlarge their policyholders' surplus account after 1983, they will not be taxed on previously deferred amounts unless they are treated as distributed to shareholders or subtracted from the policyholders' surplus account under rules comparable to those provided under the 1959 Act, but which reflect the basic changes in the tax structure under the bill.

Specifically, for each taxable year, the excess of the sum of the following amounts over the taxes paid for the year will be added to the shareholders' surplus account: (1) LICTI (determined without regard to any distributions from the policyholders' surplus account); (2) the special life insurance company deduction; (3) the small life insurance company deduction; (4) the deduction allowed the company for intercorporate dividends received; and (5) excluded tax-exempt interest.

Senate amendment

The Senate amendment is the same as the House bill, except it also contains a special provision to relieve a company from tax on a distribution from a policyholders' surplus account due to a reduction of premium volume brought about by a reinsurance transaction ordered by the Federal Reserve Board.

Conference agreement

The conference agreement follows the House bill.

The conferees understand that the rules governing distributions from the policyholders' surplus account have been altered somewhat to reflect the general structure and goals of the new bill. However, the shareholders' surplus account will continue to be maintained as an account of certain positive additions representing items that can be characterized generally as previously taxed or nontaxable amounts that would be available for distribution to shareholders before requiring a distribution from the policyholders' surplus account. Thus, for these purposes, the item of LICTI added to the shareholders' surplus account can never be less than zero. Also, the conference agreement makes it clear that when there are distributions from the policyholders' surplus account, the amount of the distribution (whether actual or deemed, or by the indirect use of amounts in the policyholders' surplus account for the benefit of shareholders) is taxed in addition to LICTI and not as part of the LICTI computation. Thus, distributions from the policyholders' surplus account cannot be offset by life insurance company losses and are not subject to the special and small life insurance company deductions.

4. Computation of reserve deductions

Present law

A life insurance company is allowed to deduct (or exclude from income) increases in its year-end reserves over those for the prior year. A life insurance company's tax reserves are based on its reserves for State regulatory purposes (i.e., statutory reserves) and, as a general rule, a company's deduction reflects an increase in its statutory reserves over its statutory reserves for the prior year. Reserves computed for statutory purposes on a preliminary term basis may be revalued to a net level premium basis using either an exact revaluation method or an approximate revaluation method.

House bill

In general, life insurance companies are allowed a deduction for a net increase in reserves and must take into income any net decrease in reserves. In computing the net increase or net decrease in reserves, the House bill specifies that six items, which are all reserves or in the nature of reserves, be taken into account. These are (1) life insurance reserves; (2) unearned premiums and unpaid losses included in total reserves; (3) amounts that are discounted at interest to satisfy obligations which are obligations under insurance and annuity contracts which do not involve life, accident, or health contingencies when the computation is made; (4) dividend accumulations and other amounts held at interest in connection with insurance and annuity contracts; (5) premiums received in advance and liabilities for premium deposit funds; and (6) reasonable special contingency reserves under contracts of group term life insurance or group accident and health insurance which are held for retired lives, premium stabilization, or a combination of both.

Computation of reserves.—For purposes of determining life insurance company taxable income, the House bill provides that the life insurance reserves for any contract shall be the greater of the net surrender value of the contract or the reserves determined under Federally prescribed rules. Generally, the comparison of the net surrender value of a contract and the Federally prescribed reserves for the benefits under the contract is made on an aggregate benefit basis; however, the comparison may be made on a benefit-by-benefit basis if the benefit is a qualifying supplemental benefit or qualifying substandard risk.

The House bill requires that, in computing the Federally prescribed reserve for any type of contract, the tax reserve method applicable to that contract must be used, along with the prevailing State assumed interest rate and the prevailing commissioner's standard tables for mortality or morbidity.

Reserve method.—With respect to the reserve method to be used, the House bill prescribes specific tax reserve methods for particular types of contracts. For life insurance contracts, the prescribed method is the applicable Commissioners' Reserve Valuation Method (CRVM) in effect when the contract is issued. For annuity contracts, the prescribed method is the applicable Commissioners' Annuities Reserve Valuation Method in effect when the contract is issued. For noncancellable accident and health insurance contracts, a 2-year full preliminary term method is required. Finally, for all other contracts, the reserve method prescribed by the NAIC or, if no method is so prescribed, a method consistent with whichever of the prescribed methods that would be most appropriate for the contract.

There is a special rule for any company domiciled in a State which, in determining minimum reserves for an annuity contract for State purposes, does not reduce the reserves for surrender charges. The bill provides that if a State has continuously pursued this practice since September 27, 1983, then any life insurance company domiciled in that State may adjust its Federally prescribed reserves by taking into account the reasonable surrender charge.

There is also a special rule which allows a company to use the net level premium reserve method for tax purposes for noncancellable accident and health insurance contracts, if the company was using that method for statutory reserves on such contracts as of December 31, 1982, and continues to do so for annual statement purposes for such noncancellable accident and health contracts.

Senate amendment

The Senate amendment is generally the same as the House bill, except that it does not include the special reserve rule for annuity contracts if the State of domicile requires that reserves be computed without reduction for surrender charges. It also does not include the special rule that allows companies to use the net level method for noncancellable accident and health insurance contracts under certain circumstances.

In addition, the Senate amendment specifies that the reserve methods prescribed for tax reserves do not incorporate any provisions which increase the reserve because the net premium (computed on the basis of Federally prescribed assumptions) exceeds the actual premiums or other consideration charged for the benefit. Thus, the computation of the tax reserves will not take into account any State law requirements regarding "deficiency reserves" (whether such reserves are as defined under present law or whether the NAIC prescribed method would otherwise require a company's reserves to reflect a gross premium charge that is less than the net premium based on minimum reserve standards).

Finally, the amendment differs from the House bill in that it provides a special rule for contracts issued before January 1, 1989 under plans of insurance in existence on March 15, 1984, for purposes of computing tax reserves with respect to riders for term life insurance and annuity benefits. Term life insurance and annuity benefits included in insurance contracts will be treated as qualified supplemental benefits, for purposes of allowing the tax reserve to be computed for such benefits as though each benefit were a separate contract. However, such benefits will not be treated as qualified supplemental benefits for purposes of using the statutory reserve as the tax reserve for such benefits.

Conference agreement

The conference agreement generally follows the Senate amendment, but also includes the special rule that allows a company which computed all its noncancellable accident and health contract reserves on a net level basis for State purposes to continue to do so for tax purposes also. The conferees wish to clarify that a company can use the net level reserve method for tax purposes for noncancellable accident and health contracts sold under a particular plan of insurance, if the company computed all its reserves for such contracts on that method for statutory purposes as of December 31, 1983 (as evidenced by its 1983 annual statement, as originally filed) and continues to do so for all such reserves on both new and existing business. If the company was not using a net level reserve method as of December 31, 1983, with respect to contracts sold under a particular plan of insurance, the company must use the generally prescribed reserve method (2-year full preliminary term method) for all contracts under the plan. Likewise, the generally prescribed method must be used for noncancellable accident and health insurance contracts sold under any new plans of insurance.

In adopting the Senate amendment with respect to the computation of annuity reserves, the conferees understand that the practices of the various States differ on whether surrender charges should be taken into account (and reduce the amount of the reserve) and that the matter is currently being considered by the NAIC for a recommendation. In light of these events, the conferees intend that, in the case of annuity reserves, if the NAIC in 1984 clarifies what surrender charge factors are to be disregarded (and not to reduce the amount of the reserve) under the CARVM, then this clarification is to be considered in effect on the date of issuance of such contracts. The conferees recognize that giving retroactive effect to a NAIC recommendation in this instance is an exception to the general rule that reserves must be computed for tax purposes under the method prescribed by the NAIC (or the prevailing State interpretation thereof) in effect on the date of issuance of the contract.

Also, the conference agreement adopts a special rule for purposes of identifying the prevailing interest rate with respect to life insurance reserves on noncancellable accident and health insurance contracts (e.g., the reserve in addition to the unearned premiums and unpaid losses on such contracts). Until States specifically prescribe an interest rate for these reserves, the conference agreement provides that, because of the analogous character of these reserves to reserves on ordinary life policies, the prevailing interest rate for reserves on life policies will be used.

Finally, the conference agreement adopts a transitional rule for recomputation of reserves for group contracts if the issuance date (or the date benefits were guaranteed) cannot be determined. In such a case, the issuance date must be determined on the basis prescribed by Treasury. It is anticipated that Treasury will develop some method for approximating the date of issuance that generally reflects the pattern of growth in the type of group business.

5. Variable contracts

Present law

In general, either a variable annuity [1] or a variable life insurance contract is a contract under which any amounts or premiums received are invested in a separate asset account of the insurance company, and the amounts paid in or paid out reflect the investment return and the market value of such separate account. Under a variable annuity, either the cash surrender value before the annuity starting date or annuity payments made after the annuity starting date (or both) reflects the investment activity of the separate account; under a variable life insurance contract, the cash surrender value and the amount of death benefit fluctuates with the investment activity of the separate account.

Generally, income on an annuity contract is taxed only once, at the policyholder level when the income is distributed. This is accomplished by means of a deduction at the company level for amounts credited to policyholders under annuity contracts. However, under present law, income on a nonqualified variable annuity (i.e., one that is not purchased as part of a qualified pension plan) may be taxed at the company level as well as at the policyholder level. Under separate accounting provisions of present law, amounts credited to the holder of a nonqualified variable annuity based on appreciation in the value of the separate asset account are not deductible by the company. Thus, under present law, the company pays a tax at a capital gains rate on the sale of an appreciated asset, without an offsetting deduction for the income credited to the contractholder. When the income is distributed, it is taxable as ordinary income to the contractholder. The result is that amounts credited to a variable annuity that reflect the appreciation in the value of assets in the separate accoiunt are taxed once at the company level at the capital gains rate and once to the con-

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[1] The term variable annuity is used generally to refer to a contract which reflects the investment activity of a company and also a contract that reflects the investment return and market value of a segregated asset account within a company, although the latter may be referred to more specifically as "a contract with reserves based on a segregated asset account." See present-law sec. 801(g).

tractholder as ordinary income. This consequence was recognized as appropriate in 1959 and again in 1962,[2] although it was eliminated for qualified pension contracts in 1962.

The special provisions described above do not cover the newer variable life insurance contracts. In the case of such accounts, there is no company level tax on amounts credited to contractholders that reflect the appreciation of the assets in the underlying separate account. Further, the company is allowed an ordinary deduction for such appreciation, whether realized or unrealized, when it is credited to the variable life insurance contract (and is reflected in reserves or the cash surrender value) and is taxed at the capital gains rate on the appreciation income when it is realized upon sale of the asset.

House bill

The House bill continues to provide special rules for variable annuities and contracts with reserves based on segregated asset accounts and extends those rules to variable life insurance contracts. Thus, with respect to any variable contract, the reserve items taken into account at the close of the taxable year for purposes of determining net increases or net decreases must be adjusted by subtracting any amount attributable to appreciation in value of assets or by adding any amount attributable to depreciation. Such adjustments for appreciation or depreciation are to be made whether or not the company has disposed of the assets during the taxable year. This adjustment in computing the annual increase or decrease in reserves for variable contracts results in the capital gain or loss being recognized and taxes at both the company level and the policyholder level, since no adjustment is made in either the company's basis or the policyholder's investment in the contract.

The House bill also continues the separate accounting requirements under present law for various income, exclusion, deduction, asset, reserve, and other liability items properly attributable to variable contracts. Likewise, the equity base of the separate account will be determined under the separate accounting requirement and aggregated with the company's average equity base for its general account business.

Senate amendment

The Senate amendment is the same as the House bill with respect to the separate accountng requirements for segregated accounts and variable contracts. However, the company's basis in the assets underlying all variable contracts will be adjusted for appreciation or depreciation, to the extent the reserves are so adjusted. Thus, the corporate level capital gains tax is eliminated. This basis adjustment provision generally conforms the tax treatment of all variable contracts to that of variable pension plan contracts under present law.

The Senate amendment also permits the Treasury to prescribe diversification standards for investments of segregated asset accounts underlying variable contracts. If the segregated asset account does not meet the prescribed diversification standards, then

[2] S. Rep. 291, 86th Cong., 1st Sess. 36 (1959); and S. Rep. 2109, 87th Cong., 2d Sess. 7-8 (1962).

a variable contract based on the account will not be treated as an annuity, endowment or life insurance contract for purposes of subchapter L (relating to taxation of insurance companies), section 72, and section 7702(a) (relating to the definition of a life insurance contract). There is an exception from the general investment diversification provisions for a segregated asset account used for variable life insurance contracts, if the account invests only in securities issued by the United States Treasury. Also, a company can use an independent investment advisor with respect to the segregated asset accounts underlying any of its variable contracts.

Conference agreement

The conference agreement generally follows the Senate amendment, but further defines the range of the diversification requirement within which Treasury has authority to set standards. Specifically, the conference agreement provides that any fund that is at least as diversified as the requirements of a regulated investment company under section 851(b) will be considered to be adequately diversified without further showing, if the fund has no more than 55 percent of its assets held in cash, cash items, Government securities, or securities of other regulated investment companies. The exception that allowed variable life insurance to be based on a fund fully invested in securities issued by the Treasury continues to be provided. In addition, the conference agreement allows any diversified fund to be used as the basis of variable contracts so long as all shares of the funds are owned by one or more segregated asset accounts of insurance companies, but only if access to the fund is available exclusively through the purchase of a variable contract from an insurance company. The fact that a similar fund is available to the public will not cause the segregated asset fund to be treated as being publicly available.

In authorizing Treasury to prescribe diversification standards, the conferees intend that the standards be designed to deny annuity or life insurance treatment for investments that are publicly available to investors and investments which are made, in effect, at the direction of the investor. Thus, annuity or life insurance treatment would be denied to variable contracts (1) that are equivalent to investments in one or a relatively small number of particular assets (e.g., stocks, bonds, or certificates of deposits of a single issuer); (2) that invest in one or a relatively small number of publicly available mutual funds; (3) that invest in one or a relatively small number of specific properties (whether real or personal); or (4) that invest in a nondiversified pool of mortgage type investments. This new diversification authority is not intended to allow the imposition of any requirement that the investment fund reflect a diverse range of investment goals (e.g., short-term/long-term, or fixed income/equity securities need not be mixed in a single fund). This diversification requirement will not apply to funds underlying pension plan contracts defined under new section 818. The conference agreement also clarifies that a variable contract will cease to be treated as an annuity, endowment or life insurance contract when and if the underlying fund fails to be adequately diversified.

In addition, Treasury will have regulatory authority (under an amendment to sec. 514) to subject to tax the assets of a segregated asset account if the account is used to circumvent the acquisition indebtedness rules.

6. Policyholder dividends

Present law

In general, under present law, policyholder dividends are dividends and similar distributions to policyholders. Interest paid and return premiums are not policyholder dividends. This statutory language has been expanded in regulations so that the term policyholder dividends generally refers to amounts returned to policyholders that are not fixed in the contract and depend on the experience of the company or the discretion of management. However, taxpayers have taken the position that the term does not include excess interest even though such amounts are not fixed in the contract but depend upon the experience of the company or the discretion of management.

Under present law, policyholder dividends are accounted for on a reserve basis, and a company is allowed to deduct additions to its policyholder dividend reserves for dividends that are payable during the year following the taxable year.

House bill

The House bill adopts a broad definition of the term policyholder dividends to include any distribution to a policyholder that is the economic equivalent of a dividend. Thus, in addition to any amount paid or credited to policyholders (including an increase in benefits) when the amount is not fixed in the contract but depends on the experience of the company or the discretion of management, the term policyholder dividends specifically includes excess interest, premium adjustments, and experience-rated refunds.

As under present law, the House bill allows a deduction for dividends or similar distributions to policyholders. The bill departs from present law, however, in that the amount of the deduction for any taxable year is the amount of policyholder dividends paid or accrued during the taxable year rather than the amount of the increases in the reserves for policyholder dividends that are payable during the year following the taxable year. Under the fresh start transitional rule, this change from a reserve to an accrual method is not to be treated as a change in a method of accounting. Thus, no income or loss is to be recognized with respect to amounts in existing policyholder dividend reserves.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

7. Reduction of certain deductions of mutual companies

Present law

Under present law, policyholder dividends paid by mutual and stock life insurance companies are deductible at the company level. Special rules apply, however, to limit the amount of this deduction. Under the 1959 Act, the policyholder dividend deduction is limited to the excess of gain from operations over taxable investment income, plus $250,000. TEFRA adopted, for 1982 and 1983, a more generous limit on policyholder dividends, allowing either (1) an amount computed under the 1959 Act rule with the $250,000 statutory amount increased to $1 million, phasing down to zero as the sum of the company's policyholder dividends and other special deductions increased from more than $4 million to $8 million, or (2) an amount equal to the statutory amount (as modified), plus 100 percent of dividends on pension business, plus 77½ percent of non-pension policyholder dividends for mutual companies (85 percent for stocks).

House bill

Although the general rules and definitions relating to policyholder dividends apply to stock and mutual life insurance companies alike, the amount of the deduction for mutual companies is reduced by the "differential earnings amount." If the differential earnings amount exceeds the allowable deduction, then such excess will reduce the closing balance of the company's reserves. This reduction reflects recognition that, to some extent, policyholder dividends paid by mutual companies are distributions of the companies' earnings to the policyholders as owners. Thus, the bill recognizes an ownership differential between policyholders of mutual and stock life insurance companies.

The "differential earnings amount" is computed by multiplying the company's average equity base for the taxable year by the "differential earnings rate" for the taxable year. The differential earnings rate is the excess of the "imputed earnings rate" over the "average mutual earnings rate". The "imputed earnings rate" is set in the Code, and subsequently adjusted in accordance with future changes in the average earnings rate of the 50 largest stock life insurance companies.

The House bill provides a 5-year transition rule for high surplus mutual life insurance companies for purposes of applying the ownership differential provision. A company is a high surplus company if its equity base to asset ratio for 1984 exceeds a percentage of assets that is approximately 130 percent of the arithmetic average equity base to asset ratio of the 50 largest mutual life insurance companies, (as determined by the Secretary using the most recent data available). A high surplus company need not apply the differential earnings rate to the excess portion of its equity base. However, in no event can the amount of any excess not taken into account exceed $50 million in 1984. The amount of any excess equity not taken into account in applying the differential earnings rate, as well as the $50 million cap, will decrease ratably each year, until 1989 when the entire equity base of a high surplus company is subject to the differential earnings rate.

Senate amendment

The Senate amendment is the same as the House bill except in three instances. First, the amendment contains a special transition rule for determining the average equity base of a life subsidiary of a mutual life insurance company issuing excess interest life insurance contracts. Second, a special rule is provided for certain mutual life insurance companies that are successor companies to fraternal benefit societies. Third, the amendment has the same transition rule for high surplus mutual life insurance companies except it does not have a $50 million cap on the amount of excess surplus that can be taken into account.

Conference agreement

The conference agreement follows the House bill and the Senate amendment with respect to the general rules for the ownership differential. In order to simplify the administration of the ownership differential provisions for the initial years covered by the bill, the conference agreement substitutes a fixed differential earnings rate of 7.8 percent to be used for purposes of filing returns for the 1984 tax year and for estimated taxes for 1985. Likewise, in order to eliminate distortions in the computation of the average earning rate of the 50 largest stock companies, the Secretary will have the authority to omit aberrational rates caused by disproportionately small equity bases (for example, when a company is close to being or is insolvent). The conference agreement also clarifies that Treasury has authority under section 6001 to require the relevant stock or mutual life insurance companies to submit information returns from which Treasury will be able to ascertain data necessary for it to implement the ownership differential provisions, even with respect to tax years ending before 1984.

In determining the average equity base to which the differential earnings rate is to apply, both the House bill and the Senate amendment provide that voluntary reserves are to be treated as part of equity. The conferees wish to clarify that this reference to voluntary reserves is not limited to reserves for potential or unaccrued liabilities relating to insurance contracts. It is anticipated that Treasury regulations will provide guidance for classifying reserves as voluntary. For example, a reserve for Federal taxes may be in whole or in part a voluntary reserve. If the reserve is for a Federal income tax liability that might arise in the future if certain items are identified on audit, such a reserve will be treated as a voluntary reserve because liabiilty for those amounts is contingent on detection of the tax issue, assertion of a deficiency, and resolution of the issue. If the reserve is for taxes accrued and payable on the due date of the return for the year, it will not constitute a voluntary reserve. In cases that are less clearcut, such as when the reserve is for deficiencies that have been asserted after audit, the Secretary will have authority to give further guidance on whether the reserve is voluntary.

The conference agreement adopts the Senate amendment for a transitional rule for certain mutual life insurance companies with life subsidiaries issuing excess interest life insurance contracts. In doing so, the conferees wish to clarify that this special provision is limited to the sale of such contracts under plans to insurance in existence on July 1, 1983, and that for these narrow purposes any change in the contract that requires approval by the State insurance department or that changes the form and timing of amounts credited will be considered a change in the plan of insurance. Thus, a company cannot change a traditional participating policy with policyholder dividends payable on the policy anniversary to an excess interest contract with excess interest guaranteed for a period in advance in order to qualify for the special transition rule for excess interest life insurance contracts.

The conference agreement adopts the Senate amendment with respect to mutual successors to fraternal benefit societies and extends the rule to apply to mutual life insurance companies that assumed the surplus of such an organization in March 1961, as well as in 1950.

The conference agreement follows the Senate amendment with respect to the transitional rule for high surplus mutual life insurance companies. Also, it clarifies that the amount of excess equity taken into account by any mutual life insurance company for any year (before being phased down ratably over the 5-year period of the transitional rule) cannot exceed the amount of the excess equity determined for 1984. The conference agreement simplifies the administration of the high surplus transitional rule by adopting fixed percentages to be used in lieu of computing 130 percent of the average equity to asset ratio of the 50 largest mutual life insurance companies to determine the excess equity threshold. These are: 14.5 percent for taxable years beginning in 1984; 14.0 percent for taxable years beginning in 1985 and 1986; and 13.5 percent for taxable years beginning in 1987 and 1988.

For purposes of determining whether a company is a high surplus company and the amount fo excess equity, the assets taken into account in the equity to asset ratio include all assets (e.g., certain nonadmitted assets) taken into account in determining its equity base and for purposes of the rules for the treatment of stock companies owned by mutual life insurance companies. Thus, all the assets of any life insurance subsidiary whose equity is included in the equity of the parent mutual company, as well as any assets of separate asset accounts, are included in assets for purposes of applying the high surplus transitional rule. Payables and receivables between the parent and life subsidiaries should be ignored, while the same items between the parent and a nonlife subsidiary should be taken into account. Also, the rule against double counting should be observed generally in this area. Thus, for example, if a company purchases bonds at the end of the year and carries a suspense account for the amount of the consideration to be transferred, the value of the bonds should be included in assets and the amount of the suspense account should not.

8. Operations loss deduction

Present law

Generally, operations losses may be carried back to each of the 3 taxable years preceding the loss year and may be carried over to each of the 15 taxable years following the loss year. For a life insurance company that qualifies as a new company in the loss year, the 3-year carryback may be added, instead, to the 15-year carryover.

House bill

The operations loss deduction provided in the House bill is substantially the same as that in section 812 in present law and new section 810 is treated as a continuation of present-law section 812. Modifications are made that will conform the definition of an operations loss deduction to the new method for determining life insurance company taxable income. In both the bill and present-law section 812, the operations loss deduction is consistent with the general treatment for a net operating loss in section 172.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

9. Accounting provisions

Present law

Generally, under present law, all computations entering into the determination of life insurance company taxable income are to be made under an accrual method of accounting or, to the extent permitted under regulations, under a combination of an accrual method with any other recognized method other than the cash receipts and disbursements method. Except as provided in the general rule, all such computations are to be made in a manner consistent with the manner required for purposes of the annual statement approved by the National Association of Insurance Commissioners.

When two or more related parties (within the meaning of sec. 1239) are parties to a reinsurance agreement, present law gives the Secretary authority to allocate or recharacterize any items necessary to reflect the proper source and character of the taxable income of each related party.

Also, there was a temporary rule (adopted under TEFRA) for computing reserves on contracts where interest is guaranteed beyond the end of the taxable year; any interest which is computed at a rate which is in excess of the lowest rate assumed in the contract and is guaranteed beyond the end of the taxable year is taken into account in computing reserves as if such interest were guaranteed only up to the end of the taxable year.

Finally, under present law there are specific rules for the amortization of premium and accrual of discount on bonds and for life insurance companies with short taxable years.

House bill

The House bill retains the general rule in present law that life insurance companies must use an accrual method, or a method permitted under the regulations that combines an accrual method with another recognized method. However, the bill makes it clear that accounting methods required for State regulatory purposes apply only to the extent that they are not inconsistent with Federal tax accounting rules.

In the case of reinsurance agreements, the House bill expands the reallocation authority granted Treasury. As under present law, in the case of a reinsurance agreement between two or more related persons, the Treasury can allocate among the parties and recharacterize income, deductions, assets, reserves, credits, and any other items related to the reinsurance agreement in order to reflect the proper source and character of the items for each party. Under the bill, however, related parties are defined as they are in section 482. Also, Treasury can use its recharacterization authority for a reinsurance agreement between unrelated parties where one of the parties to the agreement (with respect to any contract covered by the agreement), in effect, is an agent of, or conduit for, another party to such agreement. Treasury's new allocation and recharacterization authority will apply to any contract issued before September 27, 1983, which is reinsured before such date under a reinsurance agreement entered into before such date.

Finally, the House bill includes, as a permanent provision, the accounting rule adopted as a temporary provision in TEFRA for computing reserves for contracts that guarantee excess interest beyond the end of the taxable year. Under the bill, the provision is modified to reflect the new Federally prescribed reserve rules.

With respect to the special rules for amortization of premium and accrual of discount on bonds, and short taxable years for life insurance companies, the House bill makes no change from present law.

Senate amendment

The Senate amendment is the same as the House bill except that it further clarifies Treasury's new allocation and recharacterization authority so that it specifically applies to reinsurance agreements between unrelated parties if one of the parties to the agreement is an agent for another party to the agreement or is a conduit between related persons. The Senate amendment also has a different effective date for the new authority; it will apply to any risk reinsured after September 27, 1983, whether or not the reinsurance agreement was entered into before such date.

Conference agreement

The conference agreement generally follows the Senate amendment, but further extends Treasury's authority to examine reinsurance transactions by adopting an additional provision covering transactions between unrelated parties. Thus, under the conference agreement there are two rules which permit the Secretary to make adjustments in reinsurance transactions to prevent tax avoidance or evasion.

The first provision is a modified form of the provision in the Senate amendment permitting reallocations in related party reinsurance transactions to reflect the proper source and character of income. Under the conference agreement, if 2 or more related insurance companies enter into a reinsurance contract, the Secretary may allocate between or among such companies income, deductions, assets, reserves, credits and other items related to the agreement or may recharacterize such items. The Secretary also may make any other adjustment or recharacterization for one or both parties (if the transaction has unrelated parties acting as agents or conduits for another) necessary for these purposes. This authority is generally similar to that provided under section 482 for the Secretary to make correlative adjustments between related parties, except that the authority extends to a broader class of items and may be exercised whenever it is necessary to reflect the proper character and source of item.

Under the second provision of the conference agreement, if the Secretary determines that a reinsurance contract between unrelated insurance companies has a significant tax avoidance effect on any party to the contract, the Secretary may make an adjustment to one or both parties to eliminate the tax avoidance effect, including treating the contract as terminated on December 31 of each year and reinstated on January 1 of the next year. This unrelated party reinsurance rule differs from the general related party reallocation authority in that before making adjustments under this second rule the Secretary must determine that there is a "significant tax avoidance effect" to the reinsurance agreement as opposed to meeting the lower standard of "necessary to effect the proper source and character of the taxable income." Any transaction which would be within the scope of the unrelated party rule but for the fact that the parties are related, would be within the scope of the related party reinsurance rule. On the other hand, a transaction which would not give rise to adjustments if entered into by unrelated parties might result in adjustments as among related parties.

The operative standards for both of the reinsurance adjustment provisions are objective tests of (1) whether adjustments are necessary to more properly reflect income or (2) whether the transaction has a significant tax avoidance effect. The motivations of the parties is wholly irrelevant in making this determination. The fact that a transaction has a business purpose or was not entered into with tax avoidance or evasion as a principal purpose or is entered into at arm's length will not foreclose Treasury from examining a reinsurance transaction under either the provision dealing with related parties or the new provision in the conference agreement dealing with unrelated parties.

In the case of a reinsurance transaction between unrelated parties, the determination of a significant tax avoidance effect for one party to a reinsurance contract, for example, together with any adjustments deemed proper by the Secretary (including deemed termination of the contract), will not require that any correlative adjustments be made to the other party to the contract. Also, the adjustment authority under either reinsurance provision can be exercised with respect to any transaction characterized as reinsurance or insurance by the parties. The exercise of such authority will not preclude the Treasury from also questioning whether the transaction constitutes insurance or reinsurance for other purposes.

In general, whether a reinsurance contract has a tax avoidance effect with respect to any party should be determined by reference to the effect (with respect to one or both parties) in the current year or any other year, after taking into account the time value of money. A tax avoidance effect may arise, for example, when the reinsurance contract artificially reduces a company's equity, changes the source or character of any item, defers taxation of income items, eliminates the "SRLY taint" of a previous net operating loss, artificially transfers tax benefits between taxpayers in different tax brackets, or effectively extends a carryover period. A tax avoidance effect is significant if the transaction is designed so that the tax benefits enjoyed by one or both parties to the contract are disproportionate to the risk transferred between the parties. There is no significant tax avoidance effect for a reinsurer, however, merely because a tax reduction arises from a loss on the reinsurance contract for a particular year, if the loss experienced was no greater than if the reinsurer had written the allocable portion of the reinsured business directly.

In making the determination whether a reinsurance agreement between unrelated parties has a significant tax avoidance effect with respect to one or both of the parties, the Secretary should examine the economic substance of the transaction, taking into account factors such as those described below. These factors may suggest that a significant tax avoidance effect exists for either or both of the parties, but none alone will be determinative.

First, the duration or age of the business reinsured should be taken into account because it bears directly on the issue of whether significant economic risk is transferred between the parties. For example, the coinsurance of new contracts may carry a risk of lapse as well as the mortality risk of the underlying contracts; thus, there may be a significant economic risk that the reinsurer will not realize its share of the potential profits of the underlying contracts. On the other hand, the reinsurance of an old block of business, for which the risk of lapse is minimal, may not result in a significant economic risk being transferred between the parties in proportion to the tax benefits enjoyed.

Second, the character of the business reinsured should be taken into account in determining whether the tax benefits of any party are disproportionate to the risk transferred. For example, coinsurance of yearly renewable term life insurance will generally not have significant tax avoidance effect for the parties to the transaction because it does not involve the transfer of long-term reserves as under the coinsurance of ordinary life insurance.

Third, the structure for determining the potential profits of each of the parties and any experience rating should be considered by Treasury. If the experience rating formula results in the reinsurer receiving only an annual risk premium, plus a fixed fee, the transaction might be viewed as economically equivalent to yearly renewable term reinsurance combined with a financing arrangement between the ceding company and the reinsurer. However, if the experience rating formula results in the reinsurer assuming a risk of loss beyond the annual mortality risk, as well as enjoying a share of the profits commensurate with its loss exposure, such a factor may indicate that tax benefits arising from the assumption of reserve liabilities by the reinsurer are not disproportionate to the risk transferred between the parties.

Fourth, the duration of the reinsurance agreement between the parties should be considered. The fact that there has been a longstanding agreement for automatic reinsurance of certain types of policies would tend to indicate that there is no significant tax avoidance effect when a coincidental tax benefit is enjoyed by a ceding company because income arising from the reinsurance transaction offsets an expiring loss carryover. On the other hand, even a longstanding agreement may be ignored if the experience rating formula in effect allows the parties to tailor income, expense, and profit allocation on an individual contract basis.

Fifth, the parties' rights to terminate the reinsurance agreement and the consequences of a termination should also be taken into account. For example, a contract may contain payback provisions to protect a reinsurer against termination of the reinsurance agreement after a large upfront ceding commission has been paid, but before the reinsurer has been able to enjoy the future profit stream. Such a provision may be a reasonable business practice and should not automatically be viewed as creating a tax avoidance effect. On the other hand, a payback provision which allows a reinsurer to recover all its losses in any case, through adjustments in future premiums or specific termination provisions, would indicate that the transaction is merely a financing arrangement.

Sixth, the relative tax positions of the parties is a factor that should be considered. The essential tax benefit or avoidance effect from a reinsurance transaction arises because income and deductions will have differing economic value depending on the tax bracket of the insurance company. For example, under the new life insurance provisions, bracket shifting is possible between small and large companies, as well as between profit and loss companies or between life and nonlife insurance companies.

Seventh, the general financial situations of the parties may be relevant. For example, surplus relief insurance for an otherwise insolvent insurance company tends to indicate that the transaction may not have a significant tax avoidance effect.

Taking into account the factors described above, and until Treasury regulations can be issued, the conferees believe there are certain kinds of reinsurance transactions which generally will not require Treasury to exercise its reallocation authority. First, yearly renewable term reinsurance will not require adjustments for the parties, to the extent it requires only the payment of a premium for the annual risk and no sharing of expenses. Second, coinsurance of annual renewable term life insurance will generally not require adjustments, because it requires the transfer of an annual risk premium and a sharing of expenses, but does not involve the transfer of long-term reserves. Third, a coinsurance contract covering new business of the ceding company and which allocates expenses and income items between the ceding company and the reinsurer in the same proportion as the allocation of the risk reinsured generally will not require adjustment by Treasury. The same will be true with respect to the reinsurer for the coinsurance contract entered into to cover èxisting business, if the initial ceding commission is reasonable in reflecting the proper allocable share of past expenses of the ceding company and any premium that might be paid by the reinsurer to the ceding company that reflects anticipated profitability of the reinsured business. The conferees anticipate that the Treasury will provide more guidance in regulations under these provisions. To the extent that future regulations in these areas are inconsistent with the above-described specific examples of situations that will not require Treasury to exercise its adjustment authority, the conferees intend that those regulations have effect only prospectively.

The provision for related party reinsurance is effective with respect to risks reinsured on or after September 27, 1983. The provision for unrelated party reinsurance is effective with respect to risks reinsured after December 31, 1984. For these purposes, a risk is not considered reinsured prior to the time it arises under the contracts covered by the reinsurance agreement. The conference agreement also clarifies that both the reinsurance provisions will apply to reinsurance transactions between insurance companies taxable under subchapter L.

10. Definition of company's share and policyholders' share

Present law

Under present law, all items of investment yield (i.e., gross investment income, including tax-exempt interest and dividends received, less certain investment expenses) are allocated between the policyholders and the company. Amounts allocated to policyholders are not included in taxable investment income or gain from operations. Generally, this allocation is accomplished by means of a proration formula which, in general, compares amounts credited to policyholders to investment yield. The practical effect of the proration formula is to treat additions to reserves as funded in part out of tax-exempt income thus limiting the tax benefit a company can enjoy by the receipt of tax-exempt income.

House bill

The general concept that items of investment yield should be allocated between policyholders and the company has been retained from present law.

Specifically, under the House bill the policyholders' share of any item is 100 percent of the item reduced by the company's share of the item. The company's share is defined as the percentage obtained by dividing the company's share of net investment income by total net investment income. The company's share of net investment income is the excess of net investment income over the sum of (1) the deductible portion of policyholder dividends and (2) all amounts in the nature of interest paid or credited to policyholders as customers pursuant to insurance or annuity contracts (including all pension plan contracts).

Under the House bill, net investment income is defined as the excess of gross investment income over investment expenses. Gross investment income is generally the same as under present law, and includes tax-exempt interest. However, gross investment income does not include dividends received from a subsidiary which are eligible for the 100 percent dividends received deduction (or which would have been eligible for the 100 percent dividends received deduction if the recipient were not a foreign corporation) except to the extent such dividends are paid, directly or indirectly, out of tax-exempt income. Investment expenses are defined as the sum of the direct investment expenses plus an allocable share of the general expenses. General expenses of the life insurance company must be allocated to gross investment income in the same proportion as gross investment income for the taxable year bears to the gross receipts for the taxable year. For purposes of this formula, general expenses are indirect expenses not directly allocable to investment income or underwriting income.

Senate amendment

The Senate amendment is generally the same as the House bill but has a proration fraction that will be simpler to compute. Under the amendment, net investment income is defined as 90 percent of gross investment income. Also, the company's share of net investment income is the excess of net investment income over the sum of: (1) required interest for reserves; (2) any excess interest; (3) any amount in the nature of interest (whether or not a policyholder dividend) credited to a policyholder or customer fund under a pension plan contract for employees not yet retired or to a deferred annuity contract before the annuity starting date; and (4) a fraction of the deductible portion of policyholder dividends (not including any amounts previously included under (1), (2) or (3) or any premium or mortality charge adjustments associated with a contract for which excess interest was credited during the taxable year).

Conference agreement

The conference agreement follows the Senate amendment.

11. Foreign tax credit

Present law

Life insurance companies are generally subject to the same rules governing foreign income as other U.S. corporations. The United States taxes U.S. citizens and residents and U.S. corporations on their worldwide income. The United States allows U.S. taxpayers to offset the U.S. tax on their foreign income by the income taxes paid or accrued to a foreign country ("foreign tax credit").

The Code contains a limitation to ensure that the credit offsets the U.S. tax on only the taxpayer's foreign income. To calculate U.S. taxable income and foreign taxable income, which is necessary to compute the limitation, all deductions must be allocated against gross income, and apportioned against gross U.S. income or gross foreign income. Expenses that are properly allocated or apportioned to a class of U.S. (or foreign) source income reduce gross income in that category (sec. 861(b), 862(b), and 863; Reg. sec. 1.861-8). Expenses that cannot definitely be allocated to a class of gross income are generally deducted ratably from all classes of gross income.

House bill

Under a general rule, the House bill provides that in calculating U.S. source income and foreign source income, three items will be treated under regulations as items which cannot definitely be allocated to an item or class of gross income, but will be allocated ratably among all classes of gross income. These items are policyholder dividends (determined under new section 808(c)), reserve adjustments (under subsections (a) and (b) of new section 807), and death benefits and other amounts described in new section 805(a)(1).

Also, taxpayers will be able to elect to treat the expenses that are the subject of the general rule of the bill as properly apportioned or allocated among items of gross income in the manner and to the extent prescribed in regulations. The election will apply for all taxable years of the taxpayer to which the bill applies. It must be made on or before September 15, 1984. Once made, it will be irrevocable, except with the consent of the Commissioner.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment, but changes the date by which the foreign tax credit election must be made to September 15, 1985, so that the election may be made on the return for the first year to which the new rules apply.

12. Foreign life insurance companies' minimum surplus

Present law

A foreign corporation carrying on an insurance business within the United States, that would qualify as a life insurance company if it were a U.S. corporation, is taxable like a U.S. life insurance company on its income effectively connected with its conduct of any U.S. trade or business. A special rule may alter the U.S. tax on foreign life insurance companies doing business in the United States when they hold a relatively small surplus attributable to the U.S. business in the United States. If the foreign insurance company's surplus held in the United States is less than a specified minimum amount, then certain deductions of the company are decreased to reflect imputed earnings on any deficiency in surplus compared to the specified minimum surplus.

House bill

The House bill generally retains the Secretary's ratio adjustment, with modifications. A foreign company taxable as a life insurance company must compare its surplus held in the United States to a required surplus computed under the new statute. If the required surplus exceeds the actual surplus, the company must increase its income by the product of that excess and its current investment yield.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

13. Contiguous country branches of U.S. life insurance companies

Present law

U.S. corporations are taxable on worldwide income, including foreign income (although the foreign tax credit may offset U.S. tax on foreign income). In general, foreign corporations (even those wholly owned by U.S. persons) are not subject to U.S. tax on foreign income. Foreign branch operations of U.S. taxpayers generally are subject to tax currently. Generally, a U.S. mutual life insurance company may elect to exempt the income of its branches that operate in Canada or Mexico so long as the foreign branch does not repatriate its income to the United States. Repatriation of contiguous country branch income results in an increase in life insurance company taxable income. In this respect, the treatment of contiguous country branches corresponds generally to the treatment of foreign subsidiaries of U.S. parent companies.

House bill

The House bill retains the contiguous country branch rule of present law, with technical modifications.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

14. Rules relating to capital gains and losses

Present law

With respect to property used in a trade or business and held for more than 12 months, present law provides, in general, that if the gains from the sale or exchange of such property exceed such losses, then the net gain is treated as not being from the sale or exchange of a long-term capital asset. If the losses exceed the gains, then the net loss is considered as not being from the sale or exchange of a capital asset, with the result that ordinary gain or loss is realized.

In the case of life insurance companies, a special rule applies which modifies the general rule by limiting the term "property used in the trade or business" to include only property used in carrying on an insurance business. Further, for purposes of section 1221(2) (excluding certain property from the term "capital assets"), the reference to property used in trade or business is treated as including only property used in carrying on an insurance business.

In both cases, the term "property used in carrying on an insurance business" means only those assets used in the operation of the insurance trade or business.

Under present law, the amount of gain that is recognized on the sale or other disposition of certain property acquired before December 31, 1958 is limited. In the case of property acquired after December 31, 1958, having a substituted basis (within the meaning of sec. 1016(b)), the limitation on the gain recognized shall apply if the property or properties were held only by life insurance companies during the relevant periods. The term "property" does not include insurance and annuity contracts (and contracts supplementary thereto) and property described in section 1221 relating to stock in trade or inventory-type property.

House bill

The House bill continues the present-law treatment relating to capital gains and losses and gains and losses on property used in the trade or business for life insurance companies and continues the current distinction between indemnity and assumption reinsurance arrangements.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

15. Technical and conforming amendments

House bill

The House bill contains 27 technical changes to the provisions of the Internal Revenue Code of 1954 outside of Part I of subchapter L to conform the existing provisions of the 1954 Code to the new single phase tax system adopted for life insurance companies under the bill.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

16. General effective date

House bill

Generally, the life insurance company taxation provisions apply to taxable years beginning after December 31, 1983.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

17. Transitional rules

a. Reserves computed on a new basis

House bill

As of the beginning of the first taxable year after December 31, 1983, the reserve for any contract shall be recomputed as if the amendments made in the House bill had applied to such contract when it was issued. This provision applies to reserves held by any company taxable under subchapter L of the Code (relating to the taxation of insurance companies).

Any change in accounting (e.g., in computing the policyholder dividends deduction) or any change in the method of computing reserves which is required by the House bill will not be treated as a change in the method of accounting or in the method of computing reserves, and will not give rise to income or loss. This "fresh start" provision will apply only to life insurance companies and solely to changes made between any company's first taxable year beginning after December 31, 1983, and the preceding taxable year.

Senate amendment

The Senate amendment is generally the same as the House bill, except it clarifies how a nonlife insurance company should recompute life insurance reserves and extends the "fresh start" benefits to any insurance company required to recompute reserves under the new provisions.

The Senate amendment provides that a company with less than $500 million in assets may elect not to recompute its reserves for existing business and may use instead statutory reserves for such business for tax purposes. If a company has made this election, and also qualifies for the full small company deduction, it may also elect to compute tax reserves for contracts issued after 1983 and before 1989 according to a formula that adjusts statutory reserves depending on the difference between the prevailing interest rate and the assumed interest rate.

Conference agreement

The conference agreement follows the Senate amendment, with the modification that the election not to recompute life insurance reserves for existing business is limited to companies with less than $100 million in assets.

b. Allocation of the "fresh start" in certain cases

House bill

No provision.

Senate amendment

The Senate amendment allocates the "fresh start" benefit between the ceding company and the reinsurer with respect to reserves subject to a coinsurance agreement entered into during 1982 or 1983. Generally, the "fresh start" benefit is allocated by income recognition or deductions upon termination of the reinsurance agreement, making the amounts under the allocation reflect the duration of the agreement between the parties after 1983.

Conference agreement

The conference agreement follows the Senate amendment with certain technical clarifications.

c. Denial of "fresh start" in certain cases

House bill

The "fresh start" rule is not applicable to any recomputation of reserves transferred pursuant to a reinsurance agreement entered into, modified or terminated after September 27, 1983, and before January 1, 1984. The bill also provides that if expenses have been transferred between insurance companies pursuant to a reinsurance agreement that is entered into, modified, or terminated after September 27, 1983 (and before January 1, 1984), any income attributable to those expenses and taken into account in a later year cannot be taken into account for purposes of determining the amount of the special life insurance company deduction and the small life insurance company deduction. Also, the "fresh start" rule does not apply to any reserve strengthening reported for Federal income tax purposes after September 27, 1983, for a taxable year ending before January 1, 1984.

Senate amendment

The Senate amendment does not deny the benefits available under the "fresh start," per se, but shifts the tax effects of certain events occurring between the announcement of the "fresh start" proposal and the effective date of the bill. Specifically, the Senate amendment provides that, for purposes of computing life insurance company taxable income, a reinsurance agreement entered into or a modification to a reinsurance agreement (to the extent of the modification) made after September 27, 1983 (and before January 1, 1984), will not be taken into account until January 1, 1984. Likewise, any reserve strengthening reported for Federal income tax purposes after September 27, 1983, for a taxable year ending before January 1, 1984, will not be taken into account until January 1, 1984.

For these purposes, the phrase "any reserve strengthening" includes the computation of reserves on contracts issued in 1983, under plans of insurance in existence on September 27, 1983, on a more conservative basis than was the customary practice of the company for similar contracts, or to the strengthening of reserves for tax purposes, generally, on existing business. Reserve strengthening for tax purposes resulting from a proper election under section 818(c) of present law will be eligible for a fresh start if more than 95 percent of the section 818(c) amount arises from risks under life insurance contracts issued by the taxpayer under a plan of insurance first filed after March 1, 1982, and before September 28, 1983.

Conference agreement

The conference agreement follows the House bill with respect to the denial of the "fresh start" for reserves transferred pursuant to the entering into or the modification of a reinsurance agreement entered into after September 27, 1983, and before January 1, 1984, as well as for reserve strengthening claimed after September 27, 1983, for a taxable year ending before January 1, 1984. It does not deny a "fresh start" for reserves transferred because of a termination of the reinsurance agreement during the proscribed period. The conference agreement follows the Senate amendment with respect to the statutory definition of reserve strengthening and the exception therefrom for certain proper elections under section 818(c) of present law.

For situations in which there is a denial of the "fresh start," the conference report provides specific rules for how the amount arising from the recomputation of reserves will be taken into account. Generally, the amount will be taken into account ratably over 10 years, unless a 10-year spread would not have been applicable under the 1959 Act. Thus, any decrease in reserves attributable to the section 818(c) revaluation that is not allowed under the required reserve recomputation of the bill will be taken into account in the first taxable year beginning after December 31, 1983. Also, any amount included in income as a decrease in reserves, and any income attributable to expenses transferred in connection with a proscribed transfer of reserves, will not be taken into account for purposes of determining the amount of the special and small life insurance company deductions.

Finally, the conference agreement follows the substance of the Senate amendment with respect to the denial of the deductions for nonparticipating contracts and accident and health insurance and group life insurance contracts, if those deductions arose from the entering into or the modification of a reinsurance agreement during the proscribed period. Rather than denying such deductions by treating the proscribed reinsurance activities as occurring in the 1984 tax year, the conference agreement denies the deductions for the 1983 tax year.

18. Special rules

House bill

If, prior to January 1, 1984, an election is made to treat income from an installment obligation as investment income, any income from such obligation will be treated as attributable to a noninsurance business.

The House bill provides that, in certain specific cases, involving the acquisition of one or more insurance companies (after 1979 and before April 1, 1983), if certain tests are met, then the tentative LICTI of the corporation holding the assets for taxable years 1984 and 1985 will be increased by the deduction allowable for the amortization of the cost of insurance contracts acquired in the acquisition and for any portion of any operations loss deduction attributable to such amortization.

Finally, the House bill provides that any company that has been operating for a 10-year period ending on December 31, 1983, as a hybrid company (i.e., as a mutual life insurance company with shareholders), will be treated as part stock and part mutual life insurance company.

Senate amendment

The Senate amendment is the same as the House bill with respect to the treatment of installment contracts. It is the same as the House bill with respect to the treatment of amortization of expenses for certain acquisitions of insurance companies between 1979 and April 1, 1983, but the provision is limited in its application to certain acquiring life insurance companies domiciled in Texas, Alabama and Oklahoma, and the benefit is extended to all taxable years after December 31, 1983. The Senate amendment treats a hybrid life insurance company as a stock life insurance company.

Finally, the Senate amendment has a special provision to treat the ownership of certain stock as noninsurance business for purposes of computing tentative LICTI if the stock was acquired through debt financing.

Conference agreement

The conference agreement follows the House bill and Senate amendment with respect to the treatment of installment contracts.

It follows the Senate amendment with respect to the treatment of amortization of expenses for certain life insurance company acquisitions between 1979 and April 1, 1983, but with the modification that to be eligible to use the special rule a company must be domiciled or have its principal place of business in Alabama, Arkansas, Oklahoma, or Texas.

The conference agreement adopts a similar rule for a company with certain losses on guaranteed interest contracts used in pension business by allowing a deduction of those losses after the computation of the special and small life insurance company deductions. The losses arise in situations in which a company has guaranteed a long-term interest rate and intended to meet the obligation by matching the interest rate guarantee with investments in discounted bonds, relying on both the current income of the bond and the amount of the discount to be realized at capital gain rates. To the extent the guaranteed interest rate exceeds the current income of the discounted bond, the company is allowed a deduction after the special and small life insurance company deductions at a full 46 percent tax rate in order to maintain the economics of the transactions with respect to existing guarantees. The rule is narrowly drawn because of special reliance on present-law tax rules (i.e., the pricing reflected in expected tax savings) in structuring the transaction. Moreover, the amount of tax benefit that can be enjoyed because of this rule is limited to $4.5 million in 1984, $4.5 million in 1985, $3.0 million in 1986, $2.0 million in 1987, and zero for 1988 and thereafter.

Also, the conference agreement follows the substance of the Senate amendment with respect to the treatment of certain ownership of stock acquired through debt financing, requiring that the income and deductions related to such stock ownership also be taken into account after computation of the special and small life insurance company deductions (without any loss limitations).

Finally, the conference agreement adopts the Senate amendment with respect to hybrid life insurance companies.

19. Waiver of estimated tax penalty

Present law

Corporate taxpayers are required to pay tax quarterly on an estimated basis. In the case of an underpayment of estimated tax, an additional amount is due, determined at the deficiency interest rate on the amount of the underpayment for the period of underpayment.

House bill

The House bill is the same as present law.

Senate amendment

Any penalty for underpayment of estimated tax by an insurance company, for any 1984 period, is waived to the extent the underpayment is due to changes from present-law tax provisions that are made retroactive by the effective date of the bill.

Conference agreement

The conference agreement follows the Senate amendment.

B. Taxation of Life Insurance Products

1. Definition of a life insurance contract

Present law

Generally, there is no statutory definition of life insurance under present law, except for purposes of tax-free exchanges. Income earned on the cash surrender value of a contract is not taxed currently to the policyholder, but it is taxed upon termination of the contract prior to death to the extent that the cash surrender value exceeds the policyholder's investment in the contract. Gross income does not include amounts received by a beneficiary under a life insurance contract, if the amounts are paid because of the death of the insured.

In TEFRA, Congress enacted temporary guidelines for determining whether flexible premium life insurance contracts (e.g., universal life or adjustable life) qualified as life insurance contracts for purposes of the exclusion of death benefits from income. Violation of the guidelines at any time during the contract causes the contract to be treated as providing a combination of term life insurance and an annuity or a deposit fund (depending on the terms of the contract). In the event of the death of the insured, only the term life insurance component is excluded from gross income.

House bill

The House bill adopts a definition of a life insurance contract for purposes of the Internal Revenue Code. This provision extends to all life insurance contracts rules that are similar to, but narrower than, those contained in the temporary provisions of TEFRA.

A life insurance contract is defined as any contract, which is a life insurance contract under the applicable State or foreign law, but only if the contract meets either of two alternatives: (1) a cash value accumulation test, or (2) a test consisting of a guideline premium requirement and a cash value corridor requirement. Whichever test is chosen, that test must be met for the entire life of the contract in order for the contract to be treated as life insurance for tax purposes (e.g., the cash value accumulation test must be met (at all times) by the terms of the contract). For purposes of applying the definitional tests, computational rules and adjustment rules are specifically provided.

If a contract fails to meet either of the alternative tests, the contract will be treated as a combination of term life insurance and a currently taxable fund.

The provision is effective for contracts issued after December 31, 1983. Contracts issued during 1984, will qualify (1) if they meet the present-law flexible premium contract tests (whether or not they are flexible premium contracts); (2) if not flexible premium contracts, they would meet the new definition by substituting 3 percent for 4 percent in the cash value test and treating the maturity date as the latest permitted in the contract (but not less than 20 years after date of issue or age 95, if earlier); or (3) if they meet a statutory description of irreplaceable life. The House bill also has a transition rule or grandfather for certain 20-pay contracts issued under existing plans of insurance (as of September 28, 1983), which allows "3 percent" to be substituted for "4 percent" for purposes of meeting the cash value accumulation test.

Senate amendment

The Senate amendment is generally the same as the House bill, except for certain technical clarifications in the computational rules, and for differences in the treatment of failing contracts and in the effective date provisions.

Contracts that fail are treated as a combination of term life insurance and an annuity as of the date of failure; upon failure, an excise tax of 10 percent of the net surrender value of the contract is imposed on the company.

The definition is effective for contracts issued after December 31, 1984, except increasing death benefit policies (1) issued under post-March 14, 1984, plans of insurance, or (2) having premium funding more rapid than 10-year level premiums, for which the definition is effective January 1, 1984. A special rule allows the sale of certain single premium increasing death policies until June 1, 1984, where face amount is $5,000 or less, and there is no more than 1 policy sold per customer. There is an extension of the flexible premium contracts provision for 1 year.

The Senate amendment has the same provision for grandfathered contracts under existing plans of insurance as in the House bill.

Conference agreement

The conference agreement generally follows the House bill and the Senate amendment, with the technical clarifications in the computational rules of the Senate amendment. It follows the House bill with respect to the consequences of failing to meet the definition of life insurance.

With respect to the effective date, the conference agreement follows the Senate amendment, adopting a general effective date that makes the new definitional provisions applicable to contracts issued after December 31, 1984. The new provisions will be effective for a contract issued after June 30, 1984, if the contract has an increasing death benefit and premium funding more rapid than 10-year level premium payments, unless the contract meets one of the three transition rules described in the House bill. Thus, present law applies through 1984 (with sec. 101(f) extended for the same period), except in the case of the above described increasing death benefit contracts.

There is an additional transition rule for certain increasing death benefit policies, which makes the new definitional provisions applicable only for a contract issued after September 30, 1984, if the contract would meet the new definition by substituting "3 percent" for "4 percent" in the cash value accumulation test (assuming that the rate or rates guaranteed on issuance of the contract can be determined without regard to any mortality charges), and if (with the same "3 percent" for "4 percent" substitution) the cash surrender value of the contract does not at any time exceed the net single premium which would have to be paid at such time to fund future benefits at the then current level of benefits.

Finally, the conference agreement provides a transition rule for 20-pay qualified contracts that permits certain existing plans of insurance to be modified to permit the crediting of excess interest or similar amounts annually and not monthly, without forfeiting the grandfather provision.

2. Treatment of certain annuity contracts

Present law

Cash withdrawals prior to the annuity starting date are includible in gross income to the extent that the cash value of the contract (determined immediately before the amount is received and without regard to any surrender charge) exceeds the investment in the contract. A penalty tax of 5 percent is imposed on the amount of any such distribution that is includible in income, to the extent that the amount is allocable to an investment made within 10 years of the distribution. The penalty is not imposed if the distribution is made after the contract holder attains age 59½, when the contractholder becomes disabled, upon the death of the contractholder or as a payment under an annuity for life or at least 5 years. No income is recognized to the recipient of an annuity on the death of the contractholder. However, since the recipient has the same investment in the contract as the deceased contractholder, the recipient is subject to income tax on the income accumulated in the contract prior to death when it is distributed from the contract.

House bill

The House bill generally retains the present-law provisions for annuity contracts. However, the 5-percent penalty on premature distributions will apply to any amount distributed to the taxpayer, without regard to whether the distribution is allocable to an investment made within 10 years, unless the taxpayer owner has attained age 59½.

In the event that the owner of any annuity contract dies before the annuity starting date, an amount equal to the cash surrender value of such contract shall be treated as paid to the contractholder immediately before death.

These provisions apply to contracts issued after the day which is six months after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill except in the event of the annuity owner's death before the annuity starting date. Under the Senate amendment, if the owner of any annuity contract dies before the annuity starting date, specific distribution rules will apply, depending on the decedent's beneficiary with respect to the contract. First, if there is a nonspousal beneficiary, the income in the annuity contract generally will have to be distributed within 5 years after the death of the owner. Second, if the decedent's spouse is the beneficiary, the annuity contract may be continued (together with deferral of tax on the accrued and future income under the contract) until distribution to or the death of the spouse. Third, if the beneficiary is a dependent minor child, the contract can be continued until the child reaches age 26. Fourth, if the beneficiary is a dependent handicapped individual, the contract can be continued until that individual reaches age 26, and then an annuity for the beneficiary can be commenced covering any period (including the life of the handicapped individual).

Conference agreement

The conference agreement follows generally the Senate amendment, but with some modifications to the rules for the treatment of annuity contracts in the event of the contractholder's death. These modified rules generally conform to those applicable to qualified pension plans and IRAs.

To be treated as an annuity contract, the contract must provide that, if the contractholder dies on or after the annuity starting date and before the entire interest in the contract has been distributed, the remaining portion of such interest will be distributed at least as rapidly as the method of distribution in effect. If the contractholder dies before the annuity starting date, generally, the entire interest must be distributed within 5 years after the date of death of the contractholder, or must be annuitized for some period (including the life of a designated beneficiary) within 1 year after that date. If there is a spousal beneficiary upon the contractholder's death, the contract (including deferral of income tax) may be continued in the name of the spouse as the contractholder.

As under both the House bill and the Senate amendment, the new provisions will be effective for contracts issued more than 6 months after enactment. For these purposes, an annuity contract issued in exchange for another will be considered a new contract subject to the new penalty and distribution-at-death rules. The grandfather provisions granted in TEFRA for amounts invested in or credited to investments in annuity contracts prior to August 13, 1982, continue in effect for purposes of applying the distribution of income-first rules applicable to annuity contracts.

The conference agreement also adopts a technical correction to the TEFRA annuity provisions which allows any investment in a multiple premium annuity contract (issued prior to the effective date of the new penalty provisions) to be treated as having been made on January 1 of the year of investment. This technical correction is intended to simplify the accounting requirements of the 10-year-aging rule in TEFRA for the penalty on early distributions from annuity contracts.

3. Policyholder loans

Present law

Under present law, no deduction is allowed for interest on policyholder loans made pursuant to a plan which contemplates systematic borrowing, or for interest on a loan incurred to purchase or carry a single premium life insurance contract. These rules do not apply if (1) 4 out of the first 7 annual premiums due are paid without borrowing, (2) the total interest subject to limitation is less than $100, (3) borrowing is incurred because of unforeseen substantial income loss or increased financial obligations, or (4) borrowing is incurred in a trade or business.

House bill

In addition to present law, the House bill provides an overall limitation for deduction of interest on policyholder loans. The amount of the limitation is equal to the deficiency interest rate times: (1) $250,000, for individuals; (2) $500,000, for joint returns; and (3) $500,000, for each qualified individual insured in a trade or business. A qualified individual is one who has whole life coverage of at least 10 percent of the amount of coverage on the individual with the greatest coverage. Generally, unused limitations may be carried over.

The new provision applies only to policies issued after September 27, 1983.

Senate amendment

The Senate amendment does not alter present law.

Conference agreement

The conference agreement follows the Senate amendment.

4. Certain exchanges of insurance policies

Present law

Under present law, no gain or loss is recognized on the exchange of (1) a contract of life insurance for another contract of life insurance or for an endowment or annuity contract; (2) a contract of endowment insurance for another contract of endowment with the same or earlier payment date or for an annuity contract; or (3) an annuity contract for an annuity contract. For purposes of this exchange rule, an endowment contract or life insurance contract with a life insurance is defined, in part, as a contract with a life insurance company (as defined for tax purposes).

House bill

The House bill does not alter present law.

Senate amendment

The Senate amendment changes the definition of an endowment contract and a life insurance contract to include contracts issued by any insurance company taxable under subchapter L of the Code, rather than just by life insurance companies. The amendment will be effective as if included in the Internal Revenue Code of 1954.

Conference agreement

The conference agreement follows the Senate amendment.

5. Group-term life insurance purchased for employees

Present law

The cost of group term life insurance purchased by an employer for an employee for a taxable year is included in the employee's gross income to the extent that the cost is greater than the sum of the cost for $50,000 of life insurance plus any contribution made by an employee to the cost of the insurance. This rule does not apply to former employees because of retirement or disability. An employer may provide group-term life insurance for these two groups of former employees in amounts greater than $50,000 without any portion of the costs being included in their gross income.

If a group-term life insurance plan maintained by an employer discriminates in favor of any key employee, the exclusion for the cost of the first $50,000 of this insurance is not available. In that event, the full cost of the group-term life insurance for any key employee is included in the gross income of the employee (based on the uniform cost table).

House bill

The House bill effects three changes in the present-law treatment of group-term life insurance. First, the $50,000 limitation on the amount of group-term life insurance that may be provided tax-free to employees also will apply to retired as well as active employees. Second, the nondiscrimination rules will be applied to plans covering retired employees. Third, under the House bill, if a plan fails to qualify for the exclusion because it is discriminatory, then the employees and retirees will have to include in income the actual cost of their insurance benefit rather than the table cost prescribed by the Treasury.

The provisions are effective for taxable years beginning after December 31, 1983. However, the new provisions do not apply to individuals covered by plans of group-term insurance in existence on

September 27, 1983 (or comparable successor plans) to the extent of their coverage guaranteed for retirement on that date.

Senate amendment

The Senate amendment is generally the same as the House bill with a specific clarification that the cost of the group-term life insurance coverage will be included in the income of a retired employee for the year in which the coverage is received, whether or not the benefit of retirement coverage vests upon retirement.

However, the Senate amendments make the provisions applicable to taxable years that begin after December 31, 1983, but not to any group-term life insurance plan in existence on January 1, 1984 or to any group-term life insurance plan of the employer (or successor employer) which is a comparable successor to an existing plan, with respect to an individual who retires under the plan and who attained age 55 on or before January 1, 1984. The provision for nonapplication of the new provisions will not itself apply to any plan which is discriminatory after March 15, 1987, with respect to any individual retiring after that date.

Conference agreement

The conference agreement generally follows the Senate amendment. By adopting the Senate amendment, including the clarification of when the group-term life insurance benefit for a retired employee is included in income, the conferees do not intend to affect in any way the determination of whether the form of the benefit received by an employee upon retirement constitutes group-term life insurance for purposes of section 79.

However, the conference agreement does modify the nonapplicability provision for existing plans. That is, the new provisions will not apply to any group-term life insurance plan in existence on January 1, 1984 (or to any comparable successor plan), but only with respect to those individuals who retire under the plan, who were employed during 1983 by the employer having the plan, and who attained age 55 on or before January 1, 1984. The new provisions do not apply to any employees who retired before January 1, 1984. Also, the nonapplication provision will not apply to any plan that is discriminatory after December 31, 1986, with respect to any individual retiring after that date.

C. Studies

Present law

No specific provision.

House bill

The bill requires that certain studies and reports be made on revenue, segment balance and other issues arising under the new life insurance tax provisions. These reports are to be made by Treasury in consultation with the House Committee on Ways and Means, the Senate Committee on Finance, and the Joint Committee on Taxation.

The final report is to be submitted by January 1, 1989, to the House Committee on Ways and Means and the Senate Committee on Finance. Interim reports are to be submitted to the committees not later than July 1, 1986, 1987, and 1988.

Senate amendment

The Senate amendment is the same as the House bill, except that consultation is not required.

Conference agreement

The conference agreement follows the House bill. The conferees wish to emphasize that in preparing this report, the Treasury should give specific attention to the revenue impact of allowing consolidated returns to be filed by life insurance companies with nonlife or noninsurance companies. Likewise, the conferees intend that the general authority granted to Treasury to gather information to study the revenue effect and assess the tax policy adopted under the insurance provisions be used to gather information on the volume and use of policyholder loans so that the committees will have useful information for future legislative work in that area.

III. CHARITABLE DEDUCTION RULES; PRIVATE FOUNDATION PROVISIONS; EXEMPT ORGANIZATIONS

A. General

Charitable Deduction Rules

1. Public charities

Present law

Contributions of cash or ordinary-income property by an individual to public charities or private operating foundations are deductible up to 50 percent of the donor's contribution base for the year (adjusted gross income, with certain modifications). Contributions in excess of this limitation, or of the 30-percent limitation applicable to gifts by individuals of capital-gain property to such charities, may be carried forward and deducted over the following five years, subject to applicable percentage limitations in those years (Code sec. 170).

House bill

No provision.

Senate amendment

The Senate amendment increases to 60 percent the present-law 50-percent limitation on the deductibility by individuals of certain charitable contributions, and extends to 15 years the present-law five-year carryover period for certain excess contributions.

This provision applies to contributions made after December 31, 1984. Carryovers of excess pre-1985 contributions to post-1984 years remain subject to the present-law carryover period and deduction limitations.

Conference agreement

The conference agreement does not include the Senate amendment.

2. Nonoperating (grant making) foundations

Present law

In general, all contributions to private nonoperating foundations are deductible up to 20 percent of the donor's contribution base for the year, with no carryover of excess contribution amounts.

The amount deductible for contributions of appreciated capital-gain property to nonoperating foundations equals the donor's basis in the property plus 60 percent of the appreciation (i.e., 60 percent of the excess of fair market value over the donor's basis). Contributions of such property to public charities or operating foundations are deductible at full fair market value (subject to a special rule for unrelated-use tangible personal property).

House bill

The House bill increases the percentage limitation on deductibility of contributions of cash or ordinary-income property to nonoperating foundations (and of certain other charitable contributions) to 30 percent of the donor's contribution base, effective for contributions made after 1984. The bill retains the 20-percent limitation for all gifts of capital-gain property except such gifts to public charities or private operating foundations. Thus, gifts of capital-gain property to private nonoperating foundations (including gifts of certain appreciated stock which are deductible under the bill at fair market value) remain subject to the 20-percent limitation. Also, excess post-1984 contributions are eligible for a five-year carryover.

The House bill generally allows a deduction at full fair market value for contributions, made after 1984 and before 1995, to nonoperating foundations of up to 10 percent of the stock of a corporation for which (as of the contribution date) market quotations for the stock are readily available on an established securities market.

Senate amendment

Under the Senate amendment, the income tax treatment of contributions by individuals to private nonoperating foundations is the same as that of contributions by individuals to public charities or operating foundations, effective for contributions made after the date of enactment.

Conference agreement

The conference agreement follows the House bill, with modifications to the effective date. The percentage limitation and carryover provisions of the bill apply to contributions in taxable years ending after the date of enactment. The provision on deductibility of contributions of certain stock applies to such contributions made after the date of enactment and before January 1, 1995.

3. Expansion of circumstances in which a deduction may be claimed for qualified conservation contributions

Present law

Subject to certain limitations as to amount and type of property interest, present law provides a deduction for contributions of property to charitable organizations, to the United States, or to a State or local government. Charitable deductions are provided for income, gift, and estate tax purposes (Code secs. 170, 2055, and 2522).

Gifts of less than the donor's entire interest in property are subject to special restrictions. An exception to these restrictions is provided in the case of qualified conservation contributions. One of the requirements for a qualified conservation contribution to be tax-deductible is that surface mining be precluded on the land with respect to which the contribution is made.

House bill

No provision.

Senate amendment

The Senate amendment provides that deductions are allowable for qualified conservation contributions of property even though surface mining is not precluded if two conditions are satisfied. First, the surface and mineral estates in the property must have been separated at all times after June 12, 1976. Second, the probability of surface mining occurring on the property must be so remote as to be negligible.

This provision is effective for contributions made after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

4. Collection of amounts for U.S. Olympic Committee

Present law

There is no procedure under present law for collecting amounts for nongovernmental organizations through Federal tax returns.

House bill

No provision.

Senate amendment

Individuals may forego $1 of their income tax refund ($2 on a joint return), or may pay an additional $1 in tax ($2 on a joint return), to be transferred, less collection costs, by the Treasury to the U.S. Olympic Committee. No charitable deduction is allowed in either situation. A U.S. Olympic Trust Fund is established to administer the funds.

This provision is effective for returns filed for 1984 through 1988.

Conference agreement

The conference agreement does not include the Senate amendment.

5. Charitable expense deduction for use of passenger automobile

Present law

In determining the amount of charitable contribution deduction attributable to use of a car in providing services to a charity, a taxpayer may deduct actual "out-of-pocket" expenses (Treas. Reg. sec. 1.170A-1(g)). Alternatively, the taxpayer may use a standard mileage rate; at present, this rate is set by the IRS at nine cents a mile (Rev. Proc. 82-61, 1982-2 C.B. 849). Under either computation method, the taxpayer may also deduct parking fees and tolls, but may not deduct general repair or maintenance expenses, depreciation, insurance, registration fees, etc.

House bill

No provision.

Senate amendment

The standard mileage rate used in determining the amount of a taxpayer's charitable contribution deduction for the use of a passenger automobile in performing donated services, if the actual expense method is not used, is increased to 12 cents a mile. (As with the present mileage rate, the taxpayer may also deduct parking fees and tolls, but may not also deduct general repair or maintenance expenses, depreciation, insurance, registration fees, etc.) The deduction is allowable, as in the case of other types of charitable contributions, only if verified pursuant to Treasury regulations (sec. 170(a)(1)).

The provision is effective for taxable years beginning after 1984.

Conference agreement

The conference agreement follows the Senate amendment.

B. Private Foundation Provisions

1. Exemption for certain operating foundations from excise tax on investment income

Present law

Private foundations are subject to a two-percent excise tax on their net investment income for the taxable year (Code sec. 4940).

House bill

The House bill provides that a private operating foundation (such as a museum or library) which previously had been publicly supported for at least 10 years (or qualified as an operating foundation on January 1, 1983), which has a governing body broadly representative of the general public (with at least 75 percent consisting of persons unrelated to the foundation), and none of whose officers otherwise are disqualified persons, is exempt from the two-percent excise tax on net investment income, effective for taxable years beginning after 1984, and that post-1984 grants to such foundation are not subject to the expenditure responsibility rules.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

2. Reduction in excise tax on investment income if charitable payout increases

Present law

Private foundations are subject to a two-percent excise tax on their net investment income for the taxable year (Code sec. 4940).

House bill

Under the House bill, the excise tax on investment income is reduced to one percent for the year if the foundation's payout for charitable purposes (computed on a five-year average) is increased by an equivalent amount, effective for taxable years beginning after 1984.

No provision.

Conference agreement

The conference agreement follows the House bill.

3. Limitation on grant administrative expenses as qualifying distributions

Present law

A private nonoperating foundation generally must make charitable payouts ("qualifying distributions") at least equal to five percent of the fair market value of its net investment assets (Code sec. 4942). Administrative expenses incurred in making grants to other charities or in directly carrying on charitable activities count, without limitation, toward satifying the payout requirement, and hence may reduce the amounts which the foundation actually distributes to charitable beneficiaries.

House bill

The House bill provides that the amount of administrative expenses incurred by a foundation in making qualified grants or contributions can be counted toward satisfying the charitable payout requirement only up to 15 percent of the amount of qualified grants or contributions made by the foundation, computed on the basis of a five-year average.

The limitation does not apply to administrative expenses incurred by a foundation directly for the active conduct by the foundation of exempt activities of the foundation. The term "directly for the active conduct" of exempt activities has the same meaning as in section 4942(j)(3)(A) and the Treasury regulations thereunder, but disregarding the special allocation rule in Treas. Reg. sec.

53.4942(b)-1(b)(1) which states that for purposes of the definition of operating foundations under section 4942(j), all reasonable administrative expenses necessary to conduct a foundation's exempt activities, regardless of whether incurred directly for the active conduct of such exempt activities, are treated as qualifying distributions expended directly for the active conduct of such exempt activities.

The grant administrative expense provision is effective for taxable years beginning after 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill, with modifications. The conferees believe that a reasonable limitation should be placed on the extent to which grant administrative expenses may be counted in satisfaction of the payout requirement, in order to ensure that more foundation expenditures actually reach charitable beneficiaries. Under the conference agreement, foundations must actually pay out amounts equal to 4.35 percent of its payout base (net investment assets) as grants or contributions, program-related investments (sec. 4944(c)), expenditures directly for the active conduct by the foundation of exempt activities of the foundation, or qualified administrative expenses incurred directly in making such direct operating expenditures or program-related investments.

Under the conference agreement, (1) the limitation on the amount of grant administrative expenses which may be counted as qualifying distributions is expressed as 0.65 percent of net investment assets (i.e., of the minimum investment return base as computed under sec. 4942(e)), computed on the basis of a three-year average; (2) a conforming change is made in the transitional rule applicable with respect to pre-1985 base period years; (3) it is clarified that qualified administrative expenses incurred directly in making such program-related investments (within the meaning of sec. 4944(c)) are not subject to the limitation; and (4) the limitation will not apply to taxable years beginning after December 31, 1990. Also, the general definition of qualifying distributions in section 4942(g)(1)(A) is amended by substituting "(including that portion of reasonable and necessary administrative expenses)" in place of "(including administrative expenses)".

In addition, the IRS is authorized and directed by the Congress to modify the foundation information return (Form 990-PF) as soon as practicable to require additional and more detailed information on expenditures by nonoperating and operating foundations, both by categories of expenditures (such as grants, direct operating expenditures, program-related investments, other investments, administrative expenses, etc.) and by types of administrative expenses (e.g., separate line items within each of such categories for salaries, rent, legal fees, accounting fees, consulting fees, utilities, traveling expenses, etc.). The revised form is to require the foundation to attach a statement of the accounting principles and practices by which it allocates administrative expenses among those which will satisfy the definition of qualifying distributions as modified by the bill (sec. 4942(g)(1)(A)) and other categories of administrative expenses.

The Treasury is to submit a study to the tax-writing committees by January 1, 1988 concerning administrative expenses incurred by nonoperating and operating foundations, on the basis of the revised forms. To the extent practicable, the study is to examine (a) the amount of qualifying distributions which actually reach charitable beneficiaries; (2) the administrative costs of such payouts; (3) the effect of the revised general definition (sec. 4942(g)(1)(A)) of those administrative expenses which are eligible to be qualifying distributions, subject to the new limitation; and (4) the additional information provided by the revised form concerning categories and types of administrative expenses, and the basis for allocating such expenses among categories of foundation expenditures. This study is intended to provide more detailed information concerning foundation administrative expenditures than is now available.

Also, the conferees clarified that the mere fact that a State attorney general, or other State government or official, has approved the amount of director fees or other expenditures by a foundation does not establish that such amounts or expenditures are reasonable or not excessive reasonable for purposes of any of the private foundation tax provisions.

Under section 170, contributions by individuals to private nonoperating foundations receive certain favorable treatment if the foundation makes qualifying distributions (which are treated as corpus distributions) equal to 100 percent of the amount of contributions received in the year within 2½ months after the close of that year (secs. 170(b)(1)(D), 170(e)(1)(B)). For purposes solely of determining qualifying distributions under these deduction rules relating to "conduit" foundations, the Treasury is authorized to prescribe by regulations that the grant administrative expense limitation is to be expressed as 15 percent of the amount of such pass-through contributions, and to prescribe in the regulations any necessary or desirable conforming and coordinating rules with respect to the section 4942 limitation which is expressed as a percentage of the foundation's net investment assets.

4. Technical amendments to charitable payout rules

Present law

In 1981, Code section 4942 was amended to define the required minimum payout as five percent of the value of the foundation's net investment assets (rather than the higher of that figure or net income). The 1981 amendment failed to add back to the newly defined payout amount the previously applicable modifications set forth in section 4942(f)(2)(C), relating to (i) repayment to the foundation of amounts previously treated as qualifying distributions (e.g., scholarship loans); (ii) amounts received on disposition of assets previously treated as qualifying distributions; and (iii) amounts previously set aside for a charitable project but not so used.

House bill

The House bill adds to the required minimum payout the amounts specified in Code section 4942(f)(2)(C) (certain loan repayments, proceeds from assets dispositions, and unused set-asides), effective for post-1984 taxable years. Also, the bill corrects certain cross-references, effective on enactment.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference amendment follows the House bill and the Senate amendment.

5. Abatement of first-tier taxes in certain cases

Present law

Any violation of the private foundation rules (secs. 4941–4945) generally results in automatic imposition of an initial excise tax on the foundation (or in the case of self-dealing, on the disqualified person who entered into the prohibited transaction with the foundation).

House bill

The House bill provides the IRS with discretionary authority to abate the automatic first-tier penalty taxes (other than the sec. 4941 tax on self-dealing) if the foundation establishes that the violation was due to reasonable cause and not to willful neglect, and corrects the violation. This provision applies to taxable events occurring after 1984.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

6. Modification to limitations on foundation support of voter registration drives

Present law

A foundation may support a section 501(c)(3) organization conducting a voter registration drive only if the tax-exempt organization conducting the drive meets certain support and expenditure requirements, and if the voter registration activities are nonpartisan, are not confined to one specific election period, and are conducted in at least five States (Code sec. 4945(f)).

House bill

Under the House bill, the five-State requirement is dropped, effective January 1, 1984; all other requirements of present law are retained (e.g., that the voter registration drive is nonpartisan and not confined to one election period).

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House provision.

7. Definition of disqualified persons

Present law

All lineal descendants (and their spouses) of a substantial contributor to a foundation themselves constitute "disqualified persons" (Code sec. 4946(d)). Status as a disqualified person is important because holdings of disqualified persons are aggregated with those of the foundation for purposes of the business holdings limitations, and because a disqualified person in precluded from engaging in certain business transactions with the foundation.

House bill

Under the House bill, lineal descendants more distant than great-grandchildren will not be treated as disqualified persons, effective January 1, 1985.

Senate amendment

Under the Senate amendment, lineal descendants more distant than grandchildren will not be treated as disqualified persons, effective January 1, 1985.

Conference agreement

The conference agreement follows the House bill.

8. Public disclosure requirements

Present law

A private foundation must publish annually a newspaper notice of availability of its annual return (Code sec. 6104). The notice must state the address of the foundation's principal office, but need not state its telephone number.

House bill

The House bill provides, effective January 1, 1985, that the annual newspaper notice required under Code section 6104 must contain the telephone number for the foundation's principal office.

Also, the IRS is directed to enforce fully the present-law rules relating to foundation annual information returns (Form 990–PF), including the imposition, in appropriate cases, of penalties for failure to file a (complete) return where the return as filed fails to provide all required information.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

9. Reliance on IRS classifications of donees

Present law

Treasury regulations and IRS rulings specify circumstances under which donor private foundations may rely on IRS classifications of donee organizations as public charities, so that the grantor need not exercise expenditure responsibility over grants to such donees.

House bill

There is no statutory provision in the House bill relating to reliance on IRS classifications of donees. However, the committee report directs Treasury to extend the advance ruling period during which qualifying new organizations are considered public charities to five years, and to amend its regulations to permit greater reliance on IRS classifications concerning new organizations in the first five years of their existence.

Senate amendment

The Senate amendment provides that a private foundation making a grant to a charitable organization may rely in specified circumstances on an IRS determination of the organization's public charity or operating foundation status, effective for grants made after 1984.

Conference agreement

The conference agreement follows the House directions to Treasury to extend the advance ruling period, and to amend its regulations to permit greater reliance on IRS classifications concerning new organizations in the first five years of their existence and in any other circumstances in which Treasury concludes that greater reliance is appropriate.

10. Expenditure responsibility rules

Present law

In the case of grants to organizations other than public charities, a private foundation must exercise "expenditure responsibility" over the grant (Code sec. 4945(d)). To ensure that such grants will be properly used by the recipient for charitable purposes, the grantor must make reasonable efforts, and establish adequate procedures, to see that the grant is spent solely for proper uses, to obtain full reports from the grantee, and to make full reports to the IRS on the grants. Treasury regulations set forth guidelines under which donor foundations may satisfy the section 4945 rules.

House bill

There is no statutory provision in the House bill on expenditure responsibility rules. However, the committee report directs the Treasury Department to review its expenditure responsibility regulations for purposes of modifying any requirements which are found to be unduly burdensome or unnecessary. As part of its review, Treasury is to modify the required grantor reports to the IRS.

Senate amendment

The Senate amendment is the same as the approach under the House bill.

Conference agreement

The conference committee reaffirms the central purpose of the expenditure responsibility rules—to ensure that foundation grants will be properly used by the recipient organization solely for exempt purposes. At the same time, because the committee is concerned whether implementation of the statutory requirements in Treasury regulations may have added unduly burdensome or unnecessary requirements in some respects (which may operate to deter grants by some foundations to newly formed, community-based foundations), the conference agreement follows the approach under the House bill and the Senate amendment in directing the Treasury to review its expenditure responsibility regulations for purposes of modifying any requirements which are found to be unduly burdensome or unnecessary. As part of its review, the Treasury is to modify the required grantor reports to the IRS. The Treasury is to report to the tax-writing committees on its review and modifications.

11. Divestiture of post-1969 holdings acquired by gift or bequest

Present law

If a private foundation acquires, by gift or bequest after May 26, 1969, business holdings exceeding permitted limitations (generally, 20 percent), the foundation must reduce its holdings to the permitted level within five years (Code sec. 4943(c)(6)).

House bill

The House bill authorizes the IRS to allow an additional five-year period for disposition of an unusually large gift or bequest (after 1969) of either diverse or complex business holdings, on a showing by the foundation of diligent efforts to divest during the initial period but that divestiture had not been possible because of the size and complexity or diversity of the holdings. This provision applies with respect to business holdings as to which the initial five-year divestiture period ends after October 31, 1983.

Senate amendment

The Senate amendment generally is the same as the House bill. However, the Senate amendment adds as justifications for failure to divest within the initial period a Federal or State court order, or Federal or State law, which effectively precluded divestiture; also, the additional period is extended beyond five years if such a court order is then in effect. The Senate amendment requires that the divestiture plan be submitted to the relevant State attorney general.

Conference agreement

The conference agreement follows the House bill, with a modification adding the requirement in the Senate amendment that the divestiture plan must be submitted to the relevant State attorney general.

12. Divestiture of grandfathered business holdings of foundations

Present law

The Tax Reform Act of 1969 in effect generally limited the combined ownership of a business corporation by a private foundation and disqualified persons to not more than 20 percent of the voting stock (Code sec. 4943). Under transitional rules for divestiture of then existing holdings, the 1969 Act provided that if on May 26, 1969, a foundation (together with disqualified persons) had business holdings exceeding the limitations, the existing holdings generally could be retained, subject to gradual reduction over several phases.

Under the first phase, by the deadlines shown below the combined foundation/disqualified person holdings cannot exceed 50 percent of the voting stock of the corporation—

Ownership on 5/26/69:	Deadline to reach 50% combined holdings:
More than 95% by foundation alone	May 26, 1989.
More than 75% combined holdings	May 26, 1984.
More than 50% combined holdings	May 26, 1979.

After expiration of the first phase, a second set of divestiture requirements becomes operational—

(1) If disqualified persons do not own more than two percent of the corporate voting stock at any time during the second phase (the 15 years after the close of the first phase), the combined foundation/disqualified person holdings must be reduced to not more than 35 percent by the end of that period (i.e., for a foundation which itself owned 95 percent of the stock on May 26, 1969, by May 26, 2004); and if at any time after the end of the second phase the holdings of disqualified persons exceed two percent, then the foundation itself cannot hold more than 25 percent of the voting stock during the third (and final) phase.

(2) If the holdings of disqualified persons exceed two percent at any time during the second phase, then at all times thereafter the combined foundation/disqualified person holdings are limited to 50 percent, with no more than 25 percent of the voting stock being held by the foundation.

House bill

No provision.

Senate amendment

Under the Senate amendment, holdings acquired prior to May 27, 1969 in a business enterprise are exempt from the section 4943 divestiture rules if—

(1) the management of the foundation and the management of the business enterprise are sufficiently unrelated,

(2) no disqualified person who was not a foundation manager on March 12, 1984 can become a foundation manager after that date,

(3) no disqualified person receives compensation (other than reasonable director fees) from both the foundation and the business enterprise,

(4) the foundation continues to meet the charitable payout rules of present law, and

(5) the foundation and any disqualified persons comply with the section 4943 rules applicable to any holdings in the enterprise acquired after May 26, 1969.

This provision is effective on enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

13. Exception to "downward ratchet" rule

Present law

Grandfathered excess business holdings are subject to reduction by operation of the "downward ratchet" rule (Code sec. 4943(c)(4)(A)(ii)). This rule, in effect, provides that if there is any reduction in the holdings of a private foundation or in combined private foundation/disqualified person holdings, then these holdings can never go up again to the former grandfathered or otherwise permitted level over 20 percent (35 percent, if applicable).

House bill

The House bill provides an exception to the downward ratchet rule under which certain reductions of less than two percent in a foundation's holdings are disregarded when resulting from certain issuances of stock (or stock issuances coupled with subsequent redemptions). This provision is effective for decreases and subsequent increases occurring after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

14. Eligibility for 20-year first phase

Present law

The 20-year first phase divestiture period for grandfathered holdings applies where the foundation itself held more than 95 percent of the stock of the business enterprise, but not where the 95-percent requirement can be met only by aggregating foundation/disqualified person holdings.

House bill

The House bill modifies the divestiture rules of present law to provide that the 20-year first phase period to reduce grandfathered excess business holdings applies if the combined holdings of the private foundation and disqualified persons exceeded 95 percent on May 26, 1969. This provision is effective on the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill, but clarifies that the provision is effective as if included in the Tax Reform Act of 1969.

Conference agreement

The conference agreement follows the House bill and the Senate amendment (with the effective date clarification in the Senate amendment).

15. Modification of second and third divestiture phases

Present law

During the second and third phases of the divestiture rules for grandfathered excess business holdings, private foundations have a lower limit (i.e., 25 percent of voting stock) for direct holdings if disqualified persons own more than two percent of the business enterprise. If disqualified persons first acquire more than two percent during those phases, present law does not permit any time for the private foundation to reduce its holdings to the lower limit and avoid excise taxes.

House bill

The House bill provides that if a private foundation's maximum business holdings must be reduced to 25 percent of the voting stock by reason of the acquisition by disqualified persons of more than two percent of the business enterprise during either the second or third phase of the divestiture rules, the private foundation is given five years to dispose of the excess over 25 percent. This provision applies to acquisitions made after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

16. Technical correction in description of Herndon Foundation

Present law

The Tax Reform Act of 1969 permitted the Herndon Foundation to retain more than 50 percent of certain business enterprises.

House bill

The House bill makes a technical correction to clarify that the Herndon Foundation is permitted to continue to hold a majority of the stock of certain business enterprises. This provision applies as if included in section 101(*l*)(4) of the Tax Reform Act of 1969.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

17. Treatment of ESOP as disqualified person for section 4943 rules applicable to grandfathered buildings

Present law

The owner of more than 20 percent of a corporation which is a substantial contributor to a private foundation constitutes a disqualified person (Code sec. 4946(a)(1)(C)), and the stock it owns is therefore aggregated with that of the foundation for purposes of the section 4943 business holdings limitations.

House bill

No provision.

Senate amendment

An employee stock ownership plan described in Code sec. 4975(e)(7) is excepted from the definition of disqualified person, only for section 4943 purposes, with respect to grandfathered business holdings acquired pursuant to a pre-1969 will. This provision is effective for taxable years beginning after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

18. Exception to self-dealing rules for certain stock transactions

Present law

Present law in effect prohibits certain transactions between a private foundation and substantial contributors (or other disqualified persons), including the sale of property between a private foundation and a disqualified person and the lending of money or other extension of credit between a private foundation and a disqualified person (Code sec. 4941). Excise taxes are imposed for violations of these rules.

House bill

The House bill exempts from the self-dealing taxes certain 1978 transactions. Under the bill, Code section 4941 is not to apply in the case of the 1978 sale of stock of Murphy Motor Freight Lines, Inc. by the Wasie Foundation to Murphy Motor Freight Lines, Inc. and the related financing by the Wasie Foundation if the total consideration received (i.e., the sum of the cash and the value of the notes) equaled or exceeded the fair market value of the stock to Wasie Foundation. The provision applies retroactively for 1978 and subsequent years.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

19. Termination of status as substantial contributor

Present law

The term substantial contributor means a person whose contributions to a private foundation exceeded two percent of all contributions received by the foundation before the close of the year in which the contribution is made, but only if the person's contributions exceed $5,000. Once a person becomes a substantial contributor, that person retains that status forever (Code sec. 507(d)(2)).

House bill

The House bill provides rules under which a person's status as a substantial contributor terminates in certain circumstances after 10 years with no connection to the foundation, effective for post-1984 taxable years.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

C. Exempt Organizations

1. Acquisition indebtedness of certain educational institutions and organizations managing property for tax-exempt organizations; tax exemption for such organizations

Present law

Under present law, tax-exempt organizations (including qualified pension trusts and IRAs) generally are subject to tax on income from a trade or business unrelated to the organization's exempt purposes. Exclusions are provided for certain types of passive income.

Income that is subject to tax includes income from debt-financed property. An exception is provided to this rule for property acquired or improved by a qualified pension trust if the acquisition satisfies certain restrictions.

Present law provides that a company that holds title to property for a tax-exempt organization is entitled to tax exemption. However, present law is unclear as to whether a title-holding company may have more than one parent.

House bill

No provision.

Senate amendment

Unrelated business income tax on debt-financed property

The special exception to the debt-financed property rules is extended to certain educational institutions (and certain affiliated support organizations) and to certain tax-exempt title-holding companies that are granted tax-exempt status by the Senate amendment. However, in order for any organization (including a qualified pension trust) to qualify for the exception, two additional restrictions must be met. First, if the real property is acquired by a partnership, the exception does not apply to any partner unless each partner is an organization eligible for the exception. Second, no part of the financing of the acquisition can be provided by the seller.

The provision is effective with respect to indebtedness incurred after the date of enactment.

Title-holding companies

The Senate amendment provides tax exemption to a title-holding corporation that has more than one parent (and to trusts established for the same purposes), only if no individual who provides investment advice to the title-holding company is an officer, member of the board of directors, etc., of the company. Organizations eligible to invest in a title-holding company include (1) a qualified pension plan, (2) a governmental pension plan, (3) the United States, or any State or political subdivision, or (4) any charitable organization described in sec. 501(c)(3).

The provision is effective for taxable years beginning after December 31, 1984.

Conference agreement

Unrelated business income tax on debt-financed property

The conference agreement generally follows the Senate amendment with one exception. Under the conference agreement, an organization that is a partner in a partnership that holds real property can qualify for the exception to the tax on unrelated business income on debt-financed real property as long as (1) all of the partners of the partnership are organizations qualifying for the exception, or (2) each allocation to a partner of the partnership that is a qualified organization is a qualified allocation. For purposes of (1), an organization is not treated as a qualified organization if any of such organization's income is unrelated business taxable income determined without regard to sec. 514(c)(9).

Under the conference agreement, an allocation generally is a qualified allocation if it meets the rules relating to partnerships under the tax-exempt leasing provisions. Thus, a qualified allocation is an allocation under which (1) the qualified organization is allocated the same percentage share of each item of partnership income, gain, loss, deduction, credit, and basis (excluding allocations with respect to contributed property), (2) such share remains the same during the entire period that the organization is a partner, and (3) such allocation has a substantial economic effect, as defined under the rules applicable to partnership allocations generally (sec. 704(b)(2)).

The conference agreement authorizes the Treasury to prescribe regulations dealing with the effect of guaranteed payments (as defined in sec. 707(c)) under this rule. Under those regulations, priority cash distributions to partners that constitute guaranteed payments should not disqualify an otherwise qualified allocation so long as the priority cash distributions are reasonable in amount (e.g., equal to the most appropriate Federal rate) and are made to all partners in proportion to their capital in the partnership. On the other hand, the conferees expect that the regulations will prevent partnerships from avoiding the qualified allocation rules by making disproportionately large guaranteed payments to its tax-exempt partners for the use of their capital.

Under the conference agreement, a qualified organization includes a qualified pension trust (sec. 401) and certain educational organizations (and their support organizations).

The conference agreement provides that the Secretary shall prescribe such regulations as may be necessary to carry out the purposes of the unrelated debt-financed income provisions, including regulations to prevent the circumvention of these provisions through the use of segregated asset accounts. The conferees intend that such regulations shall be applied only with respect to transactions entered into after the date on which any regulations relating to this provision are issued.

The conferees intend that the rules of present law relating to the transfer of property with liabilities that exceed the transferor's basis in the property shall be applied to the transfers of property to a tax-exempt organization, particularly where such transfers are designed to avoid ordinary income recapture on the property.

Title-holding companies

The conference agreement does not contain the Senate amendment.

Effective dates

The conference agreement is generally effective with respect to indebtedness incurred after the date of enactment. Certain partnership transition rules are provided under the conference agreement.

2. Exemption for certain local organizations of police and firefighters

Present law

Under present law, certain local police and firefighter organizations in Minnesota that provide pension and other benefits to members have received IRS determinations providing exemption from Federal income tax.

House bill

No provision.

Senate amendment

The Senate amendment provides income tax exemption to an organization (other than a qualified pension plan) for police and firefighter organizations that provide benefits in lieu of government-funded benefits and that meet the requirements applicable to qualified pension plans maintained by a State or local government.

The provision is effective for taxable years beginning after August 23, 1981.

Conference agreement

The conference agreement does not include the Senate amendment. However, the conferees understand that the Internal Revenue Service will issue a revenue ruling that clarifies that the affected organizations are exempt from tax.

3. UBIT exemption for renting of membership lists by Federally chartered corporations

Present law

The U.S. Court of Claims held in a 1981 case that income received by the Disabled American Veterans from other exempt organizations and commercial businesses for the use of mailing lists is subject to the unrelated business income tax (UBIT). The court found that in renting its donor lists, the DAV operated in a competitive, commercial manner with respect to taxable firms in the direct mail industry; that these rental activities were regularly carried on; and that the rental activities were not substantially related to accomplishment of exempt purposes (apart from the organization's need for or use of funds derived from renting the mailing lists). Similarly, the IRS has ruled that amounts received by an exempt charitable organization from the regular sale of its membership or mailing lists to business firms and charities are subject to the UBIT.

House bill

No provision.

Senate amendment

The Senate amendment provides an exemption from the UBIT for amounts received by certain Federally chartered corporations (named in 36 U.S. Code sec. 1101) for renting or exchanging lists of their donors or members with organizations contributions to which are eligible for charitable deductions, effective for taxable years ending after the date of enactment. The 60 some organizations benefitting from the provision include various veterans, scouting, scientific, and literary groups.

Conference agreement

The conference agreement does not include the Senate amendment.

4. Exemption from UBIT for certain gambling income

Present law

An exemption from the unrelated business income tax (UBIT) is provided for certain bingo games conducted by tax-exempt organizations (Code sec. 513(f)).

House bill

The House bill extends the bingo exemption to certain games of chance which, under State law, can be conducted only by nonprofit organizations, effective for games of chance conducted after June 30, 1981.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

5. Tax treatment of certain nonprofit child care organizations

Present law

Nonprofit organizations which are organized and operated exclusively for charitable, educational, or other specified purposes, and which meet certain other requirements, are exempt from Federal income tax, and contributions to such organizations are deductible for income, gift, and estate tax purposes. The IRS has recognized that nonprofit day care centers may be eligible for tax exemption and tax-deductible contributions where enrollment is based on financial need of the family and the need of the child for the program, or where the center provides preschool age children of working parents with an educational program through a professional staff of qualified teachers.

House bill

Under the House bill, nonprofit organizations which provide care of children (away from their homes) are deemed to have a qualifying tax-exempt purpose if both (1) substantially all of the child care provided by the organization is for the purpose of enabling individuals (the parents) to be gainfully employed, and (2) the services provided by the organization are available to the general public. This provision is effective for taxable years beginning after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment. The provision is not intended to affect the meaning of the terms "educational" or "charitable" for any purpose other than considering the child care organizations described in the provision as having educational purposes.

6. Church audits

a. Commencement of church tax inquiry

Present law

No special requirements are imposed before commencing an investigation or inquiry regarding church tax liabilities. Special requirements are imposed before the IRS may examine church books of account as defined under present law.

House bill

No provision.

Senate amendment

Under the Senate amendment, an investigation of church tax liabilities may be commenced only if the IRS regional commissioner reasonably believes, on the basis of facts and circumstances recorded in writing (1) that the church does not qualify for tax exemption as a church, or (2) that the church is engaged in taxable activities. Additionally, before commencing the investigation, the IRS is required to provide notice containing specified information to the church. This notice must contain (1) a list of Code provisions authorizing the investigation, (2) a general explanation of the church's administrative and constitutional rights in connection with the audit, and (3) an explanation of the concerns which gave rise to the investigation and the general subject matter of the investigation.

Conference agreement

Requirement of reasonable belief before commencing church tax inquiry

The conference agreement provides that the IRS may begin a church tax inquiry only if the IRS regional commissioner (or higher official) reasonably believes, on the basis of facts and circumstances recorded in writing, that the organization (1) may not qualify for tax exemption as a church, or (2) may be carrying on an unrelated trade or business (within the meaning of section 513 of the Code) or be otherwise engaged in taxable activities. A church tax inquiry is defined as any inquiry to a church (other than an examination) which serves as a basis for determining whether the organization qualifies for tax exemption as a church or whether it is carrying on an unrelated trade or business or otherwise engaged in taxable activities. An inquiry is considered to commence when the IRS requests information or materials from a church of a type contained in church records, other than routine requests for information or inquiries regarding matters which do not primarily concern the tax status or liability of the church itself (as specified in the conference agreement).

The conferees intend that the facts and circumstances which form the basis for a reasonable belief under this provision will be derived from information lawfully obtained by the IRS. Information obtained from informants used by the IRS for this purpose must not be known to be unreliable.

Notice requirement upon commencement of inquiry

Under the conference agreement, upon beginning a church tax inquiry, the IRS is required to provide written notice to the church of the beginning of the inquiry. This notice is to include (1) an explanation of the concerns which gave rise to the inquiry and the general subject matter of the inquiry, (2) a general explanation of the provisions of the Internal Revenue Code which authorize the inquiry or which may otherwise be involved in the inquiry, and (3) a general explanation of applicable administrative and constitutional provisions with respect to the inquiry, including the right to a conference with the IRS before an examination of church records.

The explanation of the concerns and general subject matter of the inquiry (item (1) above) should be sufficiently specific to allow the church to understand the particular area of church activities or behavior which is at issue in the inquiry. For example, for an inquiry regarding unrelated business income, the notice should indicate the general activities of the church which may result in unrelated income (e.g., use of a particular property or facility for other than tax-exempt purposes). For an inquiry regarding tax-exempt status, the notice should indicate those general aspects of the church's operations or activities which have given rise to questions regarding its tax-exempt status. The IRS is not to be precluded from expanding its inquiry beyond the concerns expressed in the notice as a result of facts and circumstances which subsequently come to its attention (including, where appropriate, an expansion of an unrelated income inquiry to include questions of tax-exempt status, or vice-versa).

The notice requirement is not to be interpreted to require the IRS to share particular items of evidence with the church, or to identify its sources of information regarding church activities, where providing such information would be damaging to the inquiry or to the sources of IRS information. For example, in an inquiry regarding unrelated business income, the IRS might indicate that its inquiry was prompted by a local newspaper advertisement regarding a church-owned business; however; the IRS would not be required to reveal the existence or identity of any so-called "informers" within a church (including present or former employees).

The general explanation of applicable administrative and constitutional provisions (item 3) should make reference to the various stages of the church audit procedures contained in the conference agreement (including the right to a pre-examination conference) and the principle of separation of church and state under the First Amendment. The explanation is not required to explain the possible legal or constitutional ramifications of any particular church audit.

For purposes of this and the remaining church audit procedures, a church includes (1) any organization claiming to be a church or (2) a convention or association of churches. For purposes of these procedures, a church does not include church-supported schools or other organizations incorporated separately from the church.

b. Notice before examining church records

Present law

Under section 7605(c) of the Code and the regulations thereunder, the IRS may examine church books of account (generally, accounting and bookkeeping records) only if (1) the IRS regional commissioner believes that an examination is necessary, and (2) the IRS notifies the church at least 30 days prior to examination.

House bill

No provision.

Senate amendment

The Senate amendment broadens the present law rule to require a pre-examination notice containing specified information to be sent to the church. This notice is in addition to the notice of commencement of an investigation and must be provided not less than 15 days after the prior notice. As part of this second notice, the IRS must offer the church a pre-examination meeting to seek to resolve outstanding issues and an opportunity to request, under the Freedom of Information Act, copies of any materials in the possession of the IRS which are relevant to the investigation of the church. The church is to have 15 days (i.e., a minimum of 30 days after the notice of commencement of investigation) in which to request a pre-examination meeting, during which period the IRS is prohibited from examining church records. The IRS is also prohibited from examining church records until a meeting (if requested by the church) is held, or until any any Freedom of Information Act request by the church is granted or a final administrative denial of the request is made.

Concurrently with the notice of examination to the church, the IRS regional counsel must be notified of the proposed examination and has 15 days in which to file a nonbinding objection to the examination.

Conference agreement

Additional notice and offer of IRS conference

Under the conference agreement, the IRS may examine church records or religious activities only if, at least 15 days prior to the examination, the IRS provides written notice to the church and to the IRS regional counsel of the proposed examination. This notice is in addition to the notice of commencement of inquiry previously provided to the church.

The notice of examination is required to include (1) a copy of the church tax inquiry notice previously provided to the church, (2) a description of the church records and activities which the IRS seeks to examine, and (3) a copy of all documents which were collected or prepared by the IRS for use in the examination, and which are required to be disclosed under the Freedom of Information Act (5 U.S.C. sec 552) as supplemented by section 6103 of the Code (relating to disclosure and confidentiality of tax return information). The conferees intend that the documents to be supplied under this provision will be limited to documents specifically concerning the church whose records are to be examined and will not include documents relating to other inquiries or examinations or to IRS practices and procedures in general. The conferees further specifically intend that disclosure to the church will be subject to the restrictions of present law regarding the disclosure of the existence or identity of informers. The description of materials to be examined in the notice of examination and the documents disclosed by the IRS to the church do not restrict the ability of the IRS to examine the church records or religious activities which are properly within the scope of the examination.

The conference agreement further requires the IRS regional commissioner, as part of the notice of examination, to offer the church an opportunity to meet with an IRS official to discuss the concerns which gave rise to the inquiry and the general subject matter of the inquiry. The organization may request such a meeting at any time prior to the examination. If the church requests a meeting, the IRS is required to schedule a meeting within a reasonable time and may proceed to examine church records only following the meeting. The conferees intend that the holding of one meeting with the church will be sufficient to satisfy the requirements of this provision. The conferees further intend that churches will not be able to utilize the meeting requirement in order to unreasonably delay an examination.

The purpose of a meeting between the church and the IRS is to discuss the relevant issues that may arise as part of the inquiry, in an effort to resolve the issues of tax exemption or liability without the necessity of an examination of church records. The conferees therefore intend that the church and the IRS will make a reasonable effort to resolve outstanding issues at the meeting. To avoid misunderstandings, the conferees intend that the IRS will remind the church at the meeting, in general terms, of the stages of the church audit procedures and the church's rights under such procedures. However, the IRS will not be required to reveal information at the meeting of a type properly excludable from a written notice (including information regarding the identity of third-party witnesses or evidence provided by such witnesses).

The notice of examination may be sent to a church not less than 15 days after the notice of commencement of a church tax inquiry. Thus, at least 30 days must pass between the first notice and the actual examination of church records. For example, if notice of commencement of an inquiry is sent to a church on day 1, notice of proposed examination may be sent to the church no earlier than day 15, and no examination of church records may be made prior to day 30. If an organization does not request a meeting prior to day 30, the IRS may proceed to examine church records. However, if the IRS does not send a notice of examination within 90 days after sending the notice of inquiry, the inquiry would be terminated. The conferees intend that this 90-day period be suspended during any period for which the two-year period for duration of a church audit (item (d) below) would be suspended; however, the 90-day period is not to be suspended because of the church's failure to comply with requests for information made prior to the notice of examination. If the inquiry is terminated under this provision, any further inquiry regarding the same or similar issues within a 5-

year period would then require approval of the IRS Assistant Commissioner for Employee Plans and Exempt Organizations, as specified in the conference agreement.

Notification of regional counsel

At the same time as notice of an examination is provided to a church, the IRS is required to provide a copy of the same notice to the appropriate IRS regional counsel. The regional counsel is then allowed 15 days from issuance of the notice in which to file an advisory objection to the examination. (This is concurrent with the 15-day period during which the IRS is prohibited from examining church records pending a request for a conference.) The committee intends that the regional commissioner will take any objection by the regional counsel into account when determining whether to proceed with the examination.

c. Definition of protected church records

Present law

Church books of account may be examined only to the extent necessary to determine the amount (if any) of the tax liabilities of a church or its contributors or employees. Under IRS guidelines, books of account include accounting and bookkeeping records kept in the regular course of church business. The present law notice requirements are also limited to examinations of church books of account.

Third-party records (e.g., records held by a bank) are not subject to special scope or notice requirements. However, under general third-party summons rules (sec. 7609), the church must be notified before the IRS examines such records.

Present law provides that, when an organization claims to be a church, the religious activities of the organization may be examined only to the extent necessary to determine whether the organization actually is a church.

House bill

No provision.

Senate amendment

Under the Senate amendment, all regularly kept church corporate and financial records, including (but not limited to) corporate minute books, contributor or membership lists in the possession of the church, and church books of account, may be examined only to the extent necessary to determine tax. The special notice requirements under the amendment (items (a) and (b) above) apply to examinations of any such records. The scope and notice rules do not apply to records previously filed with a public official.

As under present law, third-party records are not specially protected. However, the Senate amendment prohibits the IRS from revoking a church's tax exemption or imposing tax on a church, on the basis of third-party records, without following the proper church audit procedures.

Conference agreement

The conference agreement provides that the IRS may examine church records only to the extent necessary to determine the liability for, and the amount of, any Federal tax. The conferees intend that, as under present law, this may include examinations (1) to determine the initial or continuing qualification of the organization whose records re being examined as a tax-exempt entity under section 501(c)(3); (2) to determine whether the organization qualifies to receive tax-deductible contributions (sec. 170(c); or (3) to determine the amount of tax, if any, which is to be imposed on the organization.

Church records include all regularly kept church corporate and financial records, including (but not limited to) corporate minute books, contributor or membership lists, and any materials which qualify as church books of account under present law. The conferees further intend that church records will include private correspondence between a church and its members that is in the possession of the church. Church records protected by the conference agreement do not include records previously filed with a public official or, as under present law, newspapers or newsletters distributed generally to the church members.

Records held by third parties (e.g., cancelled checks or other records in the possession of a bank) are not considered church records for purposes of the conference agreement. Thus, subject to the general Code provisions regarding third party summonses, the IRS is permitted access to such records without regard to the requirements of the church audit procedures (sec. 7609). As under present law, either the IRS or a third party recordkeeper generally is required, however, to inform a church of any IRS requests for materials.

The conference agreement provides that the IRS may not determine that a church is not entitled to an exemption or assess tax for unrelated business income against a church solely on the basis of third party records, without complying with the church audit procedures. This limitation does not apply to assessments of tax other than for unrelated business income (e.g., for social security or other employment taxes). The conferees further intend that the IRS will be prohibited from using information obtained from third party bank records to avoid the purposes of the church audit procedures.

The conference agreement provides that, as under present law, the IRS may examine the religious activities of an organization claiming to be a church (including a convention or association of churches) only to the extent necessary to determine if the organization actually is a church. The conference agreement clarifies that this includes a determination of the organization's qualification as a church for any period.

d. Time limitation on church audit

Present law

There is no specific limitation under present law on the duration of a church audit.

House bill

No provision.

Senate amendment

The Senate amendment generally requires the IRS to complete an investigation of church tax liabilities, and to make a final determination in such an investigation, within two years after notifying the church of the commencement of the investigation. The running of this period is suspended for any period during which (1) a judicial proceeding initiated by the church or its agents challenging the IRS investigation, examination, or proceeding is pending or being appealed, (2) a judicial proceeding brought by the IRS to compel compliance with a reasonable request for an examination of church records or religious activities is pending or being appealed, or (3) the IRS is unable to take action by reason of a stay of a suit involving access to third-party records (sec. 7609). The two-year period is also suspended, under the Senate amendment, for certain periods relating to the filing of a Freedom of Information Act by the church seeking access to documents in the possession at the IRS. Additionally, the committee report provides that the two-year period is to be suspended for any period in which the IRS is unable to make a determination because of the refusal of the church or its agents to comply with reasonable and lawful requests for information or materials necessary for the conduct of the investigation.

The Senate amendment allows the two-year period to be extended by mutual agreement of the church and the IRS.

Conference agreement

The conference agreement requires the IRS to complete any church inquiry or examination, and to make a final determination with. respect thereto, not later than two years after the date on which the notice of examination is supplied to the church. The running of this two-year period is suspended for any period during which (1) a judicial proceeding brought by the church or its agents against the IRS with respect to the church tax inquiry or examination is pending or being appealed, (2) a judicial proceeding brought by the IRS against the church (or any official thereof) to compel compliance with any reasonable IRS request for examination of church records or religious activities is pending or being appealed, or (3) the IRS is unable to take actions with respect to the church tax inquiry or examination by reason of an order issued in a suit involving access to third-party records under section 7609. The two-year period is also suspended for any period in excess of 20 days (but not in excess of 6 months) in which the church or its agents fail to comply with any reasonable IRS request for church records or other information.

The conference agreement allows the two-year period to be extended by mutual agreement of the church and the IRS.

e. Period for assessment or collection of tax

Present law

The IRS is generally required to assess tax, or proceed for collection without assessment, within three years after a return is filed. No limitation period applies if no return is filed or in the case of a false or fraudulent return or willful tax evasion.

Where a limitation period is applicable, the period may be extended by mutual agreement of a taxpayer and the IRS.

House bill

No provision.

Senate amendment

The Senate amendment applies a three-year limitation period for assessment or collection of church tax liabilities whether or not a return has been filed. No limitation applies in cases of fraud, willful tax evasion, or knowing failure to file a return which should have been filed.

Under the Senate amendment, the three-year limitation period is suspended during periods for which the two-year limit on duration of a church audit (item (d) above) is suspended. As under present law, the three-year period may be extended by mutual agreement of a church and the IRS.

Conference agreement

Under the conference agreement, for examinations regarding revocation of tax-exempt status, where no return is filed, the IRS is to be limited initially to an examination of church records which are relevant to a determination of tax status or liability for the three most recent taxable years preceding the date on which the notice of examination (i.e., second notice) is sent to the church. If the church is proven not to be exempt for any of these years, the IRS may examine relevant records and assess tax (or proceed without assessment), as part of the same audit, for a total of 6 years preceding the notice of examination date.

For examinations relating to unrelated business taxable income, where no return is filed, the IRS may assess or collect tax for the 6 most recent years preceding the date on which the notice of examination is sent, with no additional limit on the period of church records which may be examined.

For examinations involving issues other than revocation of exempt status or unrelated business income (e.g., examinations relating to social security or other employment taxes), no limitation period is to apply if no return has been filed.

The special limitation periods for church tax liabilities are not to be construed to increase an otherwise applicable limitation period. Thus, as under present law, a three-year limitation period would apply where a church filed a tax return before an examination was held and did not substantially understate income. No limitation period is to apply in any case of fraud, willful tax evasion, or knowing failure to file a return which should have been filed.

As under present law, the applicable limitation period may be extended by mutual agreement of the church and the IRS.

f. Declaratory judgment actions regarding tax-exempt status

Present law

Organizations (including churches) may bring a declaratory judgment action in any case involving a determination of tax-exempt status under section 501(c)(3). The action may be brought in the Tax Court, the Claims Court, or the United States District Court for the District of Columbia. The court may generally issue a declaratory judgment only after (1) a final adverse determination by the IRS, or (2) failure by the IRS to make a determination within 270 days of a request for such.

Service of process.—Where an action is brought under section 7428 in the Tax Court or the Claims Court, trial subpoenas may be served on a nationwide basis. However, if the suit is brought in the United States District Court for the District of Columbia, a trial subpoena may generally be served only within a limited distance of the place of trial.

House bill

No provision.

Senate amendment

Under the Senate amendment, an organization is entitled to bring a declaratory judgment action under section 7428 once the IRS issues a revenue agent's final report ("30-day letter") proposing to revoke a church's tax-exempt status.

Conference agreement

The conference agreement follows the Senate amendment.

Additionally, the conference agreement further provides for nationwide service of trial subpoenas in declaratory judgment actions brought under section 7428 in the United States District Court for the District of Columbia.

g. Regional counsel approval of final IRS determinations

Present law

There is no statutory provision requiring approval of IRS determinations in church audits by a particular IRS official.

House bill

No provision.

Senate amendment

The Senate amendment requires the IRS regional counsel to approve, in writing, the issuance of an adverse determination letter or deficiency notice to a church.

Conference agreement

The conference agreement requires the IRS regional counsel to approve, in writing, (1) the determination of whether an organization has tax-exempt status as a church (sec. 501(a), (2) the determination of whether such an organization is a church which is entitled to receive tax-deductible contributions (sec. 170(c)), or (3) the issuance of a notice of tax deficiency to a church following a church tax examination (in cases where deficiency procedures are inapplicable, the assessment of any underpayment of tax by the church following a church tax examination). The conference agreement further requires the regional counsel to state in writing that the IRS has substantially complied with the church audit procedures as provided by the conference agreement.

h. Prevention of repeated examinations

Present law

There is no special provision regarding approval of a second examination of a church. However, the IRS must provide special notice before inspecting any taxpayer's records twice for the same tax year.

House bill

No provision.

Senate amendment

The Senate amendment requires the appropriate IRS assistant commissioner to approve, in writing, any second investigation or examination of a church, unless the first investigation or examination resulted in (1) revocation of tax exemption or an assessment of tax, or (2) a request by the IRS for any significant changes in church operational practices (including the adequacy or sufficiency of records maintained to reflect income). The committee report indicates that this provision is to apply only to second audits involving the same or similar issues as the prior audit.

Conference agreement

The conference agreement follows the Senate amendment, but specifies that (1) the requirement of assistant commissioner approval does not apply where the second audit (i.e., church tax inquiry or examination) does not involve the same or similar issues as the preceding inquiry or examination, and (2) the requirement applies only to second audits beginning within 5 years of the date on which the notice of examination was sent to the church during the prior audit (if no notice of examination was sent, the date of the notice of commencement of inquiry). This 5-year period is to be suspended for periods during which the two-year period for completion of an audit is suspended as described under the conference agreement (unless the prior audit was actually concluded within 2 years of the notice of examination). Finally, the conference agreement clarifies that the approval of any second audit to which the provision applies is to be made by the IRS Assistant Commissioner for Employee Plans and Exempt Organizations.

The conferees intend that, in determining whether a second audit involves similar issues to a prior audit, the substantive factual issues involved in the two audits, rather than legal classifications, will govern. Specifically, the conferees intend that unrelated business income from different sources will be considered different issues for purposes of this provision.

i. Scope of church audit procedures

Present law

The Internal Revenue Code applies special procedural requirements (described above) which are primarily intended to protect churches in examinations concerning unrelated business income. Treasury regulations generally extend these rules to examinations concerning tax-exempt status of an organization claiming to be a church.

House bill

No provision.

Senate amendment

The Senate amendment applies expanded statutory procedures (described above) to investigations of church tax status and liabilities. The committee report specifies that these procedures do not apply to investigations of individuals' tax liability (e.g., liabilities of individual contributors to a church) and do not prevent routine inquiries to a church (e.g., regarding employment taxes, income tax withholding, or similar matters). However, further legislative history indicates that the procedures are intended to apply at any point at which the tax status of a church becomes the issue in an investigation.

Conference agreement

The conference agreement specifies that the church examination procedures described above do not apply to (1) any inquiry or examination of any person other than a church, (2) any termination assessment (sec. 6851) or jeopardy assessment (sec. 6861), or (3) any case involving a knowing failure to file a return or a willful attempt to defeat or evade tax. Additionally, the conference agreement clarifies that these procedures do not apply to criminal investigations.

The conferees intend that inquires or examinations which relate primarily to the tax status or liability of persons other than the church (including the tax status or liability of a contributor or contributors to the church), rather than the tax status or liability of the church itself, will not be subject to the church audit procedures. These may include, but are not be limited to, (1) inquiries or examinations regarding the inurement of church funds to a particular individual or individuals or to another organization, which may result in the denial of all or part of such individual's or organization's deduction for charitable contributions to the church, (2) inquiries or examinations regarding the assignment of income or services or excessive contributions to a church, and (3) inquiries or examinations regarding a vow of poverty by an individual or individuals followed by a transfer of property or an assignment of income or services to the church. The IRS may inquire of a church regarding these matters without being considered to have commenced a church tax inquiry and may proceed to examine church records relating to these issues (including enforcement of a summons for access to such records) without following the requirements applicable to church tax examinations, subject to the general rules regarding examinations of taxpayer books and records.

The conferees intend that inquiries or examinations conducted outside the church audit procedures will be limited to the determination of facts and circumstances specifically relating to the tax liabilities of the individuals or other organizations in question. For example, in an inurement case, the IRS could request information or examine church records regarding amounts of money, property, or services transferred to the individual or individuals in question (including wages, loans, or non-contractual transfers), the use of church funds for personal expenses, or other similar matters, outside of the church audit procedures. In an assignment of income case, the IRS could request information or examine church records relevant to an individual's assignment of particular income, donation of property, or transfer of a business to a church. However, the IRS could not examine a contributor or membership list in the possession of the church, without following the church audit procedures, for the purpose of determining the overall financial structure of the church, merely because such structure was relevant to the church's qualification as a tax-exempt entity and therefore indirectly relevant to the validity of contributors' deductions in general. The conferees further intend that the IRS will not make use of inquiries or examinations regarding individuals' or other organizations' tax liabilities to avoid the intended purpose of the church audit procedures. The failure of a church to respond to repeated inquiries regarding individuals' or other organizations' tax liabilities will be considered a reasonable basis for commencement of a church tax inquiry.

The conferees further intend that routine IRS inquiries to a church will not be considered to commence a church tax inquiry and therefore will not trigger application of the church audit procedures. Routine questions for the purpose include (but are not limited to) questions regarding (1) the filing or failure to file any tax return or information return by the church, (2) compliance with income tax or FICA tax withholding responsibilities by the church, (3) any supplemental information needed to complete the mechanical processing of any incomplete or incorrect return filed by the church, (4) information necessary to process applications for exempt status, letter ruling requests, or employment tax exemption requests by the church, and information identifying a church that is used by the IRS to update its Cumulative List of Tax Exempt Organizations and other computer files, and (5) confirmation that a specific business is or is not owned or operated by a church. Repeated failure by a church or its agents to reply to such routine inquiries will be considered reasonable basis for commencement of a church tax inquiry under the applicable church audit procedures. The IRS may further request a church to provide information necessary to locate third-party records (e.g., bank records), including information regarding the church's chartered name, state and year of incorporation, and location of checking and savings accounts, without following the church audit procedures; failure to provide this type of information is to be a factor, but not a conclusive factor, in determining if there is reasonable cause for commencing a church tax inquiry.

The conference agreement specifies that the church audit procedures do not apply to any case involving a knowing failure to file a return or a willful attempt to defeat or evade tax. The conferees are aware that, in recent years, increasing numbers of tax protesters and other taxpayers have utilized the form of religious organizations in an effort to avoid tax. In Fiscal Year 1983, the IRS closed 6,612 examinations involving alleged church tax avoidance schemes, assessing $23,803,200 in taxes and penalties (an average assessment of $3,600 per return) and leaving a calendar year-end inventory of 15,296 church tax avoidance cases (in addition to approximately 200 criminal investigations). In the first 6 months of Fiscal 1984 alone (October 1, 1983–March 31, 1984), the IRS assessed $25,620,178 in taxes and penalties in 5,498 cases relating to church tax avoidance schemes.[1] The conferees specifically intend that nothing in the church audit procedures will inhibit IRS inquiries, examinations, or criminal investigations of tax protestor or other tax avoidance schemes posing as religious organizations, including (but not limited to) tax avoidance schemes posing as mail-order ministries or storefront churches, whether such schemes are limited to one particular taxpayer or encompass a group of taxpayers.

j. Remedy for IRS violation of audit procedures

Present law

The violation of statutory procedures may generally be raised as a defense (but not an absolute defense) in a proceeding to gain access to statutorily protected records.

House bill

No provision.

Senate amendment

The Senate amendment specifies that IRS failure to follow the proper church audit procedures is a defense (but not an absolute defense) in a proceeding to gain access to church records. The committee report states that, once this defense is raised, the IRS has the burden to prove it has followed the property statutory procedures. However, the IRS is permitted to correct any procedural violations before continuing an investigation.

Conference agreement

The conference agreement provides that the exclusive remedy for any IRS violation of the church audit procedures described above is as follows: failure of the IRS to substantially comply with (1) the requirement that two notices be sent to the church, (2) the requirement that the regional commissioner approve the commencement of a church tax inquiry, or (3) that an offer of an IRS conference with the church be made (and a conference held if requested), will result in a stay of proceedings in a summons proceeding to gain access to church records (but not in dismissal of such proceeding)

[1] Information provided to Treasury Department by IRS Employee Plans/Exempt Organizations Operations Division, June 19, 1984.

until these requirements are satisfied. The two-year limitation on duration of a church audit is not to be suspended during stays of summons proceedings resulting from violations described above; however, the IRS may correct such violations without regard to the otherwise applicable time limits prescribed under the church examination procedures. The conferees intend that, in determining whether a stay is necessary, a court will consider the good faith of the IRS and the effect of any violation of the proper examination procedures.

Aside from the exclusive remedy described above, there is to be no judicial remedy for IRS violation of any of the church examination procedures provided by the conference agreement. IRS failure to comply with any of these requirements may not be raised as a defense or an affirmative ground for relief in any judicial proceeding including, but not limited to, a summons proceeding to gain access to church records; a declaratory judgment proceeding involving a determination of tax-exempt status (sec. 7428); or a proceeding to collect unpaid tax. Additionally, failure to substantially comply with the requirements that two notices be sent, that the assistant commissioner approve an inquiry, and that a conference be offered (and the conference held if requested) may not be raised as a defense or as an affirmative grounds for relief in a summons proceeding or any other judicial proceeding other than as specifically set forth above. The conferees specifically intend that a church or its representatives will not be able to litigate the issue of the reasonableness of the assistant commissioner's belief in approving the commencement of a church tax inquiry (i.e., that the church may not be tax-exempt or may be engaged in taxable activities) in a summons proceeding or any other judicial proceeding. These provisions are not, however, intended to derogate from a church's right to raise any substantive or procedural argument which would be available to taxpayers generally in the appropriate proceeding.

k. Effective date

Present law

No provision.

House bill

No provision.

Senate amendment

Under the Senate amendment, the church audit procedures are effective for investigations, examinations, or other proceedings commencing after the date of enactment.

Conference agreement

The church audit procedures contained in the conference agreement are effective for inquiries and examinations commencing after December 31, 1984.

IV. SIMPLIFICATION

A. Individual Estimated Tax

Present law

Under present law, a penalty is imposed on the underpayment of the individual estimated tax. The amount of underpayment is based on difference between payments (including withholding) made and 80 percent of tax shown on the return. No penalty is imposed if payment equals an amount based on: (1) the tax shown on the preceding year's return; (2) 80 percent of the current year's tax computed on income to date placed on an annualized basis; (3) 90 percent of the tax on income to date; or (4) tax on the prior year's facts and current year's rates and exemptions. The penalty may not be waived by the IRS. Estimated payments of the alternative minimum tax are not required.

The IRS had ruled (Rev. Rul. 83-111, 1983-2 C.B. 245) that overpayments may not be credited to estimated tax payments earlier than the date election to credit payment is made. This ruling has been revoked by Rev. Rul. 84-58, 1984-16 I.R.B. 8.

House bill

Under the House bill, the underpayment will be based on the lesser of (1) 80 percent of tax shown on the return, (2) 100 percent of tax shown on the preceding year's return, or (3) 80 percent of the current year's tax computed on income to date placed on an annualized basis. Exceptions (3) and (4) described under present law are repealed.

The penalty may be waived as the result of casualty, disaster or circumstances where imposition of tax would be inequitable. Estimated tax payments of the alternative minimum tax will be required.

The House bill overrules Revenue Ruling 83-111.

The provision is generally effective for taxable years beginning after December 31, 1984.

Senate amendment

Under the Senate amendment, the underpayment may be waived as in the House bill. Also the penalty may be waived for reasonable cause during the first 2 years after the taxpayer retires upon reaching age 62 or becomes disabled.

Estimated tax payments of the alternative minimum tax will be required.

The provision is effective for taxable years beginning after December 31, 1984.

Conference agreement

The conference agreement follows the House bill, with the Senate amendment relating to penalty waivers. The penalty waiver provision will be effective for taxable years beginning after December 31, 1983.

If the taxpayer designates that the overpayment of tax shown on his return is to be credited against his estimated tax, but the overpayment is offset for either past-due child support or non-tax Federal debt under section 6402(c) or (d), and the taxpayer is not notified of the offset prior to the due date of the estimated tax, the conferees intend that the Secretary consider these circumstances as warranting a waiver of the estimated tax penalty.

B. Domestic Relations Tax Reform

1. Treatment of transfer of property between spouses or incident to divorce

Present law

Under present law, gain is generally recognized on transfers of property in exchange for the release of marital claims (*United States* v. *Davis*, 370 U.S. 65 (1962)).

House bill

The House bill provides that transfers of property between spouses or incident to divorce will generally be non-taxable, carryover basis transactions.

The provision applies to transfers after date of enactment (other than transfers pursuant to instruments in effect on that date where the parties do not elect to have the provisions apply). The parties may elect to have the provision apply to transfers after December 31, 1983.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

2. Alimony

Present law

Alimony paid under divorce or separation instruments is deductible by the payor and includible in the income of the payee. Alimony must be in discharge of a legal obligation because of family or marital relationship; the payment may not discharge a principal sum, with an exception for certain payments which exceed 10 years.

There is no requirement to furnish the name or social security number of payee.

House bill

The House bill repeals the present law requirements to qualify as alimony. The bill's new requirements are as follows: (1) payment must be in cash; (2) payor and payee who are divorced or legally separated may not be members of the same household at time of payment; (3) payment must be terminable at death of payee spouse; and (4) the parties must not designate the payment as not being alimony.

The deduction for payments made during the first year which exceed average payments made during the second and third year by more than $15,000 will be recaptured. Also recapture will occur where second-year payments exceed third-year payments by more than $15,000. No recapture will occur where either party dies or where payee spouse remarries by the end of the third year. Recapture does not apply to temporary support decrees.

Payee must furnish payor with his or her social security number and the payor must furnish the name and social security number of the payee to the IRS; a $50 penalty may be imposed for failure to comply.

The provision applies generally to decrees and agreements executed after 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with the following modifications:

(1) The divorce or separation instrument must state that there is no liability to make payments for any period after the death of the payee spouse.

(2) If any amount specified in the instrument will be reduced on the happening of a contingency relating to a child, then an equal amount will be treated as child support rather than alimony. Thus, for example, if the divorce instrument provides that payments will be reduced by $100 per month when a child reaches age 18 (or in the month the child happens to reach that age), then $100 of each monthly payment will be treated as fixed for child support.

(3) The conference agreement generally provides that deductible alimony payments must continue for at least 6 years duration and may not vary by more than $10,000 during any of those years. Specifically, the agreement provides that any payment in excess of $10,000 per year will be deductible only if the instrument provides that the payor spouse is required to make alimony payments for at least 6 consecutive calendar years beginning with the year a payment is first made (assuming neither spouse dies during that period and that the payee does not remarry).

Also, if payments are deductible for any year, but in a subsequent year (during the 6-year period) the payments decrease by more than $10,000 from that prior year, then those excess payments (i.e., those earlier year payments in excess of the sum of the later year payments plus $10,000) will be includible in the income of the payor and deductible by the payee in the subsequent year. Thus, for example, if alimony payments of $25,000 are made in year 1 and payments of $12,000 are made in year 2, then $3,000 will be recaptured in year 2. If the payments further decline to $1,000 in year 3, then, in year 3, an additional $11,000 will be recaptured from year 1 and $1,000 will be recaptured from year 2. If, prior to the end of year 6, payments further decline, additional recapture will occur. In applying these rules, years beginning with the year of death of either spouse or remarriage of the payee spouse will be ignored if payments terminate by reason thereof. Also, for purposes of applying these rules, payments pursuant to a support decree (specified in section 71(b)(2)(C)) or payments which fluctuate as a result of a continuing liability to pay, for at least 6 years, a fixed portion of income from the earnings of a business, property or services will not be taken into account.

3. Dependency exemption

Present law

A $1,000 deduction is allowed for a dependent child of the taxpayer; to qualify as a dependent of the taxpayer, the taxpayer must furnish over one-half of his or her support.

Special rules are provided for divorced or legally separated parents or parents separated under written separation agreement where the two parents provide more than one-half of the support. The custodial parent is allowed the dependency exemption except that: (1) if the decree or agreement provides that the non-custodial parent is entitled to a deduction and that the parent provides at least $600 of the support, the non-custodial parent is treated as providing over one-half the support; or (2) if the non-custodial parent furnishes at least $1200 of the support, that parent is presumed to furnish over one-half the support unless the custodial parent clearly establishes otherwise.

A medical expense itemized deduction is allowed for expenses of a dependent child.

Numerous different rules relating to status of married individuals living apart apply.

A child is not eligible as a dependent if his or her gross income exceeds $1,000 unless the child is under age 19 or is a student.

House bill

Under the House bill, the dependency special rules will be extended to parents living apart at all times during the last 6 months of the calendar year. The custodial parent will be allowed the dependency exemption unless that parent signs a declaration that he or she will not claim the exemption for the taxable year, and the non-custodial parent attaches the declaration to his or her return. Pre-1985 agreements described under (1) of present law will continue to be recognized.

The House bill treats a child as the dependent of both parents for purposes of the medical expense deduction.

The House bill provides that parents living apart for the last 6 months of the year can be treated as unmarried or head-of-household if the other eligibility tests are met. Eligibility for unmarried status, head-of-household status, earned income credit, and credit for dependent care are not lost where the custodial parent waives the right to claim the dependency exemption.

Income received by a permanently and totally disabled individual at a sheltered workshop school will be disregarded in determining the dependency exemption.

The provision applies to taxable years beginning after December 31, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

4. Innocent spouse relieved of liability in certain cases

Present law

Under present law, a spouse filing a joint return may be relieved of liability for tax if (1) there is a more-than-25-percent omission from gross income attributable to the other spouse, (2) the spouse establishes that he or she had no knowledge, or reason to know, of the unreported income, and (3) it would be inequitable to hold the spouse liable, taking into account whether the spouse significantly benefitted from the omission.

Community income is treated as income of both spouses. An exception applies where the spouses live apart for the entire year, file separate returns, and one spouse has earned income which is not transferred to the other spouse.

House bill

The House bill extends the innocent spouse joint return rule to substantial understatements resulting from (1) omitted income and (2) deductions, basis, and credits with no basis in law or fact. A substantial understatement will be an understatement of tax exceeding $500.

The community property rule is extended to situations where a spouse establishes that he or she did not know, or have reason to know, of an item of community income, and it is inequitable to include the item in that spouse's income.

The provision applies to all taxable years to which the Internal Revenue Codes of 1939 and 1954 apply.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with the following two modifications:

(1) The joint return innocent spouse relief, to the extent the understatement is not attributable to an omission from gross income, will be available only if the liability which otherwise would qualify for relief exceeds

(a) 10 percent of the spouses's adjusted gross income for the taxable year prior to which the deficiency notice is mailed if that income was $20,000 or less, or

(b) 25 percent of the spouse's adjusted gross income for the prior taxable year if that income exceeded $20,000. (Where the spouse will meet these tests, it is not necessary to actually mail the deficiency notice.)

The conferees understand that the additional relief in the bill will be available to pending court cases where the decision in the case is not final.

(2) The Secretary may disallow the benefits of any community property law to a taxpayer if the taxpayer acts as if he or

she is solely entitled to the income and the taxpayer failed to notify the taxpayer's spouse of that income.

5. Gift and estate tax liability for transfers of property to spouses incident to divorce

Present law

Under present law, there is no gift tax liability for transfers of property to a spouse in settlement of marital or property rights pursuant to a written agreement where divorce occurs within 2 years of agreement.

House bill

The House bill provides an estate tax deduction for transfers pursuant to these written agreements. It also extends the period to enter into an agreement to one year after divorce.

The provision applies to gifts made, and estates of decedents dying, after date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

C. At-risk Provisions

Present law

Investment tax credit

Present law generally limits the amount of property on which a taxpayer (other than a non-closely held corporation) may claim the investment tax credit to the amount the taxpayer is "at risk". Real estate and certain corporate leasing activities are exempt from this rule.

There is an exception for loans from persons in the commercial lending business who are unrelated to the seller or to the taxpayer where the taxpayer is at least 20 percent at risk at all times.

Present law allows a lessor to pass the credit through to the lessee. The application of the at-risk rules to these leases is unclear.

Losses

Present law limits the losses from an activity which a taxpayer (other than a non-closely held corporation) may claim to the amount the taxpayer is at risk in the activity.

House bill

Investment tax credit

The House bill generally clarifies present law by revising the rules (including the recapture rules) so as to specifically disallow the credit with respect to property financed with nonrecourse borrowing.

The House bill generally retains the commercial lending exception. It also adds an exception for recourse loans to a subchapter S corporation where the loan is from an unrelated commercial lender and the property is used in an active trade or business with at least 3 full-time non-owner employees, including one full-time employee managing the business.

In the case of a pass-through lease, the at-risk rule will continue to apply to the lessor. For the lessee to get the full credit in the year the property is placed in service, the lessee must be liable to make non-contingent payments the present value of which at the beginning of the lease (assuming the rate of interest used in computing interest on tax underpayments) must equal or exceed 30 percent (18 percent in the case of 3-year property) of the value of the property.

These rules apply to property placed in service after date of enactment (or as if enacted by ERTA, if the taxpayer so elects).

Losses

Under the bill, an active trade or business of a closely held subchapter C corporation (other than a personal holding company or personal service corporation) will not be subject to any at-risk rules. A trade or business will be required to have three full-time, non-owner employees, one full-time employee actively managing the business, and "out-of-pocket" business expenses exceeding 15 percent of gross income. Losses from an active business may not offset income of a personal holding company or personal service company that is a member of the same affiliated group.

Certain activities will be aggregated if the taxpayer actively participates in the management of each activity.

A taxpayer can be at risk for amounts borrowed from a related party.

These rules will apply to taxable years beginning after December 31, 1983.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with the following modifications:

(1) "Section 48(d)" leases

(a) In order to reduce the possibility that in the case of a "pass-thru" lease, a lessee subject to the "at risk" rules may claim an inflated value for the property, the agreement requires that the lessor be subject to the investment tax credit at-risk rules with respect to these leases unless the lessor would not otherwise be subject to these rules and either the lessor manufactured or produced the property, the property has a readily ascertainable fair market value, or the Secretary determines by regulation that it is unnecessary for the lessor to be subject to the "at-risk" rules.

(b) The requirement that the lessee be 30-percent at risk is modified to provide that the "at risk" percentage be an amount equal to two times the credit percentage (set forth in section 46(a)) plus 10 percent (60 percent of this amount in the case of three-year property). This change is intended to insure that the lessee have an after-tax investment in the property.

(2) Definition of qualified business

(a) The legislative language is amended to specifically require that a qualifying business be an active business. It is intended that the creation of an active business be treated as the conduct of an active business for this purpose.

(b) The application of the partnership rules are revised. Under the conference agreement, a qualified corporate partner will take into account its proportionate share of the employees of a qualified partnership (or of a qualified corporate partner) substantially all the services of whom are directly related to the business of the partnership, and also will take into account its share of the income and deductions of the partnership for purposes of determining whether the corporation is engaged in a qualifying business. The corporation may aggregate its share of the partnership business with any portion of the business which it conducts directly.

A partnership is qualified if it is engaged in an active business and if there is one full-time employee of the partnership (or of a qualified corporate partner) substantially all the services of whom are involved in the active management of the business.

A qualified corporate partner is a general partner that has at least a 20-percent interest in the profits and losses of the partnership that has contributed an amount equal to the lesser of $500,000 or 10 percent of its net worth to the partnership as of the end of the taxable year.

(3) Aggregation of activities

The agreement provides that all leased section 1245 properties which are placed in service in any taxable year of a partnership or S corporation shall be treated as a single activity. In addition, the authority of the Secretary to aggregate or separate activities (under section 465(c)(3)(C)) is extended to the activities (including activities conducted by partnerships or S corporations) described in section 465(c)(2).

(4) Recapture

The conferees wish to clarify that the disposition of property in a transaction described in section 47(b) (relating to changes in form of doing business) will not result in recapture (under sec. 47(d)) to the extent the taxpayer remains liable on any debt with respect to the property and does not reduce his direct or indirect at-risk investment in the property. For example, if section 38 property financed with nonrecourse financing that is qualified commercial financing is contributed to a wholly-owned corporation by an individual, the at-risk recapture rules ordinarily will not apply where the transferor is not relieved of any personal liability for recourse financing incurred with respect to the property, or the transferor's at-risk investment in the corporation increases by the transferor's at-risk investment in the contributed property (exclusive of the nonrecourse qualified commercial financing). Appropriate exceptions may be provided in regulations.

D. Administrative Provisions

1. Miscellaneous Treasury administrative provisions

House bill

The bill makes a number of minor amendments relating to Treasury administrative provisions. The bill simplifies certain requirements of the Treasury Department to make reports to the Congress, removes the $1 million limitation of the Treasury working capital fund, increases the authorization limit from $1 million to $10 million on the revolving fund for the redemption of real property, allows the Secretary of the Treasury to accept gifts and bequests for the Treasury Department, allows an extension of time for court review of a jeopardy assessment where the government is not promptly served, removes the $1 million limitation on the Secretary of the Treasury's special authority to dispose of obligations, allows the Internal Revenue Service a minimum of 60 days to assess unpaid taxes shown on an amended return, provides the government a lien on the assets of all financial institutions which issue an unpaid guaranteed draft for the payment of taxes, and allows the disclosure of windfall profit tax returns to State tax agencies.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and Senate amendment.

2. Distilled spirits administrative provision

a. Repeal of occupational tax on manufacturers of stills and condensers

Present law

An occupational tax of $55 per year is imposed on manufacturers of stills. In addition, a tax of $22 is imposed on each still (or condenser to be used in distilling) manufactured.

Present law also requires notice to the Treasury upon removal of a still from the place of its manufacture and permission from the Treasury before setting up a still for distilling operations. Further, every person having possession or control over a still is required to register with the Treasury immediately after setting up the still.

House bill

The House bill repeals the $55 per year occupational tax on manufacturers of stills and the additional $22 tax for each still. The House bill also repeals the mandatory notice requirement upon removal of a still from the place of its manufacture and the requirement of permission prior to setting up of a still. In their place, the bill allows the Treasury Department, pursuant to regulations, to require manufacturers of stills to give notice before removal of stills from the factory. The House bill retains the requirement of registration by a user after setting up the still.

These provisions are effective on the first day of the first month beginning more than 90 days after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

b. Return of taxes on spirits used for food or medicinal purposes

Present law

Present law provides for the drawback (i.e., return to the taxpayer) of distilled spirits excise taxes where the spirits are used for food, medicinal, or other nonbeverage purposes. For a drawback claim to be allowed, Treasury regulations require that extensive supporting data be maintained by the manufacturer, including quantitative formulae which must be filed with the Treasury. Failure to comply with these requirements (including any deviation from a previously filed formula) may result in denial of a drawback claim.

House bill

In lieu of denying a claim, the House bill imposes a $1,000 penalty for each failure to comply with applicable laws or regulations, where it is established that the distilled spirits were used for nonbeverage purposes. The aggregate amount of these penalties may not exceed the taxpayer's claim. Additionally, the penalty may be waived where the failure to comply was due to reasonable cause.

This provision is effective on the first day of the first calendar month beginning more than 90 days after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

c. Disclosure of information regarding alcohol fuel producers to administrators of State alcohol laws

Present law

The Treasury Department is prohibited from disclosing tax return information (including the identity of taxpayers), without the taxpayer's consent, except under certain limited circumstances. Under this prohibition, Treasury is prohibited from disclosing the names and addresses of alcohol fuel producers to State alcohol enforcement agencies.

House bill

The House bill allows the Treasury Department to disclose the names, addresses, and business locations of persons producing alcohol for fuel use to State agencies having responsibility for the administration of State alcohol laws. This disclosure is to be made solely for use in the administration of State alcohol laws and is subject to the existing confidentiality safeguards for disclosure of tax information to other Federal and State agencies.

This provision is effective on the first day of the first calendar month beginning more than 90 days after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

d. Elimination of Government-supplied strip stamps for distilled spirits containers

Present law

Distilled spirits containers transported or sold in the United States are required to bear a stamp indicating that the Federal excise tax on the spirits has been paid. Strip stamps which satisfy this requirement are printed by the Bureau of Engraving and Printing at an estimated cost of $1.7 million per year and are distributed to distillers and bottlers free of charge.

Government-supplied strip stamps must generally be broken in order to open a distilled spirits container; thus, the stamps act as closure devices.

House bill

The House bill repeals the strip stamp requirement for distilled spirits containers and associated penalty provisions. However, the bill requires that distilled spirits containers, on determination of tax, bear a closure or other device which is designed to require breaking in order to gain access to the contents of the container. This requirement does not apply to containers having a capacity in excess of one wine gallon.

These provisions are effective on July 1, 1985. Government-supplied strip stamps may be affixed only until that date.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

e. Removal of distilled spirits without payment of tax for use in production of certain nonbeverage wine

Present law

Distilled spirits (other than wine spirits) used in production of nonbeverage wine products are taxed upon removal from the distilled spirits plant where the spirits are produced or from customs custody. This tax (less a processing fee) is later returned to the taxpayer upon filing of a proper claim for refund.

House bill

The House bill permits removal from a distilled spirits plant of distilled spirits without payment of tax for use in producing nonbeverage wine products (e.g., cooking wine).

This provision is effective on the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

3. Financial accounting for the investment tax credit

Present law

Section 101(c)(1)(A) of the Tax Reform Act of 1971 limits the ability of any Federal agency to compel with respect to any taxpayer a particular method of financial accounting for the investment tax credit. The 1971 Act also requires a taxpayer to use the same method of financial accounting for the investment tax credit in all reports subject to the jurisdiction of any Federal agency unless the Treasury approves a change to another method.

House bill

No provision.

Senate amendment

The Senate amendment repeals the provision requiring Treasury approval of a change of financial reporting method for the investment tax credit, effective as of its original effective date.

Conference agreement

The conference agreement follows the Senate amendment.

E. Tax Court Provisions

1. Certified public accountants and enrolled agents authorized to represent taxpayers

Present law

In any Tax Court proceeding, a taxpayer may appear *pro se* or be represented by any person admitted to practice before the Tax Court.

House bill

The House bill allows certified public accountants and enrolled agents to represent a taxpayer in a small tax case.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the provision of the House bill.

2. Annuities for survivors of Tax Court Judges

Present law

If a Tax Court Judge is survived by a dependent child or children, an annuity is provided. The maximum limits on these annuities have not been changed since 1961.

House bill

The maximum limits on annuities for surviving children is increased to the level provided surviving children of U.S. District Court Judges.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

3. Tax Court Commissioners and jurisdictional limit for small tax cases

Present law

Proceedings involving less than $5,000 may be assigned to Commissioners to make a decision.

House bill

The House bill increases the jurisdictional limit for small tax cases from $5,000 to $10,000.

The House bill also provides that other proceedings may be assigned to be heard by Commissioners, but no decision with respect to these proceedings may be made by a Commissioner. The title of "Commissioner" is changed to "Special Trial Judge."

Senate amendment

The Senate amendment increases the jurisdictional limit for small tax cases from $5,000 to $10,000.

Conference agreement

The conference agreement follows the House bill.

4. Publicity of Tax Court proceedings

Present law

Reports of the Tax Court and evidence received by the Court are open to public inspection.

House bill

The House bill clarifies that the Court may prevent the disclosure of trade secrets and other confidential information.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

5. Elimination of mandatory retirement age for Tax Court judges

Present law

Tax Court Judges must retire upon attaining age 70. After retirement, Judges who have served at least 10 years receive retirement pay generally equal to the salary of active Judges and may continue to hear cases. Retired Judges are not considered in determining whether the authorized maximum number of Judges (currently 19) has been reached. Retirement plan payments are not considered wages for purposes of social security taxes.

House bill

The House bill provides that Tax Court Judges may retire at any time after attaining age 70.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the provision of the House bill.

F. Simplification of Income Tax Credits

Present law

Present law provides a series of income tax credits allowable to reduce a taxpayer's tax liability.

House bill

In general, the bill groups existing income tax credits into logical categories and provides uniform tax liability limitations and carryover rules. The business credits (i.e., investment tax credit, targeted jobs credit, alcohol fuels credit, and ESOP credit) are combined into one credit and allowed up to 100 percent of the first $25,000 of tax liability and 85 percent of the remainder. The research credit will continue to be allowable against 100 percent of tax liability. A 3-year carryback and 15-year carryforward period on a FIFO basis will be allowed for the business credits.

This provision applies to taxable years beginning after 1983. Unexpired credits from each pre-1984 taxable year will be combined into a business credit carryforward from that year to be carried to post-1983 years (for a period not to exceed 15 years from the year of the original credit). Thus, for example, where a taxpayer made an investment entitling it to claim the employee plan percentage, the taxpayer may continue to make an election to claim that percentage as a carryforward from the earlier year under the rules in effect for the year the investment was made.

Carrybacks of the general business credit to pre-1984 years will be allowed.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and Senate amendment.

G. Miscellaneous Simplification

1. Preferred stock eligible under section 1244

Present law

An ordinary loss deduction of up to $50,000 per year ($100,000 in the case of a joint return) is allowed for losses on certain common stock of small business corporations ("section 1244 stock").

House bill

The House bill allows preferred stock to qualify as "section 1244 stock".

The provision applies to stock issued after date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

2. Medical expense deduction for certain lodging

Present law

Present law allows an itemized deduction for unreimbursed medical expenses in excess of five percent of the taxpayer's adjusted gross income (Code sec. 213). Expenses eligible for deduction include costs of transportation primarily for and essential to medical care, but not costs of meals or lodging (except where paid as part of a hospital bill) while away from home to obtain medical care.

House bill

Under the House bill, amounts paid for lodging while away from home, if primarily for and essential to care provided by a physician in a licensed hospital or certain equivalent medical-care facilities, are treated as medical care expenses eligible for the section 213 deduction.

The lodging amount allowable as a deduction cannot exceed $50 per night for the patient or other eligible person (such as a parent accompanying a dependent child). No deduction is allowed for lodging that is lavish or extravagant, if there is any significant element of personal pleasure, recreation, or vacation in the travel away from home, or for any expenses, such as food, other than the cost of lodging.

This provision is effective for taxable years beginning after 1983.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill. As in the case of other types of medical expenses eligible for deduction under section 213, the taxpayer must substantiate any deduction claimed for lodging expenses as prescribed by Treasury regulations (see Regs. sec. 1.213-1(h)).

H. Deadwood

1. Government retirement bonds

Present law

Present law provides for the issuance of certain government retirement bonds. Treasury has terminated the sale of these bonds.

House bill

The House bill repeals the provisions of law relating to these bonds. Current holders of the bonds will be governed by present law, but can redeem the bonds at any time.

The provision generally applies to obligations issued after December 31, 1983.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

2. Farm loss recapture

Present law

Present law provides for the recapture of certain farm losses. These provisions were terminated for losses after 1975.

House bill

The House bill repeals the farm loss recapture provisions for taxable years beginning after December 31, 1983.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

V. PROVISIONS RELATING TO EMPLOYERS AND TO EMPLOYEES AND TO RETIREMENT

A. Pension Plan Provisions

1. Deduction limits for qualified plans

Present law

Under present law, limits are imposed on the amount of employer deductions for contributions to a qualified pension, profit-sharing, or stock bonus plan ("qualified plan"). In addition, if an employer maintains a defined benefit pension plan or a money purchase pension plan and an annuity, profit-sharing, or stock bonus plan for the same employees, then the employer's deduction for plan contributions for a year is limited to the greater of (1) 25 percent of aggregate compensation paid or accrued during the year to the beneficiaries of the plan or (2) the amount necessary to satisfy the employer's minimum funding requirement under the pension plan. This limitation does not apply if the employer maintains a defined benefit pension plan and a money purchase pension plan for the same employees.

Present law provides overall limits on the dollar amount and percentage of compensation that may be provided to participants as contributions or benefits under qualified plans. In the case of an employee participating in both a defined contribution plan and a defined benefit pension plan maintained by the same employer, the sum of the fractions of the separate limits used by each plan is subject to an overall limit. TEFRA generally reduced the combined limit with respect to dollar amounts from 1.4 to 1.25.

House bill

No provision.

Senate amendment

The Senate amendment applies the 25-percent deduction limitation to situations in which an employer maintains both a defined benefit pension plan and a money purchase pension plan for the same employees. In no event, however, will the deduction limitation for a year be less than the amount necessary to satisfy the minimum funding requirement for the defined benefit pension plan.

In addition, under the Senate amendment, the total amount deductible for a taxable year under all plans of the employer is limited to the aggregate amount of compensation paid or accrued during the taxable year to the beneficiaries of the plans. In applying this aggregate limit, benefits paid by a plan (within limits) are treated as compensation paid during the year.

Under the Senate amendment, in the case of an employee participating in both a defined contribution plan and a defined benefit pension plan maintained by the same employer, the combined limit on the sum of the fractions of the separate limits used by each plan is raised to 1.4. The increased limit applies only if, at all times after June 30, 1982, no plan of the employer is (1) a top-heavy plan or (2) integrated with social security.

The provisions of the Senate amendment are effective for years beginning after December 31, 1984.

Conference agreement

The conference agreement does not contain the Senate amendment.

2. Provisions relating to top-heavy plans

Present law

Under present law, if a qualified plan is top heavy, then certain additional minimum requirements (including minimum contributions or benefits for non-key employees) are imposed. A qualified plan is top heavy if more than 60 percent of the value of accrued benefits are allocable to key employees. The accrued benefits of employees who have separated from service generally continue to be counted until 5 years after they are distributed.

Present law defines a key employee as an individual who (1) is an officer (in the case of a corporate employer), (2) is one of the 10 employees owning the largest interests in the employer, (3) owns more than a 5-percent interest in the employer, or (4) owns more than a 1-percent interest in the employer and has compensation from the employer in excess of $150,000.

In addition, present law provides that the combined limit on contributions and benefits for a key employee participating in both a defined contribution plan and defined benefit pension plan maintained by the same employer is reduced from 1.25 to 1.0. This reduction in the combined plan limit does not apply if additional minimum benefits or contributions are provided to non-key employees. In the case of a super top-heavy plan, (i.e., a plan under which more than 90 percent of the accrued benefits are provided to key employees), the reduction in the combined plan limit applies without regard to whether additional minimum contributions or benefits are provided to non-key employees.

Under present law, in testing whether an employer has satisfied the minimum contribution or benefit requirement with respect to a non-key employee and for purposes of determining the amount that has been contributed to a plan on behalf of a key employee, amounts contributed pursuant to a salary reduction arrangement are not counted.

The present-law rules relating to top-heavy plans (including the requirement that a plan contain provisions that are operative if the plan becomes top heavy) apply to governmental plans (as defined in sec. 414(d)).

House bill

No provision.

Senate amendment

Under the Senate amendment, the special combined limit on contributions and benefits under a super top-heavy plan is repealed.

The amendment also revises the definition of the term "key employee" to exclude officers who earn less than twice the dollar limit on contributions under a defined contribution plan ($60,000 for 1984).

The Senate amendment provides that if an individual has not received compensation with respect to any plan of the employer at any time during the 5-year period ending on the determination date, then any accrued benefit of the individual is disregarded for purposes of determining whether the plan is top heavy.

Under the Senate amendment, the amounts contributed to a qualified plan pursuant to a salary reduction arrangement are taken into account under the top-heavy provisions. The amendment also exempts governmental plans (as defined in sec. 414(d)) from the top-heavy plan requirements.

Under the Senate amendment, if the Secretary of the Treasury fails to issue final regulations under the rules of the Code relating to top-heavy plans before January 1, 1985, then a simplified amendment procedure applies.

The provisions generally are effective for plan years beginning after December 31, 1983. The provisions relating to separated employees and salary reduction arrangements are effective for plan years beginning after December 31, 1984.

Conference agreement

The conference agreement generally follows the Senate amendment, with two exceptions. First, the conference agreement retains the special combined limit on contributions and benefits under a super top-heavy plan. Second, the conference agreement revises the definition of the term "key employee" to exclude officers who earn less than 1½ times the dollar limit on contributions under a defined contribution plan ($45,000 for 1984).

Under the conference agreement (as under the Senate amendment), if the Secretary of the Treasury fails to issue final regulations under the Code rules relating to top-heavy plans before January 1, 1985 (as in effect on the day before the date of enactment of these provisions), the Secretary is required to publish plan amendment provisions that may be incorporated into all qualified plans of an employer. If a plan is amended to incorporate these provisions, then the plan is deemed to have met the top-heavy plan requirements and is not required to be amended further to comply with the top-heavy provisions until the date that is 6 months after the issuance of the final regulations.

Under the conference agreement, if the Secretary fails to publish the required plan amendment provisions by January 1, 1985, then a plan is treated as meeting the top-heavy plan requirements if the plan is amended to incorporate such requirements by reference. In any case in which a plan is so amended and the plan does not specify the particular provisions that apply, the conferees intend that the employer is to be considered, in those situations in which more than one provision may apply, to have elected the provision that maximizes the vested, accrued benefits for each non-key employee. For example, if a plan is amended to incorporate the top-heavy plan requirements by reference and does not specify a vesting schedule, the plan is deemed to provide a vesting schedule that maximizes the vested, accrued benefits of each non-key employee. Thus, if a particular non-key employee separates from service after two years of service, the plan is considered to have incorporated the graduated vesting schedule with respect to that employee and the employee would have a 20-percent vested accrued benefit. On the other hand, if another non-key employee under the same plan has at least three years of Service, the plan is considered to have incorporated the three-year, 100-percent vesting schedule with respect to that employee. Similarly, if an employer maintains a top-heavy group of plans and the plans are amended to incorporate the top-heavy plan requirements by reference without specifying the plan or plans under which the minimum benefits or minimum contributions are provided, then a non-key employee in any plan that is a required member of the group must be provided with the minimum contribution or benefit under each plan that is a required member in which the employee participates.

The conference agreement does not change the effective date of the top-heavy plan rules. In addition, the conferees intend that the issuance, as final regulations, of regulations similar to the proposed regulations under section 416 (published on March 15, 1983) will constitute the issuance of final regulations for purposes of this provision.

3. Distribution rules for qualified plans

Present law

Distributions prior to age 59½

Present law imposes an additional 10-percent income tax on certain distributions to employees in top-heavy plans. Amounts received under a qualified plan before a participant attains age 59½, becomes disabled, or dies are subject to this tax to the extent that (1) the amounts are includible in the participant's gross income and (2) are attributable to years in which the participant was a key employee in a top-heavy plan. The tax is designed to discourage the use of retirement funds for nonretirement purposes.

Before-death distribution rules

Present law requires that benefits provided under a qualified plan must be for the primary benefit of an employee, rather than the employee's beneficiaries. Accordingly, benefits provided for a participant's beneficiaries must be incidental. Under this incidental benefit rule, a qualified plan generally is required to provide for a form of distribution under which the present value of the payments projected to be made to the participant, while living, is more than 50 percent of the present value of the total payments projected to be made to the participant and the participant's beneficiaries. The incidental benefit rule is designed to limit the use of qualified plans for nonretirement purposes (e.g., to provide for deferral of income tax or to provide for tax-favored transfers of wealth to others). The rule is supplemented by requirements that benefits be distributed after age 70½.

Under present law, a participant's benefits under a qualified plan must be distributed by a benefit distribution date, which is the last day of the later of the taxable year in which the participant (i) attains age 70½, or (ii) retires. In the case of a key employee participating in a top-heavy plan, distributions must be made in the taxable year in which the key employee attains age 70½, without regard to whether the key employee has retired. Alternatively, distributions must begin no later than the applicable benefit distribution date and must be made over the life of the participant (or lives of the participant and the participant's spouse) or over a period not exceeding the life expectancy of the participant (or the joint life expectancy of the participant and the participant's spouse).

The distribution rules applicable to individual retirement plans (IRAs) are similar to the before-death distribution rules applicable to benefits under qualified plans except that the benefit distribution date for the owner of an IRA is the end of the taxable year in which the owner attains age 70½, without regard to whether the owner has retired.

After-death distribution rules

If a participant dies before the entire interest in a qualified plan is distributed, present law requires that amounts payable to a beneficiary (other than the participant's surviving spouse) generally must be paid to the beneficiary within 5 years after the participant's death. In addition, after the death of the participant's surviving spouse, any amounts payable to a beneficiary of the surviving spouse must be paid within 5 years after the spouse's death. The after-death distribution rules for IRAs are similar to the after-death distribution rules applicable to qualified plans.

Qualifying rollover distributions

If the balance to the credit of an employee is paid to the employee or to the surviving spouse of the employee as a qualifying rollover distribution, all or any portion of the distribution may be rolled over, tax free, within 60 days after the date of the distribution, to another qualified plan or to an IRA. Under present law, no rollover is permitted for a plan distribution that is not a total distribution. Similar rules apply to distributions from or under a tax-sheltered annuity contract.

House bill

Qualifying rollover distributions

The House bill provides for a tax-free rollover to an IRA of a distribution of at least 50 percent of the balance to the credit of an employee under a qualified plan or tax-sheltered annuity contract. As under present law, the rollover of a partial distribution is to be made within 60 days after the date of the distribution. Any subsequent distribution from the same plan (or any other plan of the employer required to be aggregated for the lump sum distribution rules) is not eligible for the special 10-year income averaging or long-term capital gain treatment accorded lump sum distributions.

Under the House bill, similar plans of the employer are aggregated for purposes of applying the 50-percent test.

35-426 O - 84 - 72

The provision is effective for distributions made after the date of enactment.

Senate amendment

Distributions prior to age 59½

Under the Senate amendment, the additional 10-percent income tax on premature distributions applies to a distribution only to the extent that the distribution is attributable to years in which the participant was a 5-percent owner (sec. 416) without regard to whether the plan was top heavy for such years.

Before-death distribution rules

Under the Senate amendment, a qualified plan is required to provide that a participant's entire interest will be distributed before the end of the taxable year in which the participant (i) attains age 70½ or (ii) retires, whichever is later. If a participant is a 5-percent owner (sec. 416) with respect to the taxable year in which the participant attains age 70½, the participant's entire interest is to be distributed no later than the close of such year even though the participant has not retired. The Senate amendment continues the incidental benefit rule of present law.

The Senate amendment provides for an alternative method of distribution over the life of the participant or over the lives of the participant and the participant's spouse. Under the Senate amendment, a qualified plan may provide that a participant's entire interest will be distributed, commencing on or before the applicable benefit distribution date, over the life of the participant (or the lives of the participant and spouse) or over a term certain not exceeding the life expectancy of the participant (or the joint life expectancy of the participant and spouse).

Under the Senate amendment, a qualified plan does not fail to satisfy the before-death distribution rules if it provides for the purchase, by the applicable benefit distribution date, of an immediate annuity contract that provides for substantially nonincreasing annuity payments to be made over the lives of the participant and a nonspouse beneficiary (or over a term certain not exceeding the joint life expectancy of the participant and a nonspouse beneficiary). A defined benefit pension plan is permitted to make substantially nonincreasing payments directly from the plan, in lieu of distributing an annuity contract.

After-death distribution rules

The Senate amendment generally continues the after-death distribution rules of present law. However, the amendment provides that the 5-year payout rule is satisfied, for both qualified plans and IRAs, by the purchase of an immediate annuity contract that provides for substantially nonincreasing payments over the life of the beneficiary or over a term certain not exceeding the life expectancy of the beneficiary. A defined benefit pension plan is permitted to make such payments directly without purchasing an annuity contract.

Qualifying rollover distributions

The Senate amendment generally follows the House bill, except that similar plans of the employer are not aggregated for purposes of applying the 50-percent test.

Effective dates

The provisions generally are effective for plan years beginning after December 31, 1984. For governmental plans, the provisions are effective for plan years beginning on or after December 31, 1986. For collectively bargained plans, the provisions are effective for plan years beginning in or after the earlier of (1) January 1, 1987, or (2) the expiration of the collective bargaining agreement. The qualifying rollover distribution provision is effective for distributions after the date of enactment, in taxable years ending after that date.

Conference agreement

Distributions prior to age 59½

The conference agreement follows the Senate amendment.

Before-death distribution rules

The conference agreement generally follows the Senate amendment, with several exceptions. Under the conference agreement, a trust is not a qualified trust unless the plan of which it is a part provides that the entire interest of the employee will be distributed no later than the required commencement date. Alternatively, the entire interest is to be distributed, beginning no later than the required commencement date, over (1) the life of the employee, (2) the lives of the employee and a designated beneficiary, (3) a period not extending beyond the life expectancy of the employee, or (4) a period not extending beyond the life expectancy of the employee and a designated beneficiary.

Under the conference agreement, the required commencement date is April 1 of the calendar year following the year in which (1) the employee attains age 70½ or (2) the employee retires, whichever is later. If an employee is a 5-percent owner (as defined in section 416) with respect to the plan year ending in the calendar year in which the employee attains age 70½, the employee's entire interest is to be distributed no later than April 1 of the calendar year following such plan year even though the employee has not retired. In the case of employer securities that may not be distributed on account of the 84-month holding period of section 409A(d), the rule applicable to 5-percent owners does not apply with respect to such securities until the applicable holding period expires.

Of course, the conferees intend that an individual who is subject to the 701/2 distribution requirement on the effective date of the conference agreement will not be treated as failing to meet the 701/2 distribution requirement merely because the individual would have been required to begin payments if the rules had been effective in earlier years. The distribution requirement with respect to such an individual commences on April 1 of the year following the first year for which the provision is effective, based on the individual's age in that year.

For purposes of the before-death distribution rules, the conferees intend that an employee's "entire interest" does not include ancillary benefits (such as lump sum death benefits) that are, in no event, available to the employee.

The conferees intend that, in implementing these before-death distribution rules, Treasury regulations will require that distributions over any of the permissible periods are to satisfy a minimum distribution rule similar to the rules under present law, except that the participant's life expectancy may be recalculated no more frequently than annually. Similarly, if payments are made over the joint life expectancy of the employee and the employee's spouse, such joint life expectancy may be recalculated no more frequently than annually. The conferees intend that, in the case of payments made over the joint life expectancy of the employee and a nonspouse beneficiary, Treasury regulations will provide a method of recalculation under the minimum distribution rule that takes into consideration the change in life expectancy of the employee, but not the change in life expectancy of the nonspouse beneficiary.

Distributions over any of the permissible periods from or under a defined benefit pension plan are deemed to satisfy the minimum distribution rule if the plan makes substantially nonincreasing annual payments over any of these periods. The conferees intend, however, that regulations will permit defined benefit pension plan distributions to increase under certain circumstances. For example, certain cost-of-living increases in an employee's annual payments, cash refunds of employee contributions upon an employee's death, an increase in annual benefit payments to the employee upon the death of the employee's beneficiary, and increases based on investment experience generally could be permitted. In no event, however, may increasing payments be permitted if the effect of the increase is circumvention of the minimum distribution rules.

Under a defined contribution plan, the minimum distribution rule is satisfied if the payments are subject to an irrevocable payout schedule that satisfies the minimum distribution rule. In addition, a defined benefit pension plan or a defined contribution plan may satisfy the minimum distribution rule by distributing an immediate annuity contract that provides for payments that satisfy the minimum distribution rule (e.g., provides for substantially nonincreasing annual payments).

The conferees intend that, as under present law, plan distributions, including distributions under annuity contracts distributed by a qualified plan, are required to meet the incidental benefit rule. For example, if a plan provides for a before-death distribution of an immediate annuity contract to the employee and a beneficiary, then the present value of the payments projected to be paid to the employee are to be more than 50 percent of the present value of the payments projected to be paid to the employee and the beneficiary. As under present law, distributions in accordance with the rules relating to qualified joint and survivor annuities will satisfy the incidental benefit rule.

After-death distribution rules

The conference agreement provides rules that apply in the case of an employee's death before the employee's entire interest has been distributed. In the case in which distributions have commenced to the employee before death, the conference agreement provides that the remaining portion of the employee's interest is to be distributed at least as rapidly as under the method of distribution in effect prior to death. For example, if an employee elected to receive benefits in the form of equal annual installments for a term of 20 years (which did not extend beyond the life expectancy of the employee) and the employee died after benefits had been paid for 10 years, the remaining interest of the employee could be distributed in equal annual installments over a term not exceeding 10 years. Of course, the beneficiary could elect to accelerate payments of the remaining interest.

In the case in which distributions have not commenced to the employee before the employee's death, the conference agreement provides that the entire interest of the employee is to be distributed within 5 years after the death of the employee. Under the conference agreement, two exceptions apply to this 5-year distribution rule.

The first exception provides that the 5-year rule does not apply if (1) any portion of the employee's interest is payable to (or for the benefit of) a designated beneficiary, (2) the portion of the employee's interest to which the beneficiary is entitled will be distributed over the life of the beneficiary (or over a period not extending beyond the life expectancy of the beneficiary), and (3) the distributions commence no later than 1 year after the date of the employee's death. The conferees intend that this exception applies only if amounts are paid to the beneficiary under rules that satisfy the minimum distribution rule applicable to before-death distributions. Recalculation of life expectancy is not permitted under this provision.

The Secretary may, under regulations, provide exceptions to the 1-year rule under appropriate circumstances (e.g., if a beneficiary cannot be located). The conferees intend, however, that the regulations could require that catch-up distributions be made with respect to amounts deferred under such exceptions.

The second exception applies if the designated beneficiary is the surviving spouse of the employee. Under this provision, the 5-year rule does not apply if (1) the portion of the employee's interest to which the surviving spouse is entitled will be distributed over the life of the surviving spouse (or over a period not extending beyond the life expectancy of the surviving spouse), and (2) the distributions commence no later than the date on which the employee would have attained age 70½. If the surviving spouse dies before payments are required to commence, then the 5-year rule is to be applied as if the surviving spouse were the employee. The conferees intend that payments to the surviving spouse will satisfy the exception to the 5-year distribution requirement if payments are made pursuant to a qualified joint and survivor annuity.

For purposes of the after-death distribution rules, the conference agreement provides that any amount paid to a child is treated as if it had been paid to the surviving spouse of an employee if the amount becomes payable to the surviving spouse when the child reaches the age of majority (or such other event as may be specified in Treasury regulations).

Under the conference agreement, similar rules are provided for after-death distributions from or under an individual retirement account or annuity. In addition, under the conference agreement, the rules applicable to after-death distributions under an annuity contract are to apply to a custodial account that is treated as a tax-sheltered annuity contract (sec. 403(b)(7)).

Qualifying rollover distributions

The conference agreement follows the Senate amendment.

Effective dates

The conference agreement generally follows the Senate amendment.

The conference agreement provides that a plan is not to be disqualified merely because it pays benefits under a designation made before January 1, 1984, in accordance with section 242(b)(2) of the Tax Equity and Fiscal Responsibility Act of 1982 (as in effect before the amendments made by the conference agreement).

4. Treatment of distributions of benefits substantially all of which are derived from employee contributions

Present law

Present law permits a qualified plan, a tax-sheltered annuity contract, or a governmental plan to be funded solely by employee contributions. Nondeductible employee contributions may be withdrawn from a qualified plan at any time without a tax penalty. In addition, the first withdrawals of nondeductible contributions (prior to the annuity starting date) are treated as a return of the nondeductible contributions, which are not includible in gross income. After the balance of the nondeductible contributions has been withdrawn, further withdrawals are considered to be income.

House bill

The House bill provides that a plan is not a qualified plan if substantially all of the accrued benefits under the plan are derived from employee contributions, other than deductible employee contributions.

The provision is effective for plan years beginning after March 31, 1984.

Senate amendment

Under the Senate amendment, if substantially all of the accrued benefits under a qualified plan are derived from employee contributions, then distributions under the plan will be considered to be income until all income has been withdrawn. In addition, if an employee received (directly or indirectly) any amount as a loan under the plan, the bill treats the amount of the loan as a withdrawal from the plan.

The provision is effective for amounts received or loans made on or after the 90th day after the date of enactment.

Conference agreement

The conference agreement generally follows the Senate amendment with two exceptions. First, the conference agreement defines a plan in which substantially all of the contributions are employee contributions as a plan with respect to which more than 85 percent of the total contributions during a representative period (such as 5 years as determined under Treasury regulations) are employee contributions. Of course, if less than 85 percent of the total contributions for all years during which the plan is in existence are employee contributions, then the plan is not a plan in which substantially all of the contributions are employee contributions.

In addition, under the conference agreement, in the case of the Federal Government or an instrumentality of the Federal Government, the 85 percent test is to be applied by aggregating all plans maintained by the Federal Government or such instrumentality. This aggregation rule applies only to those plans that are actively administered by the Federal Government or the instrumentality. For example, if a plan of the Federal Government was administered by a commercial financial institution, it would not be aggregated for purposes of applying the 85 percent test.

Of course, the conferees intend that amounts which are contributed to a qualified cash or deferred arrangement pursuant to an employee's election to defer are not treated as employee contributions to the extent that the amounts are not currently includible in gross income (sec. 402(a)(8)).

In the case of a pre-existing thrift or savings feature to an employer-funded defined benefit arrangement, the conferees intend that the 85 percent test is applied by aggregating the thrift or savings feature with the defined benefit arrangement. This aggregation rule applies only if the employer has consistently treated the 2 features as a single plan, as by consistently filing for (and receiving) one determination letter and filing one annual return covering both features. Voluntary employee contributions to a qualified defined benefit pension plan are not treated as a separate defined contribution plan merely because they are taken into account as contributions to a defined contribution plan in applying the overall limits on contributions and benefits.

5. Repeal of estate tax exclusion for qualified plan benefits

Present law

Under TEFRA, a $100,000 aggregate limit was imposed on the estate tax exclusion for certain benefits payable under qualified plans, tax-sheltered annuities, individual retirement plans (IRAs), and certain military retirement plans. The TEFRA provision was effective for decedents dying after December 31, 1982.

House bill

No provision.

Senate amendment

The Senate amendment repeals the separate $100,000 estate tax exclusion for benefits under qualified plans, tax-sheltered annuities, IRAs, and military retirement plans.

The provision is effective with respect to decedents dying after December 31, 1984. An exception is provided for the estate of any decedent whose benefits are in pay status on the date of enactment and who, prior to that date, made an irrevocable election to designate the beneficiaries who will receive the retirement benefits and the form of such benefits. In addition, the effective date of the TEFRA estate tax provision is amended to provide a similar exception with respect to the $100,000 limit imposed by TEFRA.

Conference agreement

The conference agreement generally follows the Senate amendment with two modifications. First, the conference agreement continues the rule of present law applicable to certain interests created by community property laws. Thus, under the conference agreement, if the spouse of an employee on whose behalf contributions or payments are made by an employer to a qualified plan or a tax-sheltered annuity dies, the spouse's gross estate does not include the value of any interest of the spouse in the plan or annuity. This treatment applies only if the spouse's interest is attributable to the employer's contributions or payments and arises solely by reason of the spouse's interest under the community property laws of a State.

Second, the conference agreement modifies the exception to the effective date provision of the Senate amendment. Under the conference agreement, an exception is provided for the estate of any decedent whose benefits are in pay status on the date of enactment and who, prior to that date, made an irrevocable election to designate the form of the retirement benefits (including the form of any survivor benefits). The conference agreement does not require the irrevocable designation of a beneficiary in order to qualify for the exception. In addition, the effective date of the TEFRA estate tax provision is amended to provide a similar exception with respect to the $100,000 limit imposed by TEFRA.

6. Affiliated service groups and employee leasing arrangements

Present law

Affiliated service groups

Under present law, all employees of employers that are members of an affiliated service group are treated as employed by a single employer for purposes of the requirements for qualified plans. An affiliated service group consists of certain service organizations and related organizations.

Employee leasing arrangements

Present law provides that, for purposes of certain of the tax-law rules for qualified pension plans and simplified employee pensions (SEPs), certain leased employees are treated as employees of the person who receives their services (the recipient). Present law includes a safe harbor rule under which the leased employee is not treated as the employee of the recipient for purposes of the employee leasing rules if certain requirements are met.

House bill

Affiliated service groups

No provision.

Employee leasing arrangements

The House bill clarifies the present law definition of a leased employee to include only those individuals who are not otherwise employees of the recipient.

The provision is effective for plan years beginning after December 31, 1983.

Senate amendment

Affiliated service groups

The Senate amendment provides that, in determining whether a group of employers constitutes an affiliated service group, more comprehensive attribution-of-ownership rules are provided to include "brother-sister" relationships.

The provision is effective for plan years beginning after December 31, 1984.

Employee leasing arrangements

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the Senate amendment. In addition, the conference agreement provides the Secretary of the Treasury with regulatory authority to develop any rules as may be necessary to prevent the avoidance of any employee benefit requirement to which the employee leasing provisions apply through the use of employee leasing or other arrangements. The conferees do not intend to imply that such regulations could only be applied prospectively.

For example, the conferees are aware of situations in which professionals are hired as leased employees of their own professional corporations in order to avoid the nondiscrimination rules applicable to qualified plans. The conferees intend that regulations will prevent the avoidance of the nondiscrimination rules through the use of such employee leasing arrangements.

The conferees do not intend any inference that this example is the sole situation in which employee leasing is used to avoid the qualified plan requirements. However, the conferees do not intend to imply that legitimate uses of employee leasing are necessarily abuses. For example, the conferees recognize that the historical use by businesses of temporary help company employees on temporary projects generally is not an avoidance situation subject to the Secretary's regulatory authority provided under the conference agreement if the project has an ascertainable termination date and it is not customary under the circumstances to hire permanent employees for such a project.

7. Determination of whether there is a collective bargaining agreement

Present law

Under present law, special rules relating to employee benefits apply with respect to plans covering collective bargaining units. Some of these rules provide effective dates that are more appropriate for these plans. In other cases, rules forbidding discrimination in favor of highly compensated employees are modified or waived with respect to employees included in a collective bargaining unit.

House bill

The House bill clarifies present law by providing that, in determining whether there is a collective bargaining agreement between employee representatives and one or more employers, an organization is not to be considered an employee representative if more than one-half of its members are employees (including a self-employed individual who is considered to be an employee under the rules for qualified pension plans) who are owners, officers or executives of the employer. This provision is effective on April 1, 1984.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

8. Standards for cash-or-deferred arrangements

Present law

Under present law, a cash-or-deferred arrangement is subject to special tests under which the amount that highly compensated employees can elect to defer (and exclude from current gross income) depends upon the level of deferrals by other employees. These special tests do not permit employer-provided social security benefits to be taken into account. However, proposed Treasury regulations permit a cash-or-deferred arrangement to satisfy the general nondiscrimination standards applicable to qualified plans in lieu of the special tests. The general nondiscrimination rules permit employer-provided social security benefits to be taken into account.

House bill

Under the House bill, a cash-or-deferred arrangement is not a qualified cash-or-deferred arrangement unless the special tests applicable to such an arrangement are satisfied. If an arrangement fails to satisfy the special tests, amounts deferred are not excluded from gross income, but the plan of which the arrangement is a part is not to be disqualified if it meets the usual rules for qualification, including the general nondiscrimination requirements.

All plans of an employer required to be aggregated for nondiscrimination purposes are aggregated for purposes of applying the special tests.

The provision is effective for plan years beginning after December 31, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement generally follows the House bill, with two amendments. First, the conference agreement provides that the deferral percentage taken into account for purposes of applying the special deferral percentage tests is the sum of the deferral percentages for an employee under each cash or deferred arrangement in which the employee participates.

Second, under the conference agreement, the provision does not apply to a cash or deferred arrangement maintained, on June 8, 1984, by a State government and with respect to which a determination letter had been issued on December 6, 1982. The conferees intend that no inference is to be drawn from this effective date provision with respect to the issue of whether a State government may maintain a profit-sharing plan.

In addition, the conferees intend that the agreement does not change the rule contained in proposed Treasury regulations, nonelective contributions by the employer to a cash or deferred arrangement may be taken into account in applying the special deferral percentage tests. Such contributions may be taken into account only if the contributions (1) are nonforfeitable when made and (2) satisfy the withdrawal restrictions applicable to elective deferrals under a qualified cash or deferred arrangement.

9. Treatment of certain medical, etc., benefits under pension plans

Present law

Present law limits contributions and benefits under qualified pension, profit-sharing, and stock bonus plans. Medical benefits provided under a qualified plan are not taken into account in applying the limits.

House bill

Under the bill, in the case of a qualified plan, medical benefits are to be taken into account with respect to any participant who has an individual medical benefit account. A plan is required to maintain such an account for each key employee. The provision applies to years beginning after March 31, 1984.

Senate amendment

The Senate amendment is the same as the House bill, except that the provision is limited to top heavy qualified plans. The provision applies after the date of enactment.

Conference agreement

The conference agreement follows the House bill.

10. Limits on contributions and benefits under qualified plans

Present law

TEFRA reduced the overall dollar limits on contributions and benefits under qualified plans (qualified plans). In addition, TEFRA suspended all cost-of-living adjustments to these dollar limits until 1986. Beginning in 1986, the limits will be adjusted for post-1984 cost-of-living increases under the formula then in effect to provide cost-of-living increases in social security benefits.

House bill

The House bill suspends the cost-of-living adjustments to the dollar limits on benefits and contributions under qualified plans until 1988.

The provision is effective on the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

11. Application of cash-or-deferred arrangement rules to pre-ERISA money purchase pension plans

Present law

Through 1979, the tax treatment of cash-or-deferred profit-sharing and stock bonus plans and money purchase pension plans with salary reduction arrangements in existence on June 27, 1974, was grandfathered under the law before January 1, 1972. The Revenue Act of 1978 provided rules (sec. 401(k)) for all profit-sharing and stock bonus plans with cash-or-deferred arrangements. No new rules were provided by the 1978 Act for pre-ERISA money purchase pension plans with salary reduction arrangements.

House bill

The House bill applies the cash-or-deferred arrangement rules relating to profit-sharing and stock bonus plans to money purchase pension plans with salary reduction arrangements in existence on June 27, 1974. This treatment applies only if employer and employee contributions under the plan do not exceed the limits under the plan's contribution formula in effect on June 27, 1974.

The provision is effective for plan years beginning after the date of enactment. The rules in effect prior to ERISA apply for plan years beginning after December 31, 1979, and before the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

12. Dollar limits on benefits under qualified pension plans for airline pilots

Present law

Under present law, if benefits begin before age 62, the dollar limit on benefits under a defined benefit pension plan is to be actuarially reduced to reflect the value of early payment. Federal regulations require that commercial airline pilots retire after attaining age 60.

House bill

Under the House bill, the reduction of benefits on account of early retirement applies only to those commercial airline pilots whose benefits commence before age 60. The dollar limit on benefits at age 60 is increased to $90,000 for commercial airline pilots.

The provision is effective for years beginning after December 31, 1982.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the Senate amendment.

13. Elimination of retroactive application of amendments made by Multiemployer Pension Plan Amendments Act of 1980

Present law

The Multiemployer Pension Plan Amendments Act of 1980 (MPPAA) was enacted on September 26, 1980. Under ERISA, as amended by that Act, liability generally is imposed on an employer who withdraws from a multiemployer defined benefit pension plan. The withdrawal liability provisions of the MPPAA generally apply retroactively to withdrawals after April 28, 1980.

House bill

No provision.

Senate amendment

Generally, under the Senate amendment, any liability incurred by an employer under the withdrawal liability provisions of ERISA, as a result of the complete or partial withdrawal from a multiemployer plan before September 26, 1980, is void. The amendment provides for refunds of amounts paid by an employer to a plan sponsor as a result of such withdrawal liability, reduced by a reasonable amount for administrative expenses incurred by the plan sponsor in calculating, assessing, and refunding the payments.

In the case of an employer who, on September 26, 1980, had a binding agreement to withdraw from a multiemployer plan, the effective date for withdrawal liability is changed to December 31, 1980.

This provision is effective on the date of enactment.

Conference agreement

The conference agreement generally follows the Senate amendment. Under the conference agreement, a plan sponsor is required to refund with interest (as determined under sec. 401(a)(2)) any amounts paid by an employer to a plan sponsor as a result of any withdrawal liability imposed by reason of a complete or partial withdrawal from a multiemployer plan before September 26, 1980. The plan sponsor may deduct a reasonable amount for administrative expenses incurred by the plan sponsor, other than legal expenses of the plan, incurred in collecting the liability.

The conferees do not intend that multiemployer plans are to be liable for any legal expenses incurred by the withdrawn employer (e.g., in opposing its withdrawal liability).

14. Treatment of certain distributions from a qualified terminated plan

Present law

If a lump sum distribution is paid to an employee (or the spouse of a deceased employee) under a qualified plan, tax is deferred on the portion of the distribution rolled over, within 60 days, to another qualified plan or to an IRA. A distribution from a qualified plan is not a lump sum distribution unless it consists of the balance to the credit of the employee under the plan and is made within one taxable year of the recipient.

House bill

No provision.

Senate amendment

The amendment provides special relief for certain pension plan distributions received during 1976 and 1977 and transferred to an IRA. Under the amendment, the transfers are treated as a qualifying rollover distributions. Thus, to the extent the payments were, in fact, rolled over to an IRA within 60 days of receipt, the distribution will not be includible in income.

The amendment is effective upon enactment.

Conference agreement

The conference agreement follows the Senate amendment.

15. Special rule for Trans-Alaskan Pipeline employees

Present law

Under a qualified plan, benefits are provided to participants under plan formulas that determine the amount of the benefit a participant may earn, the portion of that benefit that has been earned (accrued), and the portion of the earned benefit that is vested or nonforfeitable.

Under the Code, if an employer maintains a qualified plan and an act of the employer (e.g., dismissing employees) causes a partial termination of the plan, then the rights of all affected employees to benefits accrued to the date of the partial termination generally must be nonforfeitable to the extent those benefits are funded.

Under the Code, whether a partial termination of a qualified plan has occurred (and the time of its occurrence) is determined by the Commissioner of Internal Revenue on the basis of all the facts and circumstances in a particular case.

House bill

No provision.

Senate amendment

Under the Senate amendment, a partial termination does not occur in the case of a turnover of employees under a plan in the State of Alaska occurring between December 31, 1975, and January 1, 1980, in connection with the completion of the Trans-Alaskan Oil Pipeline construction project if certain requirements are met.

The provision is effective on the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

16. Distribution requirements for plans, accounts, and annuities of an insurer in rehabilitation proceedings

Present law

Under present law, distributions under a qualified plan generally must commence in the later of the taxable year in which a participant (1) retires or (2) attains age 70½. Distributions under an IRA must commence no later than the year in which the owner attains age 70½. If the IRA distribution rules are not satisfied, a 50-percent excise tax is applied to the amount that should have been distributed.

House bill

No provision.

Senate amendment

The Senate amendment provides that an amount is not required to be distributed under the usual rules for qualified plans and IRAs to the extent that the amounts are held by an insurer that, on March 15, 1984, is engaged in a rehabilitation proceeding under applicable State insurance law (e.g., Baldwin-United). The provision applies only for the period during which the insurer is engaged in the proceedings.

The provision is effective on March 15, 1984.

Conference agreement

The conference agreement follows the Senate amendment.

17. Extension of time for repayment of qualified refunding loans

Present law

TEFRA imposed limits on the extent to which an individual can borrow amounts from a qualified plan without the loan being treated as a distribution to the individual under the plan. Under TEFRA, a transition rule was provided for certain "qualified refunding loans" made on or after August 13, 1982, and repaid before August 14, 1983.

House bill

No provision.

Senate amendment

The bill extends the period for making and repaying a qualified refunding loan to January 1, 1985, with respect to individuals who are not key employees, without regard to whether the plan is top-heavy.

The provision is effective as if enacted in TEFRA.

Conference agreement

The conference agreement follows the Senate amendment.

18. Pension portability involving telecommunications divestiture

Present law

Under the rules for qualified plans, all employees of related employers are treated as employed by a single employer. Consequently, an employee's service with a predecessor employer is treated as service with a successor employer. Generally, two or more employers may agree to provide for transferability of benefit and service credits (portability) under their plans even though they were never related.

Under the modified final judgment requiring the divestiture of AT&T subsidiaries, with respect to an employee's service with AT&T or any of its subsidiaries subject to the judgment, an employee's service performed before 1985 is treated as service for each other employer subject to the judgment. Under the judgment, however, post-1984 service for one of the employers subject to the judgment is not to be taken into account as service by any of the other employers subject to the judgment.

House bill

No provision.

Senate amendment

Under the Senate amendment, the recognition after December 31, 1983, of creditable service of a transferred qualifying employee, and the treatment after that date of associated accrued benefits and assets, are to be governed by the provisions of the modified final judgment as those provisions applied during calendar year 1984 with respect to transfers to or from the divesting corporation and any subsidiary. The provision applies in the case of a qualifying employee who transfers between any entities subject to the modified final judgment. The Senate amendment does not limit benefits that would otherwise be provided under the modified final judgment or under applicable law.

The Senate amendment provides that, in computing the overall limits on contributions and benefits (sec. 415 of the Code) for any employee who, on December 31, 1983, was an employee of an entity subject to the modified final judgment, contributions and benefits under all plans of such entities shall be taken into account. Accordingly, contributions and benefits provided after December 31, 1983, for such employees, are to be taken into account together with contributions and benefits provided as of December 31, 1983. The provision clarifying the application of the overall limits in this case is not to be regarded as a precedent for the determination of how the limits apply in other cases.

The Senate amendment exempts the employees of Sandia Corporation of Albuquerque, N.M., from coverage under the provision.

Generally, the provision applies on the date of enactment. The provisions with respect to the limits on contributions and benefits apply for years ending after December 31, 1983.

Conference agreement

The conference agreement follows the Senate amendment with several modifications.

Under the conference agreement, in the case of any change in employment on or after January 1, 1985, by a covered employee, the recognition of service credit and the enforcement of such recognition, shall be governed in the same manner and to the same extent as provided under the divestiture interchange agreement for a change in employment by a covered employee during calendar year 1984.

Prior to divestiture, the Bell System Pension Plan provided for the full recognition and interchange of service credit and benefit obligations between and among all participating Bell System companies, and including Cincinnati Bell and Southern New England Telephone. These provisions were formally known as "interchange" agreements.

After divestiture, however, the interchange agreements were no longer applicable. In place of those agreements, a "divestiture interchange agreement" was entered into by AT&T, the regional Bell operating companies, the BOCs' Central Services Organization, Advanced Mobile Phone Service, Inc., and Cincinnati Bell.

The divestiture interchange agreement provides continued mutual reciprocal recognition of post-divestiture service credit between and among AT&T, the divested Bell operating companies, and the other parties to that agreement. Recognition of service credit applies for all purposes, including seniority provisions under applicable collective bargaining agreements.

The applicability of the divestiture interchange agreement is limited to calendar year 1984, in the case of most Bell System employees. The vast bulk of AT&T and Bell company employees, in other words, would not be able to take their accumulated service credit with them in the event of a move from one local Bell company to another, or between a local Bell company and AT&T, after 1984. *See* Plan of Reorganization submitted on December 16, 1982, in *United States* v. *Western Electric Co., et al*, Civil Action No. 82-0192 (D.D.C.), 284-289. The Plan of Reorganization, including this limited portability of service credit, was approved by U.S. District Judge Harold H. Greene on August 5, 1983. *United States* v. *Western Electric Co., et al.*, 569 F. Supp. 1057, 1091-1097 (D.D.C. 1983), aff'd *sub nom. California* v. *United States*, 104 S. Ct. 542 (1983).

Notwithstanding the time limitations in the divestiture interchange agreement, the conference agreement permanently extends beyond 1984 the provisions of the agreement that govern the recognition of service credit and the enforcement of such recognition, in the case of any change in employment by a covered employee on or after January 1, 1985. For such an employee, in other words, there would be no time limitation on the portability of service credit granted under the divestiture interchange agreement. In addition, as noted above, employees of Southern New England Telephone Company would also be covered by the legislation, even though the company did not sign the divestiture interchange agreement.

Under the conference agreement, a covered employee is an employee of an entity subject to the modified final judgment who is serving in an eligible position, and who was either (A) an employee of an entity subject to the modified final judgment, and serving in an eligible position, on December 31, 1983, or (B) a former employee who had rehire or recall rights on December 31, 1983, under applicable collective bargaining agreements, and who is rehired during the period of his or her rehire or recall rights. A covered employee can move from one entity subject to the modified final judgment to another such entity without losing service credit.

A person need not work continuously after December 31, 1983, for an entity subject to the modified final judgment (a "subject entity"), in order to be considered a covered employee. For example, suppose a person who was working for a subject entity on December 31, 1983, continues to work for that company during 1984 and 1985, but leaves in 1986 for a job with a firm that is not a subject entity. In 1987, that person returns to work at a subject entity (although not necessarily the same company he or she left in 1986). Under those circumstances, that person would be a covered employee during 1984 and 1985, and again beginning in 1987. The subject entity for which he or she is working in 1987 must recognize the service credit he or she accumulated during employment with other subject entities. The conferees do not intend that subject entities must recognize service credit earned at firms that are not subject to the modified final judgment; nor do the conferees intend this provision to require employers who are not subject to the modified final judgment to recognize service credit earned at subject entities.

The conference agreement provides that "service credit" means service credit for benefit accrual, vesting, and eligibility for any benefits under pension plan, or any other employee benefits, including seniority rights; the right to other benefits such as medical and dental care, insurance, and disability payments; the ability to bid on vacations and shifts; and any other rights which have been secured under applicable collective bargaining agreements. The term also includes the interchange and treatment of associated benefit obligations and assets.

"Change in employment" means the movement of a covered employee from one entity subject to the modified final judgment to another such entity. Even if there is a break in service—for instance, where a person moves from one entity subject to the modified final judgment to a firm not subject, and from there to another entity that is subject—the eventual movement from the first entity subject to the modified final judgment to the second such entity is a "change in employment" for purposes of this legislation. However, as noted above, only service credit earned at entities subject to the modified final judgment is required to be recognized in the event of a change in employment.

Under the conference agreement, an "eligible position" means a nonsupervisory position, or a position that pays not more than $50,000 (adjusted by the percentage increase in the consumer price index since December 31, 1983). "Modified final judgment" means the settlement of the AT&T antitrust suit, *United States* v. *Western Electric Co., et al.*, Civil Action No. 82-0192 (D.D.C.).

"Entity subject to the modified final judgment" means the 22 Bell operating companies divested under the settlement of the AT&T (except for any subsidiary that does not participate in a defined benefit pension plan, as discussed below); Southern New England Telephone Company and Cincinnati Bell Inc., which were not divested under the antitrust settlement, but in which AT&T held a minority interest on December 31, 1983; and any Interchange Company, as defined in the divestiture interchange agreement, together with any subsidiary of such company which was established as of December 31, 1983, and which participates in a defined benefit pension plan maintained by the Interchange Company.

AT&T, the seven regional Bell holding companies, the BOC's Central Services Organization (now called Bell Communications Research, Inc.), Advanced Mobile Phone Service, Inc., and Cincinnati Bell, Inc. are Interchange companies under the divestiture interchange agreement, and are therefore included in the term "entity subject to the modified final judgment." In addition, it is the conferees' understanding that all Interchange Company subsidiaries established as of December 31, 1983 (except for AT&T's Sandia Corporation, U.S. West's Beta West, Inc. and U.S. West Services, Inc., and Bell South Enterprises) currently participate, or shortly plan to participate, in a defined benefit pension plan. Consequently, they are also entities subject to the modified final judgement. These subsidiaries include, but are not limited to, Bell Labs, Western Electric, AT&T Information Systems, and the cellular radio subsidiaries of the regional Bell operating companies. The conferees do not intend to restrict the ability of any Interchange Company to extend portability of service credit to employees at any other subsidiary, under a collective bargaining agreement, for example, or by any other means.

The conferees recognize that some subsidiaries established as of December 31, 1983, did not participate in defined benefit pension plans until after that date. The conferees intend that any subsidiary which participates in such a plan, regardless of when the decision to participate is made, will be included in the term "entity subject to the modified final judgment." The conferees also intend that such term include any subsidiary which participates in a defined pension plan on the date of enactment of this legislation.

Under the conference agreement, "divestiture interchange agreement" means the agreement among the Bell System companies and AT&T, executed as of November 9, 1983, which provides for mutual reciprocal recognition of service credit. "Consumer price index" means the Consumer Price Index (all items—United States city average) published monthly by the Bureau of Labor Statistics.

Nothing in this conference agreement is intended to limit benefits that are otherwise available to any individual under the provisions of the modified final judgment (including the divesture interchange agreement), under applicable law, or otherwise. This includes, but is not limited to, rights under the Communications Act of 1934, as amended, and the Employee Retirement Income Security Act of 1974 (ERISA), as amended. A person alleging a violation of this legislation may seek redress under the Communications Act of 1934 (which governs communications common carriers), under applicable labor and pension statutes, or at common law.

The conference agreement does not follow the Senate amendment with respect to the limits on contributions and benefits under sec. 415. It is the understanding of the conferees that present law provides for the aggregation of contributions and benefits under plans maintained by separate employers for purposes of the overall limits on contributions and benefits in situations in which prior service with another employer is recognized by the employer.

B. Welfare Benefit Plans

1. Deductions for contributions to funded benefit plans

Present law

An employer's contribution to a fund that is a part of a welfare benefit plan may be deductible in the year it is made rather than at the time the benefit is provided. Deductions for employer contributions to a nonqualified deferred compensation plan are generally not allowed until an amount is includible in the gross income of the employee.

House bill

The House bill generally limits employer deductions for a contribution to a VEBA, SUB to the amount that would be deductible by a cash-method taxpayer for a payment under an unfunded plan. An additional deduction is allowed for an addition to a funded reserve. Generally, the reserve is limited to 75 percent of insurance-type benefits provided by the plan during the current year and the preceding year. A transitional rule is provided for pre-enactment accumulations.

The House bill would generally apply to contributions paid or accrued after March 31, 1984 in taxable years ending after that date. The bill provides a delayed effective date for collectively bargained plans.

Senate amendment

No provision.

Conference agreement

a. Contributions to funded welfare benefit plans

The conference agreement generally follows the House bill, with modifications. In general, deductions for contributions to a welfare benefit fund are limited to qualified costs, which is the sum of (i) qualified direct costs, and (ii) additions, within limits, to a qualified asset account. Several changes are made to the definitions of qualified direct cost and welfare benefit and substantial modifications are made to the allowable limit on a qualified asset account.

Child care facilities.—Under the conference agreement, in determining qualified direct costs with respect to a child care facility held by a fund, the adjusted basis of the facility is treated as deductible ratably over a period of 60 months. A child care facility is tangible property of a character subject to depreciation and located in the United States, and must be a child care center primarily for children of the employees of the employer. As under the House bill, qualified direct costs with respect to other capital expenditures are those which would be allowed under the usual Code rules which would be applied if the employer owned the asset.

Definition of welfare benefit fund.—In general, this section of the bill applies to contributions to welfare benefit funds which are organizations, reserves or accounts held by organizations, through which an employer provides welfare benefits to employees or their beneficiaries. In prescribing regulations relating to the definition of the term "fund," the conferees wish to emphasize that the principal purpose of this provision of the bill is to prevent employers from taking premature deductions, for expenses which have not yet been incurred, by interposing an intermediary organization which holds assets which are used to provide benefits to the employees of the employer. Thus, a retired life reserve or premium stabilization account ordinarily is to be considered a fund or part of a fund, since such an account is maintained for an individual employer and that employer has a determinable right to have the amount in such an account applied against that employer's future costs of benefit claims or insurance premiums. A similar situation exists with respect to premium arrangements, under which an employer may, in some cases, pay an insurance company more in a year than the benefit costs incurred in that year and the employer has an unconditional right in a later year to a refund or credit of the excess of payments over benefit costs. In contrast, an ordinary disability income policy under which an employer pays a premium so that employees who become disabled in that year may collect benefit payments for the duration of disability is not a fund, since the employer has no right to recover any part of the premium payment and the future benefit payments to an employee whose disability occurs during the period for which the premium is paid is not contingent on any further payments by the employer. While in many cases welfare benefit funds are designed to function in a manner similar to insurance arrangements, the conference is concerned that there are no clear standards or limitations applicable to such funds that prevent their utilization for substantial nonqualified deferred compensation funding outside the general pension plan funding, accrual and vesting rules.

Limitations on qualified asset account.—The conference agreement includes substantial modifications to the provisions setting forth the limitation on additions to a qualified asset account. Such an account consists of assets set aside for the payment of disability benefits, medical benefits, supplemental unemployment or severance pay benefits, and life insurance or death benefits.

In general, the account limit is the amount estimated to be necessary under actuarial assumptions that are reasonable in the aggregate, to fund the liabilities of the plan for the amount of claims incurred but unpaid, for benefits described in the previous paragraph and administrative costs of such benefits, as of the close of the taxable year. Claims are incurred only when an event entitling the employee to benefits, such as a medical expense, a separation, a disability, or a death actually occurs. The allowable reserve includes amounts for claims estimated to have been incurred but which have not yet been reported, as well as those claims which have been reported but have not yet been paid. An example of an incurred but unpaid claim is the occurrence of the death of an employee during the year under a plan that provides for payments to a survivor of the employee for the survivor's remaining life. Under the conference agreement, the qualified asset account may include the estimated present value of the future stream of benefits payable to this survivor, using reasonable assumptions as to earnings of the fund and mortality experience.

With respect to disability benefits, the conferees expect that Treasury regulations will provide more specific guidance as to the time at which claims are incurred. It is the intention of the conferees that a disability is to be defined as any serious physical or mental impairment which causes an inability to perform a substantial portion of the duties of an individual's ordinary employment. The conferees intend that funding of claims with respect to an indefinite period of time is to be allowed only in connection with disabilities which are determined to be long-term disabilities. Such disabilities are those which (1) a medical evaluation determines is expected to last for more than 12 months and (2) has persisted for at least 5 months. With respect to such disabilities, current deductions are to be allowed for contributions necessary to fund the expected future stream of benefit payments using reasonable assumptions as to morbidity, mortality, and fund earnings. Other disabilities which have persisted for at least 2 weeks are to be considered short-term disabilities; no more than 5 months of benefit payments may be deemed to have been incurred with respect to short-term disabilities.

In general, in addition to requiring that actuarial assumptions are to be reasonable in the aggregate, Treasury regulations may prescribe specific interest rate and mortality assumptions to be used in all actuarial calculations. Such assumptions are to be consistent with requirements provided elsewhere in conference agreement for the computation of tax reserves held by life insurance companies.

Limitation on disability, or SUB, or severance benefits taken into account.—In the case of any disability benefit, a reserve may not be established with respect to a benefit payment in excess of the lesser of the limit for the year on an annual benefit under a qualified defined benefit pension plan ($90,000 for 1984) or 75 percent of a disabled employee's annual compensation from the employer.

With respect to supplemental unemployment compensation benefits (SUB) and severance pay benefits the portion of an annual benefit in excess of 1.5 times the limit on contributions under a qualified defined contribution plan ($45,000 for 1984) for any employee is not to be taken into account in determining the limit.

Prefunding of life insurance, death benefits, or medical benefits for retirees.—The qualified asset account limits allow amounts reasonably necessary to accumulate reserves under a welfare benefit plan so that the medical benefit or life insurance (including death benefit) payable to a retired employee during retirement is fully funded upon retirement. These amounts may be accumulated no more rapidly than on a level basis over the working life of the employee, with the employer of each employee. Each year's computation of contributions with respect to retiree medical benefits is limited to the use of assumptions that the medical benefits provided to retirees in the future will have the same cost as medical benefits currently provided to retirees (projected inflation is not to be taken into account). Of course, no advance deduction is to be allowed with regard to a plan which provided medical or life insurance benefits exclusively for retirees, since such a plan would be considered a deferred compensation plan subject to the rules of section 404 rather than the provision applicable to funded welfare benefit plans. The conferees intend that the Treasury Department prescribe rules requiring that the funding of retiree benefits be based on reasonable and consistently applied actuarial cost methods, which take into account experience gains and losses, changes in assumptions, and other similar items, and be no more rapid than on a level basis over the remaining working lifetimes of the current participants (reduced on the basis of reasonable turnover and mortality assumptions).

Further, contributions for any employee who is a key employee are required to be accounted for separately by a welfare benefit fund. The separate account is to include amounts contributed to the plan with respect to any service after the employee becomes a key employee as well as a reasonable allocation (determined under Treasury regulations) of amounts contributed to the fund on account of the employee before key employee status was attained. Medical and life insurance benefits with respect to such an employee may be only from such account. In addition, in the case of a key employee, the conference agreement provides that post-retirement medical benefits are to be taken into account in applying the limitations on contributions and benefits under qualified plans (sec. 415) under principles similar to those applicable to post-retirement medical benefits provided by qualified pension plans.

In addition, under the conference agreement, if the life insurance or medical coverage provided by a plan discriminates in favor of employees who are officers, shareholders, or highly compensated, then the limit on the qualified asset account may not take account of contributions to provide such coverage.

Finally, the amount of life insurance or death benefit that may be taken into account with respect to prefunding of retiree benefits of any employee is not to exceed the amount of the insurance that may be provided to the employee tax-free under section 79. This amount generally is limited to $50,000 but the $50,000 limit may not apply in the case of certain grandfathered employees defined by amendments to section 79 elsewhere in the conference agreement.

SUB and severance pay reserve.—The conference agreement provides an additional reserve for SUB and severance pay benefits equal to 75 percent of the sum of (a) the average annual qualified direct cost of such benefits provided and (b) the administrative costs, during any 2 of the immediately preceding 7 years. Such benefits may include medical or other benefit payable to severed or unemployed workers. The agreement also authorizes Treasury regulations under which an interim limit is to be provided in the case of a new SUB or severance pay plan. The interim reserve is not available, under the agreement, in the case of a plan that provides SUB or severance benefits for any employee who is a key employee.

Safe-harbor.—The conference agreement provides that an actuarial certification by a qualified actuary (determined under Treasury regulations) justifying the taxpayer's reserve computations is not necessary if the amount in the qualified asset account is below a prescribed safe harbor, equal to the sum of separate safe harbor amounts computed with respect to each benefit. For short-term disability benefits, the safe harbor amount is 17.5 percent of benefit costs plus administrative costs in the prior taxable year; for medical benefits, the safe harbor amount is 35 percent of prior year medical benefits and allocable administrative costs. For SUB or severance benefits, the safe harbor amount is the additional reserve described above. Safe harbor amounts for long-term disability, life insurance and retiree medical benefits may be prescribed by Treasury regulations. For any safe harbor limitation based on prior plan costs, insurance premiums may not be taken into account, because the conferees do not intend that a fund is to be used as a vehicle for prepayment of insurance premiums for current benefits. Even if the safe harbors are satisfied, the taxpayer is to show that the reserves, as allowed under the general standards provided by the bill (e.g., claims incurred but unpaid) are reasonable.

Certain collectively bargained plans.—By July 1, 1985, the Treasury Department is to publish final regulations establishing special reserve limit principles with respect to welfare benefit funds maintained pursuant to an agreement that the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and one or more employers, if there is evidence of good faith bargaining over the benefits provided by the plan between the employee representatives and the employer (or employers).

In establishing these limits, the Treasury is to presume that reserves in such plans are not excessive because of the arm's length negotiations between adversary parties inherent in the collective bargaining process. Because contributions under such plans are often made on the basis of a defined contribution fixed over a multiyear period on the basis of economic assumptions which prove to be incorrect and because such contributions may be the only source of benefits to be provided during layoffs, strikes, lockouts, and economic recession, these special limits are to allow substantial flexibility in determining the application of these provisions with respect to such plans.

Transitional rule.—Under the conference agreement, in the case of a plan that was in existence on June 22, 1984, special rules are provided for the determination of the limit for each of the first four years to which the provision applies. In particular, the agreement provides that for the first year, the limit for the year is to be the sum of (1) the limit determined without regard to the transitional rule, and (2) 80 percent of the excess reserve amount. The excess reserve amount for any year is the excess of the reserve as of the end of the first plan year ending after the date of enactment over the limit determined without regard to the transitional rule. For the second, third, and fourth succeeding years, 60, 40, and 20 percent, respectively, of the excess reserve amount for such years is to be added to the limit determined under the usual rules.

Elective aggregation.—Under the conference agreement, an employer may elect to aggregate plans and funds in applying the deduction limits and the rules prohibiting discrimination in favor of certain employees. The agreement provides, however, that the election to aggregate must be consistent for deduction and discrimination purposes. For example, if an employer elects to aggregate 2 plans for deduction purposes, those 2 plans must be aggregated for discrimination purposes.

10 or more employer plans.—For a plan year in which no employer (or employers related to an employer) are required to contribute more than 10 percent of the total contributions, the conference agreement provides that the deduction limits do not apply. The exclusion is provided because under such a plan, the relationship of a participating employer to the plan often is similar to the relationship of an insured to an insurer. The agreement authorizes Treasury regulation under which the percentage may be increased in appropriate cases. For example, a higher percentage could be appropriate in the case of a plan maintained by employers in the construction industry if unusual building activity in the geographic area covered by the plan causes temporary and unusual distortions in the contribution pattern under the plan.

The agreement provides, however, that notwithstanding compliance with the 10-percent rule, and consistent with the discussion above on definition of a fund, a plan is not exempt from the deduction limits if the liability of any employer who maintains the plan is determined on the basis of experience rating because the employer's interest with respect to such a plan is more similar to the relationship of an employer to a fund than an insured to an insurer.

Effective date.—These provisions generally apply to contributions paid or accrued after December 31, 1985. However, in the case of a plan maintained under a collective bargaining contract in effect on July 1, 1985, or ratified before that date, the provisions do not apply until the termination of the contract, determined without regard to any contract extension agreed to after that date.

In addition, these provisions apply to any contribution of a facility to a welfare benefit fund after June 22, 1984, so that deductions with respect to this contribution are to be determined under usual Code rules applicable to recovery of the cost of assets (but taking account of the special rule for child care facilities described above). Further, these rules apply to other contributions, such as cash, made after that date which are to be used to acquire a facility, so that later acquisition of facility with the use of such funds will limit the deduction for the original contribution. This rule does not apply for any facility acquired under a binding contract in effect on and at all times after that date or any facility under construction on June 22, 1984.

b. Unfunded deferred benefits

The conference agreement follows the House bill, with two modifications. First, the agreement provides that any vacation benefit to which an election applies under section 463 is not to be considered a deferred benefit subject to the rules of section 404. Second, the bill provides that that provision generally is effective for amounts paid or incurred after the date of enactment. However, in the case of an extended vacation pay plan in effect on June 22, 1984 and maintained under a collective bargaining agreement, the provision is not effective until the agreement terminates (without regard to any extension agreed to after June 22, 1984). An extended vacation pay plan is one under which employees gradually over a period of years earn the right to additional vacation which cannot be taken until the end of this period. Such a plan is a deferred benefit plan, which under the conference agreement is subject to the deduction-timing rules of section 404.

However, the conferees intend that payment of bonuses or other amounts within 2½ months after the close of the taxable year in which significant services required for payment have been performed is not to be considered a deferred compensation or deferred benefit plan. The conferees also intend that the reference in the House bill to deferred compensation arrangements under section 404(b) includes all compensation, fee, and similar payments, however denominated, except those which are specifically exempted.

2. Excise taxes on funded benefit plans

Present law

No provision.

House bill

No provision.

Senate amendment

Under the Senate amendment, an excise tax is imposed on an employer who maintains a top heavy funded welfare benefit plan with an excess reserve. The tax is equal to the sum of (1) for each year in which an excess arose, the product of the addition to the excess and the highest corporate income tax rate in effect for the current year, and (2) a tax equal to interest on that amount from the time the excess arose to the current year.

The Senate amendment defines excess reserves for a year as reserves in excess of the reserve limit. The reserve limit for a year is the sum of (1) 3 times the average annual benefits paid by the fund during the current year and the preceding year for total and permanent disability, and (2) ⅓ of the average annual benefits paid by the fund during that period for medical care, severance pay, and supplemental unemployment compensation.

Under the Senate amendment, a fund is generally top heavy for a year if more than 50 percent of any class of its benefits are provided to key employees. Special rules are provided for educational benefits and in the case of a benefit that consists of the use of a facility, top heavy use of the facility would result in excise taxes on the employer and on key employees. Benefits provided by a top heavy fund to a key employee are subject to an excise tax imposed at the highest individual income tax rate for the year.

The Senate amendment defines a key employee as (a) an owner of more than 5 percent of the employer, (b) an officer of the employer, or (c) a member of the family of a key employee. Key employee status is permanent under the Senate amendment.

The Senate amendment applies to years beginning after December 31, 1984.

Conference agreement

Under the conference agreement, an excise tax is imposed with respect to disqualified benefits provided by a fund under a welfare benefit plan. The tax is equal to 100 percent of the disqualified benefits provided during a taxable year and is imposed on the employer who maintains the fund.

Under the agreement, a disqualified benefit is (1) (any medical benefit or life insurance benefit provided with respect to a key employee (sec. 416(i)) other than from a separate account established for that employee under the new rules relating to deductions under funded welfare benefit plans (sec. 419(A)(d)), (2) any medical or life insurance benefit provided with respect to a retired employee unless the benefit is provided from a fund that meets the additional requirements for tax exempt status provided by the agreement (sec. 505(b)(1)), and (3) any portion of the fund reverting to the benefit of the employer.

The amount to be charged against a key employee's account is to be determined under Treasury regulations. The conferees intend that these regulations will provide for the computation of this amount on the basis of the key employee's allocable share of the cost of providing the benefit for the year to all covered employees.

This provision is effective under the same rules applicable to the provisions relating to deductions for plan contributions.

3. Tax treatment of exempt benefit organizations

Present law

The income of certain tax-exempt organizations, including a supplemental unemployment compensation benefit trust (SUB) and a group legal service organization (GLSO) generally is not subject to income tax. However, a tax applies to the unrelated business income of such an organization. In addition, the other income of a voluntary employees' beneficiary association (VEBA) is subject to the tax on unrelated business income to the extent it is not set aside for an exempt purpose. No specific limit is provided on the amount that may be set aside for an exempt purpose.

No part of the net earnings of a tax-exempt VEBA may inure to the benefit of any private shareholder or individual other than through the payment of permissible benefits. Under Treasury Regulations, a VEBA violates this standard if it does not meet rules prohibiting discrimination in favor of employees who are officers, shareholders, or highly compensated. The eligibility criteria for VEBA membership and benefits under a VEBA may not be established or administered in a manner that limits membership or benefits to officers, etc., or entitles them to benefits that are disproportionate to benefits for other employees. A tax-exempt VEBA is required to benefit at least 2 employees.

Under present law, an organization or trust created or organized exclusively to form part of a group legal services plan (within the meaning of sec. 120) may be entitled to tax exemption.

House bill

Unrelated business income tax.—The income of a VEBA, SUB, or GLSO for a year is subject to the tax on unrelated business income to the extent that benefit plan reserves for the year exceed the reserve limit.

Benefits for certain employees.—A VEBA, SUB, or GLSO is not tax exempt if more than 25 percent of any class of benefits it provides is provided to an individual who (a) is one of the 5 highest paid officers, (b) owns more than 10 percent of the value of the employer, or (c) is one of the 10 percent highest paid employees. The provision does not apply to a collectively bargained plan.

Discrimination.—A VEBA, SUB, or GLSO is not tax exempt if any class of benefits discriminates in favor of highly compensated employees. The new nondiscrimination standard does not apply to a class of benefits for which a nondiscrimination standard is otherwise provided by the Code. The provision does not apply to a collectively bargained plan.

Reporting requirements.—A VEBA, SUB, or GLSO is not tax exempt unless it notifies the IRS of its claim to tax exempt status.

Effective date.—The provision applies to taxable years beginning after December 31, 1984.

Senate amendment

Unrelated business income tax.—No provision.

Benefits for certain employees.—Similar to the House bill except that the limit is applied to benefits provided to key employees. Under the Senate amendment, the following are key employees permanently: (1) an owner of more than 5 percent of the employer, (2) an officer of the employer, or (3) a member of the family of a key employee. The provision does not apply to a multiemployer plan.

Discrimination.—Same as the House bill except that if the Code provides standards under which a class of VEBA, SUB, or GLSO benefits is excludible from gross income, then the nondiscrimination rules of the Senate amendment are met only if those standards are satisfied. The provision does not apply to a multiemployer plan.

Reporting requirements.—An employer who maintains a VEBA, SUB, or GLSO is required to report on whether the organization meets the nondiscrimination and concentration of benefits standards.

Effective date.—Same as the House bill.

Conference agreement

Unrelated Business Income.—Under the conference agreement, the special rules applicable to voluntary employees' beneficiary associations (VEBAs) and social clubs for purposes of the tax on unrelated business taxable income are extended to supplemental unemployment compensation benefit trusts (SUBs) and group legal service organizations (GLSOs). In addition, under the agreement, more specific limits are provided with respect to the amount that may be set aside for exempt purposes by such an organization.

Under the agreement, in the case of a VEBA, etc., the amount set aside for an exempt purpose is generally not to exceed the qualified asset account limit (sec. 419A(c)) for the taxable year (without taking into account any reserve for medical benefits provided to retired employees). In addition, the amount set aside for exempt purposes is not to include any facility used to provide recreational and other certain other benefits. The limit on the set-aside applies to more-than-10-employer VEBAs which are exempt from the deduction limitations.

The agreement provides a transitional rule for existing reserves to provide medical benefits and life insurance benefits to retired employees. Under the agreement, the income attributable to an existing reserve is not subject to the new rules for calculating unrelated business taxable income. The agreement provides that an existing reserve is the amount of assets set aside as of the close of the last plan year ending before the date of the enactment of the bill for purposes of providing such benefits. The transition relief applies to a reserve to provide such benefits only to the extent the reserve does not exceed the amount that could be accumulated under the principles of Rev. Ruls. 69-382, 1969 C.B. 28, and 73-599, 1973-2 C.B. 40. All future payments of medical or life insurance benefits to retirees under plans of the employer are to be charged against the reserve to which the transition rule applies.

The new rules for calculating unrelated business taxable income are not to apply to any organization if substantially all of the contributions to the organization are made by employers who were exempt from income tax throughout the 5-taxable year period ending with the taxable year in which the contributions are made.

The agreement also provides for a tax on an employer who maintains a welfare benefit fund that is not exempt from income tax. Under the agreement, in the case of any welfare benefit fund, such as a retired life reserve account, that is not exempt from income tax as a social club, VEBA, SUB, or GLSO, the employer who maintains the fund is to include in gross income for the taxable year an amount equal to the deemed unrelated income of the fund. The agreement provides that deemed unrelated income of such a welfare benefit fund is the amount that would be unrelated business taxable income of the fund if it were a tax exempt social club, VEBA, SUB, or GLSO. In determining deemed unrelated income, at the election of the employer, 2 or more non-exempt welfare benefit funds of the employer may be treated as a single fund. Also, under the rules relating to deemed unrelated income, the aggregation rules applicable to qualified pension plans are to apply.

This provision is effective under the same rules applicable to the provisions relating to deductions for plan contributions.

Benefits for Certain Employees.—The conference agreement does not contain the provisions of the House bill on the Senate amendment.

Discrimination.—The conference agreement generally follows the provisions of the House bill establishing new nondiscrimination standards for a tax-exempt voluntary employees' beneficiary association (VEBA), or group legal services organization (GLSO). With respect to the nondiscrimination rules, certain employees who are not covered by a plan may be excluded from consideration in applying the nondiscrimination standards. These employees are employees who have not attained the age of 21, employees who have not completed 3 years of service with the employer, less than ½-time employees, employees who are included in certain collective bargaining units, and certain nonresident aliens.

The conferees wish to clarify the rules of the House bill relating to integration of benefits under a VEBA with social security. In testing whether a disability plan funded with an exempt trust violates the rules forbidding discrimination in favor of employees who are officers, shareholders, or highly compensated, a part of each employee's Social Security benefit (the part considered to be paid for by the employer) can be taken into account as if it were provided under the employer's plan. Similar integration rules are provided for qualified pension plans.

For example, a pension plan may provide a retirement benefit that is reduced by up to 83⅓ of the primary insurance amount for the employee under Social Security. This 83⅓ percent offset represents the part of the employee's Social Security benefit that the employer is considered to have provided. It includes the value of the employer's Disability Income (DI) contribution, as well as his Old-Age and Survivor's Insurance (OASI) contribution. The Disability Income benefit is considered to make up 10 percent of the value of employer-provided Social Security benefits. Thus, if the employer provides a disability benefit under the pension plan and the disability benefit is reduced by 100 percent of the Social Security benefit, then the employer may "take credit" for only 90 percent of employer-provided Social Security benefits when paying a retirement benefit. Accordingly, only 75 percent (90 percent of 83⅓) of Social Security benefits could be subtracted from the retirement benefit.

Thus, under the agreement, if an employer's pension plan is not more than 90 percent integrated—that is, it does not reduce benefits by more than 90 percent of the amount by which they could be reduced (e.g., by more than 75 percent of social security benefits)—then double integration does not occur. In this case, the agreement requires no change in either the pension plan or the disability plan.

On the other hand, if an employer's pension plan is more than 90 percent integrated, the full value of the Disability Income benefit under Social Security could not be used to reduce long-term disability benefits under the employer's plan. For example, if the pension plan is 93 percent integrated (so that 30 percent of the employer's

Social Security Disability Income benefit has been used by the pension plan), then no more than 70 percent of the Disability Income benefit could be applied to reduce long-term disability benefits under the employer's plan. Of course, if the pension plan were 100 percent integrated, the long-term disability benefit under the employer's plan could not be integrated with Social Security. The rules relating to integration of long-term disability benefits apply to benefits funded by employer contributions as well as benefits funded by employee contributions.

Of course, the agreement also permits the integration of long-term disability benefits with workers' compensation benefits.

In addition, the agreement does not affect the integration of long-term disability benefits for employees who are disabled before the effective date.

Effective date.—The conference agreement follows the House bill.

Reporting Requirements.—The conference agreement follows the House bill.

Studies.—Under the conference agreement, the Secretary of the Treasury is directed to study the possible means of providing for minimum standards for employee participation, vesting, accrual, and funding under welfare benefit plans for current and retired employees (including separated employees). The study is to include a review of whether the funding of welfare benefits is adequate, inadequate, or excessive. The Secretary is to report to the Congress with respect to the study by February 1, 1985. The conferees expect that the Secretary will provide suggestions for minimum standards where appropriate.

4. Employer and welfare benefit fund treated as related persons

Present law

Under present law, the gain from the sale of depreciable property between certain related taxpayers is treated as ordinary income but an employer and a welfare benefit fund to which the employer contributes are not generally treated as related parties.

House bill

The House bill treats an employer and a welfare benefit fund as related parties if the employer controls the fund directly or indirectly.

The provision applies to sales and exchanges after the date of enactment, in taxable years ending after that date.

Senate amendment

The Senate amendment is the same as House bill except that the provision applies to a welfare benefit fund whether or not the fund is exempt from tax.

Conference agreement

The conference agreement follows the Senate amendment.

C. Employee Benefits

1. Exclusions for certain employer-provided fringe benefits; moratorium

Present law

General rule

Gross income, for income tax purposes, includes "all income from whatever source derived" (Code sec. 61(a)). This provision "is broad enough to include in taxable income any economic or financial benefit conferred on the employee as compensation, whatever the form or mode by which it is effected" (*Comm'r* v. *Smith*, 324 U.S. 177, 181 (1945)). However, certain fringe benefits, such as health benefits, are expressly excluded from gross income by specific statutory provisions.

Moratorium

A moratorium first enacted in 1978 prohibited issuance of Treasury regulations relating to the income tax treatment of nonstatutory fringe benefits. The legislative moratorium expired on December 31, 1983. The Treasury Department has announced that Treasury and the IRS "will not issue any regulations or rulings altering the tax treatment of nonstatutory fringe benefits prior to January 1, 1985," and that "present administrative practice will not be changed during this period" (Ann. 84-5, 1984-4 I.R.B. 31).

Employment taxes

The social security and unemployment insurance payroll taxes (FICA and FUTA) and income tax withholding apply to "wages," defined in the Code as all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash (secs. 3121(a), 3306(b) and 3401(a)). The railroad retirement tax (RRTA) applies to any form of money remuneration (sec. 3231(e)). Regulations applicable to these provisions specify that the value of any noncash item is to be determined by the excess of its fair market value over any amount paid by the recipient for the item (see, e.g., Reg. sec. 31.3121(a)-1(e)).

Employer-provided housing

Present law (Code sec. 119) excludes from an employee's gross income the value of lodging provided by the employer if (1) the lodging is furnished for the convenience of the employer, (2) the lodging is on the business premises of the employer, and (3) the employee is required to accept the lodging as a condition of employment. Several court decisions have held that on-campus housing furnished to faculty or other employees by an educational institution under the circumstances involved in those cases did not satisfy the section 119 requirements, and hence that the fair rental value of the housing (less any amounts paid for the housing by the employee) was includible in the employee's gross income and constituted wages for income tax withholding and employment tax purposes.

House bill

General rule

The House bill provides a statutory exclusion from income and employment taxes for: (1) no-additional-cost services, (2) qualified employee discounts, (3) working condition fringes, (4) de minimis fringes, and (5) employer-operated athletic facilities provided to employees. No fringe benefit (other than a de minimis fringe) is excluded under the bill if another section of the Code provides rules for the tax treatment of that general type of benefit.

The House bill does not extend the moratorium on regulations which expired on December 31, 1983. Under the House bill, any fringe benefit that does not qualify for a statutory exclusion is includible in gross income, and subject to employment taxes, at the excess of its fair market value over any amount paid by the employee for the benefit.

The rules of the bill do not make any change in existing statutory or regulatory exclusions for benefits for military personnel.

Exclusion provisions

No-additional-cost service

A service provided to an employee is excluded if:

(1) the employer incurs no substantial cost (including foregone revenue) in providing the service;

(2) the service is provided by the employer or another business with whom the employer has a written reciprocal agreement, and is of the same type ordinarily sold to the public in the line of business in which the employee works;

(3) the service is provided to a current or retired employee, or a spouse or dependent child of either, or a widow(er) or dependent children of a deceased employee; and

(4) for certain highly compensated employees, nondiscrimination requirements are met (see below).

Qualified employee discount

A discount on merchandise provided to an employee is excluded to the extent it does not exceed the employer's gross profit percentage (in the relevant line of business). The exclusion does not apply to discounts on real property or on personal property of a kind commonly held for investment.

A discount on services provided to an employee is excluded to the extent it does not exceed 20 percent of the selling price of the services to nonemployee customers (with no gross profit percentage restriction).

The following conditions generally must be satisfied for the exclusion to apply:

(1) the property or service is provided by the employee and is of the same type ordinarily sold to the public in the line of business in which the employee works,

(2) the property or service is provided to a current or retired employee, a spouse or dependent child of either, or to a widow(er) or dependent children of a deceased employee, and

(3) for certain highly compensated employees, nondiscrimination requirements are met (see below).

Under a special rule, the exclusion applies to discounts provided by a department store to employees of another employer (such as a cosmetic firm) who make over-the-counter sales of merchandise within the store.

A grandfather rule relaxes the line-of-business limitation for employees of members of an affiliated group which consists primarily of a retail department store business, if, as of October 5, 1983, such employees were entitled to discounts at the store.

Working condition fringe

Property or services provided to an employee are excluded to the extent that they would be deductible as ordinary and necessary business expenses (under Code secs. 162 or 167) if the employee had paid for them.

Under a special rule, all of an auto salesman's automobile use in the dealer's sales area is excluded if the use is provided primarily to facilitate the salesman's performance of services and there are substantial restrictions on personal use.

The bill excludes, as a working condition fringe, the value of free or reduced-cost parking provided to employees on or near the employer's business premises. Under the House bill, the exclusion is available to highly compensated employees only if such parking is available on a nondiscriminatory basis.

De minimis fringe

Property or services not otherwise tax-free are excluded if their value is so small, considered in the aggregate, as to make accounting for the benefits unreasonable or administratively impracticable. For example, benefits which generally are excluded as de minimis fringes include the typing of a personal letter by a company secretary, occasional personal use of the company copying machine, monthly transit passes provided at a discount not exceeding $15, occasional company cocktail parties or picnics for employees, occasional supper money or taxi fare for employees because of overtime work, and certain holiday gifts of property with a low fair market value.

Subsidized eating facilities operated by the employer also are excluded as a de minimis fringe if located on or near the employer's business premises, if revenue equals or exceeds direct operating costs, and if (for certain highly compensated employees) nondiscrimination requirements are met (see below).

Athletic facilities

An exclusion is allowed for the value of athletic facilities provided and operated by an employer for use of its employees.

Nondiscrimination requirements

The exclusions for no-additional-cost services, qualified employee discounts, free parking, subsidized eating facilities, and qualified tuition reduction (item 2 below) are available to officers, owners, or highly compensated employees only if the property or service is provided on substantially the same terms to each member of a group of employees defined under a reasonable classification, set up by the employer, which does not discriminate in favor of officers, owners, or highly compensated employees.

Effective date

The House bill generally is effective on January 1, 1984.

Senate amendment

Moratorium

The Senate amendment extends through 1985 the legislative moratorium on issuance of Treasury regulations relating to the income tax treatment of nonstatutory fringe benefits.

Faculty housing

Under the Senate amendment, the extended legislative moratorium is applied to prohibit the issuance of income tax regulations providing for the inclusion in gross income of the excess of the fair market value of qualified campus lodging over the greater of the operating costs paid in furnishing the lodging or the rent received. The application of the extended moratorium with respect to qualified campus lodging applies only with respect to lodging furnished after December 31, 1983 and before January 1, 1986.

Conference agreement

General rules

The conference agreement follows the House bill, with modifications to the effective date and certain provisions as described below. Thus, under the conference agreement, the general legislative moratorium on regulations that expired December 31, 1983 is not extended. Instead, the conference agreement sets forth statutory provisions under which (1) certain fringe benefits provided by an employer are excluded from the recipient employee's gross income for Federal income tax purposes and from the wage base (and, if applicable, the benefit base) for purposes of income tax withholding, FICA, FUTA, and RRTA, and (2) any fringe benefit that does not qualify for exclusion under the bill and that is not excluded under another statutory fringe benefit provision of the Code is includible in gross income for income tax purposes, and in wages for employment tax purposes, at the excess of its fair market value over any amount paid by the employee for the benefit. The latter rule is confirmed by clarifying amendments to Code sections 61(a), 3121(a), 3306(b), and 3401(a) and section 209 of the Social Security Act.

The conferees intend that Treasury regulations are to be issued to implement the statutory fringe benefit provisions of the bill. Such regulations are to be consistent with the language of the bill in the legislative history as reflected in House Report No. 98-432 (Pt. 2) and this Statement of Managers. Thus, for example, as stated in the report of the Ways and Means Committee, the bill does not modify the existing rules under which benefits to military personnel, such as subsistence, housing, and uniform allowances, are excludable from gross income.

The conference agreement adds a rule giving the Treasury Department regulatory authority to provide the time and manner for collection (or payment) by an employer of employment taxes on noncash fringe benefits. To the maximum extent practicable, such regulations may provide for collection (or payment) of FICA taxes under sections 3101 and 3111 with respect to noncash fringe benefits in a calendar quarter not later than the time for collection (or payment) of such taxes on cash wages paid on the last day of that quarter. The regulations may provide similar rules for other employment taxes.

Exclusions

No-additional-cost-services; qualified employee discounts

The conference agreement provides an additional, elective grandfather rule which in certain circumstances relaxes the line of business limitation requirement for the exclusion for qualified employee discounts and (to the extent described below) for the exclusion for no-additional-cost-services.

Under this grandfather rule, if all the following requirements are met, the exclusion for qualified employee discounts (if otherwise available) extends to the providing by an employer of discounts on goods or services in a particular line of business to an employee who works in a different line of business of the employer than that line of business in which such goods or services on which the discount is available are offered for sale by the employer:

(1) On and after January 1, 1984, the employer offers such discounts on goods or services in that particular line of business to substantially all its employees in all of its lines of business which existed on January 1, 1984;

(2) The employee works in a line of business of the employer which was a line of business of the employer on January 1, 1984; and

(3) The employer timely elects the applicability of this grandfather rule.

This grandfather rule also applies, if requirements of the same nature are met, with respect to no-additional-cost services which are provided by an employer to an employee notwithstanding that the service is not the same type of service sold to the public in the line of business of the employer in which the employee works, except that this grandfather rule does not apply with respect to no-additional-cost services provided to the employee by a person other than an employer of the employee (i.e., pursuant to a reciprocal agreement between employers).

Thus, where all these requirements are met, all employees of any line of business of the employer which was in existence on January 1, 1984 are treated, for purposes of new Code sections 132(a)(1) and 132(a)(2) but not for purposes of new Code section 132(g)(2), as employees of the particular line of business (which was in existence on January 1, 1984) in which such goods or services are offered for sale by the employer.

This additional grandfather rule applies on a calendar year basis. If elected, the rule applies to the first calendar year following the year of election and to all subsequent years unless revoked by the employer. A revocation must be made prior to the beginning of the calendar year to which the grandfather rule is not to apply. The election is to be made in the manner prescribed by Treasury regulations. For purposes of the grandfather rule, all members of the same affiliated group of corporations (as defined in sec. 1504) are treated as one corporation.

Under the conference agreement, an employer making the election is subject to an excess fringe benefit excise tax for any calendar year as to which the grandfather rule election is in effect if the aggregate fair market value of all excludable no-additional-cost service benefits and qualified employee discount benefits (whether or not excludable only pursuant to the grandfather rule) provided by the employer during the calendar year to all its employees exceeds one percent of the total of all taxable compensation paid to all employees of the employer for the year. This computation takes into account all employees in all lines of business of the employer, including lines of business as to which the elected grandfather rule does not apply (e.g., where the line of business did not exist on January 1, 1984). The rate of the new excise tax is 30 percent of the excess described in the preceding sentences. The amount of tax is not deductible by the employer.

In addition, the conference agreement modifies the grandfather rule in the House bill to provide a revised definition of an affiliated group for such purposes.

Working condition fringe

The following modifications are made by the conference agreement with respect to working condition fringes:

(1) The nondiscrimination requirement in the House bill for the exclusion (as a working condition fringe) of employee parking provided on or near the business premises of the employer is deleted;

(2) The availability of the exclusion of qualified auto demonstration use (as a working condition fringe) is limited to full-time auto salespersons. The exclusion is not available to any other persons, such as part-time auto salepersons, mechanics, the dealer's bookkeeper, etc.; and

(3) The availability of the working condition fringe exclusion for certain consumer product testing and evaluation as described in the report of the Ways and Means Committee is clarified by providing that gross income does not include personal use of such consumer goods provided to an employee primarily for such product testing and evaluation which does not qualify under the requirements in such report to the extent that the employee pays or reimburses the employer for such personal use.

De minimis fringe

In lieu of the aggregation rule in the House bill, the conference agreement provides that the frequency with which similar fringe benefits (otherwise excludable as de minimis fringes) are provided by the employer to its employees is to be taken into account, among other relevant factors, in determining whether the fair market value of the property or service is so small that accounting for the property or service would be unreasonable or administratively impracticable. Under this rule, where an employer exercises sufficient control and imposes significant restrictions over personal use of a copying machine such that substantially all (at least 85 percent) of the use of the machine can be shown to be for business purposes, the employer may treat as a de minimis fringe any personal use of the machine by a particular employee which might occur.

Nondiscrimination requirements

As stated above, the conference agreement deletes the nondiscrimination requirement for the exclusion of employee parking as a working condition fringe.

Faculty housing

The conference agreement generally follows the Senate amendment in imposing a moratorium on the issuance of income tax regulations providing for the inclusion in gross income of the excess of the fair market value of qualified campus lodging over the greater of the operating costs paid in furnishing the lodging or the rent received. This moratorium with respect to qualified campus lodging applies only with respect to lodging furnished after December 31, 1983 and before January 1, 1986. No inference is intended by imposition of a moratorium for such period as to the proper income tax treatment of faculty housing furnished prior to 1984 or after 1985.

Effective date

Under the conference agreement, the provisions are effective beginning January 1, 1985, except that the moratorium with respect to qualified campus lodging applies only with respect to lodging furnished after December 31, 1983 and before January 1, 1986.

2. Qualified tuition reduction

Present law

Gross income does not include scholarships or fellowships, subject to certain limitations, unless such amounts are paid as compensation for services or for studies or research primarily for the benefit of the grantor (Code sec. 117). Treasury regulations provide that remission of the tuition of a child of a faculty member provided by another education institution under a tuition-exchange plan is considered to be a scholarship (Reg. sec. 1.117-3(a)).

House bill

The House bill provides that a reduction in tuition provided to an employee of an educational institution is excluded for income and employment tax purposes if (1) the tuition is for education below the graduate level provided by the employer or by another educational institution; (2) the education is provided to a current or retired employee, a spouse or dependent child of either, or to a widow(er) or dependent children of a deceased employee; and (3) certain nondiscrimination requirements are met (see under item 1, above). Under a special rule in the House bill, availability of a tuition reduction benefit only to faculty members is not a discriminatory classification for purposes of the nondiscrimination requirement.

In addition, the House bill provides that a tuition reduction provided to an employee of an educational institution is excluded if the tuition is for education at the graduate level provided by the employer to a teaching or research associate or assistant at that institution.

This provision is effective with respect to education furnished after June 30, 1984.

Senate amendment

See item 1, above (relating to extension of moratorium).

Conference agreement

The conference agreement follows the House bill, with modifications (1) deleting the exclusion for graduate tuition reduction provided to teaching or research associates or assistants; (2) deleting the special nondiscrimination rule in the House bill as applicable to the exclusion for tuition reduction for education below the graduate level (which deleted rule would have provided that availability of the benefit only to faculty members is not a discriminatory classification); and (3) changing the effective date to qualified tuition reductions for education furnished after June 30, 1985. In deleting the exclusion (in the House bill) for certain graduate tuition reduction, the conference committee notes that tuition reductions for graduate education remain eligible for exclusion as scholarships under Code section 117(b) if they satisfy the requirements of that provision of present law.

3. Cafeteria plans

Present law

The cafeteria plan rules of the Code provide that a participant in a nondiscriminatory cafeteria plan will not be treated as having received a taxable benefit offered under the plan solely because the participant has the opportunity, before the benefit becomes available to the participant, to choose among the taxable and nontaxable benefits offered under the plan. The term "taxable benefit" includes cash, property, and other benefits that are currently taxable to the participant upon receipt. "Nontaxable benefit" includes any benefit that is not currently taxable to the participant upon receipt (e.g., group-term life insurance up to $50,000, coverage under an accident or health plan, and coverage under a dependent care assistance program).

Present law does not permit a cafeteria plan to offer either vanpooling or any benefit that defers the receipt of compensation, with the exception of the opportunity for participants to make elective contributions under a qualified cash or deferred arrangement.

The cafeteria plan rules generally do not affect whether any particular benefit offered under the plan is a taxable or nontaxable benefit. Thus, a benefit that is nontaxable under the Internal Revenue Code when offered separately is a nontaxable benefit under a cafeteria plan only if the rules providing for the exclusion of the benefit from gross income continue to be satisfied when the benefit is provided under the cafeteria plan.

On February 10, 1984, the Internal Revenue Service issued a news release (IR-84-22), which stated that so-called "flexible spending arrangements" offered as part of cafeteria plans do not provide employees with nontaxable benefits under the Code because, under such arrangements, employees are assured of receiving the benefit of what they would have received had no covered expenses been incurred.

In May 1984, the Internal Revenue Service issued proposed regulations with respect to the cafeteria plan rules and the statutory rules governing the exclusion of benefits from gross income. These proposed regulations state that an otherwise nontaxable benefit will be nontaxable if offered in a cafeteria plan only if it continues to satisfy the provisions governing its exclusion from gross income. Accordingly, the proposed regulations state that employer contributions with respect to an accident or health plan, a qualified group legal services plan, or a dependent care assistance program are not excluded from a participant's gross income under the Internal Revenue Code to the extent that the participant is assured of receiving benefits under the plan without regard to whether he or she incurs covered expenses.

House bill

The House bill amends the definition of "cafeteria plan" to provide that such plans may offer employees choices limited to cash and those fringe benefits (other than scholarships or fellowships, vanpooling, and those benefits excludable under the nonstatutory fringe benefit provisions of the bill) that are excludable from gross income under a specific section of the Internal Revenue Code. Thus, group-term life insurance, coverage under a qualified group legal services plan, coverage under an accident or health plan, and coverage under a dependent care assistance program are permissible nontaxable benefits in a cafeteria plan. For purposes of this rule, group-term life insurance that is includible in gross income only because the amount of the insurance exceeds $50,000 or because the insurance is on the life of the employee's spouse or children is treated as a nontaxable benefit. Similarly, vacation days offered under a cafeteria plan are treated as nontaxable benefits only if the plan precludes any participant from cashing-out or using, in a subsequent plan year, any vacation days remaining unused as of the end of any plan year.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill provisions on cafeteria plans, and adopts several additional provisions.

First, the conference agreement amends the cafeteria plan rules to provide that if, for a plan year, more than 25 percent of the total nontaxable benefits are provided to employees who are key employees with respect to the plan for such year (as determined under the rules of section 416(i)(1)), such key employees will be taxed as though they received all available taxable benefits under the plan. Generally, in determining the portion of the total nontaxable benefits that is provided to key employees, coverage under a plan (e.g., an accident or health plan) and not actual expense reimbursements under such a plan are to be counted.

Second, the conference agreement applies certain reporting requirements with respect to cafeteria plans. Under regulations prescribed by the Secretary of the Treasury, each employer that maintains a cafeteria plan during a taxable year beginning after December 31, 1984, will be required to file a return for such year showing the number of employees of the employer, the number of employees participating in the plan, the total cost of the plan for the taxable year, and specified employer identification information. Based on these general returns, the Secretary is to require a select and statistically significant group of employers to file additional information returns with respect to their cafeteria plans. These additional returns will contain such information as the Secretary may require. Examples of such information include a breakdown of the above information by salary range and type of benefit provided, as well as information which may be necessary to allow Treasury to develop a plan to insure that the requirements of the cafeteria plan rules (such as nondiscrimination and maximum percentage of benefits to key employees) are adequately enforced.

Third, the conference agreement provides both general and special transition relief, with respect to the proposed Treasury regulations on cafeteria plans, for cafeteria plans and "flexible spending arrangements" in existence on February 10, 1984. (A "flexible spending arrangement" consists of a benefit of a type to which a statutory exclusion may be applied, such as an accident or health plan under sections 105 and 106, with respect to which an employee is assured of receiving, in cash or some other benefit, amounts available for expense reimbursement without regard to whether the employee incurs the covered expenses.) The general relief rule provides that a plan will not fail to be a cafeteria plan merely because of a failure to satisfy the rules relating to cafeteria plans under the proposed Treasury regulations and that a flexible spending arrangement will not fail the requirements of the applicable statutory exclusions merely because of a failure to satisfy the rules relating to such exclusions under these regulations. This general relief is provided until the earlier of January 1, 1985, or the effective date of any modification of the plan or arrangement to provide additional benefits if such modification becomes effective after February 10, 1984. The conference agreement does not prevent the application of the proposed Treasury regulations after the earlier of such dates.

Thus, for example, if on February 10, 1984, a flexible spending arrangement failed to satisfy the rules relating to accident or health plans under the proposed Treasury regulations and thereafter continues to fail such rules because such arrangement provides for the cash-out or carryover of unused amounts at the end of the plan year, such arrangement will be treated as qualifying as an accident or health plan until the earlier of the two dates provided above.

The general transition rule is applicable to both benefit bank flexible spending arrangements and zero balance reimbursement account (ZEBRA) type flexible spending arrangements. Under a benefit bank arrangement, the employee generally allocates a specified amount of dollars to a reimbursement account for specified benefits, e.g., medical, legal, and dependent care, at the beginning of the plan year. As expenses are incurred during the year, the employee is entitled to reimbursement of these expenses from the account. For example, if an employee with $500 allocated to his account incurred medical expenses of $250, he could be reimbursed for these expenses from the account. At the end of the year, he would receive the remaining $250 in cash. In contrast, under the ZEBRA-type arrangement, amounts generally are not specifically allocated to an account before the beginning of the year, but instead amounts are allocated only after an expense in incurred.

The conference agreement also provides special transition relief with respect to the rules contained in the proposed regulations relating to the statutory nontaxable benefits. This relief provision provides that a flexible spending arrangement in existence under a cafeteria plan on February 10, 1984, will not fail to be a nontaxable benefit under the applicable exclusions merely because a participant will receive amounts available but unused for expense reimbursement. An arrangement will qualify for the special relief only if, under the arrangement, the employee must fix the amount of contributions to be made on his or her behalf before the beginning of the applicable period of coverage and taxable cash is not available before the end of such period or, if earlier, at the termination of employment. In lieu of distributing taxable cash to a participant at the end of the applicable period of coverage, it would also be permissible for the unused amounts to be carried over to the succeeding year. Further, an arrangement could permit a participant to terminate contributions during the period of coverage or to change the rate or amount of contributions during the period of coverage on account of certain changes in family status or change in employment status from full-time to part-time, or vice versa. The conferees intend that this special transition relief will be available to arrangements that, on February 10, 1984, and thereafter, failed to satisfy these restrictions if such arrangements are modified, before January 1, 1985, to comply with such restrictions. The special relief under this rule is for benefits provided before the earlier of July 1, 1985, or the effective date of any modification of the arrangement to provide additional benefits if such modification becomes effective after February 10, 1984. The conference agreement does not prevent the application of the proposed Treasury regulations after the earlier of the applicable dates.

Cafeteria plans and flexible spending arrangements that were not in existence on February 10, 1984, generally do not qualify for either the general or the special transition rules under the conference agreement. Thus, the conference agreement does not prevent the current application of the proposed Treasury regulations to such plans and arrangements. However, plans that were not actually in existence as of February 10, 1984, but with respect to which substantial implementation costs had been incurred by the employer by such date are to be treated as having been in existence on such date. The conferees intend that if an employer has incurred, as of February 10, 1984, either more than $15,000 of implementation costs or more than one-half of the total costs of implementing a cafeteria plan, the transition rules are to be available with respect to the cafeteria plan. In making this determination, total implementation costs are the costs of designing and installing computer programs for operation of the plan and the costs of printing cafeteria plan brochures for employees. Costs associated with more than one plan of the same employer are to be allocated among the plans on the basis of the number of participants in the plans.

Finally, the conference agreement provides that the Secretary of Health and Human Services, in cooperation with the Secretary of the Treasury, is to submit a report to the House Committee on Ways and Means and the Senate Committee on Finance on the effect of cafeteria plans on the containment of health costs. This report is to be submitted by April 1, 1985. The study is to examine the impact which the use of cafeteria plans (including flexible spending arrangements) has on the containment of health care costs and to recommend what modifications might be desirable with respect to the cafeteria plan rules to optimize the potential to reduce medical costs while balancing against other health care policy goals. Included within the study should be an analysis of the advisability of establishing Federal guidelines relative to the type of medical plans that can qualify for cafeteria plan treatment in a manner similar to that applicable to qualified pension plans and the advisability of adding additional benefits to cafeteria plans. In this regard, the conferees intend to examine, before January 1, 1986, the operation of the nondiscrimination rules and the forfeitability requirements with respect to cafeteria plans, and the effect of such provisions on the Federal tax base and on health cost containment.

4. Nonqualified options

Present law

Generally, employees recognize income upon the exercise of a nonqualified employee stock option to the extent the value of the stock exceeds the price paid. Employers are allowed a corresponding deduction.

House bill

No provision.

Senate amendment

Under the Senate amendment, income and deductions with respect to certain employee options are deferred until the stock is disposed of. In order to qualify, the option must meet the following requirements: (1) the option price must at least equal the fair market value of the stock on the date of issue; (2) the option may be transferable only by reason of death; (3) the option must be exercised in sequence; and (4) certain notification procedures must be met.

The maximum value of stock for which options which may be granted in any one year is $100,000 (reduced by value of stock under incentive stock options). The option program may not discriminate in favor of 5-percent owners or highly paid officers.

The amount deferred on exercise is an item of tax preference.

The provision applies to options exercised after date of enactment.

Conference agreement

The conference agreement does not include the provision in the Senate amendment.

5. Incentive stock options

Present law

Incentive stock options allow an employee to receive capital gains on the sale of stock acquired on the exercise of an option, rather than ordinary income at the time of exercise.

The option price of an incentive stock option must equal or exceed the fair market value of the stock at the time the option is granted.

The "spread" on the exercise of an incentive stock option is an item of tax preference for purposes of the minimum tax.

House bill

No provision.

Senate amendment

The Senate amendment disregards "lapse restrictions" in determining the fair market value of the stock. It also treats the modification of an option making it nontransferable as the grant of a new option, thus requiring the fair market value to be determined on the modification date.

The provision generally applies to options granted, exercised or modified (as the case may be) after March 20, 1984. If an option granted after March 20, 1984, pursuant to corporate action taken before that date, the provision will not apply if the option is issued before September 20, 1984 (or, in the case of the minimum tax, if the option is exercised before December 31, 1984).

Conference agreement

The conference agreement generally follows the Senate amendment. The date by which corporate action must be taken under the transitional rule is changed to May 15, 1984.

6. Certain section 83(b) elections

Present law

Property transferred to an employee in connection with the performance of services is includible in income (to the extent the value of the property exceeds the amount paid) in the first taxable year the property is transferable and not subject to a substantial risk of forfeiture (sec. 83). A taxpayer may elect, within 30 days of the transfer of property, to include in gross income the excess of the value of the property (determined without regard to restrictions) over the amount paid, for the year the transfer occurs (sec. 83(b)).

A recent Tax Court decision held that section 83 may apply where the employee paid fair market value for the property (determined without regard to restrictions). *Alves* v. *Commissioner*, 79 T.C. 864 (1982), aff'd by the 9th Cir. on June 5, 1984.

House bill

No provision.

Senate amendment

The Senate amendment allows a taxpayer to make the election under section 83(b) with the first tax return filed after date of enactment with respect to transfers of property made after June 30, 1976 and before the date of enactment, if the taxpayer paid fair market value for the property (determined without regard to restrictions), and the employer consents to the election.

Conference agreement

The agreement generally follows the Senate amendment. However, the provision applies only to transfers before November 18, 1982 (the date of decision of the *Alves* case).

7. Employee achievement awards

Present law

Code section 274(b) generally disallows business deductions for gifts to the extent that the total cost of all gifts of cash, tangible personal property, etc., to the same individual from the taxpayer during the taxable year exceeds $25. The statute expressly defines the term gift to mean any amount excludable from gross income under section 102 (relating to gifts and bequests) which is not excludable under another statutory provision. The U.S. Supreme Court, in a case involving payments made "in a context with business overtones," defined excludable gifts as payments made out of "detached and disinterested generosity" and not in return for past or future services or from motives of anticipated benefit (*Comm'r* v. *Duberstein*, 363 U.S. 278 (1960)).

In the case of an excludable gift of an item of tangible personalty awarded to an employee for length of service, safety achievement, or productivity, the ceiling on the deduction allowed to the employer is increased to $400 of the item's cost. In addition, the ceiling on the business gift deduction is $1,600 for such an employee award under a qualified award plan provided that the average cost of all plan awards in the year does not exceed $400.

House bill

No provision.

Senate amendment

The Senate amendment provides a new income-tax exclusion to employees for awards received from an employer for productivity, safety, or length of service, in the form of watches, clocks, certain emblematic jewelry or rings, certain personal accessories, and other traditional retirement or nonretirement awards, effective for awards made after the date of enactment.

The exclusion, and the employer's deduction, for such awards to a particular employee during the year are limited to $1,600 in each achievement category (i.e., a maximum of $4,800 in cost) for awards under a qualified award plan, or $400 in each category (maximum of $1,200) for other such awards. Other restrictions, including nondiscrimination rules, apply.

Any excess of the lesser of the employer's cost for or the value of such awards over the exclusion dollar limits is expressly includible in the employee's gross income, as is the value of nontraditional employee achievement awards or any other awards to employees.

Conference agreement

The conference agreement does not include the Senate amendment.

8. Exclusion for educational assistance benefits; deferred educational benefits

a. Educational assistance

Present law

Employer-provided educational assistance benefits were excluded from gross income for income tax purposes and from wages for FICA and FUTA purposes under a provision which expired on December 31, 1983.

House bill

No provision.

Senate amendment

The Senate amendment extends the exclusion to apply to taxable years beginning before January 1, 1986.

Conference agreement

The conference agreement does not include the Senate amendment.

b. Deferred educational benefits

Present law

Deductions for contributions to a nonqualified deferred compensation plan are not allowed until an amount is includible in the employee's income. However, contributions to a fund that is part of a welfare benefit plan generally are deductible in the year made regardless of the time a benefit is provided. In one case (*Greensboro Pathology Associates, P.A.* v. *U.S.*, 699 F.2d 1196 (Fed Cir. 1982)), a court held that a plan to pay future college tuition of employees' children was a welfare benefit plan, rather than a deferred compensation plan.

House bill

No provision.

Senate amendment

The Senate amendment treats a plan for providing deferred educational benefits as a plan of deferred compensation, thus generally delaying deductions for plan contributions until the benefit is includible in the employee's income (or would be includible but for provisions excluding the benefits from income). This provision applies to taxable years ending after December 31, 1983.

Conference agreement

The conference agreement does not include the Senate amendment.

D. Employee Stock Ownership Provisions

Present law

An employee stock ownership plan ("ESOP") is a qualified stock bonus plan or a combination stock bonus and money purchase pension plan under which employer stock is held for the benefit of employees. An ESOP under which an employer contributes stock or cash in order to qualify for a credit against income tax liability is referred to as a tax credit ESOP. Under present law, the income tax credit is limited to a prescribed percentage of the aggregate compensation of all employees under the plan. For compensation paid or accrued in calendar years 1983 and 1984, the tax credit is limited to one-half of one percent. With respect to compensation paid or accrued in 1985, 1986, and 1987, the limit is three-quarters of one percent. No credit is provided with respect to compensation paid or accrued after December 31, 1987.

House bill

Freeze on maximum credit

The House bill freezes the income tax credit for contributions to a tax credit ESOP at one-half of one percent with respect to compensation paid or accrued in 1985 through 1987.

The provision is effective on the date of enactment.

Senate amendment

Freeze on maximum credit

Under the bill, the income tax credit for contributions to a tax credit ESOP is limited to one-half of one percent for compensation paid or accrued in 1985. The limit for contributions in 1986 and 1987 remains at three-quarters of one percent.

Tax-free rollover on sale to employees

The Senate amendment provides for nonrecognition of gain, at the election of the seller, from the sale of "qualified securities" if (1) the securities are sold to an ESOP or to an eligible worker-owned cooperative, and (2) within a qualified period, the seller acquires securities of certain domestic corporations.

Deduction for dividends paid on ESOP stock

The Senate amendment permits a deduction for dividends paid on stock held by an ESOP (including a tax credit ESOP), provided the dividends are either paid out currently to employees or used to repay an ESOP loan. Dividends may either be paid directly to plan participants by the corporation or may be paid to the plan and distributed to participants no later than 60 days after the close of the plan year in which paid.

Alternatively, the dividends (or some portion thereof) will qualify for the deduction if applied by the plan to repay a loan incurred under the plan to acquire employer securities. Because such dividends are deductible by the employer corporation, they do not qualify for the partial exclusion from income otherwise permitted under Code sec. 117.

Partial exclusion of interest earned on ESOP loans

Under the Senate amendment, a bank, insurance company, or other commercial lender that is a corporation may exclude from income 50 percent of the interest received on loans to a leveraged ESOP, the proceeds of which are applied by the plan to acquire employer securities. For this purpose, the loan may be made directly to an ESOP or may be made to the sponsoring corporation which, in turn, lends the proceeds to an ESOP.

Reduced tax rate for sales of stock to certain corporations

In the case of a sale or exchange of securities acquired by a taxpayer as part of an original issue in a company with a specified degree of employee stock ownership by a taxpayer other than a corporation, the bill generally increases from 60 percent to 80 percent the amount of the gain (qualified corporate gain) on the sale that is allowed as a deduction from gross income. Similarly, a lower tax rate applies with respect to the qualified corporate gain on a sale of securities by a corporation.

Assumption of estate tax liability by ESOP

The Senate amendment permits an ESOP to assume the liability of a decedent's estate for estate taxes in return for a transfer from the estate to an ESOP of stock of an equal value, provided the sponsor company guarantees payment of the tax and agrees to pay such tax over a period of years.

The executor of the estate for which the ESOP agrees to assume estate tax liability must elect the application of the provision by the time prescribed for filing the estate tax return in the manner prescribed by Treasury regulations.

Estate tax exclusion for sales to employees

The Senate amendment permits an exclusion from the gross estate of 50 percent of the proceeds from the sale of employer securities to an ESOP or a worker-owned cooperative. The proceeds from such sale are disregarded for this purpose to the extent that such securities are allocated under the plan to the donor (or decedent), family members of the donor (or decedent), or shareholders owning more than 25 percent in value of any class of outstanding employer securities.

Charitable contributions to ESOPs

Under the Senate amendment, a taxpayer generally is allowed an income, gift, or estate tax deduction under the charitable contribution rules for contributions of employer securities to an ESOP. Under the Senate amendment, if the taxpayer is permitted a charitable contribution deduction with respect to the contribution of stock to an ESOP, no deduction is permitted for the contribution under the usual rules for deductions for employer contributions to a qualified pension plan, and no portion of the amount contributed is eligible for any credit against income taxes.

Effective dates

The provisions generally are effective for years beginning after December 31, 1984. The provisions relating to the assumption of estate tax liability and partial exclusion from estate tax apply with respect to those estates of decedents that are required to file returns after the date of enactment.

Conference agreement

Freeze on maximum credit

The conference agreement follows the House bill with a technical amendment.

Tax-free rollover on sale to employees

The conference agreement generally follows the Senate amendment. Nonrecognition will be available only if, after the sale, the ESOP or cooperative holds at least 30 percent of the employer securities.

Deduction for dividends paid on ESOP stock

The conference agreement generally follows the Senate amendment. The deduction for dividends paid with respect to stock held in an ESOP will be permitted only if the dividends are paid out currently to employees.

Partial exclusion of interest earned on ESOP loans

The conference agreement follows the Senate amendment.

Reduced tax rate for sales of stock to certain corporations

The conference agreement does not contain the Senate amendment.

Assumption of estate tax liability by ESOP

The conference agreement generally follows the Senate amendment. The Secretary has the authority to require the employer to post appropriate security, such as a bond, to insure payment of the estate taxes.

Estate tax exclusion for sales to employees

The conference agreement does not contain the Senate amendment.

Charitable contributions to ESOPs

The conference agreement does not contain the Senate amendment.

Effective dates

The conference agreement follows the Senate amendment.

E. Individual Retirement Account (IRA) Provisions

Present law

Under present law, an individual generally is entitled to deduct IRA contributions up to the lesser of $2,000 or 100 percent of compensation. The $2,000 deduction limit is increased to $2,250 for any year in which (1) at least $250 is contributed to an IRA for the spouse of the individual, and (2) the spouse has no compensation for the year. Under certain circumstances, alimony may be considered compensation for purposes of the IRA deduction limits.

Present law provides that, except for tax-free rollovers, no nondeductible contributions may be made to an IRA. An annual 6-percent excise tax applies to prohibited nondeductible contributions (i.e., excess contributions) held in an IRA.

Distributions from an IRA made before age 591/2 (other than those distributions attributable to disability or death) are subject to an additional 10-percent income tax.

House bill

Nondeductible IRA contributions

Under the House bill, nondeductible IRA contributions of up to $1,750 annually are not treated as excess contributions subject to the 6-percent excise tax. The first withdrawals from an IRA are treated as coming out of earnings on the nondeductible contributions, second as out of the nondeductible contributions, and then out of other amounts.

The provision is effective for contributions made in taxable years beginning after December 31, 1983.

Senate amendment

Spousal individual retirement arrangements

The Senate amendment increases the IRA deduction limit for a married couple to (1) $2,750, for taxable years beginning in 1985 and 1986, (2) $3,250, for taxable years beginning in 1987 and 1988, (3) $3,750, for taxable years beginning in 1989 and 1990, and (4) $4,000, for taxable years beginning in 1991 and thereafter. The 100 percent of compensation limit of present law continues to apply.

The provision is effective for taxable years beginning after December 31, 1984.

Alimony treated as compensation

The Senate amendment treats all alimony received by a divorced spouse as compensation for purposes of the IRA deduction limit.

The provision is effective for taxable years beginning after December 31, 1984.

IRA withdrawals by dislocated workers

Under the Senate amendment, a dislocated worker is permitted to withdraw amounts from an IRA prior to age 591/2 without incurring the additional 10-percent income tax. A dislocated worker must (1) have at least 20 quarters of social security coverage and (2) have exhausted all rights to compensation under State law.

The provision is effective on the date of enactment.

Conference agreement

Nondeductible IRA contributions

The conference agreement does not contain the House bill.

Spousal individual retirement arrangements

The conference agreement does not contain the Senate amendment.

Alimony treated as compensation

The conference agreement contains the Senate amendment.

IRA withdrawals by dislocated workers

The conference agreement does not contain the Senate amendment.

VI. TAX-EXEMPT OBLIGATIONS

A. Mortgage Subsidy Bonds

1. Extension of authority to issue qualified mortgage bonds

Present law

Under the Mortgage Subsidy Bond Tax Act of 1980 (as amended) State and local governments were allowed to issue limited amounts of tax-exempt bonds before January 1, 1984, to finance mortgages on owner-occupied residences. Generally, at least 90 percent of the lendable proceeds of such bonds were required to be used to finance mortgage loans to individuals who had not owned a present interest in their principal residence within the 3 preceding years. The purchase price of residences was required to be less than 110 percent (120 percent in certain targeted areas) of the average area purchase price. At least 20 percent of lendable proceeds generally were required to be made available for financing in targeted areas for at least one year.

The State volume ceiling for qualified mortgage bonds was the greater of (1) 9 percent of the average area mortgage originations for single family, owner-occupied residences in the State during the preceding 3 years, or (2) $200 million.

House bill

The House bill extends the tax exemption for qualified mortgage bonds for five years, (i.e., for bonds issued through December 31, 1988).

This provision is effective for bonds issued after December 31, 1983.

Senate amendment

The Senate amendment extends the tax exemption for qualified mortgage bonds for four years, (i.e., for bonds issued through December 31, 1987).

This provision is effective for bonds issued after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment with regard to extension of the qualified mortgage bond program and the House bill with regard to effective date. Thus, the tax exemption for qualified mortgage bonds is extended through December 31, 1987, effective for bonds issued after December 31, 1983.

2. Allocation of State volume ceiling

Present law

The State volume ceiling for qualified mortgage bonds is generally allocated by the State legislature. If the State legislature does not adopt an alternative method, 50 percent of the State volume ceiling is allocated among local issuers based upon the average mortgage volume in the area of the local issuer during the 3 preceding years and the remaining 50 percent is allocated to the State.

House bill

Under the House bill, if the State does not adopt an alternative method, 50 percent of the State ceiling is allocated among local issuers on the basis of the relative populations in the areas of the local issuers and the remaining 50 percent to the State.

This provision is effective for bonds issued after December 31, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the Senate amendment.

3. Interim authority to allocate State volume ceilings

Present law

The State legislature is generally required to approve an alternative allocation of the State volume ceiling for qualified mortgage bonds. As a transitional rule under the Mortgage Subsidy Bond Tax Act of 1980, the governor of any State was given authority to allocate that State's cap until the legislature met in its first regular session after 1980.

House bill

The House bill provides that, where a State had in effect a formula to allocate the State ceiling, which formula expired as of December 31, 1983, that allocation method shall remain in effect until the effective date of any State legislation which provides for a different allocation formula. If the expiring formula requires action by a State official to allocate the State ceiling, actions of such officials will continue to be effective during this period.

Senate amendment

The Senate amendment includes the provision of the House bill, but also provides that the Governor of Kentucky will have the power to allocate the State ceiling until December 31, 1986.

Conference agreement

The conference agreement follows the Senate amendment. Additionally, the conference agreement provides the Governors of Texas and Nevada with interim authority to allocate their respective State volume ceilings.

4. Reporting requirements

Present law

There is no special reporting requirement with respect to mortgage subsidy bonds. Under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), reporting requirements were imposed with respect to certain private purpose bonds.

House bill

The House bill requires issuers of mortgage subsidy bonds (including qualified mortgage bonds and qualified veterans' mortgage bonds) to submit, by the fifteenth day of the second calendar month after the close of the calendar quarter during which the bonds was issued, a statement containing specified information to the Treasury. This statement is to include the name and address of the issuer, the date of the issue, the amount of lendable proceeds, the rate, term, and face amount of each obligation which is part of the issue, and such other information as the Treasury may require (including information required in order to determine whether the issue qualifies for tax-exemption and the extent to which proceeds of the issue have been made available to lower-income individuals). The Treasury is permitted to grant extensions of time for providing any information where there is reasonable cause for delay.

This provision is effective for bonds issued after December 31, 1983.

Senate amendment

The Senate amendment extends the reporting requirements of the House bill to qualified mortgage bonds but not to qualified veterans' mortgage bonds. Under the Senate amendment, this provision is effective for bonds issued after the date of enactment.

The Senate amendment further requires elected officials of governmental units issuing qualified mortgage bonds to submit to the

Treasury Department an annual report which states the housing, development, and income distribution policies which the governmental unit is to follow in issuing mortgage subsidy bonds and mortgage credit certificates (discussed below). This report also is to include an assessment of (1) the compliance of the governmental unit during the preceding 1-year period with the equivalent statement of policy that was set forth in the next previous report (if any) of such unit, and (2) the performance of the issuer's program relative to the stated intent of Congress, discussed below, that bonds and credits be made available, to the greatest extent possible, to lower-income families. This provision is effective for bonds issued after December 31, 1984 (i.e., the first statement must be filed by December 31, 1984, for bonds issued in 1985).

Conference agreement

Reporting requirements

The conference agreement extends the information reporting requirements contained in the House bill and the Senate amendment to all mortgage subsidy bonds (including qualified mortgage bonds and qualified veterans' mortgage bonds). Information regarding the use of proceeds by lower-income individuals is not required to be supplied with the report for each issue, but may be consolidated with the annual policy statement to be completed by the issuer as described below.

This provision is to apply to bonds issued after December 31, 1984.

Policy statements

The conference agreement includes the requirement of an annual policy statement contained in the Senate amendment. This requirement applies only to qualified mortgage bonds.

The conferees intend that, in the case of multiple jurisdiction issuers, the requirement of an annual report will be satisfied if the issuer files a single report with the Treasury which is signed by (1) an elected official of each governmental unit on whose behalf bonds have been issued, or (2) the governor of the State in which the issuer is located.

This provision is effective for bonds issued after December 31, 1984.

5. Statement of program goals

Present law

Present law includes various rules designed to direct mortgage subsidy bond financing to individuals having the greatest need for the subsidy. There is no general statement of Congressional intent regarding the use of qualified mortgage bond proceeds.

House bill

No provision.

Senate amendment

The Senate amendment includes a statement of Congressional intent that issuers are expected to use qualified mortgage bonds and mortgage credit certificates, to the greatest extent possible, to make loans available to lower-income families who can use the loans to afford home ownership before making such loans available to higher-income families, taking into account prevailing conditions in the housing market and prevailing interest rates. Elected officials of issuing jurisdictions are required to submit an annual report to the Treasury Department which states the policy of the issuer in distributing proceeds of qualified mortgage bonds and mortgage credit certificates and evaluates the performance of the issuer's program relative to the Congressional intent. In addition, the Treasury Department, in consultation with the Department of Housing and Urban Development (HUD), is required to make an annual report to Congress on the performance of issuers relative to program goals.

Conference agreement

The conference agreement generally follows the Senate amendment. The Treasury Department is to prepare a report concerning the performance of issuers relative to Congressional policy goals at a reasonable time prior to the December 31, 1987 sunset date for qualified mortgage bonds.

This provision is effective for bonds issued after December 31, 1984.

6. Qualified veterans' mortgage bonds

Present law

Under present law, unlimited amounts of tax-exempt general obligation bonds may be issued to provide mortgages for the purpose of financing residences for veterans (qualified veterans' mortgage bonds). Unlike qualified mortgage bonds, the authority to issue these bonds did not expire on December 31, 1983.

House bill

The House bill provides that, beginning in 1985, the State ceiling for qualified mortgage bonds is to be reduced by the volume of qualified veterans' mortgage bonds issued by the State during the preceding year. In addition, the authority to issue qualified veterans' mortgage bonds is to sunset (together with the sunset for qualified mortgage bonds) on December 31, 1988.

This provision is generally effective for qualified veterans' mortgage bonds issued after December 31, 1983, except for bonds authorized by a State referendum before October 18, 1983, or pursuant to a State referendum before December 31, 1983, which referendum was authorized by action of the State legislature taken before October 18, 1983.

Senate amendment

No provision. However, the Senate amendment includes a sense of the Senate resolution (1) that qualified veterans' mortgage bonds not be considered in applying State volume ceilings for qualified mortgage bonds, and (2) that no sunset date be enacted for qualified veterans' mortgage bonds.

Conference agreement

The conference agreement does not include the volume limitations or sunset date for qualified veterans' mortgage bonds contained in the House bill. However, the conference agreement provides that (1) the authority to issue qualified veterans' mortgage bonds is limited to programs that issued such bonds before June 22, 1984; (2) loans made with the proceeds of qualified veterans' mortgage bonds issued after June 22, 1984, are to be limited to veterans who served in active duty for any period before 1977; and (3) applications for a loan made with the proceeds of qualified veterans' mortgage bonds must be made before the later of (a) the date which is 30 years from the date of discharge from military service, or (b) January 31, 1985. Additionally, under the conference agreement, qualified veterans' mortgage bonds are limited to principal residences as defined for purposes of qualified mortgage bonds.

The conference agreement further provides that State qualified veterans' mortgage bond programs may not issue bonds in excess of the average annual volume of bonds issued for the period 1979–1983.

7. Advance refunding of qualified veterans' mortgage bonds

Present law

Neither qualified mortgage subsidy bonds nor qualified veterans' mortgage bonds may be advance refunded.

House bill

No provision.

Senate amendment

The Senate amendment allows the State of Oregon, under specified conditions, to advance refund up to $300 million of qualified veterans' mortgage bonds.

This provision is effective on the date of enactment.

Conference agreement

The conference agreement follows the House bill. Additionally, the conference agreement allows the State of Oregon, under specified conditions, the option of borrowing from the Federal Financing Bank in amounts necessary to meet the debt service on the bonds.

8. Limited equity cooperatives

Present law

Tenant-shareholders of cooperative housing corporations are allowed a deduction for rents paid to the cooperative equal to their allocable share of interest and real estate taxes paid by the cooperative. Cooperative housing corporations are eligible to use tax-exempt financing under the rules applicable to owner-occupied housing (i.e., qualified mortgage bonds).

House bill

Under the House bill, limited equity cooperative housing corporations may make an irrevocable election to be eligible for tax-exempt financing under the rules applicable to multi-family rental housing, including the requirement that 20 percent of units (15 percent in certain targeted areas) must be occupied by individuals of low or moderate income. If such an election is made, the tenant-shareholders of the cooperative will not be entitled to a deduction for interest and taxes paid by the cooperative. Additionally, the volume of such bonds will count toward the State ceiling for qualified mortgage bonds, except to the extent that the financing has previously been counted toward the State's volume cap for private activity bonds.

Limited equity housing cooperatives eligible to make an election include cooperative housing corporations (as defined under sec. 216(b)(1)) in which (1) the cost of any stock in the cooperative does not exceed the amount paid for the stock by the original stockholder (as adjusted for cost-of-living increases), increased by certain payments and contributions attributable to the stockholder, and (2) the excess assets of the cooperative are used only for public or charitable purposes or directly to benefit the cooperative and are not to be used directly to benefit any stockholder.

This provision is effective for bonds issued after December 31, 1984.

Senate amendment

There is no provision regarding the treatment of housing cooperatives for purposes of qualified mortgage bonds; however, the Senate amendment specifies that mortgage credit certificates may be issued to residents of cooperatives who otherwise qualify under the credit program.

Conference agreement

The conference agreement follows the Senate amendment.

9. Termination of transitional rules under the Mortgage Subsidy Bond Tax Act of 1980

Present law

The Mortgage Subsidy Bond Tax Act of 1980 was enacted generally to direct the subsidy provided by tax-exempt housing bonds to those individuals having the greatest need for the subsidy, to increase the efficiency of the subsidy, and to reduce the overall revenue loss to the Federal Government from the use of tax-exempt bonds for housing. The 1980 Act provided a number of transition rules designed to permit issuers who were in the process of issuing mortgage subsidy bonds during Congress' consideration of that Act to issue those bonds without regard to the rules in the 1980 Act (including State volume ceilings). In addition, the Act provided a general grandfather rule under which the limitations did not apply to bonds issued before January 1, 1981, for which loan commitments were made, or construction begun, within 1 year from the issue date.

House bill

No provision.

Senate amendment

Under the Senate amendment, most bonds issued to finance new mortgages for owner-occupied, single-family housing after June 15, 1984, and before January 1, 1985, pursuant to the transitional rules of the 1980 Act, will not be tax-exempt unless the State allocates a portion of its 1984 State volume ceiling to that issue, under the general rules for allocation of State volume ceilings, prior to the date of issuance. In addition, most of the transitional rules of the 1980 Act are to terminate after December 31, 1984.

Conference agreement

The conference agreement follows the Senate amendment.

10. Treatment of Kansas City, Missouri and Kansas City, Kansas as a unified metropolitan statistical area

Present law

Metropolitan statistical areas are used for various purposes under Federal law, including the determination of purchase price limitations applicable to qualified mortgage bonds. Kansas City, Missouri and Kansas City, Kansas, together with surrounding countries, currently are treated as separate metropolitan statistical areas.

House bill

No provision.

Senate amendment

The Senate amendment provides that Kansas City, Missouri and Kansas City, Kansas (and surrounding counties) are to be treated as one metropolitan statistical area for tax and all other purposes of Federal law.

This provision is effective on the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

B. Mortgage Credit Certificates

1. Authority to issue mortgage credit certificates (MCCs)

Present law

Before January 1, 1984, State and local governments were allowed to issue limited amounts of tax-exempt bonds to finance mortgages on owner-occupied residences (qualified mortgage bonds). There was no provision for exchanging qualified mortgage bond authority for authority to issue mortgage credits.

House bill

The House bill allows States to trade in all or part of their authority to issue qualified mortgage bonds (as extended under the bill) for authority to issue mortgage credit certificates (MCCs). Home purchasers receiving MCCs are entitled to a non-refundable income tax credit equal to a specified percentage of the interest that the home purchaser pays during the taxable year on the mortgage on his principal residence. This percentage may not exceed 50 percent, but may not be less than 10 percent, of the interest on the qualifying indebtedness. The amount of the homebuyer's interest deduction in any year is reduced by the amount of the MCC for that year. Excess unused credits may be carried forward by the recipient to later taxable years.

Senate amendment

The Senate amendment generally is the same as the House bill. However, under the Senate amendment, excess credits may not be carried forward by the recipient to later taxable years.

Conference agreement

The conference agreement adopts the House provision with a modification limiting the time during which credits may be carried forward to three years.

2. Volume of MCC Authority

Present law

No provision.

House bill

Under the House bill, the amount of MCCs that a State may issue for any year (determined by aggregating the amount of the products resulting from multiplying the principal amount of each certificate by the applicable percentage rate) is equal to 15 percent of the amount of qualified mortgage bond authority that the State trades in for that year. The maximum amount of qualified mortgage bond authority that a State may trade in for MCCs may not exceed 9 percent of the average annual amount of mortgages originated in the State during the preceding 3 years. Where a State issued less than its statutory ceiling of qualified mortgage bonds in 1983, a phase-in rule limits the amount of qualified mortgage bond authority that the State may trade in during the first 5 years (i.e., through 1988) for authority to issue MCCs.

Under the House bill, an MCC does not apply to any debt incurred after the close of the calendar year following the calendar year for which the issuing authority elects to trade in qualified mortgage bond authority. Thus, under the House bill, authority to issue MCCs may be held over for a maximum of one year before the credits are issued.

Senate amendment

Under the Senate amendment, a State may issue MCCs in an amount equal to 20 percent of the amount of qualified mortgage bond authority that the State trades in for that year. The amount of bond authority which the State may trade in for MCCs is not limited to 9 percent of average mortgage originators.

The Senate amendment applies a phase-in rule, similar to that under the House bill, for States which issued less than their statutory ceiling of qualified mortgage bonds in 1983. However, under the Senate amendment, the phase-in rule applies for a 4-year period (i.e., through 1987), and is applied at the State level, rather than at the level of each individual issuer. Additionally, the Senate amendment requires an affirmative election by issuers within the State to forego authority in excess of the phase-in level.

Under the Senate amendment, once a State has exchanged qualified mortgage bond authority for authority to issue MCCs, the State may issue the MCCs in any calendar year. Thus, the authority to issue MCCs may be held over on an indefinite basis.

Conference agreement

The conference agreement provides that a State may issue MCCs in an amount equal to 20 percent of the amount of the qualified mortgage bond authority that the State trades in for that year. However, if (1) the State volume ceiling exceeds 20 percent of the average annual amount of mortgages originated in the State during the preceding three years, or (2) the State issued less than $150 million of qualified mortgage bonds in 1983, then the average size of credits issued in the State may not exceed 20 percent. There is no special phase-in rule for States which issued less than their statutory maximum of qualified mortgage bonds in 1980.

Under the conference agreement, an MCC will not apply to any debt incurred after the close of the second calendar year following the calendar year for which the issuer elects to trade in qualified mortgage bond authority for authority to issue the MCC. Thus, authority to issue MCCs may be held over for a maximum of two years before the credits are issued.

3. Eligibility to receive MCCs

Present law

No provision.

House bill

Under the House bill, eligibility for MCCs is generally limited to the same individuals who are eligible for qualified mortgage bonds. Thus, the recipient of an MCC must generally be a first-time homebuyer, the purchase price of the residence generally may not exceed 110 percent (120 percent, in certain targeted areas) of the average area purchase price, the residence must be the principal residence of the individual, and the mortgage must be a new mortgage except in the case of certain rehabilitation and improvement loans and certain mortgage assumptions. In addition, at least 20 percent of MCCs under each program must be made available for financing in targeted areas for at least one year.

Senate amendment

The Senate amendment is similar to the House bill, except that the purchase price of residences eligible for MCCs is limited to 90 percent of the average area purchase price (including residences in targeted areas). Additionally, the Senate amendment includes an annual income limitation under which the amount of the credit is limited to 25 cents for each dollar by which the greater of (a) area median income for a family of four, or (b) $20,000, exceeds the taxpayer's income for the year in question. Adjustments to this formula are provided based on family size and in the case of adjustable rate mortgages. Finally, under the Senate amendment, there is no requirement that a specific portion of MCCs be made available in targeted areas.

The Senate amendment specifically provides that MCCs are available (1) to shareholders in housing cooperatives who otherwise meet the MCC eligibility requirements, and (2) under Treasury regulations, to finance manufactured homes which qualify as real property for depreciation purposes of (sec. 168(g)(7)).

Conference agreement

The conference agreement follows the House bill with respect to the purchase price limitations and the other general eligibility requirements for MCCS. The conference agreement further specifies that no assumptions of MCCs are to be allowed.

There is no income limitation for recipients of MCCs under the conference agreement. However, the maximum credit which a taxpayer may receive in any year is limited to the greater of (1) 20 percent of the qualifying indebtedness on the taxpayer's principal residence, or (2) $2,000. The conferees intend that this limitation will encourage States to issue higher percentage credits to individuals who purchase lower-priced residences and who can therefore benefit from a higher percentage credit despite the $2,000 limitation.

Under the conference agreement, MCCs will be available for manufactured homes that have a minimum of 102 inches in width and have a minimum of 400 square feet of living space. The conferees further intend MCCs will not be available for recreational vehicles, campers, and other similar vehicles. Manufactured homes will not be taken into account in computing the average area purchase price or statewide volume limitation formula applicable to MCCs. MCCs are additionally to be available to shareholders in housing cooperatives who are otherwise eligible to receive MCCs.

The conferees intend that, as in the case of qualified mortgage bonds, a State or locality may establish more stringent criteria for participation in an MCC program, subject to the rules against limiting MCCs to loans provided by a particular lender or to residences in a particular development (discussed below). The conferees intend that any such additional criteria will be consistent with the goal of making credits available to those individuals most in need of a subsidy.

4. Restrictions on MCC Distribution

Present law

No provision.

House bill

Under the House bill, MCCs must be issued under a plan that does not limit the credits to mortgages provided by specified lenders. MCCs may be limited to residences in a particular development if the developer certifies that the price is not increased because of the presence of the MCCs. No MCC is allowed for loans between related parties or for interest on mortgages financed with tax-exempt bonds.

Senate amendment

The Senate amendment generally is the same as the House bill, except that (1) the prohibition against limiting MCCs to specified lenders may be waived by Treasury regulations, and (2) there is no provision allowing MCCs to be limited to residences in a particular development.

Conference agreement

The conference agreement follows the Senate amendment with respect to specific lenders and the House bill with respect to particular developments.

5. Administration of MCC program

Present law

No provision.

House bill

The House bill contemplates administration of the MCC program by the State and local governments, under Treasury regulations, with certain Federal reporting requirements. The States are to be responsible for ensuring that the total amount of MCCs and qualified mortgage bonds does not exceed the applicable State ceiling. Where a State does issue excess MCCs, the State's mortgage bond ceiling for the succeeding year is to be reduced by two times the excess issuance. Individuals granted MCCs but who are not properly eligible are not entitled to the credits.

Under the House bill, lending institutions are required to certify, under penalty of perjury, that recipients meet the applicable purchase price and first-time homebuyer requirements. Lenders are further required to file regular informational reports with the IRS, with a $200 penalty for failure to file information with respect to any homebuyer.

Senate amendment

The Senate amendment contemplates central administration of the MCC program, under regulations, by the Treasury Department or its delegate, which is to maintain current accounts regarding the total amount of MCCs and qualified mortgage bonds that each State has issued. State or local issuers (alternatively, central State authorities) are to inform Treasury of each decision to exchange bond authority for authority to issue credits. Excess credits would be invalid and excess bonds would forfeit tax exemption. The Treasury is authorized to enter into contracts with a private firm or a quasi-public agency to administer the MCC program on the Treasury's behalf.

Under the Senate bill, eligibility of a particular individual for an MCC is to be based upon verified statements provided by the homebuyer (for the principal residence and first-time homebuyer requirements) and the lender (with regard to purchase price limitations). Credits issued based on erroneous certifications would remain valid, but monetary penalties would be imposed for negligent ($1,000) and fraudulent ($10,000) misstatements in connection with an MCC. The Senate amendment also permits certain fees to be charged by the central administration facility (not exceeding $200 per MCC) and the State or local issuer (not exceeding $100) to cover program costs.

Under the Senate amendment, borrowers would secure a letter of MCC entitlement from the issuer and would then be allowed to "shop" for an appropriate lending institution. The lender would verify with Treasury or its delegate that the letter was valid (including verification that the State volume ceiling had not been exceeded) and would inform Treasury of the actual amount of the loan for which the credit was being issued (to allow accurate recordkeeping).

Conference agreement

The conference agreement adopts the House bill with modifications.

To the extent permitted by regulations, the conference agreement permits issuers to charge MCC recipients a fee to cover the cost of administering the program. This provision is similar to a statement in the Senate Finance Committee Report that would permit fees to be charged to cover administrative costs.

The conference agreement requires by statute that issuers of MCCs file reports concerning the volume of MCCs issued under each election that the issuer makes to issue MCCs. The time and manner of filing the report and the information to be contained in the report is to be specified in regulations. The conferees intend that issuers will be subject to penalties for failure to file the requisite reports and for the filing of false or fraudulent reports. This requirement codifies a statement in the House report that anticipated regulations would require such a report and clarifies that penalties are to be imposed for failure to file and for the filing of false or fraudulent reports.

The conference agreement provides that Treasury shall issue regulations requiring MCC recipients to file with the lender statements, under penalties of perjury with respect to whether the MCC recipient meets the eligibility requirements for an MCC. If statements are filed, as required by the regulations, the conferees intend that the MCC will not be revoked for failure to meet the eligibility requirements unless the MCC recipient provided fraudulent statements to the lender. If an MCC recipient provides fraudulent information to the lender, it is intended that the MCC recipient's tax return will be treated as a fraudulent return and the MCC will be revoked. The government will have the burden of proving that the statements submitted to the lender were fraudulent. The conference agreement is a modification of the provision in the Senate amendment that would treat an MCC as valid under all circumstances if specified verified statements and information were filed with the lender.

Under the conference agreement, before issuing qualified mortgage bonds or MCCs, issuers are required to obtain a certification from a State official that the bond issue or MCC election does not exceed the issuer's allocation of the State's volume limitation. The fact that an issuer obtains a certification from the State does not preclude the application of penalties for overissuance if overissuance in fact occurs. This provision modifies and adds to the statute a requirement contained in the Ways and Means Committee Report.

The penalty for issuance of MCCs in excess of the volume limitations and issuance of MCCs that do not meet certain statutory requirements (i.e., prohibition against the use of MCCs with tax-exempt financing and the linkage of MCCs with indebtedness of a particular lender, and requirements where a block of MCCs is used in connection with a particular development) is reduced from twice the amount of the "correction amount" to the correction amount multiplied by 1.25.

In lieu of the system contemplated by the House bill, Treasury is authorized, under the conference agreement, to adopt a centralized system of administration similar to the system contemplated by the Senate amendment.

6. Effective date of MCC program

Present law

No provision.

House bill

Under the House bill, the authority to issue MCCs is effective for interest paid or accrued after December 31, 1983, on mortgages executed after that date, with respect to elections to trade in qualified mortgage bond authority for years after 1983.

Senate amendment

Under the Senate amendment, the MCC program is effective for credits issued after December 31, 1984, using exchanged qualified mortgage bond authority for years after 1983.

7. Termination of MCC program

Present law

No provision.

House bill

Under the House bill, the authority to trade in qualified mortgage bond authority for authority to issue MCCs expires on December 31, 1988.

Senate amendment

The Senate amendment does not contain a specific sunset provision for MCCs. However, under the Senate amendment, the authority to issue qualified mortgage bonds terminates on December 31,

1987. Thus, the ability of States to exchange qualified mortgage bond authority for MCCs would expire on that date.

Conference agreement

The conference agreement provides that the MCC program will terminate on December 31, 1987, together with the qualified mortgage bond program.

C. Private Activity Bonds

1. Volume limitation for certain IDBs and student loan bonds

Present law

Interest on State and local government obligations is exempt from Federal income tax. However, industrial development bonds (IDBs) are taxable except when issued for certain specified purposes. Industrial development bonds are obligations issued as part of an issue all or a major portion of which are to be used in any trade or business carried on by a nonexempt person and the payment of principal or interest on which is derived from, or secured by, money or property used in a trade or business.

Interest on IDBs is tax-exempt if the bonds are issued to finance the following activities ("exempt purpose" IDBs): (1) projects for low-income residential rental property; (2) sports facilities, (3) convention or trade show facilities, (4) airports, docks, wharves, mass commuting facilities, and parking facilities, (5) sewage and solid waste disposal facilities, and facilities for the local furnishing of electric energy or gas, (6) air or water pollution control facilities, (7) certain facilities for the furnishing of water, (8) qualified hydroelectric generating facilities, (9) qualified mass commuting vehicles, and (10) local district heating and cooling facilities. In addition, the interest on certain IDBs issued for the purpose of acquiring or developing land as a site for an industrial park is exempt from taxation.

Present law also permits tax-exemption for interest on certain "small issue" IDBs if the proceeds are used for the acquisition of land or depreciable property. A small issue cannot exceed $1 million ($10 million if certain capital expenditures are counted). The small issue exception is scheduled to expire on December 31, 1986.

Present law also allows tax-exempt financing for student loans and organizations that qualify for tax-exemption under section 501(c)(3)), (The small issue exception is schedule to expire on December 31, 1986. (such as private, nonprofit hospitals and private, nonprofit educational institutions).

There is no per capita limitations under present law on the face amount of private activity bonds that a State or local government may issue.

House bill

The House bill limits the maximum face amount of private activity bonds that a State and local governments within the state may issue annually to $150 per capita (reduced to $100 per capita after 1986 to reflect the scheduled expiration of the small-issue exception). Private activity bonds include (subject to the exceptions described below) and student loan bonds (defined as any bond whose proceeds are used, directly or indirectly, to finance loans to individuals for educational purposes).

Unless a State otherwise allocates its volume ceiling, 50 percent of the State ceiling is allocated to State and 50 percent to local jurisdictions within the State on the basis of population.

Under the House bill, states may elect to carry over for up to 3 years a portion of their annual ceiling for a specified project (6 years for pollution control projects).

The House bill provides a one-year phased reduction to $150 per capita for States whose 1983 volume exceeded that amount not treated as private.

Exceptions.—The following bonds are not subject to the volume limitations under the House bill:

(1) IDBs to finance multifamily residential rental property and bonds exempt under section 11(b) of the U.S. Housing Act of 1937.

(2) IDBs to finance convention or trade show facilities or airports, docks, wharves, or mass commuting facilities (including mass commuting vehicles), if the financed facility being financed is owned for tax purposes by a governmental unit.

(3) Refunding bonds (other than advance refundings) if amount of such bonds does not exceed the amount of the refunded obligations and, in the case of student loan bonds, the maturity date of the refunding bonds does not exceed the later of the maturity date of refunded bonds or 15 years after issuance of refunded bonds.

Effective date.—The volume limitation under the House bill applies generally to bonds issued after December 31, 1983. A transitional rule provides priority of allocation for certain bonds with respect to which an inducement resolution was given before October 1983, but only if the beneficiaries of those bonds notify the issuing authority within 30 days of enactment.

Senate amendment

The Senate amendment does not impose a per capita volume limitations on private activity bonds.

Conference agreement

The conference agreement limits the maximum face amount of private activity bonds which a state or local issues within the state may issue annually to the greater of (1) $150 per capita, or (2) $200 million. Private activity bonds include IDBs and student loan bonds subject to the exceptions below.[1]

The $150 per capita amount will be reduced to $100 in 1986 to reflect the scheduled expiration of the small issue exception. For purposes of the volume limitation, the District of Columbia is to be treated as a state (and therefore entitled to a $200 million volume limitation). However, U.S. territories with authority to issue tax-exempt bonds will be limited to the $150 per capita rule.

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[1] The State of Texas has a program called the Texas Veterans' Bond Program under which general obligation bonds are issued for the purchase of land. Loans under this program are limited to $20,000 per veteran. Where the proceeds of such a bond issue, other than an amount which is not a major portion of the proceeds, are used, for example, for the acquisition of land for recreational or investment purposes, the issue would not be subject to this limitation. The use of the proceeds by the veteran may be established by an affidavit of the veteran.

Under the conference agreement, unless a state otherwise allocates, 50 percent of the state's volume ceiling is allocated to state and 50 percent to local jurisdictions on the basis of population. State statutes and the actions of state governors to implement allocation of the volume limitation are to be effective whether occurring before or after enactment. The governor or other official designated in a state statute may retroactively allocate bond authority for bonds issued in 1984 (i.e., allocate to projects for which bonds have already been issued). However, bonds issued during 1984 but before the date of enactment or, if earlier, the date of public action to allocate the state balance ceiling, action in (3) above may not be denied allocation to the extent (of the authority which the issuer would receive based upon population) (i.e., if no alternative allocation method has been adopted).

As under the House bill, states may elect to carry over portions of their annual ceiling for up to 3 years for specified projects (6 years for pollution control projects.

States which issued private activity bonds equal to more than $150 per capita in 1983 (based on annualized volume for the first 9 months of the year) are allowed a two years phased down to the volume ceiling.

Exceptions.—The conference agreement includes the exceptions to the private activity bond volume ceiling for certain housing bonds (including IDBs for multi-family residential property and section 11(b) bonds) and refunding bonds contained in the House bill. The conference agreement also includes the exception for IDBs used to finance publicly owned airports, docks, wharves, mass facilities, and convention or trade show facilities, with the following additional provisions.

(a) Parking facilities subsidiary to qualified public facilities are exempt from volume ceiling, but only if the parking facilities satisfy the same requirements for exemption as the facility to which they are subsidiary and that facility is also exempt from the ceiling;

(b) Qualified public owned facilities owned by a governmental unit are exempt from the volume limitation only if all rents charged to tenants are not front-loaded to achieve an effect more accelerated than a straight-line rent over the life of the property.

(c) qualified public facilities owned by corporations issuing bonds on behalf of governmental units (Rev. Proc. 63-20) are exempt from the volume ceiling if the facilities satisfy the requirements applicable to governmentally owned facilities.

Effective date.—The volume ceiling for private activity bonds is effective for bonds issued after December 31, 1983, with the following transitional rules:

Projects for which an inducement resolution was adopted before June 19, 1984, are exempt from any volume ceiling if the bonds are issued on or before December 31, 1984.

Projects for which an inducement resolution was adopted before October 19, 1983) *and* for which either (1) the construction of the facilities had commenced before October 19, 1983, and the user is the original user of the facilities, or (2) a binding contract existed before October 19, 1983, and at all times thereafter which committed the purchaser to incur significant expenditures for construction or acquisition of the facilities, will receive priority of allocation for 1985 and later years (in addition to being exempt from the 1984 ceiling). For purposes of this rule, significant expenditures will generally mean expenditures equal to 20 percent of the estimated cost of the facilities.

2. Restrictions on cost recovery deductions

Present law

Property financed with tax-exempt bonds generally is restricted to straight-line cost recovery deductions over the applicable ACRS periods.

Full ACRS deductions are allowed for low-income rental housing, municipal sewage or solid waste facilities, air or water pollution control facilities, and certain facilities with respect to which a UDAG grant is made.

House bill

The House bill requires straight-line cost recovery deductions for property, other than multifamily residential rental property, that presently is eligible for full ACRS deductions.

This provision of the House bill applies to property placed in service after December 31, 1983, to the extent financed with tax-exempt bonds issued after October 18, 1983. Transitional rule exempts facilities with respect to which (1) a binding contract to incur significant expenditures was entered into before October 19, 1983, or (2) construction began before October 19, 1983 (and original use of facility begins with taxpayer).

Senate amendment

The Senate amendment makes no change in the cost recovery rules for property presently eligible for full ACRS deductions. However, the Senate amendment extends the cost recovery period for property restricted under present law to straight-line deductions over the ACRS periods as follows:

3-year property	4 years
5-year property	7 years
10-year property	13 years
15-year public utility property	20 years
18-year residential real property	18 years
18-year nonresidential real property	22 years

This provision applies to property placed in service after June 30, 1984, to the extent financed with tax-exempt bonds issued after March 15, 1984. A transitional rule exempts facilities with respect to which (1) a binding contract to incur significant expenditures was entered into before March 15, 1984, or (2) construction began before March 15, 1984 (and original use of facility begins with taxpayer).

Conference agreement

The conference agreement follows the House bill.

3. Denial of tax-exemption to Federally guaranteed bonds

Present law

Present law imposes no general statutory restrictions on Federal guarantees of tax-exempt bonds. However, the Internal Revenue Code denies tax exemption for interest on obligations where (1) payment of principal or interest is guaranteed (in whole orin part) by the United States under a program with the principal purpose of encouraging production or conservation of energy, or (2) payment of principal or interest is to be made (in whole or in part) with funds provided under such a program of the United States, a State, or a political subdivision of a State.

House bill

The House bill denies tax-exemption to interest on bonds that are Federally guaranteed. Bonds are considered to be Federally guaranteed where the payment of principal or interest is guaranteed directly or indirectly by the United States or any agency or instrumentality thereof; where a significant portion of the bond proceeds is to be used to make Federally guaranteed loans; or where a significant portion of the bond proceeds is to be invested in Federally insured deposits (FDIC, FSLIC, NCUA, etc.) For purposes of these restrictions, an entity with statutory authority to borrow from the United States is treated as an instrumentality of the United States. Exceptions to this rule are provided for the District of Columbia and for bonds other than private activity bonds issued by U.S. possessions.

Exceptions.—The House bill provides the following exceptions to the restrictions on Federally guaranteed tax-exempt bonds:

(1) Federal Housing Authority (FHA), Veterans Administration (VA), Fannie Mae, Freddie Mac, and Ginnie Mae guarantees;

(2) Small Business Administration (SBA) guarantees under the SBA pollution control program, only if the SBA charges a fee for making the guarantee of at least 1 percent of the amount guaranteed;

(3) Bond proceeds invested for an initial temporary period or in bona fide debt service funds, qualified reserve funds, SLGs, or other investments permitted by Treasury regulations;

(4) Bond proceeds loaned to Federally insured financial institutions under a loans-to-lenders program; and

(5) IDBs for low-income residential rental property, mortgage subsidy bonds, and bonds issued under section 11(b) of the Housing Act of 1937 (except for proceeds invested in Federally insured deposits or accounts).

Effective date.—These provisions of the House bill apply generally to bonds issued after December 31, 1983. The restrictions with respect to bonds, the proceeds of which are invested in Federally insured deposits apply to bonds issued after April 14, 1983.

Senate amendment

The Senate amendment includes no general rules prohibiting Federal guarantees, but contains a provision identical to the House bill with respect to bonds the proceeds of which are invested in federally insured deposits (FDIC, FSLIC, NCUA, etc. Bond proceeds invested for an initial temporary period, in a bona fide debt service fund, or in a qualified reserve fund, are exempted from this rule.

The Senate amendment also denies tax exemption for bonds where a significant portion of proceeds is to be used for a facility also benefitting from (including indirect guarantees) under the SBA. This rule does not apply if the SBA charges a "reasonable" (as determined by the Secretary of the Treasury).

The Senate restrictions on investment of tax-exempt bond proceeds in Federally insured deposits in financial institutions apply to bonds issued after April 15, 1983, except to bonds issued pursuant to a contract binding at all times after March 3, 1983. The SBA guarantee rules apply to bonds issued after the date of enactment.

The House bill denies tax-exemption to interest on bonds that are Federally guaranteed. Bonds are considered to be Federally guaranteed where—

(1) Payment of principal or interest is guaranteed directly or indirectly by U.S. or any agency or instrumentality thereof;

(2) A significant portion of bond proceeds is to be used to make Federally guaranteed loans; or

(3) A significant portion of bond proceeds is to be invested in Federally insured deposits (FDIC, FSLIC, NCUA, etc.).

For purposes of these restrictions, an entity with statutory authority to borrow from U.S. is treated as instrumentality; exceptions are provided for D.C. and possessions bonds other than private activity bonds.

The House bill provides the following exceptions to the restrictions on Federally guaranteed tax-exempt bonds:

(1) FHA, VA, FNMA, FHLMC, GNMA guarantees;

(2) SBA guarantees under the SBA pollution control program, but only if the SBA charges a fee for making the guarantee. Fee must be at least 1 percent of the amount guaranteed;

(3) Bond proceeds invested for an initial temporary period, in bona fide debt service fund, in qualified reserve funds, in SLGs, or other investments permitted by Treasury regulations; and

(4) Bond proceeds loaned to Federally insured financial institutions under a loans-to-lenders program; and

(5) Bonds issued under section 11(b) of Housing Act of 1937 and mortgage subsidy bonds (except for proceeds invested in Federally insured deposits or accounts).

These provisions of the House bill apply generally to bonds issued after December 31, 1983. The restrictions with respect to bonds, the proceeds of which are invested in Federally insured deposits apply to bonds issued after April 14, 1983.

Senate amendment

The Senate amendment includes no general rules prohibiting Federal guarantees, but contains provision the same as the House bill with respect to bonds the proceeds of which are invested in Federally insured deposits (FDIC, FSLIC, NCUA, etc.).

The Senate amendment also restricts tax-exemption for bonds where a significant portion of proceeds is to be used for facility also benefitting from SBA guarantee (or subordination) under SBA—

(1) pollution control loan guarantee program, or
(2) certified development loan program.

Exceptions.—The Senate amendment provides exceptions for
(1) SBA guarantees under—
(i) SBA's pollution control program, or
(ii) SBA's certified development loan program,

but only if the SBA charges a fee for making the guarantee. Fee must equal at least 1 percent of the amount guaranteed, and fee must be "reasonable," as determined by the Secretary of the Treasury; and

(2) Bond proceeds invested for an initial temporary period, in a bona fide debt service fund, or in a qualified reserve fund.

The restrictions on investment of tax-exempt bond proceeds in Federally insured deposits in financial institutions apply to bonds issued after April 15, 1983, except to bonds issued pursuant to a contract binding at all times after March 3, 1983.

The SBA guarantee rules apply to bonds issued after the date of enactment.

Conference agreement

The conference agreement generally follows the House bill except for certain transitional rules with respect bonds benefitting from certain Federal insurance programs contained in the Senate amendment.

4. Arbitrage restrictions

Present law

Present law includes rules which limit the amount of arbitrage (i.e., the difference between the interest rate paid on tax-exempt bonds and the rate of income earned on investments made with the bond proceeds). Under these rules, the maximum income permitted to be earned generally cannot exceed the interest rate paid on the bonds by more than ⅛ of 1 percentage point. Unlimited amounts of income can be earned on all bond proceeds for a temporary period and on reasonably required reserves.

Where the issuer elects not to have unlimited income during a temporary period, the maximum permitted earnings are increased to ½ of 1 percentage point over the interest rate paid on the bonds.

In addition, in the case of program related investments (such as student loans), the maximum permitted earnings are increased to 1½ percentage points over the interest rate paid on the bonds.

Finally, in the case of student loan bonds, the student assistance payment (SAP) is excluded from the arbitrage computation, so that permitted arbitrage is 1½ percentage points plus the SAP.

Under these rules, certain costs also are excluded from the arbitrage limitation, so that these costs can be earned in addition to the permitted spreads.

Present rules permit issuers to retain any arbitrage earned under these rules.

Present law also provides additional arbitrage rules in the case of qualified mortgage bonds. Under these rules, the maximum permitted difference between the earnings rate on mortgages and interest rate paid on the bonds is 1⅛ percentage points. No costs, including costs related to the bond issue, are excluded from this arbitrage limitation so all costs must be covered within the 1⅛ percentage points. Subject to certain temporary period exceptions, all bond proceeds other than proceeds invested in debt service reserves not in excess of 150% of the debt service on the bonds, must be invested in mortgages. In addition, any arbitrage earned on nonmortgage investments must be either paid to the mortgagors (i.e., homebuyers) or to the Federal Government.

House bill

The House bill provides that, pursuant to Treasury regulations, arbitrage rules similar to the arbitrage rules applicable to mortgage subsidy bonds are to apply to industrial development bonds and student loan bonds. These new rules are in addition to the existing arbitrage rules of Code section 103. Also, as under the present arbitrage rules, special assistance payments are not considered for purposes of the new arbitrage rules.

Exceptions from the new arbitrage rules are provided for—

(1) Bonds for financing of multifamily residential rental property (including bonds issued under section 11(b) of the U.S. Housing Act),

(2) Bonds to refund student loan bonds issued before January 1, 1986.

Except for student loan bonds, these provisions of the House bill are effective with respect to bonds issued after December 31, 1983. In the case of student loan bonds, the provisions are effective with respect to bonds issued after December 31, 1985.

Senate amendment

Like the House bill, the Senate amendment provides new arbitrage rules (in addition to those provided under present law) for IDBs and student loan bonds. The rules in the Senate amendment are similar to the rules of the House bill.

Industrial development bonds

The Senate amendment provides the following new arbitrage rules for IDBs:

(1) After the initial temporary period, and except for temporary periods related to debt service, all bond proceeds must be applied to the governmental purpose of the issue (except for an amount which may not exceed 150% of the annual debt service on the bonds and which may be otherwise invested; and

(2) Arbitrage earned on investments that are not acquired in order to carry out a governmental purpose (i.e., all nonpurpose obligations) must be paid to the Federal Government. At least every 5 years, 90 percent of the arbitrage earned to that date must be paid with any remaining balance paid 30 days after the bonds are retired. Exceptions are provided if arbitrage is less than $100,000 or if the loan proceeds are expended for governmental purposes within 6 months from the date of issue.

Student loan bonds

The Senate amendment directs the Treasury Department to prescribe new arbitrage regulations for student loan bonds. These new regulations may provide that (1) the exceptions for temporary period and reasonably required reserve funds and the special treatment of student assistance payments will not apply, and (2) the new arbitrage rules prescribed for IDBs apply to student loan bonds.

Exceptions are provided for—

(1) Bonds for financing of multifamily residential rental property;

(2) Bonds for financing of municipal sewage and solid waste facilities.

These provisions of the Senate amendment apply generally to bonds issued after December 31, 1984.

The new arbitrage regulations for student loan bonds would be effective with respect to bonds issued after the later of—

(1) the date that the Higher Education Act of 1965 expires or is extended, or

(2) six months after the date of publication of the regulations.

Conference agreement

The conference agreement follows the Senate amendment with respect to IDBs and Guaranteed Student Loan (GSL) bonds, and the House bill with respect to non-GSL student loan bonds.

In addition, the conference agreement clarifies that a certain State permanent university fund does not violate the arbitrage restrictions or present law as that fund is presently operated.

5. Limitations on acquisition of land and existing facilities

Present law

Acquisition of land and existing facilities may be financed with tax-exempt bonds to the extent the land or facilities are (1) used for an exempt purpose; or (2) the requirements of the small-issue exception are satisfied.

House bill

The House bill restricts the use of all IDBs (exempt purpose and small issue) to finance the acquisition of land or existing facilities, as follows:

(1) *Nonagricultural land.*—Tax-exemption is denied for bonds if 25 percent or more of proceeds of issue are used for nonagricultural land.

(2) *Agricultural land.*—Tax-exempt financing for agricultural land (and facilities located on such land) is restricted to a maximum of $250,000 and is further restricted to first-time farmers.

(3) *Existing facilities.*—Tax-exempt financing for existing facilities is permitted only if amount equal to at least 15 percent of cost of building (and equipment therefor) is spent for rehabilitation of building (and equipment).

These provisions apply generally to bonds issued after December 31, 1983. A transitional rule exempts property where (1) binding contract to incur significant expenditures was entered into before October 19, 1983, or (2) construction began before October 19, 1983 (and original use of facility begins with taxpayer).

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with various modifications and exceptions and appropriate transition rules, including a provision that the determination of whether a substantial rehabilitation occurs is made on a project, rather than a building, basis.

6. Elimination of IDB-financing for certain facilities

Present law

Present law does not include a list of facilities for which tax-exempt financing generally is prohibited. However, interest on small-issue IDBs is not exempt if—

(1) more than 25 percent of the proceeds of the issue are used to provide a facility the primary purpose of which is automobile sales or service or the provision of recreation or entertainment; or

(2) any portion of the proceeds of the issue is to be used to provide the following: any private or commercial golf course, country club, massage parlor, tennis club, skating facility (including roller skating), racquet sports facility (including handball and racquetball courts), hot tub facility; suntan facility, or racetrack.

House bill

The House bill eliminates tax-exemption for interest on all types of IDBs (exempt purpose, industrial park, and small issue), if any portion of the proceeds of an issue are used for—

(1) any airplane,

(2) a skybox, or other private luxury box,

(3) any facility primarily used for gambling, or

(4) any store the principal business of which is sale of alcoholic beverages for consumption off-premises.

This provision of the House bill applies generally to bonds issued after December 31, 1983. A transitional rule exempts property where (1) binding contract to incur significant expenditures was entered into before October 19, 1983, or (2) construction began before October 19, 1983 (and original use of facility begins with taxpayer).

Senate amendment

The Senate amendment generally is the same as the House bill, but also eliminates tax-exemption for interest on all types of IDBs (exempt purpose, industrial park, and small issue), if—

(1) any portion of the proceeds of an issue is used to finance a health club facility, or

(2) more than 20 percent of the proceeds of an issue is used to finance facilities in any one of the following categories:

(a) office equipment;

(b) medical and health facilities (other than hospitals;

(c) facilities used by doctors, lawyers, accountants, or similar professions; or

(d) parking facilities.

Additional restrictions in the Senate amendment do not apply to certain projects with respect to which a UDAG grant is made.

The additional restrictions included in the Senate amendment apply to bonds issued after April 13, 1984. A transitional rule related to additional restrictions exempts property where binding contract existed or construction began before April 14, 1984.

Conference agreement

The conference agreement includes the Senate provision with respect to health clubs, but not with respect to other additional facilities. A special transition rule delays the effective date for certain race tracks with respect to which an inducement resolution was approved before June 19, 1984.

7. Repeal of advance refunding for qualified public facilities

Present law

Advance refunding of IDBs generally is prohibited. Advance refunding issues are bonds issued more than 180 days before retirement of the original bonds.

Advance refundings are permitted for certain convention and trade show facilities, airports, docks, wharves, and mass commuting facilities.

House bill

The House bill repeals the provision of present law that permits advance refundings for certain convention and trade show facilities, airports, docks, wharves, and mass commuting facilities.

This provision applies to refunding bonds issued after the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with appropriate transition rules.

8. Amendments to small-issue exception

a. Extension of small-issue exception

Present law

Present law permits tax-exemption for certain "small-issue" IDBs if the proceeds are used for acquisition of land or depreciable property. A small issue may not exceed $1 million ($10 million if certain capital expenditures are counted). The small-issue exception expires after December 31, 1986.

House bill

No provision.

Senate amendment

The Senate amendment extends the small-issue exception for 4 years, through December 31, 1990.

Conference agreement

The conference agreement extends the small issue exception only with respect to bonds used to finance manufacturing facilities.

b. Aggregate limit per taxpayer for small-issue exception

Present law

Present law imposes no overall limitation per beneficiary for small-issue IDBs.

House bill

The House bill provides that interest on small-issue IDBs is not tax-exempt if the face amount of issue allocated to any beneficiary (when increased by outstanding tax-exempt IDBs of the beneficiary) exceeds $40 million. Beneficiary means any person who is a user of the financed facilities. The bill provides the following rules for allocating IDBs to beneficiaries of a facility:

(1) Entire amount to beneficiary using more than 50 percent of facility; or

(2) If no one uses over 50 percent, equally among all beneficiaries using at least 25 percent (but no more than 50 percent to any one beneficiary); and

(3) To extent not allocated in (1) or (2), to owner/lessor of facility.

Bonds to refund outstanding issues are not allocated under the provision.

This provision applies generally to bonds issued after December 31, 1983. A transitional rule exempts property where (1) binding contract to incur significant expenditures was entered into before October 19, 1983, or (2) construction began before October 19, 1983 (and original use of facility begins with taxpayer).

Senate amendment

The Senate amendment is the same as the House bill except for allocation rules and exceptions to the restriction.

Under the Senate amendment, bonds are allocated as follows:

(1) To each user of 5 percent or more of facility, the percentage of the face amount of the issue equal to percentage of facility he uses; and

(2) To lessor, portion of face amount of issue equal to percentage of facility with respect to which he is lessor.

In addition to the exception for refunding bonds, the Senate amendment also provides exceptions for—

(1) Bonds to finance manufacturing facilities (including equipment therefore), and

(2) Bonds to finance facilities with respect to which a UDAG grant is made.

Conference agreement

The conference agreement follows the Senate amendment with modified allocation rules and a transition rule for facilities with respect to which an inducement resolution was approved before June 19, 1984. The conference agreement does not include the exceptions contained in the Senate amendment.

c. Aggregation of issues for single project

Present law

It is possible under present law to divide the ownership of a single building or project in such a manner that it is treated as multiple buildings or projects each of which qualifies for small-issue IDB financing (under the $1 million, or elective $10 million, volume limitations).

House bill

Two or more issues to be used with respect to a single project are treated as one issue in applying the small-issue volume limitations.

A project is defined as a single building, an enclosed shopping mall, or a strip of offices, stores, etc., using substantial common facilities.

A principal user of any single issue is treated as a principal user with respect to the aggregated issue.

This provision applies generally to bonds issued after December 31, 1983. A transitional rule exempts projects (1) with respect to which a binding contract to incur significant expenditures was entered before October 19, 1983, (2) on which construction began before October 19, 1983 (and the original use of the facility begins with the taxpayer).

Senate amendment

The Senate amendment is generally the same as the House bill.

Conference agreement

The conference agreement follows the Senate amendment with a transition rule for facilities with respect to which an inducement resolution was approved before June 19, 1984.

d. Clarification that residential property may be in a mixed use structure

Present law

Exempt purpose IDBs may be issued to finance low- and moderate-income residential rental property. Present law is unclear as to whether an entire building must consist of such housing for interest on the bonds to be tax-exempt.

House bill

The House bill clarifies that a part of a building qualifying as low-and moderate-income residential rental property may be used for nonresidential purposes, but limits tax-exempt financing to portion of building used for such housing.

This provision applies to bonds issued after December 31, 1983.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

e. Increase in small-issue IDB capital expenditure limitation for facilities with respect to which a UDAG grant is made

Present law

In lieu of the $1 million small-issue IDB volume limitation, an election may be made to issue up to $10 million of such bonds, if certain capital expenditures over a 6-year period are counted towards the $10 million limitation. The $10 million limitation is increased to $20 million in the case of a project with respect to which a UDAG grant is made.

House bill

The House bill increases $20 million limitation to $25 million for facilities with respect to which a UDAG grant is made.

This provision applies to bonds issued after December 31, 1983.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House provision.

f. Extension of substantial user rules

Present law

Interest on IDBs (exempt purpose, industrial park, and small issue) is not tax-exempt if the bonds are held by a substantial user of the facilities financed by the bonds or a related party.

Related parties include family members, fiduciaries, and corporations or partnerships subject to common control.

House bill

The House bill expands the definition of related party to include all partners of a partnership and spouses and dependent children of partners.

This provision applies to bonds issued after December 31, 1983.

Senate amendment

The Senate amendment includes the same provision as the House bill, and also treats all shareholders of an S corporation and spouses and dependent children of such shareholders as related persons.

Conference agreement

The conference agreement follows the Senate amendment.

g. Extension of certain requirements of the Internal Revenue Service Code to bonds exempt from tax pursuant to other provisions of law

Present law

Interest on bonds issued by the District of Columbia, by U.S. possessions, and under section 11(b) of the Housing Act of 1937 is exempt from tax by virtue of provisions outside of the Internal Revenue Code, and such bonds are not subject to the Code requirements for tax-exemption.

The Surface Transportation Assistance Act of 1982 provided that any tax-exemption for such bonds is deemed to exist by reason of Code section 103. This provision was repealed because of the order in which that Act and another Act were signed into law.

A court has ruled that section 11(b) bonds are exempt from Federal estate tax. Bonds with respect to which interest is exempt from tax under Code section 103 are not exempt from estate tax.

House bill

The House bill generally subjects bonds, the interest on which is tax-exempt by virtue of a provision of law outside the Code, to the Code rules governing tax-exempt bonds.

Senate amendment

The Senate amendment is the same as the House bill, except the Senate amendment also authorizes the Virgin Islands and American Samoa to issue IDBs, subject to the restrictions of the Code.

Conference agreement

The conference agreement follows the House bill with certain modifications and a special effective date in the case of bonds issued pursuant to section 11(b) of the Housing Act of 1937.

h. Prohibition on use of tax-exempt bonds for consumer loans

Present law

Present law does not provide limitations on the use of the proceeds of tax-exempt bonds for private purposes except in the case of bonds where the proceeds are used in the taxable trades or businesses (i.e., industrial development bonds) or bonds where the proceeds are used to provide financing for owner-occupied housing (i.e., mortgage subsidy bonds).

House bill

No provision.

Senate amendment

The Senate amendment provides that tax-exempt bonds may be used to make loans or finance loans to persons which are not governmental units or tax-exempt organizations.

Exceptions are provided for:

(1) bonds issued before October 1, 1986, to finance student loans receiving special allowance payments;

(2) bonds issued after September 30, 1986, to finance any student loans;
(3) mortgage subsidy bonds;
(4) industrial development bonds;
(5) bonds whose proceeds are used to finance any governmental tax or general assessments;
(6) bonds whose proceeds are used to acquire obligations other than obligations for the governmental purpose giving rise to the issue (i.e., nonpurpose obligations) to the extent permitted under the arbitrage rules;
(7) Texas Veterans' Land Bonds (for bonds issued before January 1, 1987); and
(8) certain student loan bond refunding issues.

This provision applies generally to bonds issued after the date of enactment.

Conference agreement

The conference agreement generally follows the Senate amendment, with certain modifications regarding student loan bonds.

D. Miscellaneous Tax-exempt Bond Provisions

1. Tax-exempt obligations issued by Pennsylvania State University

Present law

Interest on obligations is excluded from gross income where the obligations are issued by or on behalf of a State or local government. The determination of whether an entity is a State or local government depends upon whether that entity has sovereign powers or is controlled by an entity with sovereign powers.

House bill

The House bill provides that the Pennsylvania State University is to be treated as a State governmental unit for purposes of issuing tax-exempt obligations.

This provision applies to obligations issued after December 31, 1953.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

2. Clarification of public approval requirement in the case of certain public airports

Present law

Issuance of private activity tax-exempt bonds must be approved by a public hearing, an elected official, or by a voter referendum. Facilities located in more than one jurisdiction must satisfy the public approval requirements in all such jurisdictions.

House bill

The House bill provides that in the case of airports located in more than one jurisdiction, but owned and operated by the jurisdiction issuing the tax-exempt bonds, only the issuing jurisdiction is required to satisfy the public approval requirements of present law.

This provision applies to bonds issued after December 31, 1983.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

3. Principal users of certain solid waste disposal facilities

Present law

Unlimited amounts of tax-exempt IDBs can be issued to finance solid waste disposal facilities. Under Treasury regulations, facilities cease being solid waste disposal facilities when the solid waste is processed to produce the first marketable product. In the case of solid waste that is burned to produce heat, the first marketable product is steam. Facilities for processing beyond the first marketable product can be financed with tax-exempt IDBs only under the small-issue exception. In determining whether the requirements of the small-issue exception are satisfied, the capital expenditures of all principal users of financed facilities must be taken into account.

House bill

No provision.

Senate amendment

The Senate amendment provides that the purchaser of all of the steam output of a specified solid waste disposal facility is not to be treated as a substantial user of the solid waste disposal facility.

This provision applies to bonds issued after December 31, 1983.

Conference agreement

The conference agreement follows the Senate amendment.

4. Tax-exempt financing for Power Authority of the State of New York

Present law

Under present law, tax-exempt financing is available for the acquisition of facilities which are used in taxable business of an electric utility only if the service area of the utility does not exceed two contiguous counties (or a city and one contiguous county) or the bond meets the requirements of the small-issue exception.

House bill

No provision.

Senate amendment

The Senate amendment provides that tax-exempt bonds may be issued (1) to finance facilities for the Power Authority of the State of New York (PASNY) if there is not mark up by the purchasing utility of the electricity from PASNY when the purchasing utility sells the electricity to its rate-payers.

This provision applies to bonds issued after the date of enactment and to certain bonds issued after December 31, 1969; which were tax-exempt when issued.

Conference agreement

The conference agreement follows the Senate amendment with certain modifications.

5. Tax-exempt financing for acquisition of railroad track and rights-of-way of bankrupt railroads

Present law

Tax-exempt financing is available for the acquisition of facilities which are used in taxable businesses of railroads only if the requirements of the small-issue exception are satisfied.

House bill

No provision.

Senate amendment

The Senate amendment provides that tax-exempt bonds may be issued to finance the acquisition of railroad track and rights-of-way from bankrupt railroads where the Federal Railroad Administration provides joint financing for such facilities.

This provision applies to bonds issued after December 31, 1983.

Conference agreement

The conference agreement follows the Senate amendment.

6. Exemption from local furnishing rule for Long Island Lighting Company and Bradley Lake Hydroelectric Facility

Present law

Tax-exempt financing is available for the acquisition of facilities which are to be used in taxable business of an electric utility only if the service area of the utility does not exceed two contiguous counties (or a city and one contiguous county) or if the requirements of the small-issue exception are satisfied.

House bill

No provision.

Senate amendment

The Senate amendment provides an exception from the local furnishing rule for the Long Island Lighting Company and the Bradley Lake Hydroelectric Facility. This provision applies to bonds issued after December 31, 1983.

Conference agreement

The conference agreement allows advance usage of the State volulme cap, under specified conditions, for certain specially identified projects.

7. Exemption from restriction on financing food and beverage facilities for certain catering facility

Present law

In 1982, TEFRA provided that interest on small-issue IDBs is not tax-exempt if more than 25 percent of the proceeds of an issue are used to finance any retail food and beverage service facility.

House bill

No provision.

Senate amendment

The Senate amendment provides that a facility the primary purpose of which is to provide catering services and meeting rooms for groups of 2,500 or more individuals is not treated as a facility the primary purpose of which is providing retail food and beverage services.

This provision applies to bonds issued after December 31, 1983.

Conference agreement

The conference agreement does not include the Senate provision.

8. Review of Department of Education determinations on tax-exempt student loan bonds

Present law

The Student Loan Consolidation and Technical Amendments Act of 1983 eliminates tax-exemption for interest on student loan bonds unless the Department of Education approves issuance of the bonds.

House bill

No provision.

Senate amendment

The Senate amendment provides for review and filing of a report by the Department of the Treasury with respect to any adverse determinations by the Department of Education regarding issuance of tax-exempt student loan bonds.

This provision applies to bonds issued after December 31, 1983.

Conference agreement

The conference agreement follows the Senate amendment.

9. Issuance of taxable bonds by agencies issuing qualified scholarship funding bonds

Present law

Interest on qualified scholarship funding bonds is tax-exempt. Such bonds are bonds issued by State authorities meeting prescribed requirements, including the requirement that the authorities be organized exclusively to acquire student loan notes funded with tax-exempt bonds.

House bill

No provision.

Senate amendment

The Senate amendment permits student loan bond issuers to issue taxable bonds without prejudice to their ability to issue tax-exempt bonds.

This provision applies to bonds issued after December 31, 1983.

Conference agreement

The conference agreement follows the Senate amendment.

10. Study of role of tax-exempt student loan bonds

Present law

No provision.

House bill

No provision.

Senate amendment

The Senate amendment requires the General Accounting Office and the Congressional Budget Office to conduct a study of the appropriate role of tax-exempt bonds in financing student loans and to report to Congress within 9 months after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment with certain technical modifications.

VII. TECHNICAL CORRECTIONS

House bill

The bill contains technical, clerical, and conforming amendments to provisions enacted by the Tax Equity and Fiscal Responsibility Act of 1982, the Subchapter S Revision Act of 1982, the Highway Revenue Act of 1982, the Social Security Amendments of 1983, and other recently enacted tax legislation. The amendments are meant to carry out the intent of Congress in enacting the original legislation.

Senate amendment

The Senate amendment contained no separate technical corrections title.

Conference agreement

The conference agreement generally follows the House bill with the following modifications:

1. Alternative minimum tax

(a) The amount includible in gross income with respect to the alcohol fuels credit (sec. 87) will not be included in alternative minimum taxable income since that credit is not allowed against the minimum tax; (b) The House bill contains a provision clarifying the treatment of losses from limited business interests, for purposes of the investment interest limitations of the alternative minimum tax. In order to further clarify the application of that provision, the following example is given:

> Assume that a taxpayer had $100,000 of dividend income and also held a limited partnership interest in a partnership all of whose income is derived from a trade or business. The taxpayer's distributive share of partnership income included $200,000 of gross income and $300,000 of deductions which are not preferences (including partnership deductions for business interest). Because any income or loss derived from the limited partnership interest is taken into account for purposes of computing net investment income, the taxpayer would have no net investment income for the taxable year and, therefore, could deduct no "below the line" interest (other than eligible housing interest), including interest on debt used to purchase or carry the limited partnership interest.[2]

2. Casualty loss deduction

The House bill provides that adjusted gross income, for purposes of computing the 10-percent floor for the casualty loss deduction, is determined without regard to the application of section 1231 to gains or losses from involuntary conversions arising from casualty or theft. The conference agreement retains this rule for taxable years beginning in 1983, but replaces this rule with a new set of rules for determining capital gains treatment and applying the 10-percent floor with respect to these gains and losses for taxable years beginning after December 31, 1983.

Under the conference agreement, gains and losses from an involuntary conversion of property described in section 165(c)(3) arising from fire, storm, shipwreck, or other casualty or from theft will no longer be subject to the application of section 1231. Section 1231 will thus be applied without regard to these gains and losses. Gains and losses from these personal casualties (without regard to the period the property was held) will be netted. If the recognized gains exceed the recognized losses from these transactions, then all such gains and losses will be treated as gains and losses from the sale or exchange of a capital asset, and the losses will not be subject to the 10-percent floor. (The amount of any recognized loss will be subject

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[2] See General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982, page 20, for similar example under the TEFRA provisions as enacted.

to the $100 floor before netting). If the recognized losses exceed the recognized gains, all gains and losses will be ordinary. Losses to the extent of gains will be allowed in full. Losses in excess of gains will be subject to the 10 percent adjusted gross income floor.

Thus, for example, assume a taxpayer has $100,000 of adjusted gross income (without regard to casualty gains and losses described in section 165(c)(3)), $50,000 of such casualty gains, and $40,000 of such casualty losses (after applying the $100 floor) for a taxable year. All the taxpayer's personal casualty gains and losses for that year will be treated as capital gains and losses. The 10-percent floor will not be applicable. Assume, however, that the taxpayer's losses for the year are $70,000 rather than $40,000. The gains and losses will all be treated as ordinary. $60,000 of losses will be allowed as a deduction ($50,000 plus the $10,000 excess of the remaining $20,000 over the $10,000 (10 percent of $100,000) AGI floor).

3. Amendments to section 338

(a) Deemed sales price.—The House bill provides that the deemed sales price will be the fair market value of the target corporation's assets. Under the conference agreement, the fair market value deemed sale price of the target corporation's assets may be determined in a manner to be prescribed by regulations. It is contemplated, for example, that the regulations may provide the determination of fair market value using an elective formula which takes into account liabilities (including recapture taxes) and other relevant items. The regulations may also provide that if the taxpayer chose not to use the formula approach a proper appraisal of the target corporation's assets will be considered evidence of fair market value.

(b) Deemed purchase price.—Under present law, the deemed purchase price is an amount based on the grossed-up basis of all of the purchasing corporation's stock in the target corporation. Under the conference agreement, the deemed purchase price to be used in determining the basis of the target corporation's assets is the grossed-up basis of the target corporation's stock purchased by the purchasing corporation during so much of the acquisition period as ends on the acquisition date plus its basis in other target corporation stock which it owns on the acquisition date. As under present law, adjustments are to be made under regulations for target corporation liabilities (including any recapture taxes) and other relevant items. The grossed-up basis of the purchased stock is determined by multiplying the basis (before grossing up) of such stock by a fraction, the numerator of which is the percentage by value of the target corporation's outstanding stock represented by such purchased stock plus stock not owned by the purchasing corporation, and the denominator of which is the percentage by value of such purchased stock. The total basis, as under present law, is to be allocated among the target corporation's assets under regulations.

An election is provided under the conference agreement pursuant to which the deemed purchase price of the target corporation's assets may be determined by stepping up the basis of the target corporation's stock held by the purchasing corporation that was not purchased during the acquisition period. The stepped-up basis is to be determined under regulations and is applicable if the purchasing corporation elects to recognize gain as if the stock were sold on the acquisition date. The deemed sale price and basis of such stock is the amount determined by multiplying the grossed-up basis of the stock purchased during so much of the acquisition period as ends on the acquisition date by a fraction, the numerator of which is the percentage of the value of the target corporation's stock represented by such stock held but not purchased by the purchasing corporation during so much of the acquisition period as ends on the acquisition date and the denominator of which is the percentage by value of all the remaining target corporation stock.

Thus, for example, assume that the purchasing corporation purchases 80 percent of the target corporation's stock for $8 million during the 12-month acquisition period, that it held an additional 8 percent of the stock with a basis of $200,000 on the acquisition date, and that 12 percent of the stock was not held by the acquiring corporation on the acquisition date. Assume that there are no liabilities (including recapture liabilities). Under the conference agreement, the target corporation's basis in its assets will be $9.4 million (92%/80% times $8 million (i.e., $9.2 million) plus $200,000). The purchasing corporation may elect to treat the 8 percent stock as sold for $800,000 ($9.2 million multiplied by the fraction 8 percent over 92 percent). If the election is made, the purchasing corporation will recognize gain of $600,000 and then the target corporation will have a basis in its assets of $10 million.

(c) Exceptions to the deemed election rule (sec. 338(e)(2)).—Under present law, a section 338 election is deemed made in certain cases where the purchasing corporation acquires assets directly from the target corporation or an affiliate of the target. Exceptions to this treatment are made for property the basis of which is determined in whole or in part by reference to its basis to the transferor, assets located outside the United States to the extent provided in regulations, and other acquisitions described in regulations.

The conference agreement modifies the carryover basis exception by requiring the basis of the acquired property to be determined wholly by reference to its basis to the transferor in order to qualify for this exception.

The conference agreement clarifies the scope of the present law regulatory authority under section 338(e)(2) by specifically providing that conditions may be imposed by the regulations in order to come within the scope of this exception. It is contemplated, for example, that the regulations may permit the purchasing corporation to elect, with respect to property acquired from the target corporation or a target affiliate during the consistency period, to take as its basis in the acquired property the adjusted basis of such property in the hands of the person from whom acquired. It is contemplated that such an election would not apply to any item of property if the result would be a basis to the purchasing corporation in excess of the cost of such item to the purchasing corporation. A corporation making such an election would be bound by all of the terms and conditions prescribed in the regulations, notwithstanding any other provision of the Internal Revenue Code.

(d) Miscellaneous amendments.—The acquisition date applicable in the case of a deemed purchase of stock by the target corporation

is to be determined pursuant to regulations under the Conference agreement. The assets of a target corporation, including stock held in subsidiary corporations, are deemed purchased on the day following the acquisition date applicable to the target (sec. 338(a)(2)). The application of this rule may result in several acquisition dates when sec. 338 is applied to successive deemed purchases of several tiers of corporations acquired by the direct purchase of a target corporation which is the parent corporation of an affiliated group. The regulatory authority is intended to enable the Treasury Department to provide a single acquisition date when sec. 338 is applied to such a group.

Under the conference agreement, stock acquired in the course of certain reorganizations and other transactions set forth in regulations in which the transferor does not recognize the entire amount of gain shall be treated as not purchased.

Stock and asset acquisitions by 2 or more members of the same affiliated group will be treated as made by one corporation. Thus, the aggregate purchases of target corporation stock by several members of an affiliated group will be counted in determining whether there has been a qualified stock purchase. Similarly, the deemed sales price and basis of a target corporation's assets and gain recognized under section 338(c)(1) will be determined on a group basis.

A combined return may be filed, under the conference agreement, where an election applies to 2 or more target corporations purchased from a group which files a consolidated return that includes the target corporations for the taxable period in which the transaction occurs. The combined return will include the combined tax liability attributable to the deemed asset sales by the target corporations.

The regulatory authority provided in section 338(i) is amended by the conference agreement to delete the reference to the target corporation and its target affiliates and to apply such authority to certain transactions made by a purchasing group.

The conferees intend that the amendment in the House bill to the rules applicable to acquisitions made to evade or avoid income tax will not cause the disallowance of loss carryover deductions and other tax benefits of a corporation because of its qualified stock purchase and liquidation of a profitable corporation without a section 338 election, where the transaction results in no change in ownership of the purchasing corporation.

Finally, the time for making an election under section 338 with respect to pre-September, 1982, purchases is extended until 60 days after date of enactment.

4. Amendments to section 304

(a) Dividend treatment.—The conference agreement modifies the provision in the House bill amending the rules relating to redemptions through use of related corporations (sec. 304). Under the House bill, the amount to be treated as a dividend to selling shareholders when the stock sale involves two commonly controlled corporations (so-called brother-sister cases), is to be determined as if the distribution were by the acquiring corporation to the extent of

its earnings and profits and then by the issuing corporation to the extent of its earnings and profits. When stock is sold to a subsidiary of the issuing corporation (so-called parent-subsidiary cases) present law provides that the amount of any dividend to the selling shareholder is determined as if the proceeds were first distributed to the issuing corporation, then to the selling shareholders.

Hypothetical distributions to the acquiring or issuing corporation for the purpose of determining the amount of a dividend to the selling shareholder have been considered not to affect the taxable status of the putative distributee corporation under present law. *Broadview Lumber Co.* v. *U.S.* 561 F. 2d 698 (7th Cir., 1977); TEFRA Conference Report (H. Rept. No. 97-760, 97th Cong., 2d Sess., p. 543). However, the effect of such distributions on the earnings and profits of the corporation deemed to have made the distribution is unclear. If the earnings and profits are reduced, a corporation can shift earnings and profits from one member of a controlled group to another at the cost of the tax, if any, on intercorporate dividends (at most, 6.9%) and create an opportunity for the deemed distributor to make nondividend distributions to noncorporate shareholders. If a corporation sells stock in a foreign subsidiary to a domestic subsidiary, it may be argued that the effect of these rules is to characterize the distribution as a U.S. source dividend from the domestic subsidiary whereas, under present law, gain from the sale would be treated as a dividend from the foreign corporation's earnings and profits if section 304 were inapplicable. In other cases, the application of the foreign tax credit is unclear with respect to a dividend resulting from the application of section 304 to a sale of stock in a foreign corporation to a related corporation in cases where there would be a foreign tax credit under section 902 if the issuing corporation paid a dividend directly to the U.S. selling corporation.

To address these issues, the Conference agreement revises the deemed distribution rules of section 304 to provide that in all cases, i.e., both brother-sister and parent-subsidiary transactions, the characterization of a distribution as a dividend, and the source of the dividend will be determined by treating the distribution as made by the acquiring corporation directly to the selling shareholder to the extent of the earnings and profits of the acquiring corporation and then as made by the issuing corporation directly to the selling shareholder to the extent of its earnings and profits. Thus, any dividend received deduction or foreign tax credit will be allowed to the same extent as if the distribution had been made directly by the corporation which is treated as having made the distribution. Also, the earnings and profits of the corporation which is treated as having made a distribution will be reduced.

(b) Effective dates.—The effective dates of paragraphs (1) and (3) of section 712(l), relating to earnings and profits and acquisition indebtedness, will apply to transfers after June 18, 1984, unless the taxpayer elects to have the provisions apply as if enacted in TEFRA. Transfers to a Bank Holding Company where regulatory approval was requested on or before June 18, 1984, and the transfer is made within 90 days of final regulatory approval will be treated as a transfer on or before June 18, 1984, for this purpose. Notwithstanding the above, in the case of a transfer to which sec-

tion 351 does not apply, the acquisition indebtedness rule in the bill will apply if the debt was incurred after October 20, 1983.

5. Compliance

(a) The conference agreement applies the exceptions from interest reporting (sec. 6049) for payments to certain specified persons to dividend reporting (sec. 6042). Substitute dividends paid to corporations and other persons are reported under sec. 6045, as amended by this bill.

(b) The conference agreement amends the broker reporting rules (sec. 6045) to include government agencies in the definition of a person. Consequently, a government agency (such as the Bureau of Public Debt) acting as a broker is required to provide a broker report and to implement backup withholding.

(c) The conference agreement deprives the Claims Court of jurisdiction over refund cases involving the tax shelter promoter penalty (sec. 6700) and the penalty for aiding and abetting the understatement of tax liability (sec. 6701). This is done because the Claims Court lacks jurisdiction to hear the likely counterclaim of the Government for an injunction.

(d) The conference agreement provides that, for purposes of computing interest on refunds arising from net operating loss carrybacks where a "quickie refund" is filed (sec. 6411), the refund is not treated as claimed earlier than the time the "quickie refund" is claimed. If a "quickie refund" is not claimed, interest is computed under present law rules. Also, a "quickie refund" is treated as a claim for refund for interest purposes.

The conference agreement also provides that underpayments arising from claims for rebates (such as quickie refunds) are subject to the substantial understatement penalty (sec. 6661).

(e) The conference agreement corrects an incorrect reference to sec. 7602(a)(2) in sec. 7609(c)(1).

(f) The conference agreement requires that trusts or estates furnish copies of returns to their beneficiaries and that S corporations furnish copies of returns to their shareholders. The conference agreement also provides a $50 penalty on trusts, estates, partnerships, and S corporations for failures to provide copies of their returns to beneficiaries, partners, or shareholders.

(g) The conference agreement provides rules for backup withholding relating to the manner of notification from a broker to a payor with respect to readily tradeable instruments.

(h) The conference agreement amends backup withholding to permit the IRS to tell a payor enough of the reasons why a taxpayer is being placed on backup withholding to enable the taxpayer and payor to know how withholding can be stopped. Therefore, when the Secretary notifies a payor that a payee is subject to backup withholding, the Secretary will also notify the payor that backup withholding is being imposed because the TIN furnished by the payee is incorrect or because of notified payee underreporting. The prohibition on disclosure by the Secretary of the nature or details of the payee's underreporting is continued.

(i) The conference agreement restores the technical rules applicable to trusts under interest and dividend withholding to backup withholding. These rules were inadvertently repealed by the Interest and Dividend Tax Compliance Act of 1983.

(j) The conference agreement clarifies that backup withholding does not apply in the pension area. The conference agreement provides that, if a payee has not provided a proper social security number in the manner required by the Secretary or if the Secretary notifies the payor that the social security number is not correct, any election out of pension withholding is not effective. In addition, the withholding convention treating the payee as a married individual claiming three exemptions is not effective. Consequently, the payee is treated as a single individual claiming no exemptions if no withholding exemption certificate is in effect (see Treas. Reg. sec. 31.3402(f)(2)-1(a)).

The conferees anticipate that the Secretary will consider a payee's social security number to have been properly furnished so long as, before January 1, 1985, the payee provides the social security number in a manner acceptable to the payor. Therefore, if the payee has previously furnished his social security number in response to a request relating to pension withholding or backup withholding, or if the payor has otherwise obtained the number, that number is considered to have been properly furnished. The Secretary may require that, on or after January 1, 1985, the social security number must be furnished in the manner that the Secretary determines. The Secretary may, for example, require these social security numbers to be certified under penalties of perjury, if he determines that to be appropriate.

6. Energy

(a) The conference agreement amends section 44(D) (relating to the credit for producing fuel from nonconventional sources) to provide that in the case of a fiscal year taxpayer, the reference price on which the amount of the credit depends will be the reference price for the calendar year in which the fuel is sold rather than for the calendar year in which the producers fiscal year begins. This amendment ensures that producers of nonconventional fuels sold on the same day will have the same credit regardless of whether they have the same tax accounting year.

(b) The conference agreement provides for a simplified procedure under which refunds arising by reason of section 201(h)(1)(E) of the Technical Corrections Act of 1982 for periods before 1983, may be made to a partnership rather than its partners individually.

7. Subchapter S

(a) The House bill extends the grace period to make an election to be treated as a qualified subchapter S trust from 60 days to 75 days. The conference agreement changes the 75 days to 2 months and 15 days, to conform to the time for making a subchapter S election (see Treasury Temp. Reg. sec. 18.1362-(b)).

(b) The House bill provides that amounts in the accumulated adjustment account will be allocated pro-rata among all distributions made during the year. The conference agreement allows exceptions to this rule to be provided by the Treasury Department. It is anticipated that this authority would be used to provide a different rule where substantial amounts of stock in the corporation are sold or exchanged during the taxable year.

(c) The House bill provides that a corporation can make a subchapter S election within 2½ months from the beginning of a taxable year although the taxable year is less than 2½ months duration. The conference agreement clarifies that when the election for the short year is late filed but is timely for the subsequent taxable year, it will be effective for the subsequent year. This provision will apply to elections after October 19, 1982.

(d) Present law imposes a tax on subchapter S corporations with passive income and subchapter C earnings and profits. Under the conference agreement, this tax could be waived by the Internal Revenue Service if the corporation had determined, in good faith, that it had no such earnings and profits, and the earnings are distributed after their discovery.

(e) The subchapter S Act requires the basis of debt which is reduced by losses to be restored by subsequent income. The conference agreement clarifies that this applies only to the extent the basis in the debt was reduced in taxable years beginning after 1982.

(f) Present law provides that the revocation of a subchapter S election requires the consent of the shareholders holding a majority of the shares of stock. Although no statutory amendment is made, the conference agreement clarifies that this is the rule notwithstanding language in the 1982 committee reports to the contrary.

(g) The House bill provides that the basis of stock in an S corporation is to be adjusted to reflect adjustments required to the basis of corporation property when investment credits are allowed or recaptured. Corresponding adjustments are also to be made to the accumulated adjustments account.

8. Partnerships

(a) The Tax Reform Act of 1976 provided that gain is recognized when property is contributed to a partnership which is an investment company (sec. 721(b)). The conference agreement clarifies that the basis of the contributed property and the basis of the partnership interest is increased only by the gain recognized under section 721(b).

(b) Under present law, the basis of a partnership interest is generally increased by the excess of depletion deductions in excess of basis (sec. 705(a)(1)(C)). The language relating to oil and gas depletion (sec. 705(a)(3)) is amended to clarify that similar treatment applies to oil and gas depletion.

9. Highway Revenue Act

The conference agreement follows the House bill with three modifications—

(a) The period for filing floor stocks refund claims with respect to tires on which tax was reduced, but not repealed, by the Highway Revenue Act is extended for six months. Under the conference agreement, claims must be submitted to manufacturers by tire dealers before January 1, 1985; manufacturers must in turn submit claims to the Government before April 1, 1985.

(b) The provision under which taxpayers whose average daily production of crude oil is below a specified amount are permitted an additional five days in which to pay the gasoline excise tax if their payment is made by wire transfer is clarified to provide that the payment must be made by wire transfer to a Federal Reserve Bank.

(c) A clarification is made to the rules under which refunds or credits against the retail truck and trailer excise tax are available to ensure that refunds or credits for price readjustments will be available against the retail tax to the extent they were available when the tax was imposed as a manufacturers tax.

10. P.L. 98-258

The conference agreement makes the following modifications to P.L. 98-259, which forgives certain Federal income tax liabilities for U.S. military or civilian employees who die as a result of wounds or injuries sustained overseas either in certain military actions involving U.S. Armed Forces or in a terroristic activity directed against the U.S. or its allies (including a multinational force in which the U.S. participates).

(a) The effective date is changed from individuals wounded after December 31, 1979, to individuals wounded after November 17, 1978.

(b) The determination of whether terroristic action was directed against the U.S. or its allies is to be based on a preponderance of the evidence.

(c) The required relationship between the overseas wound or injury and the individual's death is clarified by providing that the individual must be a U.S. employee both at the date of incurring the wound and at the date of death.

(d) The definition of U.S. employees is modified so that the Director General of the Multinational Force and Observers in the Sinai who died February 15, 1984 is treated as a civilian employee of the United States while serving in that position.

11. Foreign currency contracts

The provision in the House bill relating to the election to treat certain foreign currency contracts as not marked-to-market is not contained in the conference agreement.

VIII. ENTERPRISE ZONES

Present law

No provision.

House bill

No provision.

Senate amendment

The Senate amendment provides for the designation of certain distressed areas as enterprise zones and provides tax incentives and regulatory relief designed to stimulate economic activity within the zones. Under these provisions, up to 75 enterprise zones are to be designated by the Secretary of the Department of Housing and Urban Development, beginning on January 1, 1985, over a period of 3 years, although no more than 25 designations may be made during each year. At least one-third of the designated zones will be in rural areas. Each enterprise zone is eligible for Federal tax and regulatory relief. The duration of each zone is 20 years, plus a 4-year phaseout period. Areas are to be nominated for enterprise zone designation by one or more local governments and the State in which the area is located. Areas nominated for such a designation have to meet certain criteria of economic distress, and designations are made through a competitive process weighing suggested plans for developing the area through tax and regulatory relief, improved services, and involvement of neighborhood and community organizations and private entities in development efforts.

Under the Senate amendment, the following Federal tax incentives are available in enterprise zones: An additional 3-percent or 5-percent investment tax credit for investments in personal property and a 10-percent credit for investments in new structures in the zone; a 10-percent credit to employers for increases in payroll to qualified zone employees and a credit for hiring disadvantaged workers for zone employment; a 5-percent credit to zone employees for wages received from zone employers; an exclusion from tax on capital gains attributable to zone property; allowance of full ACRS deductions for facilities in zones financed by industrial development bonds despite the limitation of such deductions for comparably financed facilities elsewhere, and the continued availability of the small issue exemption for industrial development bonds in zones after December 31, 1986, despite its termination on that date elsewhere.

Conference agreement

The conference agreement does not contain the Senate amendment.

IX. HIGHWAY REVENUE PROVISIONS

1. Reduction in heavy vehicle use tax and increase in diesel fuel tax

Present law

Use tax

In general, an annual excise tax is imposed on the use on the public highways of a highway motor vehicle whose taxable gross weight exceeds a prescribed minimum weight. The tax is paid by the person in whose name the vehicle is registered, and the taxable period begins on July 1. Amounts equivalent to highway use tax receipts are appropriated to the Highway Trust Fund. The tax expires on October 1, 1988.

Tax rate.—For uses occurring before July 1, 1984, the tax rate is $3 per 1,000 pounds of taxable gross weight or fraction thereof. Vehicles of 26,000 pounds or less are exempt.

The tax rate is scheduled to change to a graduated structure on July 1, 1984. Vehicles under 33,000 pounds are exempt. For vehicles between 33,000 and 55,000 pounds, the tax rate is $50, plus $25 for each 1,000 pounds or fraction thereof over 33,000 pounds. For vehicles of 55,000 pounds or more, the tax rate is $600, plus $40 (rising to $52 by 1988) for each 1,000 pounds or fraction thereof over 55,000 pounds. The maximum tax rate, applicable to vehicles over 79,000 pounds, is $1,600 (rising to $1,900 by 1988).

Operating rules.—Two rules are generally effective as of July 1, 1984. First, a vehicle that travels fewer than 5,000 miles on the public highways during a taxable period is exempt, regardless of taxable gross weight. Second, a credit or refund is allowed pro rata, if a vehicle on which use tax has been paid is retired from service because of theft, accident or other casualty.

Small owner-operators.—Special rules apply in the case of a person (a small owner-operator) who owns and operates no more than 5 taxable vehicles during a taxable period. Beginning July 1, 1984, the tax rate applicable to small owner-operators in a taxable period is the tax rate generally applicable in the immediately preceding taxable year. In addition, the 5,000-mile exemption and proration for theft or accident are not effective for small owner-operators until July 1, 1985.

Diesel fuel tax

An excise tax of 9 cents a gallon is imposed on the sale of diesel fuel for use in a highway vehicle. The tax expires on October 1, 1988.

A number of complete exemptions are provided, including an exemption for diesel fuel sold to a State or local government or nonprofit educational organization for its exclusive use and a refund or credit for tax paid for diesel fuel used in an intercity, local or school bus. Certain other diesel fuel is exempt from only a portion of the tax.

Amounts equivalent to diesel fuel tax receipts are appropriated to the Highway Trust Fund. One-ninth of these amounts (currently, 1 cent per gallon) is designated for the Mass Transit Account in the fund.

House bill

Use tax

The House bill restructures and reduces the highway use tax rate generally, and revises the operating rules for small owner-operators, effective July 1, 1984.

Tax rate.—Vehicles under 55,000 pounds are exempt. For vehicles of 55,000 pounds or more, the tax rate is $150, plus $20 for each 1,000 pounds or fraction thereof over 55,000 pounds. The maximum tax rate, applicable to vehicles over 72,000 pounds, is $500.

Small owner-operators.—For the taxable period beginning on July 1, 1984 only, the tax rate for small owner-operators is $3 per 1,000 pounds for vehicles of 55,000 pounds or more. However, if this special rule would produce a greater use tax on a small owner-operator's vehicle than does the general tax rate, then the general rate applies to that vehicle. Only the general tax rate applies to small owner-operators beginning July 1, 1985. Moreover, the 5,000-mile exemption and proration for theft or accident are made available to small owner-operators beginning July 1, 1984.

Study requirement.—The Secretary of Transportation is instructed to report to Congress within one year after the date of enactment whether trucks of 80,000 pounds or more bear their fair share of the costs of the highway system.

Diesel fuel tax

The House bill increases the excise tax on diesel fuel to 14.5 cents a gallon, effective July 1, 1984, to compensate for lower revenues from the reduced use tax provided by the bill. No modifications are made to the exemptions provided under present law: that is, complete exemptions remain complete, and partial exemptions remain at their present-law levels.

To offset the increase in fuel costs for light vehicles, the House bill provides an advanced rebate equal to the estimated extra tax to be paid over the expected life of the vehicle. A qualifying vehicle must have a gross vehicle weight of 10,000 pounds or less. The rebate is available only to (1) the original purchaser of a diesel-powered vehicle purchased after January 1, 1985, and before 1988 or (2) the holder as of January 1, 1985, of a vehicle purchased on or before that date. The rebate for a vehicle is claimed once, generally on the income tax return of (1) the original purchaser, in the taxable year of purchase, or (2) the holder, in the taxable year which includes December 31, 1984. The amount of the rebate is fixed at $96 for a new car ($180 for a new truck), and is reduced proportionally for older cars. No rebate is available if the model year is 1978 or earlier.

To maintain the currently effective designation of amounts to the Mass Transit Account, one cent per gallon (rather than one-ninth) of the diesel fuel tax is designated for that account.

Senate amendment

Use tax

Tax rate.—The Senate amendment restructures and reduces the tax rate, effective July 1, 1984. Vehicles under 55,000 pounds are exempt. For vehicles of 55,000 pounds or more, the tax rate is $75, plus $21 for each 1,000 pounds or fraction thereof over 55,000 pounds. The maximum tax rate, applicable to vehicles over 79,000 pounds, is $600.

Logging vehicles.—Under a special rule, the tax rate is reduced by one-half for logging vehicles used exclusively to haul harvested forested products from the forested site and registered for that purpose.

Agricultural vehicles.—Under a special rule, the 5,000-mile exemption is increased to 7,500 miles for State-registered agricultural vehicles which haul farm commodities to or from the farm, effective as if included in sec. 513 of the Highway Revenue Act of 1982.

Small owner-operators.—The Senate amendment is the same as the House bill with respect to rules applicable to small owner-operators.

Study requirements.—The Secretary of Transportation is required to report to Congress within one year after the date of enactment on effects of the use tax on trans-border trucking operations. In addition, the National Academy of Sciences is required to study weight-distance taxes and report to Congress within 18 months of the date of enactment.

Diesel fuel tax

The Senate amendment increases the excise tax on diesel fuel to 15 cents a gallon, effective July 1, 1984. Present law exemptions from the entire amount of tax, including the credit or refund for diesel fuel sold to a State or local government or nonprofit educational organization for its exclusive use, are generally increased to 15 cents a gallon. However, the credit or refund for diesel fuel used in intercity, local or school buses (which are not operated by or for a State or local government) is maintained at 9 cents a gallon, resulting in a 6-cents-a-gallon tax.

A rebate of the additional 6-cents-a-gallon tax is provided for taxable fuel used in vehicles which have a gross vehicle weight of 8,000 pounds or less. The rebate is generally claimed annually on the income tax form of the user who paid the additional tax.

One cent per gallon (rather than one-ninth) of the diesel fuel tax is designated for the Mass Transit Account of the Highway Trust Fund.

Conference agreement

Use tax

The conference agreement follows the Senate amendment, with the following modifications.

Tax rate.—The conference agreement restructures and reduces the tax rate, effective July 1, 1984. Vehicles under 55,000 pounds are exempt. For vehicles of 55,000 pounds or more, the tax rate is $100, plus $22 for each 1,000 pounds or fraction thereof over 55,000 pounds. The maximum tax rate, applicable to vehicles over 75,000 pounds, is $550.

Logging vehicles.—The conference agreement provides that the tax rate is reduced by 25 percent for logging vehicles that are used exclusively to haul harvested forested products to and from the forested site and are required to be registered for that purpose.

Study requirements.—The conference agreement includes the study (relating to vehicles over 80,000 pounds) provided by the House bill. Also, it provides that the study relating to weight-distance taxes will be conducted by the Department of Transportation rather than the National Academy of Sciences. These studies and the study relating to trans-border trucking will be reported to Congress before October 1, 1987.

The conferees recognize that the Internal Revenue Service may need additional time to distribute use tax forms reflecting the new rate schedule, and that taxpayers should be allowed until Septem-

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ber 30, 1984, to file the appropriate forms for the taxable period beginning July 1, 1984.

Diesel fuel tax

The conference agreement follows the House bill, with four modifications.

First, the excise tax on diesel fuel is increased by 6 cents a gallon to 15 cents a gallon.

Second, the credit or refund of tax paid on diesel fuel used in an intercity, local or school bus is generally increased to 12 cents a gallon, resulting in a 3-cents-a-gallon tax. However, this credit or refund is 15 cents a gallon in the case of a local bus while furnishing transportation, available to the general public along regularly scheduled routes, provided that the bus is operated under contract with a State or local government or that such government pays more than a nominal subsidy toward the operation of the bus.

Third, the effective date of provisions relating to the diesel fuel tax is August 1, 1984.

Fourth, the amount of the one-time rebate to purchasers and holders of qualifying vehicles is fixed (to reflect the 6-cents-a-gallon tax increase) at $102 for a new car and $198 for a new truck. As this rebate is designed to compensate the vehicle purchaser for the increase in the diesel fuel tax, the conferees intend that the rebate not be subject to those provisions of P.L. 95–355 that require separate appropriation for effecting payment of newly-enacted refundable tax credits.

2. One-year extension of refund of taxes on fuels used in qualified taxicabs

Present law

Present law provides a 4-cents-per-gallon exemption from the excise taxes on gasoline, diesel fuel, and special motor fuels when those fuels are used in certain taxicabs. The exemption is realized by means of a refund or credit rather than through exempt sales. Qualified taxicabs must be vehicles rated at above-average fuel economy and must not be precluded from offering ride-sharing. This exemption expires after September 30, 1984.

House bill

No provision.

Senate amendment

The Senate amendment extends the present 4-cents-per-gallon exemption for fuels used in qualified taxicabs through September 30, 1985.

The amendment also directs the Secretary of the Treasury to conduct a study of the effectiveness of the exemption and to report to Congress not later than January 1, 1985.

Conference agreement

The conference agreement includes the Senate amendment.

3. Increase in excise tax exemptions for alcohol fuels mixtures and alcohol fuels, income tax credit for qualified alcohol fuels, and duty on imported alcohol fuels

Present law

Excise tax exemptions

Alcohol fuels mixtures.—Present law provides a 5-cents-per-gallon exemption from the excise taxes on gasoline, diesel fuel, and special motor fuels for fuels consisting of mixtures of any of those fuels with at least 10 percent alcohol (i.e., "gasohol") (secs. 4041, 4081, and 6427). The term alcohol is defined to include only alcohol derived from a source other than petroleum, natural gas, or coal.

Alcohol fuels.—Present law provides a 9-cents-per-gallon exemption from the excise tax on special motor fuels for certain alcohol fuels comprised of at least 85 percent alcohol derived from a source other than petroleum or natural gas (sec. 4041).

Alcohol fuels credit

Present law allows a 50-cents-per-gallon income tax credit for alcohol used in mixtures with gasoline, diesel fuel, and special motor fuels where the alcohol comprises at least 10 percent of the mixture (sec. 44E). A like credit is allowed for alcohol used as a fuel, other than in a qualified fuels mixture. The term alcohol is defined to include only alcohol derived from a source other than petroleum, natural gas, or coal.

Duty on imported alcohol fuels

Present law imposes a duty equal to 50-cent-per-gallon on alcohol imported into the United States for use as a fuel (19 U.S.C. sec. 1202).

House bill

No provision.

Senate amendment

Excise tax exemptions

Alcohol fuels mixtures.—The Senate amendment increases the excise tax exemptions for gasohol to 6.75 cents per gallon.

Alcohol fuels.—The Senate amendment provides a 4.5-cents-per-gallon exemption for alcohol fuels at least 85 percent pure if the alcohol is derived from natural gas.

Alcohol fuels credit

The Senate amendment increases the alcohol fuels mixture credit and the alcohol fuels credit to 67.5 cents per gallon.

Duty on imported alcohol fuels

The Senate amendment increases the duty on alcohol imported for use as a fuel to 67.5 cents per gallon.

Definition of certain qualified alcohol

The Senate amendment clarifies that alcohol derived from peat is considered to be derived from coal.

These provisions of the Senate amendment are effective on July 1, 1984. A floor stocks refund or credit is generally allowed to a manufacturer, producer or importer of articles for which the excise tax exemption is increased. The amount of the refund or credit equals the excess tax paid on such articles sold by the manufacturer, producer or importer before July 1, 1984, and held for sale in dealers' inventory on that date.

Conference agreement

The conference agreement includes the Senate amendment, with the following modifications. The conference agreement increases the excise tax exemption for gasohol to 6 cents per gallon, the alcohol fuels mixture credit and the alcohol fuels credit to 60 cents per gallon, and the duty on imported alcohol to 60 cents per gallon.

The provisions of the conference agreement are effective on January 1, 1985. The conference agreement does not include a floor stocks refund or credit provision.

4. Exemption from excise tax for piggyback trailers

Present law

A 12-percent excise tax is imposed on the first retail sale of truck trailer and semitrailer chassis and bodies which are suitable for use with a trailer or semitrailer which has a gross vehicle weight over 26,000 pounds. The tax generally applies to retail sales made after March 31, 1983. Under prior law, a 10-percent manufacturers excise tax applied to the sale of these trailers before April 1, 1983. The changes to a retail tax and higher rate of tax were enacted in the Highway Revenue Act of 1982, which also exempted rail trailers sold after December 2, 1982, from the prior-law and present-law sales tax on heavy trailers.

House bill

No provision.

Senate amendment

The Senate amendment exempts piggyback trailers and semitrailers (including parts or accessories) from the sales tax on heavy trailers. A piggyback trailer includes any trailer which is designed for use principally in connection with trailer-on-flatcar rail service and which the seller, according to regulations prescribed by the Secretary, certifies will be so used.

The conditions for exemption of a piggyback trailer continue to apply after the first retail sale. Thus, if the purchaser of an exempt piggyback trailer subsequently ceases to satisfy the conditions for exemption, the purchaser will be liable for the 12-percent excise tax (determined as if a taxable sale had occurred at that time). Similarly, if an exempt piggyback trailer is subsequently resold, the resale will be subject to the 12-percent tax and the reseller liable to pay the tax, unless the conditions for exemption apply to the resale.

The exemption is effective as if included in that provision of the Highway Revenue Act of 1982 which exempted rail trailers. Refunds are provided for piggyback trailers sold to ultimate purchasers after December 2, 1982, and before the date of enactment.

Conference agreement

The conference agreement includes the Senate amendment, with modifications.

The conference agreement provides that the 12-percent excise tax on the sale of heavy trailers is reduced to 6 percent in the case of piggyback trailers and semitrailers. This reduced tax rate applies only to sales made during the one-year period beginning on the day of enactment, at the end of which period the tax rate returns to 12 percent. The conference agreement does not amend the treatment of piggyback trailers sold prior to the day after the date of enactment.

The conference agreement provides that the Secretary of Transportation is to report to Congress before May 1, 1985, on the appropriate application and level of the excise tax to piggyback trailers.

X. MISCELLANEOUS REVENUE PROVISIONS

A. Estate and Gift Tax Provisions

1. Qualification of certain holding company stock for installment payment of estate tax

Present law

Estate tax attributable to certain interests in closely held businesses may be paid in installments over up to 14 years (interest only for 4 years, followed by up to 10 annual installments of principal and interest). A special 4-percent interest rate is provided for certain amounts of deferred tax.

Qualifying closely held businesses may be conducted as proprietorships, partnerships, or corporations. Generally, only directly owned interests in active business operations are considered for purposes of the installment payment provision.

Present Treasury regulations take the position that the value of a trade or business carried on as a proprietorship includes only the value of those assets actually used in the trade or business. On the other hand, if the business is carried on as a partnership or a corporation, the value of the trade or business includes the value of all partnership or corporate assets, even though a portion of the partnership or corporate assets may be used for purposes other than carrying on a trade or business.

Unpaid tax (and interest thereon) is accelerated if cumulative withdrawals from or dispositions of the interest in the business exceed 50 percent of the value of the interest, if the estate has undistributed net income in certain circumstances, or if any installment is not paid within 6 months after the due date of that installment.

House bill

The House bill permits executors to elect to look through a passive holding corporation for purposes of determining whether the decedent owned an interest in a closely held business if 80 percent or more of the value of the holding corporation consists of the value of nonreadily tradeable stock in a single active business corporation.

Only the value of qualifying stock owned by the holding corporation which is attributable to the value of assets (including working capital) actually used in an active business operation is considered for purposes of the installment payment provision. If the election is made, the special 4-percent interest rate and 5-year deferral of principal payments are not available.

Conforming amendments are made to the acceleration provisions of present law providing that a disposition of an interest in or a withdrawal of property from the passive holding corporation as well as the active business may result in acceleration of unpaid tax. Likewise, dividends paid by the active business corporation to the holding corporation are treated as paid to the decedent's estate to the extent of the decedent's interest in the holding corporation.

This provision is effective for estates of individuals dying after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill except the Senate amendment also permits executors to elect to look through multiple tiers of passive holding corporations to determine whether the decedent owned an interest in a closely held business. The multiple tier look through is available only if at least 20 percent of the value of each corporation to be looked through is included (directly or indirectly) in the value of the decedent's gross estate. The Senate amendment also expands the House rule under which only the value of assets (including working capital) actually used in an active business are considered for purposes of the installment payment provision to provide that, in the case of all interests in partnerships and corporations (whether or not a passive holding corporation is present), only the value of assets directly related to the reasonable needs of the business are considered.

Conference agreement

The conference agreement follows the Senate amendment with technical modifications. Under the conference agreement, interests in active closely held corporations may be considered for purposes of the installment payment provision provided the indirectly owned interest would meet the requirements of that provision were it directly owned. Therefore, an indirectly owned interest in a single closely held corporation qualifies if the corporation has 15 or fewer shareholders or the decedent owned 20 percent or more of the corporation's voting stock. Also, the value of the business interest must exceed 35 percent of the value of the decedent's adjusted gross estate. As under present law, if a decedent owns interests in more than one closely held business, at least 20 percent of the value of each such business must be included in the decedent's estate if the businesses interests are to be aggregated for purposes of the installment payment provision.

The conference agreement retains the rules of the House bill and the Senate amendment pursuant to which the special 4-percent interest rate and the 5-year deferral of principal are not available to estates electing the special look-through provision.

Additionally, the conference agreement retains the rule that in the case of all corporations and partnerships, only active business assets are considered for purposes of the installment payment provision. The conference agreement does not apply to this rule, however, for purposes of the acceleration rules of section 6166(g).

Finally, the conference agreement includes an exception under which multiple wholly owned subsidiaries of a passive holding company may be treated as one subsidiary corporation if the holding company has fifteen or fewer shareholders on June 22, 1984, and at all times prior to the owners' death, and if at least some of the subsidiaries are carrying on a trade or business. In determining whether the subsidiary corporations are 100 percent owned, a de minimis amount of stock owned by the directors of a corporation, that under State law is treated as owned by the corporation is also treated as owned by the corporation for purposes of this rule.

2. Repeal of the generation-skipping transfer tax

Present law

A tax is imposed on generation-skipping transfers under a trust or similar arrangement upon the distribution of trust assets to a generation-skipping heir (for example, a great-grandchild of the grantor of the trust) or upon termination of an interest in or power over the trust (for example, termination of a life income interest held by the grantor's child).

Basically, a generation-skipping trust is one which provides for a splitting of benefits between two or more generations younger than the generation of the grantor of the trust. The tax imposed on generation-skipping transfers is substantially equivalent to the the tax that would have been imposed if the property had been transferred outright to each successive generation (in which case, the gift or estate tax would have applied).

House bill

No provision.

Senate amendment

The Senate amendment repeals the generation-skipping transfer tax, effective with respect to such transfers occurring after June 11, 1976 (the date on which the tax was originally effective).

Conference agreement

The conference agreement follows the House bill.

3. Tax treatment of certain disclaimers of interests transferred before November 15, 1958

Present law

A disclaimer is a refusal to accept the ownership of property or of rights with respect to property. If a qualified disclaimer is made, the Federal gift, estate, and generation-skipping transfer tax provisions apply with respect to the property interest disclaimed as if the interest had never been transferred to the person making the disclaimer. Thus, the transfer of property pursuant to a disclaimer is not treated as a taxable gift by the person making the disclaimer.

On November 15, 1958, the Treasury Department adopted regulations clarifying the requirement that a disclaimer, to be effective, must be made within a reasonable time after the transfer in which the property interest was created. These regulations applied to interests in property transferred before that date, as well as to such interests transferred after November 14, 1958. In 1976, Congress enacted statutory provisions similar to the 1958 regulations, applicable to disclaimers made after 1976 (Code sec. 2518).

On February 23, 1982, the Supreme Court upheld the applicability of the Treasury regulations to disclaimers of property interests transferred before November 15, 1958 (*Jewett* v. *Comm'r* (455 U.S. 305 (1982))).

House bill

No provision.

Senate amendment

The Senate amendment permits disclaimers of property interests created by transfers occurring before November 15, 1958, to be made within 90 days after the date of enactment in certain cases. To be qualified, these disclaimers must satisfy all requirements of the present statutory rules, except for the requirement that the disclaimer be made within nine months of the transfer creating the interest.

Conference agreement

The conference agreement follows the House bill.

4. Clarification that certain usufruct interests qualify for estate tax marital deduction

Present law

Present law generally permits an unlimited estate tax deduction for the value of interests in property passing from a decedent to his or her surviving spouse (Code sec. 2056). The election is available with respect to a "terminable interest" in property only if the executor makes a special election (i.e., makes a so-called "QTIP election"). If the election is made, the full value of the terminable interest in property is included in the estate of the surviving spouse. A terminable interest is an interest that terminates upon the lapse of time or the occurrence or failure of an event or other contingency.

Under the Louisiana Civil Code, if a surviving spouse receives a usufruct interest created by will, the interest generally is comparable to a common law life estate. Such a usufruct interest may be in consumable or nonconsumable property. It is unclear under present law whether a usufruct for life in consumable property is eligible for the QTIP election because Louisiana law does not trace the usufruct property to find if that property actually is included in the surviving spouse's estate.

House bill

No provision.

Senate amendment

The Senate amendment clarifies that a usufruct interest for life in both consumable and nonconsumable property is eligible for the QTIP election. The provision is effective for estates of individuals dying after 1981.

Conference agreement

The conference agreement follows the Senate amendment with certain clarifications as to the technical application of the provision. The conferees recognize that different results arguably might obtain in cases where a usufruct for life with respect to which a QTIP election is made is in consumable property (e.g., a certificate of deposit) as opposed to nonconsumable property. This difference could result from the fact that, unlike nonconsumable property, the consumable property is commingled with the spouse's own property and Louisiana law does not provide for tracing of the consumable property in the estate.

In the case of nonconsumable property, because the specific QTIP property can be identified, the entire value of that property is included in the estate of the second spouse to die exclusively under Code section 2044. Therefore, the value of the property is counted only one time in determining the value of the spouse's estate. Similarly, no deduction is allowed under section 2053 for any claim against a surviving spouse's estate by the naked owner of the nonconsumable usufruct property for which a QTIP election was made by the estate of the first spouse to die.

The conferees wish to reiterate that, as provided by the Senate amendment, these same results obtain in the case of a usufruct for life in consumable property with respect to which a QTIP election is made. A usufruct for life in consumable property for which a QTIP election is made is to be treated as exclusively included in the estate of the second spouse to die under section 2044 to the extent of the naked owner's claim against the spouse's estate with respect to the property, and as exclusively included under section 2033 to the extent of any excess value. Similarly, the claim of that spouse's estate for contribution from the naked owners of the property arising under section 2207A is to be limited to an amount of tax determined as if the value of the usufruct interest included in the spouse's estate were equal to the amount included in the estate under section 2044. Finally, no deduction is allowed under section 2053 for any claim against the surviving spouse's estate by the naked owners of the consumable usufruct property for which a QTIP election was made by the estate of the first spouse to die.

5. Special estate tax credits

Present law

A deduction generally is allowed for estate tax purposes for certain amounts transferred for charitable purposes (Code sec. 2055). The United States is a qualified donee of such deductible transfers. Credits against estate tax are not provided for transfers for charitable purposes.

House bill

No provision.

Senate amendment

The Senate amendment provides special estate tax credits for the estates of Nell J. Redfield and Elizabeth Schultz Rabe. The credits apply to the transfer, without reimbursement or payment, to the Secretary of Agriculture for addition to the Toiyabe National Forest of real property located within or adjacent to the boundaries of that national forest.

Conference agreement

The conference agreement follows the Senate amendment.

6. Perfection of estate tax current use valuation elections

Present law

An executor may elect to value certain real property used in farming or other closely held business operations for estate tax purposes based upon its current use rather than its full fair market value (Code sec. 2032A). The election may be made only on the first estate tax return filed. Additionally, all persons with an interest in the property to be specially valued must enter into an agreement to the election, which agreement is binding under local law. Treasury regulations require that a notice of election and the required agreement must be filed with the estate's Federal estate tax return.

House bill

No provision.

Senate amendment

The Senate amendment directs the Treasury Department to develop procedures permitting perfection of notices within 90 days of a request from the Internal Revenue Service. Under the Senate amendment, the right to perfect a notice of election or agreement applies only where those items, as originally filed, substantially comply with the requirements of the regulations.

Conference agreement

The conference agreement follows the Senate amendment. The conferees wish to reiterate that, as under the Senate amendment, perfection of notices of election and of agreements to current use valuation elections is to be permitted only in cases where the estate tax return, as filed, evidences substantial compliance with the requirements of the Treasury regulations. For example, merely checking the applicable box on the Federal estate tax return that an election is being made is not sufficient action by the estate to secure the benefits of the current use valuation provision. Both a notice of election and an agreement that themselves evidence substantial compliance with the requirements of the regulations must be included with the estate tax return, as filed, if the estate is to be permitted to perfect its election.

Illustrations of the type of information that may be supplied after the initial filing of a notice of election are omitted social security numbers and addresses of qualified heirs and copies of written appraisals of the property to be specially valued. This provision does not, however, permit such appraisals to be obtained only after the estate tax return is made. Rather, the provision simply permits the submission of previously obtained appraisals. Likewise, a notice of election which does not provide a legal description of the property to be specially valued may not be perfected unless the notice, as initially filed with the estate tax return, described the property with reasonable clarity, even though the full legal description was not provided.

As stated above, an agreement to the current use valuation election may be perfected under this provision provided the agreement, as filed with the estate tax return, evidences substantial compliance with the requirements of the regulations. To be eligible for perfection, the agreement as originally filed must at a minimum be valid under State law and must include the signatures of all parties having a present interest or a remainder interest other than an interest having a relatively small value.[1] The right to perfect agreements is intended to be limited to cases where, for example, a parent of a minor remainderman, rather than a *guardian ad litem* as required under State law, signs the agreement. Similarly, failure to designate an agent in the agreement as filed may be corrected under this provision.

7. No gain recognized from net gifts made before March 4, 1981

Present law

Gift tax is the liability of the person making a gift. Satisfaction of a person's debt or other liability generally results in income to the person relieved of the liability. The Supreme Court, in *Diedrich* v. *Comm'r* (457 U.S. 191 (1982)), held that a net gift (i.e., a gift in which the gift tax is paid by the donee of the transferred property)

[1] The conferees are aware that the current use valuation provision requires that, when successive interests or concurrent interests are created in specially valued property, all parties with any interest in the property must be qualified heirs and all such parties must enter into the agreement to the election, regardless of the relative values of their interests. The de minimis rule established in this provision is intended to apply solely as a guideline in determining whether perfection of an agreement is to be permitted. The guideline is not intended to give rise to an inference that parties having an interest in specially valued property which has a relatively small value are not required to enter into the agreement or that such persons need not be qualified heirs.

results in income to the donor to the extent that this gift tax exceeds the donor's basis in the transferred property.

House bill

The House bill provides that payment of gift tax by a donee does not result in income to the donor in the case of net gifts made before March 4, 1981. The effect of this provision is to reverse the Supreme Court decision in *Diedrich* v. *Comm'r* with respect to net gifts made before that date.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

8. Reformation of certain charitable split-interest trusts

Present law

Trusts having both charities and noncharities as beneficiaries generally must be structured as unitrusts or annuity trusts to qualify for a charitable deduction. These requirements were enacted by the Tax Reform Act of 1969.

Certain trusts created before December 31, 1978 (including trusts created in wills executed before that date) could be reformed (amended) to satisfy the unitrust, etc. requirements if (1) judicial or other proceedings were begun before January 1, 1982, and (2) the trust were amended within 30 days after completion of the proceedings (Code sec. 2055).

Present law includes no rule permitting reformation of defective charitable split-interest trusts created after December 31, 1978.

House bill

The House bill provides a permanent rule permitting reformation of charitable split-interest trusts if certain requirements are satisfied. Under this provision of the House bill, the relative values of the charity and the noncharity interests in the trust may not vary by more than 5 percent as a result of the reformation. Additionally, unless reformation proceedings are begun within 90 days after the due date of the Federal estate tax return (or the first trust income tax return if no estate tax return is due), the trust must, as executed, provide for an annuity trust or unitrust amount.

The provision is effective generally for reformations made after December 31, 1978.

Senate amendment

The Senate amendment is the same as the House bill, except the Senate amendment also provides that a reformation is deemed to occur to the extent that, pursuant to trust provisions, property passes directly to a charity before the due date of the estate tax return.

Conference agreement

The conference agreement follows the Senate amendment.

9. Alternate valuation date election

Present law

The value of property included in an individual's gross estate for Federal estate tax purposes generally is determined on the date of the individual's death. However, the executor of an estate may elect to value all property included in the gross estate as of the alternate valuation date, which generally is the date six months after the date of the decedent's death. The election to use the alternate valuation date must be made on a timely filed estate tax return (Code sec. 2032).

House bill

The House bill limits eligibility for the alternate valuation date election to estates where both the total value of the individual's gross estate and the amount of estate tax liability are reduced as a result of the election. The House bill also provides that the alternate valuation date election may be made on the first estate tax return filed (whether timely filed or late filed). Once an election is made, it is irrevocable.

The provision is effective for estates of individuals dying after the date of enactment.

Senate amendment

The Senate amendment is similar to the House bill with the following modifications:

(1) The total estate tax liability of the estate is not required to be reduced as a result of the election;

(2) The executor must determine in "good faith" that the value of assets in the gross estate for which no charitable or marital deduction is allowable is decreased (even though the value of the gross estate itself may not be decreased);

(3) A late-filed return on which a valid election is made may not be filed more than one year after the due date for the return and the principal purpose of the late filing may not be to make the election; and

(4) The provision is effective for estates of individuals who died before the date of enactment provided those estates satisfy the new requirements imposed by the amendment.

Conference agreement

The conference agreement follows the House bill with two modifications. First, as under the Senate amendment, an election may be made on a late-filed return only if the return is filed within one year of the due date. (As under the House bill, the election must be made on the first return filed, and is irrevocable, once made.)

Second, as under the Senate amendment, in addition to applying to estates of individuals dying after enactment, the conference agreement applies retroactively to estates that would qualify under the amended provision had the decedent died after the date of enactment. This retroactive effect is available, however, only if the period of limitations for assessment of estate tax remains open on the date of enactment, and if the estate makes a claim for refund within 90 days of enactment.

B. Excise Tax Provisions

1. Excise tax on sport fishing equipment

Present law

Imposition of tax.—A 10-percent excise tax is imposed on the sale by a manufacturer, producer or importer of fishing rods, creels and reels, and artificial lures, baits and flies (including parts and accessories).

Time of payment.—Treasury regulations generally require monthly or semi-monthly payment of excise taxes. If excise tax liability is more than $2,000 in any month, then tax deposits must be made semi-monthly during the following quarter.

House bill

Imposition of tax.—There is no provision in H.R. 4170. However, in H.R. 2163 as passed by the House, the 10-percent tax is expanded to various additional articles of sport fishing equipment, and supplies and accessories, including tackle boxes. A special 3-percent tax is imposed on electric outboard motors. These changes are effective for articles sold after December 31, 1983.

H.R. 2163 continues imposition of the tax at the manufacturer's level, with a Committee Report statement to indicate that the IRS is to enforce actively the present-law constructive-sales price rules to insure that the incidence of the tax be equivalent for all manufacturers, producers and importers, regardless of form of business organization.

Time of payment.—H.R. 2163 changes the time of payment for the excise tax on sport fishing equipment to require payment on a quarterly basis: March 31, June 30, September 24, and a date to be prescribed by Treasury regulations, for the respective prior calendar quarter's tax liability.

Senate amendment

Imposition of tax.—The Senate amendment expands the 10-percent excise tax on sport fishing equipment to include the same additional articles as under the House bill except for tackle boxes which are taxed at a 3-percent rate. The Senate amendment also applies the 3-percent tax to electric outboard boat motors (as in the House bill) and certain fish finders (sonar devices suitable for finding fish, *except* graph recorders, digital type or meter readout devices, with a maximum tax of $30 per item). These changes generally are effective for articles sold after September 30, 1984, except that the tax on tackle boxes and fish finders is effective on October 1, 1985.

The Senate amendment replaces the manufacturers tax with a tax on the *last sale before retail* (generally the wholesale level except where an article sold directly from a manufacturer/producer or importer to a retailer). Under a special rule where the last sale before retail occurs before importation, the tax is imposed on the importer at the point of entry. This change in the level of the tax is effective for articles sold after September 30, 1984.

Time of payment.—The Senate amendment excuses small manufacturers (i.e., those having gross sales receipts of $100,000 or less for the preceding calendar year) from the present-law excise tax deposit requirements, thereby enabling these manufacturers to pay the tax on a quarterly basis with their regular Federal excise tax return. Other taxpayers must pay the tax as provided under present law.

Conference agreement

Imposition of tax.—The conference agreement follows the House bill with regard to the articles subject to tax at the 10-percent rate. As provided by the House bill and the Senate amendment, electric outboard boat motors will be subject to tax at a 3-percent rate, and as provided in the Senate amendment, certain sonar devices suitable for finding fish will be subject to tax (up to a maximum tax of $30).

The conference agreement generally follows the House bill with regard to the point at which tax is imposed. Therefore, the excise tax on sport fishing equipment will continue to be imposed at the manufacturer's (or importer's) level. However, the conference agreement provides that tax will be imposed a second time, on the sale of an article subject to tax by any wholesale distributor or retailer who (1) is a related party to the manufacturer or importer of the article sold, and (2) acquires the article from an unrelated party (i.e., from a party other than the manufacturer or importer). In cases where the tax is imposed a second time on any article, a credit for prior tax paid is available, provided the wholesale distributor or retailer can document the amount of tax that actually was paid previously. This documentation requirement generally will be considered as satisfied only through submission of copies of actual records of the party that previously paid the tax. For purposes of these rules, the term related party generally includes parties described in Code section 2670.

The conferees also are concerned that certain manufacturers and importers of taxable sport fishing equipment are engaged in arrangements that are not covered under the related party rules adopted above, but that do not represent true arm's-length dealings. Rather these transactions are in substance (if not form) dealings between related parties or are transactions conducted primarily to reduce Federal excise tax. Therefore, the conference agreement provides that, except as provided in Treasury regulations, certain sales are not to be treated as taxable first sales by a manufacturer or importer. Rather, the regulations will provide that tax is to be imposed on a later sale in such cases. The conferees intend that these regulations generally will provide that a sale by a manufacturer or importer is not to be treated as a taxable first sale for purposes of this tax unless the party selling the articles (1) conducts all manufacturing or importation transactions and related documentation in its own name; (2) assumes risks of late delivery and loss and pays freight, insurance costs, and customs duties (in the case of importers); (3) has on its payroll the employees who are engaged in the manufacturing process conducted by it or who are engaged in all aspects of the importation or other distribution of articles processed by it, including dealings with manufacturers with regard to quantity, quality control, design specifications and shipping; (4) finances the manufacture or purchase of previously manufactured articles on its own account; (5) maintains inventories of the articles in its own name; and (6) earns normal profits (determined by reference to industry standards) on its sales that are to treated as taxable first sales.

Finally, the conferees wish to state that they found persuasive arguments that inadequate State fisheries budgets have necessitated reductions in staff and programs. State fishery agencies have collectively indicated a pressing need for over $162 million per year in additional revenue to manage adequately the nation's recreational fishery resources. The conferees, in establishing this expanded funding source, intend that the new revenues be added to existing State fishery program funds available from traditional sources and not as a substitute therefor.

Time of payment.—The conference agreement generally follows the Senate amendment except all manufacturers and importers are excused from making deposit requirements in the case of the excise tax on sport fishing equipment. Under the conference agreement, the sport fishing equipment excise tax will be payable in full on the date established by the Treasury Department for filing of the quarterly return of that tax. The conferees have reached this decision because of the unique seasonal nature of the market for sport fishing equipment and intend that this action not be cited as precedent for excusing payers of other Federal excise taxes from deposit requirements.

Effective date.—The conference agreement is effective for sales occurring and for payments of tax due after September 30, 1984.

2. Aquatic Resources Trust Fund and Land and Water Conservation Fund

Present law

Financing of special funds.—Under present law, there is no special trust fund for sport fish restoration or for the Federal boating safety program. However, the sport fish restoration program is funded by an appropriation of amounts equivalent to the prior fiscal year revenues from the existing 10-percent excise tax on fishing equipment. The Federal boating safety program is financed through an appropriation to a special "fund" not having the status of a trust fund (the National Recreational Boating Safety and Facilities Improvement Fund). The appropriation is equivalent to revenues attributable to the 9-cents-per-gallon excise tax on motorboat fuels, up to $45 million per fiscal year for 1983-1988 (with a maximum fund balance at any time of $45 million). Any excess motorboat fuels tax revenues go to the Land and Water Conservation Fund, along with certain other, nontax monies (including general appropriations).

Fund expenditures.—The sport fish restoration program provides matching funds (up to 75 percent) for State fish restoration and management projects. A portion (8 percent) of the annual appropriation is available to the Secretary of the Interior for Departmental administrative expenses relating to the program. The balance of the appropriation is allocated to the States pursuant to a statutory formula. The Federal boating safety program provides financing for Federal-State recreational boat safety and facilities improvements projects. Currently monies are allocated one-third for boating safety programs and two-thirds for boating facilities improvement programs, and are allocated by formula among eligible States.

House bill

Financing of funds.—H.R. 2163, as passed by the House, establishes the Aquatic Resources Trust Fund. The new Trust Fund would include two separately financed accounts.

(1) *Sport Fish Restoration Account.*—This Account is to be financed from revenues attributable to (a) the expanded excise tax on sport fishing equipment; (b) motorboat fuels taxes, to the extent these revenues exceed the amounts transferred to the Boating Safety Account and Land and Water Conservation Fund (see below); and (c) import duties on sport fishing equipment and yachts and pleasure craft.

(2) *Boating Safety Account.*—This Account is to be financed by revenues attributable to the 9-cents-per-gallon motorboat fuels taxes, up to $45 million per fiscal year for 1983–1988 (with the present $45 million balance limit).

In addition, the Land and Water Conservation Fund will be limited to $1 million per fiscal year from the motorboat fuels tax revenues; the other financing sources for that Fund remain the same as under present law.

Fund expenditures.—H.R. 2163 also expands and redefines the purposes for which the new Aquatic Resources Trust Fund monies may be spent for the sport fish restoration and Federal boating safety programs. (No changes are made in the expenditure purposes for the Land and Water Conservation Fund.)

(1) *Sport fish restoration program.*—Monies must be allocated equitably between marine and freshwater sport fishing projects. Each State is required to allocate a minimum of 10 percent of its program monies to projects that improve public access to recreational boating waters. Also, States are authorized to use up to 10 percent of their allocation for aquatic resource education programs. Department of Interior administrative expenses are limited to 6 percent per year of the Account's monies.

(2) *Federal boating safety program.*—Monies will be reallocated so that (a) two-thirds (up to $30 million per year) are used for State boating safety programs and (b) one-third (up to $15 million per year) is made available to the U.S. Coast Guard to defray the costs of services provided by it for recreational boating safety. Amounts will no longer be available under this program for boating facilities improvements. (Amounts will be available for this purpose under the expanded sport fish restoration program.)

Effective date.—Trust fund monies may be expended for the period October 1, 1983 through March 31, 1989.

Senate amendment

Financing of funds.—The Senate amendment is generally the same as the provisions of H.R. 2163, except for the differences in tax rates on tackle boxes and fish finders (see above).

Fund expenditures.—The Senate amendment is the same as H.R. 2163 regarding the trust fund expenditure purposes.

Effective date.—Trust fund monies are available for expenditure for the period October 1, 1984 through March 31, 1989.

Conference agreement

The conference agreement follows the Senate amendment, including the provision that the popular name of the Aquatic Resources Trust Fund will be the Wallop-Breaux Fund.

3. Excise tax on certain arrows

Present law

An 11-percent manufacturers excise tax is imposed on the sale of any bow having a draw weight of 10 pounds or more and of any arrow measuring 18 inches overall or more in length. Revenues attributable to this tax are appropriated to the Federal Aid to Wildlife Program ("Pittman-Robertson" fund) for support of State wildlife programs.

House bill

The House bill contains no provision; however, H.R. 2163, as passed by the House, expands the tax on arrows to include those arrows fewer than 18 inches in length which are suitable for use with a taxable bow (i.e., crossbows). The expanded tax applies to sales of such arrows after December 31, 1983.

Senate amendment

The Senate amendment is the same as H.R. 2163, except that the expanded tax applies to sales after September 30, 1984.

Conference agreement

The conference agreement follows the Senate amendment.

4. Exemption of certain helicopter operations from aviation excise taxes

Present law

Present law provides exemptions from the aircraft fuels and air transportation taxes for helicopters employed in hard mineral resource exploration and mining and in forestry operations provided the helicopters do not use Federally aided airports or Federal airway facilities.

House bill

No provision.

Senate amendment

The Senate amendment expands the present exemptions to include helicopters employed in the exploration and development of oil and gas. This provision is effective on April 1, 1984.

Conference agreement

The conference agreement follows the Senate amendment.

5. Superfund excise tax corrections

Present law

Under present law, an excise tax is imposed on certain specified chemicals to fund the Hazardous Substance Response Trust Fund. Proposed Treasury regulations would apply this tax to (1) light hydrocarbons added to motor fuels, and (2) metal compounds occurring temporarily during refining processes. Present law provides an exemption for fertilizer which is administered by using a certification procedure required by statute.

House bill

No provision.

Senate amendment

The Senate amendment makes three technical amendments to the Hazardous Substance Response Revenue Act of 1980. First, light hydrocarbons added to gasoline, diesel fuel, and aviation fuel are exempt from the tax. Second, cupric sulfate, cupric oxide, cuprous oxide, lead oxide, zinc chloride, zinc sulfate, and barium sulfide are exempt if they have only a transitory presence during smelting, refining, or extracting metal from ore. Third, the certification procedure for the fertilizer exemption is eliminated.

These provisions apply as if included in the Hazardous Substance Response Revenue Act of 1980.

Conference agreement

The conference agreement follows the Senate amendment with technical modifications.

C. Income Tax Credits

1. Residential renewable energy tax credits

Present law

Individuals are allowed a 40-percent energy tax credit on expenditures up to $10,000 for renewable energy property, which is defined as solar, wind or geothermal property. Qualified property must be installed in or on a taxpayer's principal residence. Expenditures may be made through 1985, and unused credits at the end of 1985 may be carried forward through 1987. The maximum amount of credits is $4,000.

House bill

No provision.

Senate amendment

Residential renewable energy credits are extended for two additional years, through 1987. Unused credits may be carried forward through 1989.

Conference agreement

The conference agreement follows the House bill.

2. Business energy tax credits

Present law

(a) *Solar, wind, geothermal and ocean thermal property.*—Qualified property is eligible for a 15-percent energy tax credit, which will expire at the end of 1985.

(b) *Rules for geothermal property.*—Qualified geothermal equipment is defined as being necessary to transmit or use energy from an underground reservoir. The energy consists of natural heat which is stored in rocks, liquid or vapor, and has a temperature exceeding 50 degrees Celsius (122 degrees Fahrenheit). This definition also applies to residential geothermal sources.

(c) *Dual purpose equipment.*—Under current regulations, equipment that serves both geothermal and nongeothermal functions does not qualify for the energy tax credit; however, emergency backup systems are not disqualified.

(d) *Biomass property.*—A 10-percent energy credit is available for qualified biomass property that is placed in service through 1985 and produces a qualified fuel from an alternate substance, i.e., neither oil, gas or one of their products.

(e) *Shale oil hydrogenation equipment.*—The 10-percent energy credit for shale oil equipment used through the retorting process and for equipment for hydrogenation or other processes subsequent to retorting in the vicinity of the extraction site expired after 1982, except for an affirmative commitment rule. Hydrogenation equipment is not eligible for the credit under the affirmative commitment rule.

(f) *Tar sands equipment.*—No provision.

(g) *Affirmative commitment.*—Energy credits which expired after 1982 remain available after their statutory expiration date for projects that require 2 or more years for completion, if (1) all engineering studies have been completed, and all necessary construction and environmental permits have been filed for, before 1983, (2) binding contracts for 50 percent of specially designed equipment have been entered into before 1986, and (3) the project is completed and placed in service before 1991.

(h) *Photovoltaics.*—Photovoltaic cells are eligible for the 15-percent solar credit through 1985.

House bill

No provision.

Senate amendment

(a) *Solar, wind, geothermal, and ocean thermal property.*—The credit is extended at the 15-percent rate for 3 years, through 1988.

(b) *Rules for geothermal property.*—The qualifying temperature threshold is reduced to 40 degrees Celsius (104 degrees Fahrenheit), as measured at the wellhead or at the intake to the distribution system. This change applies also to geothermal sources for residential renewable energy systems.

(c) *Dual purpose equipment.*—Equipment that serves dual functions will qualify for the credit in equal percentage to the geothermal use, if at least 50 percent of the use is for geothermal purposes.

Geothermal equipment also will qualify for the regular investment credit, if the equipment is used for geothermal purposes at least 50 percent of the time, and the remaining energy requirement is supplied by an alternate substance, i.e., neither oil, gas or one of their products. This rule does not change the present law rules relating to structural components.

(d) *Biomass property.*—The credit for qualified biomass property is extended for an additional 3 years, through 1988. Qualifying property also will include methane-containing gas for fuel or electricity which is produced by anaerobic digestion from nonfossil waste materials at farms or other agricultural facilities, and at facilities for the first processing of agricultural products.

The extension of the credit will not apply, however, to biomass property used in a trade or business that is included in the forest or paper products industries.

(e) *Shale oil hydrogenation equipment.*—Hydrogenation equipment that qualified for the energy credit before 1983 will continue to qualify under the extension of the affirmative commitment rules, (g) below.

(f) *Tar sands equipment.*—The 10-percent energy credit is made available for tar sands equipment, which includes mining, quarrying and extraction equipment through extraction of oil and other processing (including hydrogenation), but the credit will not be available for equipment used in refining. December 31, 1988, is the intended termination date for the credit, and the affirmative commitment rule will apply, as extended in (g) below.

(g) *Affirmative commitment rules.*—

(1) *Synthetic fuels projects.*—The rules requiring completion of certain actions by specific dates are deferred by several years for synthetic fuels projects that involve coal, shale oil and tar sands, if (1) required studies and filings for permits are completed before 1987, (2) binding contracts are entered into for 50 percent of specially designed equipment before 1990, and (3) the project is completed and placed in service before 1993.

(2) *Renewable energy sources.*—The expiration date of the energy credit for solar, wind, geothermal, and ocean thermal equipment is extended for one additional year, through 1989, if required studies and permit filings are completed before January 1, 1989, and (2) binding contracts are entered into for 50 percent of specially designed equipment before July 1, 1989.

(h) *Photovoltaic equipment.*—Photovoltaic property will become eligible for a 25-percent energy credit for 1985 and 1986, a 20-percent energy credit for 1987, and a 15-percent energy credit for 1988. These credits are available in lieu of the 15-percent renewable energy credit that is extended through 1988.

Qualified property includes equipment which is an integral part of a system that converts sunlight directly into electricity, and (2) structures that house or support eligible equipment. Photovoltaic equipment is not eligible for the solar and wind energy credits and does not include public utility property. The at-risk rules which apply to the investment credit will apply also to the energy credit for photovoltaic equipment.

The photovoltaic equipment energy credit will be available for property placed in service on or after January 1, 1985.

(i) *Effective date.*—The revisions in the provisions for business energy credits are effective on the date of enactment unless another date is specified.

Conference agreement

The conference agreement follows the House bill. The conferees understand that the House will hold hearings on the expiring credits so that informed decisions can be made in 1985 about whether to extend these credits.

3. Definition of new property for tax credit purposes

a. Energy property

Present law

Regular investment tax credits and energy property tax credits are allowed with respect to certain kinds of new property. In determining whether property is new property for purposes of the regular investment credit, property subject to a lease is treated as originally placed in service not earlier than the date the property is used under the lease, but only if the property is leased within 3 months of the date it is in fact placed in service. No similar rule applies in determining whether property is new for purposes of the energy property tax credit.

House bill

No provision.

Senate amendment

Under the Senate amendment, the 3-month rule, as amended by the bill, is applicable in determining whether property is new for regular investment credit purposes is applicable in determining whether property is new for energy property credits as well.

The provision is effective for property placed in service after April 11, 1984.

Conference agreement

The conference agreement follows the Senate amendment.

It is clarified that the provision is effective for property in fact placed in service after April 11, 1984.

b. Investment credit property

Present law

Investment tax credits are allowed with respect to certain kinds of new property. In determining whether property is new property for this purpose, property subject to a lease is treated as originally placed in service not earlier than the date the property is used under the lease, but only if the property is leased within 3 months after such property is placed in service (sec. 48(b)).

House bill

No provision.

Senate amendment

For investment credit purposes, the 3-month rule is limited to sale-leasebacks. Thus, only in the case of property which is originally placed in service by a person and which is sold and leased back by such person within 3 months of the date such property was originally placed in service will such property be treated as originally being placed in service not earlier than the date it is used under the lease. The rule is also made applicable for purposes of the energy property tax credit.

The provision is effective for property placed in service after April 11, 1984.

Conference agreement

The conference agreement generally follows the provision in the Senate amendment.

The conferees understand that taxpayers buying property from a manufacturer often take delivery of it and place it in service before they have their financing in place. Shortly after they place it in service, the property may be sold (or the purchase order assigned) by such taxpayer to another taxpayer who then leases it to the first taxpayer. The conferees intend the 3-month rule to be applicable in that case. Therefore, the conference agreement clarifies that the 3-month rule applies if the person who originally placed the property in service leases it within 3 months of having originally placed it in service.

It is clarified that the provision is effective for property in fact placed in service after April 11, 1984.

4. Extension of targeted jobs tax credit

Present law

The targeted jobs tax credit is available for wages paid to individuals who (1) begin work for an employer before January 1, 1985, and (2) are included in one of 9 categories of individuals who are economically disadvantaged or handicapped or who receive public assistance. The credit generally is 50 percent of the first $6,000 of wages paid in the first year of employment and 25 percent in the second year of employment.

An authorization of appropriations for funds to administer the certification of eligible individuals expires after fiscal year 1984.

To claim the targeted jobs credit for wages paid to a targeted group member, an employer must receive or request a certification that a new employee is a member of a targeted group on or before the day the individual begins work for the employer.

House bill

No provision.

Senate amendment

The Senate amendment extends the targeted jobs tax credit to apply to individuals who begin work for the employer before January 1, 1988, and extends the authorization for administrative funds through fiscal year 1987.

The Senate amendment extends the deadline for requesting certification to 5 days after the individual begins work for the employer, if the individual has received a "voucher" (i.e., a preliminary determination of targeted group eligibility) on or before the day the individual begins work for the employer.

Conference agreement

The conference agreement follows the Senate amendment, with modifications. First, the credit is extended for one year, to apply to individuals who begin work for the employer before January 1, 1986, and the authorization of administrative funds is extended through fiscal year 1985. Second, the credit is amended to treat a successor employer as if it were the predecessor for purposes of computing the amount of credit. Third, the conference agreement provides that the credit is allowed with respect to the remuneration of an employee who performs services for another person only if the payment by the other person to the employer exceeds the remuneration paid by the employer to the employee. This change is intended to prevent employers from lending or donating the services of individuals on their payroll to tax-exempt or other organizations which do not have sufficient tax liability to take advantage of the credit. Fourth, the credit is amended to provide that the age requirements of a summer youth employee are tested on the basis of the employee's age on May 1, if later than the hiring date. Fifth, the conference agreement deletes an obsolete provision dealing with the beginning of the 1-year credit eligibility period for vocational rehabilitation referrals.

5. Earned income tax credit

Present law

Certain individuals or couples with children are allowed a refundable tax credit equal to 10 percent of the first $5,000 of earned income, for a maximum credit of $500. The maximum credit is phased down to zero as income increases from $6,000 to $10,000.

House bill

No provision.

Senate amendment

The Senate amendment increases the rate of the credit to 10.5 percent and, thus, the maximum credit to $525, and raises the income level at which the credit is fully phased out to $11,000. The provision is effective for taxable years beginning after December 31, 1984.

Conference agreement

The conference agreement increases the rate of the credit to 11 percent and, thus, the maximum credit to $550, and raises the income range over which the credit is phased out to $6,500 to $11,000. The provision is effective for taxable years beginning after December 31, 1984.

The conference agreement also provides that the amount of credit allowed is reduced by the amount of a taxpayer's liability for alternative minimum tax.

6. Investment tax credit for soil and water conservation expenditures; increase in cost recovery period for single purpose agricultural structures

(a) Soil and water conservation credit

Present Law

A taxpayer may elect to deduct (i.e., expense) certain expenditures for the purpose of soil or water conservation that would otherwise be added to his or her basis in the land on which the conservation activity occurs (Code sec. 175). Deductible expenditures include amounts paid for items such as grading, terracing, and contour furrowing, the construction of drainage ditches, irrigation ditches, dams and ponds, and the planting of wind breaks. Also included assessments levied by a soil or water conservation drainage district are deductible under this provision to the extent those expenditures would constitute deductible expenditures if paid directly by the taxpayer.

The cost of acquiring or constructing machinery or facilities that is depreciable may not be expensed. In the case of depreciable items such as irrigation pumps, concrete dams, or concrete ditches, the taxpayer is allowed to recover his or her cost only through cost recovery allowances and only if he or she owns the asset. Certain depreciable assets also are eligible for the regular 10-percent investment credit.

Certain costs incurred in connection with soil and water conservation are deductible as trade or business expenses without regard to section 175. For example, interest expenses and property taxes are deductible as current expenses. Similarly, the cost of repairs to a complete soil or water conservation structure are deductible as current expenses. Certain other capital expenditures made primarily to produce an agricultural crop are deductible expenses (secs. 180 and 182), but are not treated as soil or conservation expenditures under section 175, because such expenditures only incidentally may conserve soil.

The deduction for soil and water conservation expenditures under section 175 is limited in any one year to 25 percent of the gross income derived by the taxpayer from farming. Any excess amount is carried forward to succeeding taxable years.

House bill

No provision.

Senate amendment

The Senate amendment provides a nonrefundable 10 percent investment credit for certain soil and water conservation expenditures. The credit is available with respect to (1) qualified expenditures otherwise chargeable to the basis of the land on which the conservation activity occurs, and (2) certain expenditures by district conservation authorities. The credit is available only to persons engaged in the business of farming the land on which the conservation improvements are made.

Types of qualified property

Qualified soil conservation improvements

Property that is eligible for the conservation credit consists of any improvements which are certified to the Secretary of the Treasury by the Soil Conservation Service of the Department of Agriculture as (1) consistent with state-of-the-art conservation practices and (2) making a major contribution to the conservation of soil or water on qualified land. A separate certification must be made with respect to each conservation project for which a credit is claimed.

Eligible soil conservation improvements include generally diversion, floodwater retarding, and multiple-purpose dams; fencing for protection of conservation cover; field windbreaks; filter strips, grade stabilization structures; grassed waterways or outlets; livestock water pipelines; sediment control ponds and basins; terracing; tree planting for erosion control and/or conservation cover; waste management systems; and any other improvements specified under Treasury Department regulations.

District conservation property

In addition to soil and water conservation property that is acquired directly by a taxpayer, the portion of assessments levied by a soil and water conservation district authority to finance qualified expenditures made by the authority is creditable by the person paying the assessment.

Qualified land

Expenditures are eligible for a soil conservation credit only if the expenditures are for otherwise qualifying improvements to land located in the United States which was owned entirely by a United States citizen and, as stated above, is used by the owner in the business of farming.

Coordination with certain expensing provisions

No credit is allowable with respect to any expenditure for which a deduction is claimed under present Code section 175 (soil and water conservation expenditures), section 180 (fertilizer, etc. costs), or section 182 (land clearing expenses). In addition, in applying the present limitations on the maximum amount of those deductions under section 175 and section 182 (e.g., 25 percent of gross farming income under sec. 175 and the lesser of 5 percent of taxable farming income or $5,000 under sec. 182), expenditures with respect to which a credit is claimed are treated as if the expenditures have been deducted. For example, if a taxpayer claims a credit with respect to $10,000 of soil conservation expenditures, the taxpayer is treated as if the $10,000 has been deducted under section 175 in determining the taxpayer's maximum allowable deduction under that provision. The provision does not expand the types of expenditures for which a deduction presently is available under section 175, 180, or 182.

Other rules governing the credit

Certain highly erodible land

The credit is not available for expenditures made with respect to highly erodible land, as classified by the (Soil Conservation Service), if the expenditures are made in connection with conversion of that land from range land to crop land.

Maximum amount of credit

The soil conservation credit may not exceed 25 percent of a taxpayer's gross income derived from farming in any year. This limitation is in addition to the rule limiting investment credits generally to no more than 85 percent of tax liability in excess of $25,000.

Credit not allowed for expenditures financed with nontaxable grants

No credit is allowable with respect to conservation property financed with a grant from the Federal Government, or a State or local government, to the extent that the grant is not included in the taxpayer's gross income when received.

Carryover of unused credit and basis adjustment

The rules permitting carryforwards and carrybacks of investment credits generally apply to the credit for soil and water conservation expenditures. Additionally, an adjustment to the basis of the property equal to one-half of the credit amount is required.

Limitation on cost recovery deductions

Cost recovery deductions for any irrigation property with respect to which an investment credit is claimed must be computed using the straight-line method over the appropriate ACRS period rather than the accelerated method otherwise available.

Recapture of credit in certain circumstances

The soil and water conservation credit is recaptured if the taxpayer disposes of the land on which creditable improvements are made within 5 years after the conservation property is placed in service. In addition, the credit is recaptured if the taxpayer claiming the credit ceases to carry on the business of farming on the qualified land within 5 years after that date.

Effective Date

The provisions of the bill apply generally to taxable years beginning after December 31, 1984.

Conference agreement

The conference agreement follows the House bill.

(b) Single purpose agricultural and horticultural structures

Present law

Single purpose agricultural and horticultural structures qualify as 5 year property for ACRS purposes.

House bill

No provision.

Senate amendment

Single purpose agricultural and horticultural structures are treated as 15 year real property depreciable at a rate no more rapid than the 150 percent declining balance method.

This provision applies to property placed in service after date of enactment; however, a transitional rule exempts property where taxpayer had a binding contract to acquire or construct the property, or had commenced construction, before the date of enactment.

Conference agreement

The conference agreement follows the House bill.

7. Alternative test for definition of qualified rehabilitated building

Present law

A three-tier system of rehabilitation credits is provided for qualified expenditures incurred in connection with certain buildings. The credit is equal to 15 percent of qualified expenditures in the case of buildings at least 30 years old, but fewer than 40 years old. In the case of buildings at least 40 years old, the credit is equal to 20 percent of qualified expenditures, and in the case of certified historic structures, the credit is equal to 25 percent of qualified expenditures.

A building qualifies for the rehabilitation credits only if (among other requirements) at least 75 percent of the building's external walls are retained in place as external walls after completion of the rehabilitation.

House bill

No provision.

Senate amendment

The Senate amendment provides an alternative to the requirement that 75 percent of the building's external walls be retained in place as such. The alternative test requires that at least 50 percent of the building's external walls be retained in place as external walls, that at least 75 percent of the building's external walls be retained in place as either external walls or internal walls, and that at least 75 percent of the building's internal structural framework be retained in place.

The provision is effective for expenditures after December 31, 1983, in taxable years beginning after that date.

Conference agreement

The conference agreement follows the Senate amendment.

D. Provisions Relating to Research and Vocational Education

1. Incremental research tax credit

Present law

A 25-percent tax credit applies to the excess of qualified research expenditures incurred by a taxpayer during the year in carrying on a trade or business over the average of the taxpayer's research expenditures in a three-year base period (sec. 44F). The credit is scheduled to terminate after 1985.

The section 44F credit provision generally defines research by cross-reference to section 174, under which a current deduction is allowed for research and development costs in the experimental or laboratory sense. The amount of the section 174 deduction is not reduced by any amount of the section 44F credit.

Under present law, expenditures eligible for the credit consist of—

(1) "in-house" expenditures for research wages and supplies used in research, plus certain amounts paid for research use of computers, laboratory equipment, or other personal property;

(2) 65 percent of amounts paid by the taxpayer for contract research conducted on its behalf; and

(3) if the taxpayer is a corporation, 65 percent of its expenditures (including grants or contributions) for basic research to be performed by universities or certain scientific research organizations.

House bill

No provision.

Senate amendment

Under the Senate amendment, the 25-percent incremental research credit is made permanent.

The Senate amendment provides a statutory definition of credit-eligible research expenditures. The new definition is intended to target the credit to technological innovations developed through a process of experimentation relating to new or improved function or performance (rather than to style, taste, cosmetic, or seasonal design factors). The costs of computer software developed for the taxpayer's internal use are eligible for the credit only if the software is used in research or certain production processes, or in limited circumstances where meeting a high threshold of innovation as defined in Treasury regulations.

The Senate amendment also provides a new 25-percent nonincremental credit for the excess of (1) 65 percent of corporate contract expenditures or grants for basic research at universities or other qualified organizations over (2) the sum of the greater of two fixed maintenance-of-efforts floors (relating to 1981–83 research expenditures) plus an amount relating to university nonresearch contributions in a base period. Certain other modifications are made to the university basic research provision.

Under the Senate amendment, qualified research expenditures of startup corporations, of existing corporations for new trades or businesses, and of certain partnerships will become eligible for the credit in certain circumstances.

These provisions apply to taxable years beginning after 1984.

Conference agreement

The conference agreement does not include the Senate amendment.

2. Deduction for certain research equipment donations by corporations to universities

Present law

Corporations are allowed an augmented charitable deduction for donations of newly manufactured scientific equipment to universities for research use in the physical or biological sciences (sec. 170(e)(4)). This increased deduction is generally for the sum of (1) the corporation's costs of producing the donated property (basis) plus (2) one-half of the difference between the property's fair market value and the donor's cost basis in the property, but cannot exceed twice the basis of the property.

House bill

No provision.

Senate amendment

Under the Senate amendment, the augmented charitable deduction provision for corporate donations of research equipment is expanded, for taxable years beginning after 1984—

(1) to cover donations of used (as well as new) equipment, replacement parts, and new computer software, and to cover technological (as well as scientific) equipment;

(2) to allow certain educational (as well as research) uses for donated equipment;

(3) to include as eligible donees a tax-exempt association of universities, and (by floor amendment by Sen. Kennedy, agreed to by voice vote) certain State-owned instrumentalities associated with universities; and

(4) to cover equipment produced or assembled (as well as equipment manufactured) by the donor.

Used property qualifies only if donated within three years after first used by the donor corporation, and only if worth more than $250. The augmented deduction for used property will equal 150 percent of the donor's original basis, less accumulated depreciation (e.g., for fully depreciated equipment, 50 percent of the original basis), or fair market value if less.

Conference agreement

The conference agreement does not include the Senate amendment.

3. Payments and loan forgiveness received by graduate science students

Present law

Gross income generally does not include amounts received as a scholarship at a university or as a fellowship grant, other than as compensation (sec. 117). In general, income is realized when indebtedness is cancelled (sec. 61(a)(12)).

House bill

No provision.

Senate amendment

Under the Senate amendment, gross income will not include amounts received by graduate students in certain scientific fields as a scholarship, fellowship grant, or qualified student loan forgiveness, notwithstanding that the recipient is required to perform future teaching services for any of a broad class of universities, provided that such amounts are not received as compensation. This provision is effective for taxable years beginning after 1984.

Conference agreement

The conference agreement does not include the Senate amendment.

4. Deduction for vocational education equipment donations to certain donees

Present law

In general, the amount of charitable deduction for a donation of inventory property is limited to the donor's basis in the property (sec. 170(e)). The augmented deduction rule for corporation donations of newly manufactured scientific equipment to universities for research does not apply to donations of vocational education equipment.

House bill

No provision.

Senate amendment

The Senate amendment provides an augmented charitable deduction for corporate donations of newly manufactured technical and scientific equipment for certain vocational education uses, if the value of the donated item exceeds $250, and if certain other requirements are satisfied. (The augmented deduction is not available for donations of computer software, microcomputers, or certain other computers.) The eligible donees are public community colleges, public technical institutes, and certain area vocational education schools.

The augmented deduction under the Senate amendment is generally for the sum of (1) the corporation's costs of producing the donated property (basis) plus (2) one-half of the difference between the property's fair market value and the donor's cost basis in the property, but cannot exceed twice the basis of the property. This provision applies to contributions made after 1984.

Conference agreement

The conference agreement does not include the Senate amendment.

5. Vocational education instruction tax credit

Present law

There is no special tax credit relating to vocational education instruction.

House bill

No provision.

Senate amendment

Under the Senate amendment, a tax credit is allowed to a corporation for providing qualified teachers from its employees for post-secondary vocational education courses or for hiring qualified vocational education instructors on a temporary basis. The amount of the credit is $100 for each course taught by an employee (up to five courses), plus $100 for each instructor temporarily hired by the corporation, subject to an overall limitation of $20,000 per year.

This provision is effective for taxable years beginning after 1984.

Conference agreement

The conference agreement does not include the Senate amendment.

6. Extension of moratorium on application of research and experimental expense allocation regulation

Present law

The foreign tax credit is limited so that it cannot offset U.S. tax on U.S. source taxable income. In general, the Code requires allocation of all expenses between U.S. and foreign source gross income to determine U.S. and foreign source taxable income. A Treasury Regulation (sec. 1.861-8) rule generally requires taxpayers with foreign source income from products in an area in which the taxpayers do U.S. research to allocate part of their U.S. research and experimental expense against their foreign source income. In 1981, Congress suspended this rule for two years, so that research expenditures made for research conducted in the United States are allocated against U.S. source gross income only. The moratorium generally expires for taxable years following a taxpayer's second taxable year commencing after August 13, 1981.

House bill

No provision.

Senate amendment

The Senate amendment effectively extends for two years the moratorium on the application of the research and experimental expense allocation rules of Treas. Reg. sec. 1.861–8. For taxable years beginning on or before August 13, 1985, all of a taxpayer's research and experimental expenditures attributable to research activities conducted in the United States will be allocated to U.S. source gross income for purposes of computing U.S. source and foreign taxable income and taxable income from sources partly within and partly without the United States.

Conference agreement

The conference agreement follows the Senate amendment with a clarification of the effective date provision. The conference agreement provides that the extension of the moratorium on application of the Treasury's research and experimental expense allocation rule will generally apply to a taxpayer's taxable years beginning after August 13, 1983 and before August 1, 1985. However, in the event the taxpayer's third taxable year commencing after August 13, 1981 does not begin during this period, the extension of the moratorium applies to that taxable year also.

The moratorium applies only to the allocation of research expenses for the purpose of geographic sourcing of income. It does not apply for other purposes, such as the computation of combined taxable income of a DISC (or FSC) and its related supplier.

E. Capital Gains and Losses

1. Decrease in capital loss offset against ordinary income

Present law

Capital losses are deductible in full against capital gains. For individuals, the excess of capital losses over capital gains can be deducted against only $3,000 (or specially defined taxable income, if less) of ordinary income each year, with unlimited carryovers to future years.

Post-1969 long-term losses must be reduced by 50 percent when being deducted against ordinary income.

House bill

No provision.

Senate amendment

The Senate amendment decreases the amount of ordinary income against which capital losses may be deducted by individuals to $1,000. The amendment also treats pre-1970 loss carryovers under the rules for post-1969 losses.

The provision applies to taxable years beginning after December 31, 1984.

Conference agreement

The conference agreement does not reduce the $3,000 limit against which losses may be deducted. The agreement treats pre-1970 losses under the post-1969 loss rules for taxable years beginning after December 31, 1986.

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2. Decrease in holding period for long-term capital gains

Present law

Gains or losses on capital assets held for more than one year are considered long-term capital gains or losses. For individuals, 60 percent of the net capital gain is excluded from income. Corporations have the option of paying an alternative tax of 28 percent on net long-term capital gain.

House bill

No provision.

Senate amendment

The Senate amendment decreases the holding period for long-term capital gains from one year to six months.

The provision applies to assets acquired after February 29, 1984.

Conference agreement

The conference agreement generally follows the Senate amendment. However, the six-month holding period will apply to assets acquired after June 22, 1984, and before January 1, 1988.

F. Miscellaneous Housing Provisions

1. Disaster loss deduction for condemned residences

Present law

Nonbusiness casualty losses over $100 are allowed as itemized deductions to the extent the total amount of such losses exceeds 10 percent of the taxpayer's adjusted gross income. Generally, the deduction is available only when the casualty (e.g., storm, flood, or earthquake) causes actual physical damage to the taxpayer's property.

House bill

The House bill provides that certain taxpayers whose residences are located in a Federally declared disaster area, and who are ordered by a State or local government to demolish or relocate their residences, may deduct any loss attributable to the disaster as a casualty loss. The provision applies to taxpayers whose residences have been rendered unsafe for use as a residence as a proximate result of the disaster. At the taxpayer's election, these losses may be deducted for the year preceding the year in which the demolition or relocation order was made.

This provision applies to taxable years beginning after December 31, 1981, with respect to areas determined after that date to warrant Federal disaster assistance.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

2. Cooperative housing corporations

a. Pass-through of interest and tax deductions to tenant-stockholders

Present law

Qualification for pass-through treatment

Tenant-stockholders in cooperative housing corporations may deduct their proportionate share of mortgage interest and real estate taxes paid by the cooperative. To qualify for this pass-through treatment, 80 percent of the cooperative's gross income must be derived from tenant-stockholders. In addition, a tenant-stockholder must have the right to occupy a house or apartment solely by reason of owning cooperative stock.

Generally, only individuals qualify as tenant-stockholders. However, certain original sellers of property to a cooperative (including corporations, partnerships, and other entities) may qualify as tenant-stockholders for up to three years after acquiring stock in the cooperative. This treatment applies even if the cooperative reserves the right to approve occupancy by any nominee of such entity. Additionally, a bank or other lending institution obtaining cooperative stock by foreclosure is treated as a tenant-stockholder for up to three years, even if the cooperative retains the right to approve occupancy by the bank or its nominee.

Allowance for depreciable property

A tenant-stockholder using depreciable cooperative property in a trade or business is allowed a special deduction with respect to his cooperative stock. This deduction is generally limited to that portion of the taxpayer's adjusted basis for his stock which is allocable to the depreciable property, with no carryover of excess deductions.

House bill

No provision.

Senate amendment

Extension of pass-through treatment to non-individual entities

The Senate amendment expands the definition of tenant-stockholder to include non-individual entities (including corporations, trusts, estates, partnerships, associations, or companies) which otherwise meet the requirements applicable to tenant-stockholders. These entities may therefore qualify for a pass-through of interest and tax deductions. This treatment applies even if, by agreement with the cooperative, a nominee of such entity may not occupy a house or apartment without prior approval of the cooperative.

The special rules regarding original sellers and foreclosures by lending institutions are made unnecessary by this change and are therefore repealed. However, under the Senate amendment, a cooperative's right to approve any occupant does not affect the tenant-stockholder status of certain original sellers of property (including an individual or a non-individual entity) to the cooperative. Additionally, where any person (including an individual or a non-individual entity) acquires stock in a cooperative by operation of law (e.g., by inheritance or foreclosure), the cooperative's right to approve any occupant does not affect the tenant-stockholder status of such person.

This provision is effective on the date of enactment.

Treatment of depreciable property

The Senate amendment allows deductions exceeding the taxpayer's allocable basis for his stock to be carried over to succeeding taxable years. However, the Senate amendment further provides that no deduction may be allowed for any amount paid or accrued to the cooperative (in excess of proportionate interest and real estate taxes) to the extent that, under Treasury regulations, such amount is properly allocable to amounts chargeable to the cooperative's capital account. This rule generally prevents a tenant-stockholder from obtaining deductions for the capital costs of his cooperative unit more quickly than if he had owned the unit outright.

This provision is effective on the date of enactment.

Conference agreement

The conference agreement does not include the Senate provision.

b. Allocation of certain property taxes

Present law

A tenant-stockholder's proportionate share of rent or property taxes, for deduction purposes, is equivalent to the portion of cooperative stock owned by the tenant-stockholder. This rule applies even where special property taxes (e.g., certain California property taxes) are imposed on certain tenant-stockholders out of proportion to the value of their stock.

House bill

No provision.

Senate amendment

The Senate amendment provides that where a State or locality imposes tax based on a separate appraisal for some or all of the units in a house or apartment building, each tenant-stockholder's proportionate share of such taxes is to be the amount allocated to his unit under the applicable tax law. Thus, deductions are allocated among the tenant-stockholders according to the actual amount of such taxes each tenant-stockholder is required to pay.

This provision is effective for State tax years ending in 1984 or later years.

Conference agreement

The conference agreement does not include the Senate provision.

3. Sale-leasebacks of principal residences by taxpayers 55 or older

Present law

Qualification of a transaction involving a principal residence as a valid sale-leaseback is sometimes uncertain. Recognition of a transaction as a sale-leaseback may entitle the purchaser to certain tax benefits associated with ownership of property (e.g., cost recovery allowances). The seller may be entitled to claim the one-time exclusion for gain on the sale of a residence (sec. 121) and other tax benefits.

House bill

No provision.

Senate amendment

The Senate amendment provides a safe harbor and certain tax benefits for qualified sale-leasebacks of principal residences by taxpayers 55 or older. A sale-leaseback qualifies for this special treatment if the seller has attained the age of 55 before the date of the transaction and has owned and used the property as his or her principal residence for at least three of the five immediately preceding years. Such property must never have been depreciable property in the seller's hands. The sale price must be a fair market value amount, taking into account the burden of the lease on the property. The seller-lessee must retain occupancy rights in the property pursuant to a written lease requiring the payment of a fair rental. Finally, the purchaser-lessor must be a person who is entitled to the benefits, and contractually responsible for the risks and burdens, of ownership after the date of the transaction.

A qualified sale-leaseback does not include a sale-leaseback involving related parties or in which the purchaser-lessor is a tax shelter. For this purpose, a tax shelter is any partnership or other enterprise in which interests have been publicly offered or which is described in section 6661(b) of the Code.

The seller in a qualified sale-leaseback may elect to exclude gain from the sale to the extent provided in section 121. The seller's gain will not include the excess of the fair market value of any occupancy rights retained by the seller over the rent payable under the lease. Furthermore, any discount in the purchase price attributable to the leaseback by the seller is excluded from the gross income of the purchaser.

If the purchaser-lessor in a qualified sale-leaseback purchases an annuity for the seller-lessee as part of the consideration for the property, the cost of the annuity is deemed to be received by the seller in the year of the sale. This amount is treated as an investment by the seller-lessee in the annuity contract for purposes of section 72.

Although the purchaser-lessor will be entitled to claim depreciation on the property as the sole owner, such depreciation must be computed using the straight-line method and a 40-year useful life.

Any sale-leaseback transaction covered by the bill will, for purposes of section 183, be presumed to be one engaged in for profit unless the Secretary of the Treasury establishes to the contrary.

These provisions are effective for sales or exchanges after the date of enactment but prior to December 31, 1988.

Conference agreement

The conference agreement does not include the Senate provision.

4. Deductibility of mortgage interest and taxes paid out of tax-free allowances for military personnel and ministers

Present law

Deductions are disallowed for expenses allocable to tax-exempt income (Code sec. 265(1)). In January 1983, the IRS ruled that a minister may not take deductions for mortgage interest and real estate taxes on a residence to the extent that such expenditures are allocable to tax-free housing allowances provided for ministers under section 107 (Rev. Rul. 83-3, 1983-1 C.B. 72). This disallowance rule generally applies beginning July 1, 1983. However, for a minister who owned and occupied a home before January 3, 1983 (or had a contract to purchase a home before that date), the deduction disallowance rule will not apply until January 1, 1985, with respect to such home (IRS Ann. 83-100).

In December 1983, the IRS announced that it was studying whether members of the Armed Forces are entitled to deduct interest and property taxes to the extent they receive tax-free housing allowances from the Federal Government. The IRS stated that any determination on the issue that would adversely affect military personnel would not be applied to amounts paid before 1985 (IR 83-161).

House bill

No provision.

Senate amendment

The Senate amendment precludes application of the deduction disallowance rule under Code section 265(1) to mortgage interest and real estate taxes paid or incurred before January 1, 1986, by a minister or member of the Armed Forces.

Conference agreement

The conference agreement generally follows the Senate amendment, with modifications, as applied to ministers. The conference agreement does not include the language of the Senate amendment (or any other provision) applicable to members of the Armed Forces.

In the case of ministers, the conference agreement extends until January 1, 1986 the transitional rule date applicable to certain ministers in the circumstances defined in IRS Ann. 83–100, i.e., to a minister who owned and occupied a home before January 3, 1983 (or had a contract to purchase a home before that date). In the case of mortgage interest deductions, the provision in the conference agreement only applies to a mortgage existing on that date (or in connection with a contract to purchase a home before that date). The conference agreement does not make any change in the general effective date of July 1, 1983 for Rev. Rul. 83-3, or in any aspect of that ruling not relating to ministers.

5. Rollover of gain on sale of residence for military personnel stationed overseas

Present law

No gain is recognized on sale of a personal residence to the extent that the amount of the sales price of the old residence is reinvested in a new residence within a specified period of time, generally ending two years after the sale of the old residence. Under present law, this period is extended for up to four years where the taxpayer serves on extended active duty with the Armed Forces (Code sec. 1034(h)).

House bill

No provision.

Senate amendment

The Senate amendment provides that, in the case of a member of the Armed Forces who is stationed outside the United States or who is required to reside in government quarters at a remote site, the normal nonrecognition period will not expire until the end of four years after the sale of the old principal residence or one year after the member is no longer stationed outside the United States or no longer required to reside in such government quarters, whichever is later, but not to exceed eight years. This provision applies to sales of residences after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

6. Nonimposition of interest and penalties on tax liability with respect to home won as prize and designed for handicapped foster child of the taxpayer

Present law

Under present law, gross income generally includes amounts received as prizes, such as cash or property won in a lottery, sweepstakes, or other contest (Code sec. 74(a)).

House bill

The House bill provides that no interest or penalties are payable on the Federal income tax liability attributable to receipt of a residence won as a prize, and specially designed for a handicapped foster child of the taxpayer, where certain conditions apply, but only if the tax liability is paid not later than one year after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

7. Condominium conversions

Present law

Under present law, gain on the sale of condominium units by a building owner generally does not qualify for capital gain treatment. However, an owner generally may secure capital gain treatment by selling the property to an unrelated person, who then converts the property to condominiums.

House bill

The House bill allows a property-by-property election to treat a portion of gain on the sale or exchange of condominium units by the building owner as capital gain. This election applies to residential or commercial property used by the taxpayer in a trade or business at all times during the five-year period ending on the determination date (as described below).

Under the House bill, capital gain treatment applies to the excess (if any) of the fair market value of the property on the determination date (excluding improvements made in anticipation of conversion) over the adjusted basis of the property to the owner, reduced by depreciation recapture. The determination date is the earliest of dates on which (1) the taxpayer adopts the plan to convert the building to condominiums, (2) substantial improvements are begun in anticipation of conversion, or (3) the form of ownership of the property changes into condominium units. If more than two years elapse between the sale of the first and second, the date of the second sale is substituted for (1) and (3) above. The amount eligible for capital gain treatment is allocated among individual units according to their fair market value on the determination date and realized in part on the sale of each unit (together with any ordinary income gain).

Where property is overvalued (whether or not such overvaluation is intentional), the amount eligible for capital gain treatment is reduced by 20 percent for each full percentage point by which the property is overvalued in excess of 15 percent. The amount of this reduction is treated as ordinary income.

This provision applies to property the form of ownership of which is changed into condominium units after the date of enactment, in taxable years ending after such date.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House provision.

G. Extensions of Existing Provisions and Miscellaneous Transition Rules

1. Investment income from S corporations

Present law

Investment interest deductions are generally limited to investment income plus $10,000. The treatment of income with regard to

S corporations is not entirely clear under prior law. One case held that subchapter S income under prior law was investment income (*William H. Crook*, 80 T.C. 27 (1983)).

House bill

The House bill provides that for taxable years beginning in 1983 and 1984, a taxpayer may elect to treat income (other than personal service income) from an S corporation as investment income.

Senate amendment

No provision.

Conference agreement

The conference agreement generally follows the House bill. The agreement provides an election for 1983 and 1984 to characterize income from an S corporation, for purposes of section 163(d), under the law in effect prior to the enactment of the Subchapter S Revision Act of 1982. No inference is intended as to the proper interpretation of prior law.

2. Extension of the Payment-in-Kind Tax Treatment Act of 1983

Present law

The Payment-in-Kind Tax Treatment Act of 1983 generally treats commodities received under a 1983 PIK program as if they were grown on the land withdrawn from production under the PIK program; the Act also provides that estates are not disqualified from certain special estate tax provisions solely by reason of participation in a PIK program.

USDA determined that the $50,000 limit applicable to crop diversion payments did not apply to 1983 PIK payments; USDA has applied the limit to the 1984 wheat PIK program.

House bill

The House bill extends the PIK tax provisions to property withdrawn from production under the 1984 wheat PIK program. The bill also directs the Comptroller General to bring a declaratory judgment action to determine if the $50,000 payment limit applies to 1984 wheat PIK payments.

Senate amendment

The Senate amendment is the same as the House bill, except it does not mandate the Comptroller General to bring a declaratory judgment action with respect to application of the $50,000 payment limitation in the case of payments in kind (as opposed to payments in cash).

Conference agreement

The conference agreement follows the Senate amendment. The conferees wish to state, however, that their reason for not adopting the House bill's requirement that the Comptroller General bring a declaratory judgment action with respect to the application of the $50,000 payment limitation was that the Secretary of Agriculture has applied that limitation to the 1984 wheat PIK program.

3. Transitional rule for safe-harbor leasing of coal gasification facilities

Present law

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) generally reduced the tax benefits of safe-harbor leasing between July 1, 1982, and January 1, 1984, and repealed safe-harbor leasing for agreements entered into after December 31, 1983. However, these modifications do not apply to transitional safe-harbor lease property, which generally is property placed in service before January 1, 1983, provided that certain additional requirements are met.

House bill

No provision.

Senate amendment

The Senate amendment generally provides that transitional safe-harbor lease property includes certain coal gasification facilities that would meet the requirements of the general transitional rule in TEFRA if July 1, 1984, were substituted for the January 1, 1983, placed-in-service date. The provision applies only to the lease of an undivided interest in the facility in an amount which does not exceed the lesser of $67.5 million or 50 percent of the cost basis of the entire facility.

Conference agreement

The conference agreement includes the Senate amendment. The conferees intend that under the agreement, a coal gasification facility placed in service prior to July 1, 1984, may be leased in a safe harbor lease transaction within three months after it is placed in service by the lessee without losing its status as transitional safe harbor lease property.

4. Provisions of Indian Tribal Governmental Tax Status Act of 1982 made permanent

Present law

For years 1983 and 1984 only, Indian tribal governments are treated as State governments for most purposes of the Internal Revenue Code.

Special restrictions apply to this treatment in certain cases. For example, Indian tribal governments are permitted to issue tax-exempt bonds only to finance traditional public activities (e.g., schools, streets, and sewers). Additionally, the proceeds of these bonds must be used in an "essential governmental function." Tribal governments are not permitted to issue private activity bonds (i.e., industrial development bonds, student loan bonds, and mortgage subsidy bonds).

Additionally, exemptions from Federal excise taxes provided for State governments apply to articles sold to the Indian tribal governments only if the articles are sold for the tribal government's exclusive use in carrying out an essential governmental function.

House bill

No provision.

Senate amendment

The Senate amendment makes permanent the present law provisions that are scheduled to expire at the end of 1984.

Conference agreement

The conference agreement follows the Senate amendment with three modifications. These modifications permit Indian tribal governments to be treated as State governments for the following purposes in addition to the purposes for which such treatment is available under present law:

(1). Treatment of payments under certain State accident and health plans;

(2). Deductibility of certain costs associated with appearances before the State legislatures; and

(3). Rules relating to treatment of original issue discount on certain State obligations.

5. Amortization of low-income housing rehabilitation expenditures

Present law

Present law includes no special provision regarding cost recovery deductions for low-income housing rehabilitation expenditures. Before January 1, 1984, however, a taxpayer could elect (in lieu of any other cost recovery method) to amortize up to $20,000 generally of rehabilitation expenditures with respect to a unit of low-income housing over a 60-month period.

House bill

No provision.

Senate amendment

The Senate amendment reenacts the provision of prior law that permitted amortization over a 60-month period of certain expenditures for rehabilitation of low-income housing. The reenacted provision is effective for 3 years, through December 31, 1986.

Conference agreement

The conference agreement follows the Senate amendment.

6. Disallowance of deduction for costs of demolishing structures

Present law

Costs and other losses incurred in connection with the demolition of buildings generally may be claimed as a current deduction unless the building and the property on which it is located are purchased with an intent to demolish the building. If so purchased, costs and other losses are added to the basis of the land.

Before 1984, costs and other losses incurred in connection with the demolition of certified historic structures were required to be added to the basis of the land on which the structure was located in all cases. A certified historic structure is a building that is certified by the Secretary of the Interior as having historic significance and that meets certain other requirements.

House bill

No provision.

Senate amendment

The Senate amendment provides a general rule under costs and other losses incurred in connection with the demolition of all buildings, including certified historic structures, must be added to the basis of the land on which the demolished building were located, rather than claimed as a current deduction.

The provision generally is effective for demolition beginning after December 31, 1983.

Conference agreement

The conference agreement follows the Senate amendment. The conferees expect that this additional extension of the moratorium will allow the Treasury Department and the industry adequate time to resolve this issue and that no further extensions of this moratorium will be requested.

7. Reinstatement of deduction for elimination of certain barriers to the handicapped and the elderly

Prior law

Under prior law, Code section 190 provided a special tax deduction for up to $25,000 of expenses incurred during a taxable year in removing architectural or transportation barriers to the handicapped and the elderly. This provision was effective for taxable years beginning before 1983. Thus, for taxable years beginning after 1982, no special deduction for such expenses is provided.

Section 190 applied to expenses incurred to make more accessible to, and usable by, the handicapped and elderly facilities or public transportation vehicles owned or leased by the taxpayer for use in the taxpayer's trade or business. To be entitled to the deduction, the taxpayer had to establish that the barrier removal met standards set by the Treasury with the concurrence of the Architectural and Transportation Barriers Compliance Board. Under section 190, the definition of an elderly person was a person age 65 or over, and handicapped individuals included the blind and the deaf.

The maximum deduction allowed under prior law to a taxpayer (including a controlled group of corporations filing a consolidated return) for any taxable year was $25,000.

House bill

No provision.

Senate amendment

Under the Senate amendment, section 190 is reinstated and made applicable to expenses incurred in taxable years beginning after December 31, 1983, and before January 1, 1986. (Thus, the special deduction provided by section does not apply to expenses incurred in taxable years beginning in 1983.) The maximum deduction allowed to a taxpayer (including a controlled group of corporations) is increased to $35,000.

This provision is effective on the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

H. Additional Items

1. Employee tips

Present law

A large food or beverage establishment must allocate to employees as tips the excess of 8 percent of gross receipts over tips reported by the employees to the employer. The IRS can reduce the percentage up to which allocations must be made to as low as 5 percent.

House bill

No provision.

Senate amendment

A majority of the employees or the employer can petition the Internal Revenue Service for a reduction in the percentage of gross receipts required to be allocated. The minimum percentage required to be allocated is reduced from 5 to 2 percent. The provision is effective on the date of enactment. The Secretary is required to prescribe regulations within one year of the date of enactment that describe the applicable recordkeeping requirements for tipped employees.

Conference agreement

The conference agreement follows the Senate bill, with a modification clarifying that a person owning 50 percent or more of the value of a corporation that operates the food or beverage establishment is not considered employees, only for purposes of determining whether the establishment normally employed more than 10 employees. The conferees anticipate that an establishment will ordinarily not be able to prove down to the 2-percent rate.

2. FUTA treatment of tips

Present law

Tip income is considered wages for purposes of the Federal Unemployment Tax Act (FUTA) only to the extent paid directly to the employee by the patron, reported by the employee to the employer, and used by the employer to satisfy the minimum wage requirement of the Fair Labor Standards Act.

House bill

The House bill provides that all tip income reported by the employee to the employer is considered wages for FUTA purposes.

The provision generally is effective on January 1, 1985. However, in the case of any State the legislature of which (1) did not meet in a regular session which begins during 1984 and after the date of enactment, and (2) did not meet in a session which began on the date of enactment and remained in session for at least 25 calendar days after the date of enactment, the provision is effective on January 1, 1986.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill, except that the effective dates are one year later than under the House bill.

3. FUTA treatment of certain fishing activities

Present law

Remuneration paid to fishing boat crew members is generally subject to FUTA if the services performed are related to catching halibut or salmon for commercial purposes or if the services are performed on a vessel of more than 10 net tons.

Under a provision which expired on December 31, 1982, remuneration paid to fishing boat crew members was exempt from FUTA if the remuneration depends on the boat's catch and the crew normally consists of fewer than 10 members.

House bill

No provision.

Senate amendment

The Senate amendment extends the exemption through December 31, 1984.

Conference agreement

The conference agreement follows the Senate amendment.

4. Taxation of unemployment compensation for pre-1978 periods

Present law

The Revenue Act of 1978 provides that the unemployment compensation taxation provisions apply to payments of unemployment compensation made after 1978, in taxable years ending after 1978. Thus, benefits paid in 1979 and later years may be subject to income tax even if attributable to periods of unemployment before 1979.

House bill

The House bill amends the Revenue Act of 1978 to provide that the provisions of that statute which make includible in income a portion of unemployment compensation benefits apply to payments of unemployment compensation made after 1978 except payments for weeks of unemployment ending before December 1, 1978. The bill also extends until one year after enactment the period for claiming any credit or refund attributable to this amendment.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

5. Tax refunds relating to traveling expenses incurred in 1970–74 for employment at North Dakota ABM site

Present law

No deduction is allowed for commuting costs. However, traveling expenses (transportation, meals, and lodging) incurred by a taxpayer away from home in connection with temporary employment are deductible as business expenses (Code sec. 162). Court decisions generally hold that temporary employment means employment which can reasonably be expected to last only for a short period of time.

The U.S. Court of Appeals for the Eighth Circuit has allowed deduction of transportation expenses incurred by a carpenter while employed during 1970–73 at an antiballistic missile (ABM) site in Nekoma, North Dakota. However, other workers at the site are barred by the period of limitations from filing refund claims on the basis of that decision.

House bill

The House bill allows deductions for traveling expenses incurred between 1970 and 1974 in employment at the Nekoma, North Dakota, ABM site, if such expenses were claimed as deductions on the individual's tax returns. For a taxpayer who is precluded by the period of limitations from filing a refund claim with respect to such deductions, the bill allows a refund claim to be filed within one year after the date of enactment.

This provision applies to taxable years ending after 1969, with respect to expenses incurred after 1969 and before 1974.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House provision.

6. Shore-based fishery processing facilities

Present law

Certain tax benefits are provided U.S. taxpayers owning or leasing vessels operating in the foreign or domestic commerce of the U.S. or in U.S. fisheries. Such taxpayers are entitled to deduct from income certain amounts deposited in a capital construction fund pursuant to certain agreements. Earnings from the investment or reinvestment of amounts in such a fund are excluded from income. Furthermore, withdrawals from the fund, made in accordance with the applicable agreement, for the acquisition, construction, or reconstruction of certain vessels, or for the payment of principal on certain indebtedness, are not taxable, although the taxpayer's basis in the property involved is reduced by the amount of the withdrawal. Finally, for investment credit purposes only, the taxpayer's basis in the property is not reduced by more than 50 percent of the withdrawal.

House bill

No provision.

Senate amendment

The tax benefits available under present law are also made available to U.S. citizens (and certain other persons) owning or leasing a fishery facility in the U.S. In addition, deposits into, and withdrawals from a capital construction fund (made in accordance with the applicable agreement) which are used for the acquisition, construction, or reconstruction (not including routine minor repair and maintenance) of certain fishery facilities, are entitled to the tax treatment indicated above. For this purpose, a fishery facility includes land, structures, and equipment used for the unloading and receiving from vessels, the processing, the holding, and the distribution of fish from fisheries.

The provision is effective upon enactment.

Conference agreement

The conference agreement does not contain the provision in the Senate amendment.

7. Tax exemption for the National Credit Union Central Liquidity Facility

Present law

The National Credit Union Central Liquidity Facility ("Central Liquidity Facility") was created by Congress in 1978 [2] to meet the liquidity needs of credit unions, including the need for short-term adjustment credit, seasonal credit, and protracted adjustment credit in the event of unusual or emergency circumstances. Under present law, the Central Liquidity Facility is not explicitly exempt from Federal, State or local taxes.

House bill

No provision.

Senate amendment

The Senate amendment provides that the Central Liquidity Facility is exempt from Federal income taxes under the Internal Revenue Code. Additionally, the Central Liquidity Facility is exempt from State or local taxes, other than taxes on real property (to the extent that similar property held by other persons is taxed). The Senate amendment also clarifies that the Central Liquidity Facility

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[2] Pub. L. 95-630, 95th Cong., 2d Sess., November 10, 1978 (12 U.S.C. sec. 1795 *et seq.*).

is to be an instrumentality of the United States for all purposes under Federal law.

Under the Senate amendment, notes, bonds, and other obligations issued on behalf of the Central Liquidity Facility, and the income from such obligations, are exempt from State and local taxation, other than gift, estate, inheritance, or other wealth transfer taxes. However, such obligations (and the income therefrom) are subject to Federal tax.

These provisions are effective on and after October 1, 1979, i.e., the effective date of the legislation creating the Central Liquidity Facility.

Conference agreement

The conference agreement follows the Senate amendment. The conference agreement further specifies that future tax exemptions for instrumentalities of the United States must be provided in the Internal Revenue Code.

8. Exclusion from gross income for cancellation of certain student loans

Present law

Gross income generally includes income from the discharge of indebtedness (Sec. 61(a)(12)).

Under a provision enacted in the 1976 Tax Reform Act, and later extended through 1982, an individual does not realize gross income from cancellation of student loans made by government agencies where the individual in return works for a certain period of time in certain professions in certain geographical areas or for certain classes of employers.

House bill

No provision.

Senate amendment

The Senate amendment provides a permanent exclusion from income for amounts realized by reason of cancellation of certain student loans where the recipient performs certain professional services for any of a broad class of employers.

This provision is effective for discharges of indebtedness on or after January 1, 1983.

Conference agreement

The conference agreement follows the Senate amendment.

9. Duck stamps

Present law

Duck stamps and postage stamps are considered a type of Federal obligation, and reproduction of them is forbidden under Federal anticounterfeiting laws. Limited reproduction in black and white is permitted for philatelic, numismatic, education, historical or newsworthy purposes, and color reproductions of postage stamps is permitted under carefully prescribed conditions.

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House bill

No provision.

Senate amendment

The Secretary of the Interior, with the concurrence of the Secretary of the Treasury, is authorized to license color, as well as black and white, reproductions of duck stamps. The reproductions would have to be less than three-fourths, or more than one and one-half, of the size of the original stamp. The proceeds from such licensed reproductions would be deposited in the Migratory Bird Conservation Fund. Reproductions may be made for commercial purposes which may include facsimiles on such products as placemats and shotguns.

Conference agreement

The conference report follows the Senate amendment, with a technical amendment which specifies that any proceeds from reproductions of duck stamps will be paid into the Migratory Bird Conservation Fund and with an amendment that permits the color reproduction of duck stamps in philatelic (or stamp-collecting) advertising designed to encourage collectors to purchase duck stamps. The conferees understand that duck stamp reproductions used in philatelic advertising will not be subject to the licensing requirements of the Senate amendment, but they would have to otherwise conform to the requirements imposed under anticounterfeiting provisions.

10. Boundary Waters Canoe Act payments

Present law

Equity grants have been provided to resort and recreational activities operators in the Boundary Waters Canoe Area to assist them in converting their business operations to conform with more restrictive rules governing activities in the area since it was designated as a wilderness area.

Because of the wilderness designation, resort operators have experienced an economic effect similar to an involuntary conversion, in which event the basis of property received is reduced by the amount of funds received but not spent, as provided by law.

House bill

No provision.

Senate amendment

The Senate amendment permits resort and recreational activities operators to make tax-free investments of equity-grants in depreciated property for use in activities within the Boundary Water Canoe Wilderness Area. The property to which taxpayers allocate equity grants must be placed in service before the later of two years after the date of enactment or two years after the payment is received. The basis for each item of property will be reduced by the amount of the equity grant and will be increased by the amount repaid on sale of property. No credit or ACRS deduction may be taken for the portion of any property funded by an equity grant.

Conference agreement

The conference agreement follows the Senate amendment.

11. Physicians' and surgeons' mutual protection associations

Present law

In general, the gross income of a mutual insurance company (other than a life insurance company) includes gross premiums and other consideration, gross investment income, and gain from the sale or other disposition of property. Gross income, generally, does not include any contribution to capital. Present law provides a specific deduction for dividends and similar distributions paid to policyholders in their capacity as such.

Under present law, premiums for liability insurance in carrying on any trade or business are deductible in the year they are paid or incurred. However, no deduction is allowed as an expense paid or incurred during the taxable year for a contribution to capital.

House bill

No provision.

Senate amendment

The Senate amendment provides special rules for the tax treatment of certain physicians' and surgeons' mutual protection and indemnity associations. The gross income of such associations will not include any payment made by a member as an initial payment (or capital contribution) upon joining the association, if the payment does not release the member from obligations to pay current or future dues, assessments or premiums, and if the initial payment is a condition precedent to receiving benefits of membership. Any repayment of an amount so excluded will not be deductible (as a policyholder dividend or otherwise) by the association.

The initial payments of capital will not be excluded from the income of the association to the extent the member makes an election to treat the initial payment as a trade or business expense. Generally, a member making the election (upon joining the association) will be able to deduct the initial payment of capital (or portion thereof) during each of the first 6 years of membership, to the extent the annual premium that would be payable to an independent insurance company for similar coverage exceeds the dues, assessments, or premiums paid during the taxable year to the association.

The provision applies only to those organizations that were operating and providing medical malpractice liability protection under State laws prior to January 1, 1984, and only with respect to payments made to, receipts of, and refunds of payments by such associations, after the date of enactment.

Conference agreement

The conference agreement follows the House bill.

12. Tax treatment of regulated investment companies

Present law

Regulated investment companies.—Under present law a regulated investment company (RIC) is treated, in essence, as a conduit for tax purposes. If a corporation qualifies as a RIC, it is allowed a deduction for dividends paid (or deemed paid) to its shareholders. Thus, no corporate level tax is payable on earnings of a RIC distributed (or deemed distributed) to its shareholders.

Accounting for certain obligations.—Issue discount on certain short-term government obligations issued at a discount and redeemable at maturity without interest is deemed to accrue at the earlier of the date the obligation is paid, or the date it is sold or otherwise disposed of.

House bill

Regulated investment companies.—The House bill repeals the prohibition of present law which denies eligibility for RIC status to a personal holding company (PHC), and provides that the undistributed investment company taxable income of any RIC which is a PHC will be subject to tax at the highest rate (presently 46 percent). In addition, the bill provides, in effect, that corporations with accumulated earnings and profits attributable to a non-RIC year will be ineligible to elect RIC status without a distribution of those earnings.

Accounting for short-term government obligations.—The House bill provides that the issue discount accruing with respect to any short-term government obligation will be taxable to the RIC as it accrues, if the company so elects in a manner prescribed by the Internal Revenue Service.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement is the same as the House bill and the Senate amendment. However, a transitional rule is added under which a corporation with earnings attributable to a non-RIC year will be eligible to elect RIC status without distributing such earnings if it completed all the economic steps required to elect RIC status during the period beginning on January 1, 1982 and ending on November 7, 1983, and elects or has elected RIC status for its first taxable year beginning after November 8, 1983.

13. Increased payments for presidential nominating conventions

Present Law

Congress has authorized the payment from the Presidential Election Campaign Fund of up to $3 million for presidential nominating conventions of major parties; lesser amounts may be made available to minor parties. The base amount is adjusted for inflation. The payments are to be used only to defray expenses incurred with respect to a presidential nominating convention.

House bill

No provision.

Senate amendment

The Senate amendment authorizes an increase in the limitation to $4 million. The additional amount is intended to defray the expenses for security arrangements at the two presidential nominating conventions.

Conference agreement

The conference agreement follows the House bill.

XI. STUDIES

1. Study of alternative tax systems

Present law

There is no specific provision.

House bill

The House bill provides that the Secretary of the Treasury is to submit to the Congress a study of a simplified gross income tax (covering both individual and corporate income taxes). The report is to be submitted within 6 months of enactment.

Senate amendment

The Senate amendment provides that the Secretary of the Treasury is to submit to the Congress a study of alternative tax systems (covering both the individual and corporate income taxes), including a simplified gross income tax, a consumption-based tax, a value-added tax, a national sales tax, and broadening of the current income tax base combined with lowering of tax rates. The report is to be submitted within 6 months of enactment.

Conference agreement

The conference agreement generally follows the Senate amendment; except that the report is to be submitted to the Congress by December 31, 1984, and that the report is to include a study of tax shelters.

2. Treasury study on foreign taxation of certain U.S. services

Present law

The foreign tax credit cannot offset U.S. tax on U.S. source income. The United States considers income for services performed in the United States for use in foreign countries to be U.S. source income; some foreign countries consider the same income to be local income. Double taxation may arise.

House bill

No provision.

Senate amendment

The Senate amendment directs the Treasury Department to study the practices of foreign countries that impose taxes on the basis of services that are performed in the United States, including the status of treaty negotiations with such countries, and options to alleviate the resulting double tax burden on U.S. taxpayers. The Treasury Department is to report on the results of its study to the Senate Committee on Finance and the House Committee on Ways and Means no later than August 31, 1984.

Conference agreement

The conference agreement follows the Senate amendment, except that the Treasury study will be due on December 31, 1984.

XII. MISCELLANEOUS TARIFF PROVISIONS

1. Cordage products

Present law

Cordage manufactured from a plastics material is classified in the Tariff Schedules of the United States (TSUS) as either "cordage" under the textiles part of the TSUS, or as a plastics article in a different TSUS part. The difference depends on whether the strips from which the cordage is made exceed certain dimensions. Cordage classified as a plastics article is subject to a lower tariff rate than if it is classified as a textile article.

House bill

No provision.

Senate amendment

The Senate amendment classifies cordage (twine, rope, and cables) currently classified as plastic products in TSUS schedule 7 as articles to be classified under schedule 3 (textile products).

The provision is applicable to articles entered, or withdrawn from warehouse for consumption, on or after the 15th day after the date of enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

2. "Like agricultural products"

Present law

A petition for relief under the antidumping or countervailing duty laws must be filed by an "interested party" which, in general, means a representative of an industry producing a "like product" to the allegedly dumped or subsidized article. Section 771(10) of the 1979 Trade Agreements Act defines "like product" to mean a product which is "like or in the absence of like, most similar in characteristics and uses with, the article" subject to an investigation.

House bill

No provision.

Senate amendment

The Senate amendment amends section 771(10) of the 1979 Act to encompass within the meaning of "like product" agricultural products at earlier stages of processing than imported articles.

The provision is applicable to articles entered, or withdrawn from warehouse for consumption, on or after the 15th day after the date of enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

3. Fish nets

Present law

The MFN tariff rate on fish netting and nets made of textile materials other than cotton or vegetable fibers is being reduced in stages to 17 percent ad valorem by 1989. The rate currently is 18 cents per pound plus 28.6 percent ad valorem.

House bill

No provision.

Senate amendment

The Senate amendment permits the 17-percent MFN tariff rate to apply immediately to the first 1.75 million pounds of fish nets, or 28 percent of the prior year's domestic consumption, whichever is greater.

The provision is applicable to articles entered, or withdrawn from warehouse for consumption, on or after the 15th day after the date of enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

4. A telescope and its apparatus

Present law

Scientific instruments and apparatus, and repair components, entered for the use of nonprofit educational institutions may enter duty-free if the Commerce Department determines domestic equipment of equivalent scientific value is unavailable.

House bill

No provision.

Senate amendment

The Senate amendment directs the Secretary of the Treasury to admit duty-free any articles provided by the Max Planck Radio Astronomy Institute in Germany for a joint project with the University of Arizona.

The provision is effective on the date of enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

DIVISION B—SPENDING REDUCTION ACT OF 1984

TITLE I—GENERAL PROVISIONS

The conference agreement rescinds a specified amount of funds for the "Energy Security Reserve". The rescission is agreed to with the understanding that the five vacancies on the Board of the Synthetic Fuels Corporation will be filled with qualified individuals and that the Board will submit to the appropriate committees of the Congress a plan for the future operations of the Corporation.

The Comptroller General of the United States ruled on February 15, 1984, that the unused portion of a commitment of financial assistance provided to a project may be used for another project if the first project is halted. To clear any confusion over the status of funds from the Colony Shale Oil Project, the managers have agreed to include these funds in the rescission.

Senate amendment

Contains provision which would revise section 715 of the 1984 Defense Appropriation Act, Public Law 98–212. That section limits to 13,500 pounds the costs the government will cover for the movement of household goods for civilian and military personnel of the Department of Defense undergoing permanent change of station. The Senate provision would increase the limitation of 18,000 pounds for Department of Defense civilian employees, effective on the date of enactment of Public Law 98–212.

House amendment

Contains no comparable provision.

Conference agreement

The conference agreement does not retain the Senate provision. The conferees recommend that the limitation on transportation of baggage and household goods be reviewed in connection with action on the fiscal year 1985 Defense Appropriation bill.

TITLE II—CIVIL SERVICE AND MILITARY RETIREMENT PROGRAMS

SEC. 2201. COST-OF-LIVING ADJUSTMENTS UNDER GOVERNMENT RETIREMENT SYSTEMS

House Amendment—The House amendment contains no provision relating to a change in the effective date of cost-of-living adjustments.

Senate Amendment—Section 1201 of the Senate amendment requires the commencing effective date of cost-of-living adjustments to be moved to December 1 of each year, and further provides that these adjustments would be payable on January 1. These cost-of-living adjustments have already been delayed as a result of the enactment of H.R. 4169.

Conference Agreement—The conferees agreed to those provisions of the Senate amendment which provide that the monthly annuity for any month may not be paid until the first business day of the next succeeding month and to a technical amendment which perfects the manner in which initial cost-of-living adjustments are prorated. The conferees note that provisions permanently delaying the effective date of cost-of-living adjustments until December of each year were enacted as part of the Omnibus Budget Reconciliation Act of 1983.

SEC. 2202. TECHNICAL AMENDMENT RELATING TO PREVAILING RATE EMPLOYEES

House Amendment—The House amendment contains no provision relating to the pay comparability adjustment for federal employees.

Senate Amendment—Section 1202 of the Senate amendment provides a 3.5% pay raise in January 1984 for General Schedule employees and effects a permanent delay in the date of the adjustment from October 1 to January 1 for General Schedule employees and a three month delay for wage board employees.

Conference Agreement—The Senate recedes to the House with a technical amendment which clarifies that pay adjustments for prevailing rate employees scheduled during fiscal year 1984 will be delayed 90 days. This is consistent with the intent of the Omnibus Reconciliation Act of 1983 which provided, generally, for a three-month delay in Federal pay adjustments. The Conference Agreement doesn't necessarily result in precluding a delay of the fiscal year 1985 federal pay adjustment.

SEC. 2203. DEDUCTION FROM CIVILIAN PAY FOR COST-OF-LIVING ADJUSTMENT OF RETIRED OR RETAINER PAY

House Amendment—The House amendment contains no provision relating to the deduction from civilian pay for cost-of-living adjustment of retired or retainer pay.

Senate Amendment—The Senate amendment repeals the reduction in civilian pay for cost-of-living adjustments of retired or retainer pay.

Conference Agreement—The conferees agreed to the Senate amendment, and included language to establish an effective date for the repeal.

SEC. 2204. LEAVE FOR CERTAIN OVERSEAS EMPLOYEES

House Amendment—The House amendment contains no provision relating to the leave for certain overseas employees.

Senate Amendment—The Senate amendment removes the 75 day limit on leave accumulated by teachers in the Department of Defense Dependents Schools.

Conference Agreement—The House recedes to the Senate.

SEC. 2205. CIVIL SERVICE RETIREMENT DEPOSITS COVERING MILITARY SERVICE

House Amendment—The House amendment contains no provision regarding retirement deposits.

Senate Amendment—Section 1205 of the Senate amendment amends section 306(g) of the Omnibus Budget Reconciliation Act of 1982, relating to deposits by certain retirees to receive credit for post-1956 military service. The Senate amendment extends application of section 306(g) to employees who retire prior to October 1, 1985.

Conference Agreement—The conferees agreed to the Senate provision.

SEC. 2206. ELECTION OF RETIREMENT PLAN

House Amendment—The House amendment includes no provision in this area.

Senate Amendment—Section 1207 of the Senate amendment extends the period during which eligible federal employees can make retirement elections, as provided in the Federal Employee Retirement Contribution Temporary Adjustment Act of 1983.

Conference Agreement—The House recedes to the Senate with an amendment extending the election period until September 15, 1984.

SEC. 2207. SALARY ADJUSTMENTS FOR JUDGES

House Amendment—The House amendment includes no provision in this area.

Senate Amendment—Section 1604 of the Senate amendment provides a 4% pay increase to federal judges, effective retroactive to January 1, 1984.

Conference Agreement—The House recedes to the Senate.

SEC. 2208. RETIREMENT BENEFITS FOR NATIVES OF THE PRIBILOF ISLANDS

House Amendment—The House amendment includes no provision in this area.

Senate Amendment—Section 1607 of the Senate amendment revises the Fur Seal Act Amendments of 1983 (P.L. 98–129) to extend retirement credit to eligible annuitants.

Conference Agreement—The conferees agreed to the Senate

SEC. 2209. AMENDMENT TO OMNIBUS BUDGET RECONCILIATION ACT OF 1981

Section 2209 of the conference report continues in effect the provisions of section 1722 of the Omnibus Budget Reconciliation Act of 1981 (95 Stat. 759; Public Law 97-35), which prohibits the Postal Service from taking any action to reduce, or plan to reduce, the number of days each week for regular mail delivery. The current prohibition, which will expire September 30, 1984, is continued in effect until September 30, 1987.

The policy statements enacted by Congress in the Postal Reorganization Act and incorporated in section 101 of title 39, United

States Code, are the principles specifically designed to guide postal management in determining service levels.

The conference intends to ensure compliance with these principles and the provisions of section 2209 as statutory requirements for effective postal services. Any proposal which would, if implemented, reduce the number of days each week for regular mail delivery, or diminish the frequency or quality of delivery service in accordance with the standards for delivery service in effect at the present time, would violate the provisions of section 2209. To consider such a proposal, in the view of the conference managers, is to "take any action," and therefore also would violate the specific language of the prohibition contained in section 2209.

Retirement Cost-of-Living Adjustments During Fiscal Years 1986 and 1987

House amendment

The House amendment contains a provision to limit cost of living adjustments for military and civilian retirees under age 62 to one-half the actual cost of living adjustment in fiscal years 1986 and 1987.

Senate amendment

The Senate amendment has no comparable provision.

Conference agreement

The House recedes to the Senate.

Pay Increases for Certain Employees in Panama

House amendment

The House amendment includes no provision in this area.

Senate amendment

Section 1206 of the Senate amendment provides pay raises for federal employees in the Panama Canal Zone.

Conference agreement

The Senate recedes to the House.

Title 3—Medicare, Medicaid, and Maternal and Child Health Amendments

1. Short Title (Section 2300)

Present law

No provision.

House bill

The House bill would specify that the short title of the bill is "Medicare and Medicaid Budget Reconciliation Amendments of 1984."

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

Subtitle A.—Medicare Amendments

2. Payment for Costs of Hospital-Based Mobile Intensive Care Units (Section 2320)

Present law

Ambulance services are reimbursed under Part B of Medicare. The patient is responsible for a coinsurance payment of 20 percent.

a. Medicare payments

House bill

The House bill would provide that Medicare make payment to hospitals under Part A for the operation of mobile intensive care units if certain conditions are met.

Senate amendment

Similar provision.

Conference agreement

The conference agreement follows the House bill.

b. Hospital requirements

House bill

The House bill would specify that the hospital must be located in a State which has a statewide prospective payment system approved by HHS either under a demonstration waiver or under the new Section 1886(c) programmatic waiver.

Senate amendment

The Senate amendment would specify that the hospital must be located in New Jersey and operating under a demonstration project approved under Sec. 402 of the 1967 amendments.

Conference agreement

The conference agreement follows the Senate amendment.

c. Application of provision

House bill

The House bill would provide that where the State has a demonstration waiver, the provision would apply unless the State notifies the Secretary of HHS, within 30 days of the date of enactment of this bill, that the State does not want the provision to apply.

Senate amendment

Similar provision.

Conference agreement

The conference agreement follows the Senate amendment.

d. Notification

House bill

The House bill would provide that in the case of a Section 1886(c) waiver, the State must notify the Secretary within such reasonable period as the Secretary may establish if the State does not want the provision to apply.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House provision.

e. Required assurances

House bill

The House bill would require the State to provide satisfactory assurances that total Medicare and Medicaid payments to the hospitals covered under the State system will not exceed the total payments which would have been made if the State were not under a waiver.

Senate amendment

Same as House bill.

f. Effective date

House bill

The House bill would make the provision retroactive to January 1, 1983.

Senate amendment

The Senate amendment would be effective upon enactment. Payment under Part A would only be permitted for the duration of the current waiver.

Conference agreement

The conference agreement specifies that the provision is effective on enactment and until such time as the waiver is terminated. However, the provision may not be terminated prior to 90 days after the publication of the final regulations implementing the Section 1886(c) programmatic waiver authority.

3. Removing Costs of Nurse Anesthetists From DRG-Based Payments (Section 2312)

Present law

Medicare's payments to hospitals under Part A are based on the diagnosis of the patient and are intended to cover all the services that hospitals customarily furnish in caring for patients with a specified diagnosis. All non-physician services provided to hospital inpatients can be paid for only under Part A. However, the Department of Health and Human Services (HHS), in its regulations governing hospital payments, established a temporary provision to provide for a transition with respect to payment for the services of certified registered nurse anesthetists (CRNA's) billed under Part B. The regulations provide that, if a physician employed nurse anesthetists during a designated period prior to implementation of prospective payment, then that physician may continue to receive payment from Medicare Part B for CRNA's through the hospital's cost reporting periods beginning before October 1, 1986.

a. Revision in definition of operating costs

House bill

The House bill would remove from the definition of "operating costs of inpatient hospital services" for purposes of prospective payment, costs related to employment of, or contracts for, professional services of certified registered nurse anesthetists. Thus, such costs would be reimbursed on a "pass through" basis.

Senate amendment

The Senate amendment includes a similar provision.

Conference agreement

The conference agreement follows the Senate amendment, with a modification to clarify that the provision is limited to anesthesia services furnished by certified registered nurse anesthetists.

The conferees intend that the term "anesthesia services" means those related to the preparation for, administration of, and recovery from anesthesia.

b. Payments to hospitals

House bill

No provision.

Senate amendment

The Senate amendment would require the Secretary to provide an additional payment amount to hospitals which are operating under the prospective payment system for the hospital's reasonable costs incurred for anesthesia services provided by a CRNA. Such reasonable costs could not be based on a greater number of CRNA's than were employed by a hospital in 1982, unless the Secretary determined that changes in patient volume, patient mix, or a loss of physician services required otherwise.

Conference agreement

The conference agreement follows the Senate amendment with modification. It strikes the portion of the Senate amendment which limits (with certain exceptions) reasonable cost payments to those based on the number of CRNA's employed by a hospital in 1982.

c. Study

House bill

The House bill requires the Secretary to include recommendations on the advisability and feasibility of determining payments for CRNA's on the basis of DRG's in the report to Congress on physicians' services to hospital inpatients.

Senate amendment

The Senate amendment requires the Secretary to study possible Medicare reimbursement methods which would not discourage the use of CRNA's by hospitals and to report to Congress as soon as is practicable.

Conference agreement

The conference agreement follows the Senate amendment.

d. Effective date

House bill

The House bill would be effective for hospital cost reporting periods beginning on or after October 1, 1984 and before October 1, 1986.

Senate amendment

The Senate amendment would be effective for hospital cost reporting periods beginning on or after October 1, 1984.

Conference agreement

The conference agreement follows the House provision with a modification to move the termination date to October 1, 1987.

It is the understanding of the conferees that, in conjunction with this legislation, the Administration intends to continue to permit those physicians who employed nurse anesthetists, as of cost reporting periods ending before September 30, 1983, to continue to bill for CRNA services. In addition, it is the understanding of the conferees that the Administration intends to modify the regulations to permit physicians who did not employ CRNA's before the specified date to bill for the services of CRNA's whom they have subsequently employed. The conferees believe the modification with respect to physicians employing CRNA's for the first time is appropriate, on the understanding that these billing arrangements will be permitted only during the same time period the provisions of this amendment are in effect. Similarly, the conferees expect that the regulations with respect to physicians already employing CRNA's will be terminated on the same date as this amendment.

4. Determination of Hospital Area Wage Index (Section 2316)

Present law

Medicare payments to hospitals under the prospective payment system must be adjusted to reflect the hospital wage level in a hospital's geographic area relative to the national average hospital wage level.

a. Adjustment report

House bill

The House bill would require the Secretary to develop, in consultation with the Secretary of Labor and the Commissioner of the Bureau of Labor Statistics, methods of refining and improving the adequacy and equity of the area wage indices and to report to Congress on such developments not later than June 1, 1984.

Senate amendment

The Senate amendment would require the Secretary, in consultation with the Secretary of Labor, to conduct a study to develop an appropriate index to adjust the prospective payment amounts to reflect area differences in average hospital wage levels, taking into account wage differences of full-time and part-time workers. The Secretary would be required to report the results of the study to Congress prior to May 1, 1984.

Conference agreement

The conference agreement follows the Senate amendment with a modification specifying that the report is due 30 days after enactment.

b. Payment adjustments

House bill

No provision.

Senate amendment

The Senate amendment would require the Secretary to adjust hospital payment amounts for cost reporting periods beginning on or after October 1, 1983, to reflect any changes made in the wage index as a result of the study. Overpayments or underpayments for the first cost reporting period of a hospital beginning on or after October 1, 1983, would be made by decreasing or increasing payments in the succeeding cost reporting period.

Conference agreement

The conference agreement includes the Senate amendment.

c. Adjustment criteria

House bill

The House bill would require the Secretary to establish criteria under which, to the extent deemed appropriate, a hospital's wage index adjustment would be modified if the hospital could demonstrate that its wage adjustment did not accurately reflect the wage levels in the labor market serving the hospital. Such adjustment would be made in a subsequent fiscal year to take into account a difference in payment amounts occurring in the current fiscal year resulting from a wage index inaccuracy.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House provision with a modification. The Secretary is directed to conduct a study, and include in his final report, proposed criteria by which an adjustment could be made in a hospital's wage index if such index did not accurately reflect the hospital wage levels in the labor market area serving the hospital.

5. Delay of Effective Date for Single Reimbursement Limit for Skilled Nursing Facilities. Skilled Nursing facility Reimbursement (Section 2319)

Present law

TEFRA required the Secretary to establish a single payment limit for both freestanding and hospital-based skilled nursing facilities (SNF's), effective October 1, 1982. Prior to that time, separate limits were established for these two types of facilities in recognition of the fact that the operating costs of hospital-based facilities were typically much higher than those of the freestanding facilities.

In the Social Security Amendments of 1983 (P.L. 98–21), the effective date of the single-limit requirement was postponed for one year until October 1, 1983. In addition, the Congress required the Secretary to report by December 31, 1983 on the effect of the implementation of the single-rate provision on hospital-based SNF's, given the difference (if any) in the patient populations served by such facilities and by freestanding SNF's. Further, the Secretary was required to report by the end of 1983 on the impact of hospital prospective payment on SNF's.

a. Effective date

House bill

The House bill would postpone implementation of the single reimbursement limit for SNF's until April 1, 1984.

Senate amendment

The Senate amendment would provide that for cost reporting periods beginning on or after October 1, 1982 and prior to July 1, 1984, hospital-based facilities and freestanding facilities would be paid on the same basis used to calculate reimbursement limits that had been in effect prior to the passage of TEFRA.

Conference agreement

The conference agreement follows the Senate amendment.

35-426 O 84 - 82

b. Calculation of limits

House bill

No provision.

Senate amendment

The Senate amendment would provide that for cost reporting periods beginning on or after July 1, 1984 separate limits would continue to be established for free-standing facilities in urban and rural areas at 112 percent of the mean operating costs of urban and rural freestanding facilities, respectively. Limits for urban or rural hospital-based facilities would be set at the appropriate freestanding facility limit plus 50 percent of the difference between the freestanding facility limit and 112 percent of mean operating costs for hospital-based facilities. Cost differences between hospital-based and free-standing facilities attributable to excess overhead allocations resulting from Medicare reimbursement principles would be recognized as an add-on to the limit.

Adjustments would be made to take account of differences in wage levels prevailing in a facility's area. Exceptions could be granted based upon case mix or circumstances beyond the control of the facility be it either a free standing or hospital-based facility.

Conference agreement

The conference agreement follows the Senate amendment.

c. Report

House bill

No provision.

Senate amendment

The Senate amendment would require the Secretary to submit the report required by Social Security Amendments of 1983 by April 15, 1984.

Conference agreement

The conference agreement follows the Senate amendment with a modification to require submission of the report by December 1, 1984.

d. Prospective payment proposals

House bill

No provision.

Senate amendment

The Senate amendment would require the Secretary to submit by December 1, 1984, a proposal for a prospective payment system for SNF's taking into account case-mix differences between providers. The proposal should be designed so as to permit inclusion of payments to hospital-based SNF's within the DRG system and to permit implementation on October 1, 1985.

Conference agreement

The Conference agreement follows the Senate amendment with a modification. The Secretary is required to submit to Congress by August 1, 1984, the results of the study required by TEFRA relating to the development of legislative proposals for prospective reimbursement of SNF's. In addition, the Secretary is required to report to the Congress by December 1, 1984 on the range of options available for prospective payment of SNF's. Included in the study should be an examination of the feasibility advisability and methods of incorporating into the hospital DRG system payments for SNF services. This examination should take into account case mix differences between providers.

The Conferees wish to express their concern over the protracted delays which have occurred in the submission of reports required by law. The Conferees expect and intend that the SNF reports required by this and previous laws shall be submitted on a timely basis.

6. Limitation on Increase In Hospital Costs Per Case (Section 2310)

Present law

TEFRA expanded previously existing limits on Medicare costs effective October 1, 1982. Among other things, it established a 3-year target rate reimbursement system which limited allowable rates of increase in Medicare payments per case over the fiscal year 1983–1985 period. The target rate is equal to the previous year's allowable operating costs per case (or after the first year, the previous year's target amount) increased by the percentage increase in the hospital wage and price index (market basket (MB)) plus 1 percentage point. Penalties and bonuses were established for hospitals, with costs above and below the target.

The "Social Security Amendments of 1983" (Public Law 98–21) provided for the establishment of a prospective payment system for certain hospitals to be phased-in over a 3-year period. During the transitional period, a portion of a hospital's payments will be based on the new Federal prospective payment rates and a portion on each hospital's own cost base. In the first year, the blend is 75 percent hospital specific and 25 percent the appropriate Federal rate; in the second year, the blend is 50/50; in the third year, the blend is 25 percent hospital specific and 75 percent the appropriate Federal rate.

The Federal rates are derived from historical Medicare cost data. For fiscal years 1984 and 1985, payment amounts from the previous fiscal years would be increased by the market basket, plus one percentage point. For fiscal years beginning on or after October 1, 1986, the rate of increase is left to the discretion of the Secretary.

Those hospitals and hospital units exempt from the prospective payment system are paid on the basis of historical costs subject to the existing rate of increase limits which provide for an annual rate of increase of MB plus 1 percentage point. For accounting years beginning on or after October 1, 1986, the rate of increase is left to the discretion of the Secretary.

a. Rate of increase limits

House bill

No provision.

Senate amendment

The Senate amendment would limit, for two hospital cost reporting periods beginning on or after October 1, 1984, the rate of increase in the hospital specific portion of the payment amount to the market basket minus one-half percentage point. The rate of increase in the Federal portion of the payment amounts during fiscal years 1985 and 1986 would be limited to the market basket plus one-half percentage point.

Conference agreement

The conference agreement follows the Senate amendment with a modification. The modification specifies that the rate of increase applicable for hospitals in fiscal year 1985 shall be market basket plus one-quarter of one percentage point. However, budget neutrality would continue to apply in fiscal year 1985. In fiscal year 1986, the rate of increase may not exceed the market basket plus one-quarter percentage point. The Secretary, taking into account the recommendations of the Prospective Payment Commission, would have authority to establish a rate of increase, as under current law, but at a rate not in excess of market basket plus one-quarter of one percentage point.

Recognizing that budget neutrality will be a primary consideration in the establishment of the fiscal year 1985 hospital payment rates, the conferees are nevertheless concerned about the perception that they may be unfair and inequitable. The conferees realize that the appropriateness of the new levels of payment will be vital to the success of the full implementation of the prospective payment system. This provision deals with but one factor which is taken into consideration when new rates are set. For the future those rates will be determined by the Secretary and the Prospective Payment Assessment Commission. Nevertheless, the conferees urge the Secretary to carefully evaluate the potential impact of the proposed rates on the long-term success of the prospective payment system.

b. Limits for Exempted Hospitals

House bill

No provision.

Senate amendment

The Senate amendment would provide that exempted hospitals and exempted hospital units would be subject to similar rate of increase limitations applicable to their costs (MB − ½ and MB + ½) in the same proportion as hospitals under the prospective payment system with the same accounting years. This would result in a rate of increase for exempted hospitals of MB in the first year and MB + ¼ in the second year.

Conference agreement

The conference agreement follows the Senate amendment with a modification. The modification provides that the rate of increase for exempted hospitals and exempted hospital units shall not exceed market basket plus one-quarter percentage point in the first year and shall not exceed market basket plus one-quarter of one percentage point in the second year.

The Secretary, taking into account the recommendations of the Prospective Payment Commission, shall continue to have authority to establish a rate of increase, as under current law, but not more than market basket plus one-quarter of one percentage point during the applicable period.

7. Classification of Certain Rural Hospitals (Section 2311)

a. Redesignation of urban facilities

Present law

Public Law 98–21 provided for the establishment of a prospective payment system for hospitals based on DRG's (diagnosis-related groups). The system is to be phased-in during a three year transition period during which a declining portion of the total prospective payment will be based on the hospital's specific rate and an increasing portion on the Federal rate. Different Federal rates are calculated for hospitals located in rural areas and hospitals located in urban areas.

Urban areas are metropolitan statistical areas (currently MSA's, previously SMSA's) or New England county metropolitan areas (NECMA's) as well as five specified counties in New England. All other areas are rural areas. The determination as to whether or not an area is urban or rural is made by the Office of Management and Budget. The determinations are periodically changed. In June of 1983, a large number of statistical areas were redesignated.

House bill

No provision.

Senate amendment

The Senate amendment would provide that hospitals located in counties redesignated as rural since enactment of the prospective payment system would be allowed a two year transition to the rural rates. In the first year, the hospital would be paid the rural rate plus two-thirds of the difference between its rural and urban rate. In the second year, it would be paid the rural rate plus one-third the difference between the rural and the urban rates.

Conference agreement

The conference agreement follows the Senate amendment.

b. MSA's

Present law

Separate Federal rates are calculated for the 9 regions (census divisions). In some cases, MSA's are located in more than one region resulting in hospitals in the same MSA receiving different payment amounts based on different Federal rates.

House bill

No provision.

Senate amendment

The Senate amendment would specify that a hospital located in an MSA shall be deemed to be in the region in which a majority of the hospitals are located or, at the option of the Secretary, the region which accounts for the majority of the Medicare discharges.

Conference agreement

The conference agreement follows the Senate amendment with a modification. The Secretary shall not recoup amounts from payments for discharges occurring in accounting years beginning prior to October 1, 1984, in those cases where a hospital is deemed to be in a lower rate region.

c. Regional and national referral centers

Present law

Public Law 98-21 authorized the Secretary to provide exceptions and adjustments appropriate to regional and national referral centers, including those hospitals of 500 or more beds located in rural areas.

House bill

No provision.

Senate amendment

The Senate amendment would permit a hospital classified as a rural hospital to appeal to the Secretary to be classified as a rural referral center, based on criteria established by the Secretary. The criteria would allow a hospital to demonstrate that it should be reclassified by reason of certain of its operating characteristics being similar (which may include wages, scope of services, service area, and mix of medical specialties) to those of a typical urban hospital in the same region. The amendment would require that criteria must be published by June 1, 1984 for implementation by October 1, 1984. An appeal would have to be submitted within the first quarter of a hospital's cost reporting period and the Secretary would have to make a final determination on the appeal within 60 days. Payments would be retroactive to the beginning of the hospital's reporting period.

Conference agreement

The conference agreement follows the Senate amendment with a modification. The modification requires publication of the criteria within 30 days after enactment. Further, the modification provides that hospitals must appeal their current designation as a rural, non-referral hospital, in the quarter preceding the start of their accounting year except for the accounting year beginning on October

1, 1984 in which case an appeal would be allowed to be made until January 1, 1985.

d. Study

House bill

No provision.

Senate amendment

The Senate amendment would require the Secretary to conduct a study on the advisability of making adjustments in the nonlabor component of those DRG's which have high fixed nonlabor costs. The report is due to Congress within 6 months after the date of enactment.

In addition the Secretary is required to study the degree of variation in inpatient costs within each DRG. The study must also present alternative means of computing payments and a discussion of the merits of a method of payment under which a percentage of the payment amount could be determined on a regional basis. The report is due to Congress prior to September 1, 1984.

Conference agreement

The conference agreement follows the Senate amendment with a modification. The prospective payment system pays rural hospitals at a lower rate than urban hospitals because rural hospitals are generally less costly to operate. In developing DRG payment rates, it is assumed that labor accounts for 80% of the costs while nonlabor items represent 20% of the costs. However, for some DRG's the current payment differential may be too large because a substantial part of the treatment involves non-labor costs (e.g., the costs of medical devices such as artificial hips) which do not vary between urban and rural areas. Therefore, the Secretary is directed to review the urban/rural payment differential with respect to such DRGs and report the findings to the Committees on Ways and Means and Finance within 6 months of the date of enactment.

Additionally, the Secretary would be required to study the advisability and feasibility of varying by DRG the proportion of the labor and non-labor components of the Federal payment amount, instead of applying the average proportion of those components to all DRGs.

It is the intent of the conferees that, in studying methods of payment made on a regional basis, the Secretary shall take into consideration regional variations in economic environment such as unemployment rates, the share of publicly funded patients, and the relationship of regional economic indicators to regional health care costs. In addition, the study shall consider scope of services, potential limitation on access to services, and service area characteristics such as market basket prices; labor market; economic base; and population growth, density and age. The study shall also address such factors as construction, utility and transportation costs.

e. Effective date

House bill

No provision.

Senate amendment

The Senate amendment would specify that the provisions (except for required reports) are effective with respect to cost reporting periods beginning on or after October 1, 1983.

Conference agreement

The conference agreement specifies that items (a) and (b) are effective for accounting years beginning on or after October 1, 1983. Item (c) is effective for accounting years beginning on or after October 1, 1984. These provisions are budget neutral for those years in which budget neutrality applies.

f. Additional considerations

Under a provision of the 1980 amendments, small rural hospitals are allowed to temporarily participate in Medicare under certain circumstances even though they are unable to meet the Medicare requirement that they provide 24-hour nursing. One of the conditions is that the hospital's lack of nursing must be due to a temporary nurse shortage and that the hospital is making a good faith effort to comply with the program's nursing standards.

The conferees believe that in assessing the hospital's effort to attract personnel, consideration should be given to the economic conditions in the area in which the hospital is located and the community's ability to attract and pay skilled hospital staff and provide employment for a spouse. Specifically, factors such as rate of unemployment, relative poverty and hardship resulting from natural disasters or economic dislocation should be identified and given weight.

In the case of a facility which functions as a sole community provider, or where a hospital is located in a geographically remote area, care shall be taken to ensure that hospital emergency services continue to be accessible to area residents.

8. Prospective Payment Assessment Commission (Section 2313)

Present law

Public Law 98-21 established the Prospective Payment Assessment Commission, which is required to assist the Department of Health and Human Services (HHS) and the Congress with issues arising from the new prospective payment system. The Commission is required to make recommendations concerning the annual percentage increase factor for diagnosis related group (DRG) payment rates and changes in the DRG's based on its evaluation of scientific evidence with respect to new practices, including the use of new technologies and treatment modalities.

House bill

No provision.

Senate amendment

The Senate amendment would clarify that the Commission is an independent body responsible for requesting appropriations. It would authorize an Executive Director and exempt the Commission from competitive public bidding and from open meeting requirements. In addition, it would authorize the Secretary to supplement the Commission's activities by carrying out or awarding grants or contracts for original research and experimentation, including clinical research. It would require the Secretary to provide the Commission with basic support services which are to be reimbursed from the Commission's appropriations. It would provide that physicians serving as personnel may be provided a physician comparability allowance.

Conference agreement

The conference agreement follows the Senate amendment with a modification. The modification permits closure of meetings, or portions thereof, upon the affirmative vote of a majority of the Commission members. The modification would not require the Secretary to provide the Commission with basic support services.

9. Hospice Contracting for Core Services (Section 2343)

Present law

Public Law 97-248, the "Tax Equity and Fiscal Responsibility Act of 1982," authorized for the period November 1, 1983, to October 1, 1986, Medicare Part A coverage for hospice services provided to terminally ill Medicare beneficiaries with a life expectancy of six months or less. The law specifies that a hospice must routinely provide directly, substantially all of the following "core services": nursing care, medical social services, physician's services and counseling services. The remaining "non-core services" may be provided either directly by the hospice or under arrangements with others, in which case the hospice must maintain professional management responsibility for all such services furnished to an individual, regardless of the location of or facility in which such services are furnished.

Under existing regulations, a hospice may use contracted staff to meet the "core service" needs of its patients but only when necessary to supplement hospice employees during periods of peak patient loads or under extraordinary circumstances.

House bill

No provision.

Senate amendment

The Senate amendment would permit the Secretary to waive the nursing care "core services" requirement for hospices which are located in rural areas, which were in operation on or before January 1, 1983, and which have demonstrated a good faith effort to hire their own nurses. A waiver request would be granted automatically unless expressly denied by the Secretary within 60 days. The granting of a waiver would not preclude the favorable consideration of a subsequent waiver request should such a request be necessary.

The Secretary would be required to study the necessity and appropriateness of the "core services" requirement and report the findings to the Congress within 18 months after date of enactment.

Conference agreement

The conference agreement follows the Senate amendment with a modification which specifies that the report on the core services requirement must be submitted to the Congress prior to January 1, 1986. This is the same date that the Secretary's report concerning the hospice program's reimbursement method and benefit structure is due.

The study to be submitted in 1986 must include not only an analysis of medicare certified hospices but also a review of non-medicare hospices. The conferees believe it is essential to have comprehensive information available to them on the characteristics of non-medicare hospices (size, affiliation, etc.) and why they are not participating in the medicare hospice benefit and if they are certified as another provider (HHA, SNF, hospital, under medicare).

10. Payment for Outpatient Diagnostic Laboratory Tests (Section 2303)

Present law

Diagnostic laboratory services for ambulatory patients are reimbursed by Medicare (subject to the Part B deductible and coinsurance) on the basis of reasonable charges when furnished by an independent laboratory or physician. Payment for such services to hospital outpatients is on the basis of the lower of charges or reasonable cost. Certain limitations are applied on the amount Medicare and Medicaid will pay a physician for laboratory services when the services are performed by an independent laboratory.

a. Fee schedule

House bill

The House bill would require establishment of a national fee schedule for all laboratory services except those provided to hospital inpatients. Payment would be based on the fee schedule unless the actual charge is lower. The fee schedule could initially be established on a statewide or regional basis; within three years the Secretary would be required to develop and implement a national fee schedule.

Senate amendment

The Senate amendment would include a similar provision except the fee schedule would be established on an area-wide basis as determined by the Secretary. The fee schedule would be established for the period May 1, 1984 to October 1, 1987.

Conference agreement

The conference agreement follows the House bill with an amendment. A fee schedule for independent clinical laboratories (including hospital laboratories furnishing services to persons who are not patients of the hospital) and for laboratory services conducted in physician's offices is to be established at 60 percent of the prevailing charge levels for the fee screen year beginning July 1, 1984. After three years, payments will be made on the basis of a national fee schedule. (The fee schedule will not apply to clinical laboratory tests furnished by ESRD facilities and included in the ESRD composite rate).

For hospital-based laboratory services serving hospital outpatients a fee schedule based on a carrier or regional area is to be established at 62 percent of the prevailing charge levels for the fee screen year beginning July 1, 1984. After the three-year period, the reimbursement for such hospital labs would revert to cost reimbursement unless the Congress acted to include them in a national fee schedule.

The agreement requires the Secretary to report on the advisability of continuing a fee schedule for hospital-based laboratories serving hospital outpatients, and if such schedule is advisable, the appropriate fee level.

b. Adjustments in fee schedule

House bill

The House bill permits the Secretary to provide for adjustments to account for wage variations.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

c. Initial payment level

i. Establishment

House bill

The House bill would establish the initial payment level for the fee schedule at 60 percent of the prevailing charge level for the fee screen year beginning July 1, 1984.

Senate amendment

The Senate amendment would establish the initial payment level at 60 percent of the prevailing charge for tests performed in independent labs and in physicians offices for the fee screen year beginning July 1, 1983. For tests performed in hospital labs the comparable percentage would be 62 percent of the prevailing charge level.

Conference agreement

The conference agreement follows the Senate amendment with a modification. The initial payment level is set at 62% of the prevailing charge level for services provided by hospital-based laboratories serving hospital outpatients and 60% of the prevailing charge level for services provided by hospitals when acting as independent laboratories. The computation is based on the prevailing charge levels in effect for the fee screen year beginning July 1, 1984. The conferees intend that all clinical diagnostic laboratory services, including those currently subject to payment at the 25th percentile, are to be paid on the basis of the fee schedule.

The conferees intend that in those States that already require direct billing for laboratory services the Secretary will take into account the fee levels in surrounding States when establishing the fee levels in direct billing States.

ii. Adjustments

House bill

The House bill would require the Secretary to adjust the fee schedules annually to reflect changes in the Consumer Price Index for all Urban Consumers (U.S. city average).

Senate amendment

Same as the House bill.

iii. Additional adjustments

House bill

The House bill would permit the Secretary to make additional adjustments based on technological changes.

Senate amendment

The Senate amendment would permit the Secretary to make adjustments or exceptions to the fee schedule to assure adequate reimbursement for: (a) emergency laboratory tests needed for the provision of bona fide emergency services in a hospital emergency room, and (b) certain low volume high-cost tests where highly sophisticated equipment or extremely skilled personnel are necessary to assure quality.

Conference agreement

The conference agreement follows the Senate amendment with a modification to allow adjustments based on technological changes and to allow the payment of bona fide emergency services in other than a hospital emergency room.

d. Payment to independent and hospital labs

Present law

Present law includes the following provisions with respect to payment to independent and hospital labs:

(i) With respect to lab services provided to outpatients by independent labs, assignment can be taken on a case-by-case basis.

(ii) Current law requires hospitals providing lab services to their hospital outpatients to accept assignment. No assignment is required in the case of non-hospital patients receiving lab services from a hospital serving as an independent lab.

(iii) Medicare is permitted to waive the coinsurance requirements for those cases where the laboratory agrees to accept a negotiated fee. (Provision never implemented.)

House bill

The House bill would make the following changes:

(i) Independent labs would be required to accept Medicare assignment;

(ii) Services conducted by hospital labs for non-hospital patients would have to be accepted on an assignment basis; and

(iii) Medicare would waive the deductible and coinsurance requirements and pay 100% of the fee screen amount or charge, which ever is lower, for those cases which are accepted on assignment.

Senate amendment

The Senate amendment would, as under current law, permit independent labs and hospital labs providing services for non-hospital patients to choose to accept assignment on a case-by-case basis. The Senate amendment includes a similar provision with respect to waiver of cost-sharing charges.

Conference agreement

The conference agreement follows the House bill with a modification. The Secretary is given flexibility to permit an independent laboratory to bill for all of the tests performed for a patient, even if some, but not all, of the tests were done by another laboratory on referral from the laboratory submitting the bill.

e. Payment for physicians' services

Present law

Under current law, physicians may bill for laboratory services regardless of whether they personally performed or supervised the test. When billing, the physician is permitted to choose on a case-by-case basis whether to accept assignment.

House bill

The House bill would permit physicians to bill for clinical laboratory services only if the physician (or another physician with whom the physician shares his practice) personally performed or supervised the performance of the test. As under current law, the physician could choose to accept or not to accept assignment. When the physician accepts assignment, Medicare reimbursement would be at 100 percent of the fee schedule amount, and the coinsurance and deductible would not apply.

Senate amendment

The Senate amendment includes a similar provision.

Conference agreement

The conference agreement follows the Senate amendment with a technical modification.

f. Specimen fee

Present law

Under current law, physicians are permitted to bill a nominal amount to cover specimen collection and handling fees in the case of those tests performed by a laboratory and billed for by the physician. Independent laboratories are also permitted to bill for a nominal specimen collection fee in limited circumstances.

House bill

The House bill would provide for the payment of a nominal fee for the collection of a patient specimen. However, the payment could be made only once per encounter to whomever draws the specimen.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with an amendment. The conferees note that the provision is meant to extend the payment of a specimen fee to labs and hospitals for such items as venipuncture and the collection of a urine sample by catheterization. The provision is not meant to disrupt current policy with respect to fees paid for the services provided in physicians' offices or to laboratories, under limited circumstances, for items such as a visit to a remote nursing home or a patient's home.

g. Simplified billing arrangements

House bill

The House bill would direct the Secretary to simplify current billing requirements for laboratory services.

Senate amendment

The Senate amendment includes a similar provision except that it would direct the Secretary to assure that information collected is sufficient to prevent fraud and abuse.

Conference agreement

The conference agreement follows the Senate amendment. The conferees note that this provision does not require patient diagnosis to appear on bills.

h. Medicaid conforming provision

House bill

The House bill provides that Federal matching funds would not be available to the extent that a State paid more for a laboratory test than would be paid for such tests under the Medicare fee schedule.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

i. Reports to Congress

House bill

No provision.

Senate amendment

The Senate amendment would require the Secretary to report to the Congress prior to June 30, 1985 on recommendations with respect to direct payment of all lab fees to physicians, the basis for the formulation of a nationwide fee schedule, and any appropriate indexing mechanism for such a schedule.

Conference agreement

The conference agreement follows the Senate amendment with a modification. The GAO is directed to report on the impact of the new fee schedule on services, the potential impact of the move to national rates and the impact such a fee schedule would have on hospital outpatient services. The GAO is also directed to report on any changes in the volume of lab tests done by physicians or labs.

The agreement modifies the language directing the Secretary to report on the advisability and feasibility of providing for a direct payment to physicians. In addition, it delays the due date of the report to January 1, 1987.

j. Effective date

House bill

The House bill specifies that the provision would apply to Medicare diagnostic laboratory tests furnished on or after July 1, 1984 and Medicaid payments for calendar quarters on or after October 1, 1984.

Senate amendment

The Senate amendment specifies that the provision would apply to diagnostic laboratory tests furnished on or after May 1, 1984 and before October 1, 1987. The requirement that only those performing or supervising the performance of the tests bill the program, would be permanent.

Conference agreement

The conference agreement follows the House bill with an amendment. A fee schedule is established on a permanent basis for independent laboratories and physicians' laboratories. The fee schedule for services provided by hospitals to outpatients is effective for three years.

11. Coverage of Administration of Hepatitis B Vaccine (Section 2323)

Present law

Current law prohibits Medicare coverage of immunizations and vaccines except in the case of pneumococcal vaccine which Congress specifically covered in 1980.

a. Coverage

House bill

The House bill would cover hepatitis B vaccine for high risk medicare beneficiaries when it is administered in a hospital or renal dialysis facility. It would authorize the Secretary to provide payments that reasonably reflect the cost of efficiently providing and administering hepatitis B vaccine.

Senate amendment

The Senate amendment includes a similar provision but it would limit coverage to ESRD patients. It would give the Secretary flexibility in the development of payment methods for vaccine administration at or through a renal dialysis facility. Payment for vaccine administered to an individual receiving dialysis, but not at or through a dialysis facility, would be either included in the comprehensive fee paid for physician ESRD services, or on a reasonable charge or other basis.

Conference agreement

The conference agreement would follow the House bill with an amendment. Coverage is permitted for high and intermediate risk individuals. The conferees anticipate that the Secretary will develop coverage guidelines using available information to define those groups at high and intermediate risk of contracting the disease, using specifically, but not necessarily exclusively, the information developed by the Centers for Disease Control (CDC).

The conference agreement permits a separate payment for vaccines for patients receiving dialysis at or through a facility. The conference agreement specifies that, for non-ESRD patients, payments may be made to ESRD facilities, hospital outpatient departments or physicians for the vaccine and its administration. Similar payment arrangements are applicable for vaccines provided to ESRD patients not cared for by an ESRD facility.

The conference agreement gives the Secretary discretion in developing payment amounts. The conferees expect that the Secretary will give consideration to the need to avoid excessive program costs (e.g., by changing frequency guidelines for Hepatitis B testing for ESRD patients) and utilization patterns. The conferees are concerned about the potential extra billing liability of beneficiaries that might inhibit them from obtaining services, and therefore urge physicians to accept assignment. The agreement directs the Secretary to monitor the provision of the vaccine and its administration. The Secretary is further required to review any changes in technology which could potentially affect the amounts paid for services.

b. Cost-sharing

House bill

The House bill would waive the applicable Part B deductible and coinsurance amounts.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House provision.

c. Effective date

House bill

The House bill specifies the effective date is for services furnished on or after July 1, 1984.

Senate amendment

The Senate amendment applies to vaccine administered on or after July 1, 1984.

Conference agreement

The conference agreement specifies an effective date of September 1, 1984.

12. Part B Payment for Services of Teaching Physicians (Section 2307)

Present law

Present law sets forth conditions governing how Medicare should reimburse for patient care services performed by physicians in a teaching setting, including a formula for calculating the physician's customary charge.

a. Formula revision

House bill

The House bill would revise the formula for calculating physicians' customary charges. As a result, customary charges cannot be less than 75 percent of the Medicare prevailing charges paid for services in the same locality as the teaching setting.

Senate amendment

Similar provision.

Conference agreement

The conference agreement follows the Senate amendment with a modification regarding calculation of customary charges. As a result, customary charges cannot be less than 85 percent of the Medicare prevailing charges in the same locality for the same service. The conferees also urge that the Secretary try to develop a simplified or expedited methodology by which teaching hospitals can demonstrate that they satisfy the existing formula for establishing customary charges.

b. Alternative method

House bill

The House bill would provide an alternative method for determining reasonable charges. If all the "teaching physicians" at a particular teaching hospital agree to take assignment for all Medicare patients they serve in that teaching hospital, then the physicians can have their reasonable charges determined according to the normal Medicare reasonable charge methodology.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House provision with an amendment.

Effective October 1, 1984, if all the "teaching physicians" at a particular teaching hospital agree to take assignment for all medicare patients they serve in that hospital, then they can receive 90 percent of the medicare prevailing charges in the same locality.

The General Accounting Office shall conduct a study of the amounts billed for the services of teaching physicians and paid by carriers to determine whether such payments are only made when all of the conditions for payment under present law (Section 1842(b)(7)) are met.

The conference agreement also includes an amendment relating to the calculation of payments that are made to hospitals as compensation for indirect teaching costs. Regulations published in January specified that teaching hospitals that generally did not employ residents and interns could count them in calculating their indirect teaching costs only if they were employed by another organization which has a longstanding relationship with the hospital and which is the sole employer of substantially all of the interns and residents furnishing services at the hospital. The conferees believe these limitations are inappropriate because the indirect teaching costs which are being calculated result from the participation of the interns and residents in the hospitals' medical education program. Who employs them is immaterial. Therefore, the conference agreement provides that the Secretary, when calculating a hospital's indirect teaching costs, take account not only of the interns and residents it employs but also any other house staff members who participate in the hospitals teaching program but who are employed by another organization.

13. Limitation on Physician Fee Prevailing and Customary Charge Levels; Participating Physician Incentives (Section 2306)

a. Physician fees

Present law

(a) *Physician Fees.*—Medicare pays for physician services on the basis of Medicare-determined "reasonable charges." Reasonable charges are the lesser of: (1) a physician's billed charge; (2) the customary charge made by an individual physician for a specific service; or (3) the prevailing level of charges made by all physicians for services in a geographic area. The customary and prevailing charges are updated annually (on July 1) to reflect changes in physician charging practices. Increases in the prevailing charge levels are limited by an economic index, which reflects changes in the physicians' practice costs and changes in general earnings levels.

House bill

No provision.

Senate amendment

The Senate amendment would freeze all customary and prevailing charges for the fee screen year beginning July 1, 1984. The amendment would continue the freeze for an additional year for the prevailing fees of physicians who are not "participating physicians". No catch-up would be permitted for fees which were frozen.

Conference agreement

The conference agreement follows the Senate amendment with a modification. The provision adopted by the Conferees freezes Medicare customary and prevailing charges for all physicians services for a 15-month period beginning on July 1, 1984 and ending on September 30, 1985. Subsequent fee screen updates would occur on October 1 of future years. Because of the importance of the cooperation of physicians nationwide in the fee freeze, the Conferees intend that the Secretary make every effort to notify physicians, on a timely basis, concerning the requirements of this provision.

The provision establishes the concept of a "participating physician" contained in both the House and Senate bills. A participating physician is one who voluntarily enters into an agreement with the Secretary to prospectively accept assignment for all services furnished to all Medicare patients for a twelve-month period. Physicians would be given a specified period of time in which they could indicate their decision to participate for the twelve-month period beginning October 1, 1984. After this specified period of time elapses, only new physicians in an area or newly licensed physicians could sign participation agreements until the next designated period of time. These agreements would be similar to the "participating physician" agreements successfully used by many Blue Shield plans.

The provision contains several administrative incentives (contained in the Senate bill) to encourage physicians to voluntarily sign participation agreements. These include publication of directories, use of toll-free telephone lines to disseminate names of participating physicians and the use of direct lines for electronic receipt of claims. In addition, physicians have an incentive to become participating physicians because any normal increase in their actual billed charges during the 15-month period when Medicare's reasonable charges are frozen, will be reflected in updating their future customary charge screen updates.

Much of the success of the new "participating physician" program will depend on the involvement of the Medicare beneficiaries nationwide. In providing an increased amount of information to the beneficiary, the Conferees hope they will take this opportunity to become increasingly informed about the practice patterns of the physicians in their communities.

The current claim-by-claim assignment system would continue in its current form for physicians who choose not to sign participation agreements (i.e., non-participating physicians). To protect beneficiaries from increased charges during the 15-month period when Medicare payment levels are frozen, the legislation provides that increased charges to Medicare patients by non-participating physicians would not be recognized in their customary charge update in future years. Further, if non-participating physicians do not comply with the fee freeze and increase their actual charges billed to Medicare patients, they could be subject to civil money penalties or exclusion from the program for up to five years. However, in light of the efforts of many medical societies that have urged their members to voluntarily freeze their fees—efforts which the Conferees recognize and commend, the Conferees believe that this provision will work in concert with those efforts and that physicians who are complying with organized medicine's voluntary fee freeze would not be subject to the non-compliance provisions. The conference agreement provides the Secretary with authority to impose civil money penalties or assessments, exclusion for up to five years from the Medicare program, or both. The purpose of this authority is to protect Medicare beneficiaries from increased charges from physicians who are not participating physicians.

The conferees expect that the Secretary will exercise this authority vigorously but prudently, applying sanctions commensurate with the offense. The conference agreement provides the Secretary with necessary discretion in applying these penalties. The conferees expect that the Secretary will impose penalties on physicians who are serious violators of the program.

The Secretary will be expected to use discretion in judging whether the increased charges occurred before the physician could reasonably be expected to have known of the conditions this section imposes. Further, the Secretary would take into account other factors, such as whether a pattern of increased charges has occurred, the extent to which the patient faced increased costs as a result, and whether the amounts of the increases are significant, and so on.

In any program of this magnitude, all violations cannot be pursued. But the conferees expect the Secretary to monitor physician charges and take action in cases where willful violation is occurring so as to give public and the physician community certainty that the program is being enforced.

The conferees note that although the Secretary is provided with the ability to exclude a physician from Medicare for up to five years, it is the expectation that this step would be taken only in extreme circumstances and that the more usual enforcement will be through the civil money penalty.

Since the civil money penalty may be imposed in amounts of up to $2,000 for each violation, the Secretary has a strong tool available to ensure enforcement. The conference agreement provides that in no circumstances will the exclusion penalty be imposed in the case of the sole physician serving a community or a physician providing essential specialized services that would otherwise not be available. Further, the impact on access to care for Medicare beneficiaries should be considered by the Secretary in making the determination of the penalty to be imposed in other cases as well.

The conferees expect the Secretary to consider whether there are enough other physicians in the area to serve the needs of Medicare patients. For example, rural communities may have few physicians. Some urban and rural areas are medically underserved. In some communities, barring a physician from Medicare might mean an effective loss of any physician to serve a person eligible for both Medicare and Medicaid.

In the cases where the Secretary determines exclusion from the program is appropriate, services provided by the physician would no longer qualify as a covered service under the Medicare program, and payment would no longer be made. The Secretary would be expected to take the appropriate steps to assure that the beneficiary was informed and protected.

The conference agreement gives the Secretary the authority to make restitution to a beneficiary out of amounts collected through civil penalties or assessments on the physician who provided him services. The Secretary would be expected to use this authority when the increased charges to the beneficiary were significant. It would be expected that restitution would not be made if the amounts in question were small or less than the administrative cost of making the restitution. The restitution in any case would not exceed either the excess amount the beneficiary paid or the amount collected from the offending physician.

In order to determine compliance of non-participating physicians with the fee freeze, the Secretary shall monitor the charges of individual non-participating physicians. The Secretary shall have the flexibility to perform the monitoring on a timely and cost-effective bases. The monitoring shall compare physician charges during periodic intervals following enactment (such as quarterly) with a base period of the April 1 to June 30, 1984 quarter (the quarter following the March 7, 1984 letter from the American Medical Association to all physicians urging a voluntary freezing of fees) and shall begin with charges on or after July 1, 1984.

In exercising her authority to enforce the price freeze, the conferees expect the Secretary would make use of the Office of the Inspector General in a similar manner as the current delegation of responsibility with respect to program sanctions and civil money penalties.

b. Participating Physician Arrangements

Present law

Physicians may decide, on a claim-by-claim basis, to accept assignment. That is, for each claim a physician may decide either (1) to accept the amount paid by Medicare (the reasonable charge) as payment in full (except for cost-sharing amounts) or, (2) to bill the patient for the entire bill, including any amount in excess of the Medicare reasonable charge. The patient is then responsible for paying the physician for the full amount of the bill and for submitting the claim to Medicare for payment of 80 percent of the Medicare reasonable charge.

House bill

The House bill would require the Secretary to offer physicians annually an opportunity to voluntarily sign as agreement to accept assignment for all services furnished to all Medicare patients in the following year.

The House bill would require the Secretary to publish annually a list of physicians who have voluntarily agreed to accept assignment for all services furnished to all Medicare patients in the following year. It would require the Secretary to notify Medicare beneficiaries annually about the availability of the list.

Senate amendment

The Senate amendment would include a similar provision with respect to the annual opportunity for physicians to sign an agreement except it includes suppliers, uses the term voluntary "participating physician or suppliers" arrangement and sets a date certain for implementation.

The Senate amendment would provide that for those physicians who have elected to become "participating" physicians, for the fee screen year beginning on July 1, 1985, prevailing fees will not be frozen.

The Senate amendment includes a provision, similar to that in the House bill, relating to publication of a list of physicians who have agreed to accept assignment and notification of beneficiaries of the availability of the list. The Senate amendment includes supplies and further requires the Secretary to make the list (directory) available in each district and branch office of the Social Security Administration, the offices of the carriers, and to senior citizens' organizations. The list would be available for purchase by the public.

The Senate amendment would provide additional incentives for participating physicians:

requires carriers to maintain toll-free lines to provide enrollees with names of participating physicians;

permits carriers to establish direct lines for electronic receipt and payment of claims;

permits carriers to use either or both of the following payment arrangements for beneficiaries with approved medigap coverage or with group health insurance plans which serve as medigap policies:

"Piggyback billing" under which the participating physician or supplier submits one bill to the carrier. The carrier pays the physician or supplier the medicare determined reasonable charge and then sends the willing medigap insurers information on the amount paid. The medigap insuror would automatically pay the physician or supplier for the beneficiary's cost sharing liabilities.

"Payment to organizations" under which the participating physician or supplier submits one bill to the medigap insurer. The medigap insuror would pay the physician or supplier an amount which the physician or supplier accepts as payment in full, including cost-sharing liabilities. The medigap plan would then collect the reasonable charge from Medicare.

Conference agreement

The conference agreement establishes participation agreements for physicians and suppliers. The participation agreements would apply for 12-month periods beginning on October 1, 1984. As incentives to participate, the Conferees adopt the following incentives in the Senate bill: directories, toll-free telephone lines and direct lines for electronic receipt of claims. The conference agreement incorporates the use of the payment to organization method for participating physicians contained in the Senate bill in the definition of participating physician. The Conferees intend that the Secretary consider making certificates or other emblems available to physicians who sign participation agreements so that beneficiaries will have an easy means of identifying them.

c. Participating physician monitoring

House bill

No provision.

Senate amendment

The Senate amendment would require the Secretary to monitor the proportion of physicians who do not become "participating physicians", the difference between actual and reasonable charges for those physicians, and any changes in per capita volume and mix of beneficiary services provided by those physicians. The Secretary would be required to report the results of such monitoring to the Congress on a semi-annual basis beginning January, 1985 and ending January, 1987. The final report would include recommendations for constraining part B growth so as to avoid an increased burden on program beneficiaries, and include an analysis of other payment methods for part B services.

The Senate amendment would specify that carrier payments from the part B trust fund are increased to the extent necessary to conduct the required monitoring.

Conference agreement

The conference agreement requires the Secretary to monitor charges of non-participating physicians for purposes of noncompliance with the fee freeze and application of sanctions as discussed above. The conference agreement also adopts a Senate provision with modifications regarding monitoring of changes in the per capita (user or enrollee) volume (services and expenditures), and mix of services (such as changes in billings for various types of medical visits) for all physicians. The provision requires a report on these charges by July 1, 1985, including legislative recommendations of how to restrict growth in part B program costs without these costs being transferred to beneficiaries.

The conferees recognize that the provisions contained in this section will necessarily mean increases in costs for carriers. Among the activities that will entail new costs are implementation of the participating physician system, preparation of the directors and historical assignment rate lists, toll free telephone lines, direct lines for electronic billing, monitoring physician charges, and notifying physicians of these significant statutory changes. Further, these activities will require rapid and immediate action by the carriers. In order to assure that resources are promptly available to assure effective implementation of these provisions, the conference agreement provides the Secretary with authority to draw on the trust fund for immediate funds to carry out these activities. The agreement provides for the transfer of no less than $8 million in FY 84 and $15 million in FY 85.

d. Information on physician assignment

House bill

The House bill would require the Secretary to compile annually a list of physicians serving medicare beneficiaries including a list of assignment rates, by percentile intervals not to exceed quartiles, of individual physicians for the previous year.

The House bill also requires the Secretary to make available, in each district office of the Social Security Administration (SSA), the historical assignment rate lists for the local geographic areas served by that office. The bill also specifies that the historical assignment rate lists would have to be available by mail from each carrier. It would require annual notification to beneficiaries of the lists' availability.

Senate amendment

The Senate amendment includes a similar provision with respect to compilation of the list, except it includes suppliers and permits the Secretary to limit the list to those physicians and suppliers who accepted assignment in a certain percentage of cases.

The Senate amendment does not include a provision, comparable to that in the House bill, with respect to making the list available.

Conference agreement

The conference agreement follows the Senate amendment but excludes the requirement to publish volume of services and allows the Secretary to exclude low volume physicians and suppliers.

14. Study of Medicare Part B Payments (Section 2309)

Present law

Payments are made to physicians on the basis of reasonable charges for specific services.

a. Study

House bill

The House bill would require the Secretary to study and report on methods by which Medicare Part B payment amounts and program policies may be modified:

(i) To eliminate inequities in the relative amounts paid to physicians by type of service, locality, and specialty, with particular attention to any inequities between cognitive services and medical procedures.

(ii) To increase incentives for physicians and other suppliers under such part to accept assignment for Medicare services.

(iii) To provide incentives for physicians and other providers not to provide increased or otherwise excessive amounts of hospital, physician, and other health care services.

The report must also include a description of one or more national or regional fee schedules for payments which are consistent with the study carried out by the Secretary.

Senate amendment

The Senate amendment would direct the Office of Technology Assessment, in consultation with appropriate physician organizations, to conduct a study to examine any imbalances in payment to physicians for their cognitive vs. their technical skills. It would require submission of a report to Congress by December 31, 1985 containing findings and specific recommendations.

The Senate amendment contains no provisions comparable to the other items of the House bill.

Conference agreement

The conference agreement generally follows the House provision, with respect to the scope of the study, but places the entire study under the direction of OTA. With respect to item (ii) the conference agreement specifies that the study shall examine the influence of payment methodologies and payment levels on the utilization (i.e. volume and intensity) of services. In addition, the Conference agreement modifies the provision on fee schedules; the study is to include information on methodologies to be applied in the development of fee schedules and other payment mechanisms on either a national or regional basis and comments on whether such fee schedules or payment methodologies are advisable or feasible.

b. Data base

House bill

The House bill requires the Secretary to develop a centralized data base utilizing information from the Medicare carriers regarding the utilization of Part B services; the assignment rates of physicians and suppliers; actual, customary and prevailing charge distributions; and differences in charge distributions among different specialities and localities.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House provision, with a modification directing the Secretary to provide the information in the data base to OTA.

c. Effective date

House bill

The House bill would require the study to be completed and the report submitted to Congress not later than June 30, 1985.

Senate amendment

The Senate amendment would require submission of the report prior to December 31, 1985.

Conference agreement

The conference amendment follows the Senate amendment.

15. Pacemaker Review and Reform (Section 2304)

Present law

The costs of inpatient hospital services with respect to the implantation of pacemakers, including the costs of the device, are subject to the new diagnosis-related group (DRG) prospective payment system. However, the costs of physicians' services for implantation and post-implantation monitoring of the devices are reimbursed under Part B. Post-implantation monitoring includes transtelephonic monitoring for which frequency guidelines have been established by the Secretary.

a. Guideline revision

House bill

The House bill would require the Secretary to revise the current guidelines on the frequency of transtelephonic monitoring.

Senate amendment

The Senate amendment includes a similar provision.

Conference agreement

The conference agreement follows the House bill.

b. Frequency guidelines

House bill

The House bill would provide that, if the Secretary fails to revise the guidelines by October 1, 1984, a specified frequency schedule would go into effect with respect to single-chamber cardiac pacemakers powered by lithium batteries. The House bill would provide that payment would not be made for monitoring which is more frequent than: (1) weekly during the first month after implantation, (2) once every two months during the period representing 80 percent of the estimated life of the device, and (3) monthly thereafter. Exceptions could be made based on special medical factors.

Senate amendment

The Senate amendment would require the issuance of revisions by April 1, 1984. No statutory schedule is set forth.

Conference agreement

The conference agreement follows the House bill with an amendment which provides that the frequency guidelines established by law will expire upon publication of the revised guidelines. The conferees expect that the revised guidelines will be published promptly. They further expect that the revised frequency guidelines will provide for exceptions where medically appropriate.

c. Payment review

House bill

The House bill would require the Secretary to review and report to the Congress on the appropriateness of the current Part B payment for physician's services associated with implantation or replacement of pacemakers and pacemaker leads. Such review would take into account the time and difficulty of the procedures compared to those when such rates were first established and take into consideration a reduction of such recognized rates by 20 percent. The House bill would require completion of the review by October 1, 1984.

Senate amendment

The Senate amendment includes a similar provision except that it would: (1) also require review of reimbursement for inpatient hospital services, and (2) not require the Secretary to take into consideration a reduction in recognized rates by 20 percent. The review and report would be due by April 1, 1984.

Conference agreement

The conference agreement follows the House bill with an amendment. The amendment requires a review of payments for implantation or replacement of pacemakers under both Parts A and B of Medicare, with the review of Part A payments conducted by the Prospective Payment Assessment Commission. Both studies must be submitted to Congress by March 1, 1985.

The conferees note that improvements in pacemaker implantation, reductions in the time required for such procedure, and changes in the difficulty and costs of such procedures have occurred over the past decade. Therefore, while the agreement eliminates the directive that the Secretary take into consideration a 20 percent reduction in recognized rates, the conferees expect the Secretary to consider whether some reduction in fees may be appropriate.

d. Registry

House bill

The House bill requires the Secretary, through the Food and Drug Administration, to provide a registry of all cardiac pacemaker devices and leads for which payment was made under Medicare.

The registry would include the manufacturer, model, serial number, and manufacturer's price, the name of the recipient, the date and geographic location of the implantation or removal, and the name of the physician, hospital or other provider. The registry would be required to include any express or implied warranties associated with the device and any other information which the Secretary deemed appropriate. The Secretary is prohibited from identifying any recipient of a pacemaker by name.

Senate amendment

The Senate amendment includes a similar provision. The registry information is substantially the same as that required by the House bill, except manufacturer price information is not specified. Submission of the information by the manufacturer would be a condition for any Medicare payments with respect to any devices or leads produced by that manufacturer.

Conference agreement

The conference agreement follows the House bill with an amendment. Inclusion of manufacturer price information in the registry is not required. Further, the amendment specifies that providers' and physicians' compliance with information requirements is a condition for Medicare payments with respect to implantation or removal of devices or leads.

The agreement further specifies that the purposes of the registry include tracing the performance of pacemaker devices and leads.

e. Return of device or lead

House bill

No provision.

Senate amendment

The Senate amendment would authorize the Secretary to require, as a condition of payment, that a provider furnish to the manufacturer information with respect to all patients bearing a device or lead for which Medicare payment was made or requested. The Secretary could also require that any device or lead removed from any such patient be returned to the manufacturer. Fiscal intermediaries could, pursuant to regulations, deny payment for replacements if the device or lead was not returned; beneficiaries could not be charged for replacements in such cases.

Conference agreement

The conference agreement follows the Senate amendment with a modification deleting the provision authorizing the Secretary to require that a provider furnish the manufacturer with information.

f. Testing

House bill

The House bill would provide that in any case where the Secretary had reason to believe that replacement of a pacemaker was related to its malfunction, the Secretary would be permitted to require the testing of such device by the FDA or that FDA personnel be present at testing by the manufacturer.

Senate amendment

The Senate amendment includes a similar provision. In addition, it would authorize the Secretary to require the manufacturer to test or analyze each returned cardiac pacemaker device or lead and provide the test results to the provider who returned it to the manufacturer, together with information as to any warranty coverage.

Conference agreement

The conference agreement follows the Senate amendment, except that it strikes the provision permitting the Secretary to require the FDA to do the testing.

g. Manufacturer reports

House bill

No provision.

Senate amendment

The Senate amendment would authorize the Secretary to require any manufacturer to provide to the FDA: (1) a written report with respect to any adverse reaction and any defect (within 10 days of the date on which the manufacturer is notified) and (2) an annual report summarizing clinical experiences with devices and leads including information on all removals, deaths, adverse reactions, device or lead defects, and the results of tests performed on all returned devices and leads.

Conference agreement

The conference agreement does not include the Senate amendment. The conferees understand that the Secretary is developing Mandatory Device Experience Reporting regulations, pursuant to section 519 of the Federal Food, Drug, and Cosmetic Act, which would establish requirements comparable to those set forth in the Senate amendment. The conferees did not wish to duplicate the provisions of those regulations or establish requirements inconsistent with them. The conferees expect the regulations to be issued soon and expect that they will accomplish the purposes of the Senate amendment.

h. Bonds

House bill

No provision.

Senate amendment

The Senate amendment would require manufacturers to post a bond or provide other assurances as the Secretary deems appropriate to ensure compliance.

Conference agreement

The conference agreement does not include the Senate amendment.

16. Limitation on Certain Foot-Care Services (Section 2325)

Present law

Routine foot care is not covered by the Medicare program. However, Medicare does allow reimbursement to physicians for debridement of mycotic toenails (i.e., the care of toenails with a fungal infection).

House bill

The House bill would require the Secretary to deny coverage under the Medicare program for debridement of mycotic toenails if performed more frequently than once every 60 days. Exceptions would be authorized if medical necessity were documented by the billing physician. The provision would be effective upon enactment.

Senate amendment

Similar provision. The provision would be effective with respect to services performed on or after enactment.

Conference agreement

The conference agreement follows the House provision, with the Senate effective date.

17. Presidential Appointment of and Pay Level for the Administrator of the Health Care Financing Administration (Section 2332)

Present law

The Administrator of the Health Care Financing Administration (HCFA) is in the Senior Executive Service and is appointed by the Secretary of Health and Human Services.

House bill

The House bill would provide for the appointment of the Administrator of HCFA by the President with the advice and consent of the Senate. It would increase the position and pay of the Administrator to level IV of the Executive Schedule.

Senate amendment

Same as House bill.

18. Permitting Limited Provider Representation on Peer Review Organizations (Section 2334)

a. Provider representation

Present law

The Secretary is prohibited from contracting with an entity which is, or is affiliated with (through management, ownership or common control), a health care facility. The Secretary, by regulation, has specified that the governing body of a peer review organization may not have a member who is a member, officer, or managing employee of a health care facility.

House bill

The House bill would provide for limited representation of providers on PRO's. For PRO's with a governing body of 15 or fewer members, one member could be a governing body member, officer, or managing employee of a health care facility. The number would be increased to two in the case of a PRO with more than 15 members.

Senate amendment

Similar provision.

Conference agreement

The conference agreement follows the Senate amendment with a modification which allows up to 20% of the members of a PRO governing body to be affiliated with providers.

b. Payer organizations

Present law

Before October 1, 1984, entities which are payer organizations are barred from being a PRO. By regulation, this has been interpreted to bar organizations whose board members include a representative of a self-insured employer.

House bill

No provision.

Senate amendment

The Senate amendment would permit entities whose board members include a representative of a self-insured employer to qualify as a PRO.

Conference agreement

The conference agreement follows the Senate amendment with a modification. An organization which has no more than one member affiliated with a health maintenance organization would not be classified as a payer organization and would therefore be permitted to qualify as a PRO.

19. Access to Home Health Services (Section 2336)

a. Disqualified physicians

Present law

A physician must certify the patient's need for services and establish a plan of care before a beneficiary can qualify for home health services. A physician may not perform these functions for patients of any agency in which the physician has a significant ownership interest or a significant financial or contractual relationship.

House bill

The House bill would permit a physician who has a financial interest in an agency which is a sole community home health agency, as determined by the Secretary, to carry out certification and plan of care functions for patients served by the agency.

The amendment would require appropriate changes in regulations within 90 days of enactment.

Senate amendment

The Senate amendment includes a similar provision except that its application would be limited to an agency which is the only home health agency in a county. The provision would be effective upon enactment.

Conference agreement

The conference agreement follows the House bill with a modification. The Secretary would be required, not later than 90 days after enactment, to revise regulations to reflect the provision. The conferees intend that the Secretary, in determining which entities meet the definition of sole community home health agencies, shall take into account the number of persons residing in the county and the size of the county. The conferees are concerned that if the determinations are made only on the basis of countyline boundaries, HHAs in counties encompassing large geographic areas or sizeable populations might not be appropriately designated.

b. Uncompensated officers or directors

Present law

Regulations specifying physicians who are disqualified from performing certification and plan of care functions for patients of a home health agency include physicians who are uncompensated officers or directors.

House bill

The House bill would delete from the list of disqualified physicians uncompensated officers or directors of agencies.

The provision would apply to certifications and plans of care made on or after date of enactment.

Senate amendment

The Senate amendment includes a similar provision which would be effective on enactment.

Conference agreement

The conference agreement follows the House bill.

20. Repeal of Special Tuberculosis Treatment Requirements and Requirement of Accreditation of Psychiatric Hospitals (Section 2395)

a. Tuberculosis treatment requirements

Present law

The law contains a number of special provisions originally intended to assure that institutional services provided to Medicare and Medicaid patients suffering from tuberculosis are not custodial in nature and can reasonably be expected to improve the patient's condition or render the condition non-communicable.

House bill

The House bill would repeal the special conditions and requirements. It would also eliminate the special provider category for tuberculosis hospitals.

Senate amendment

Similar provision.

Conference agreement

The conference agreement follows the Senate amendment.

b. Psychiatric hospital accreditation

Present law

The law requires psychiatric hospitals, and psychiatric units of hospitals, to be accredited by the Joint Commission on the Accreditation of Hospitals (JCAH) in order to participate in Medicare and Medicaid.

House bill

The House bill would repeal the requirement that psychiatric hospitals and units be accredited by JCAH, and permit the provider to participate on the basis of accreditation by organizations approved by the Secretary. [See item 26]

Senate amendment

Similar provision.

Conference agreement

The conference agreement follows the Senate amendment.

21. Indirect Payment of Supplementary Medical Insurance Benefits (Section 2339)

Present law

Part B payments generally may not be made to anyone other than a beneficiary or an entity providing services.

House bill

The House bill would permit Part B payments to be made to a health benefits plan, if the beneficiary agrees and if the physician or other supplier accepts the plan's payment as payment in full.

Senate amendment

Similar provision.

Conference agreement

The conference agreement follows the House bill but the Conferees would like to clarify that the purpose of this provision is to enable this indirect payment procedure to be available to group, as well as non-group, employments and non-employment health benefit plans such as employers, unions, insurance companies, and other organizations.

22. Including Podiatrists in Definition of "Physician" for Outpatient Physical Therapy Services and Including Podiatrists and Dentists in the Definition of "Physician" for Outpatient Ambulatory Surgery (Section 2341.)

a. Definition of "Physician" for outpatient physical therapy services

Present law

Outpatient physical therapy services are covered only if the patient is under the care of a physician. Podiatrists are not included within the definition of a physician for this purpose.

House bill

The House bill defines a podiatrist (when acting within the scope of his practice) as a physician for the purposes of establishing a plan for the outpatient physical therapy requirement.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

b. Definition of "Physician" for outpatient ambulatory service

Present law

Podiatrists and dentists are not included within the definition of "physician" for purposes of outpatient ambulatory surgery in a physician's office.

House bill

The House bill includes dentists and podiatrists within the definition of physician for purposes of outpatient ambulatory surgery in a physician's office.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House provision.

23. Establishment by Physical Therapists of Plans for Physical Therapy (Section 2342.)

Present law

Medicare payment for outpatient physical therapy services furnished to a beneficiary may be made only if a plan for furnishing such services is established and periodically reviewed by a physician.

House bill

The House bill would allow either the physical therapist or the physician to establish the plan of care. The physician would still be required to review periodically all plans of care. The provision would apply with respect to plans of care established on or after the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

24. Access to Records of Subcontractors

Present law

Any contract valued at $10,000 or more between a Medicare provider and a subcontractor must permit access to the records of the subcontractor by the Secretary or the Comptroller General.

House bill

The House bill increases the minimum amount to $50,000 with respect to contracts with subcontractors entered into on or after date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House Provision.

25. Medicare Recovery Against Certain Third Parties (Section 2344)

Present law

Medicare may limit benefit payments for services for which other third party insurance programs (e.g. worker's compensation, auto or liability insurance, and employer health plans) may ultimately be liable. However, the law does not make it explicit that the Secretary has the right of subrogation, or the right to become a party to claims against other liable parties or to recover directly from such parties.

House bill

The House bill would establish the statutory right of Medicare to: (1) bring an action directly against certain third parties, if the beneficiary does not do so; (2) bring an action against any party (except the beneficiary) who has already been paid or, (3) join or intervene in an action against a third party.

Senate amendment

The Senate amendment includes a similar provision, except the beneficiary would not specifically be exempt from suit where benefits had already been paid by the third party.

Conference agreement

The conference agreement follows the Senate amendment. The conferees note that the provision does not alter any existing authority nor create any new authority with respect to recoveries from beneficiaries. The provision would be effective with respect to items and services furnished on or after the date of enactment.

26. Use of Accrediting Organizations for Certain Entities Furnishing Services (Section 2346)

Present law

The Secretary has authority to rely on certain accrediting organizations in determining whether hospitals, skilled nursing facilities, home health agencies, ambulatory surgical centers, and hospice programs meet Medicare requirements.

House bill

The House bill extends the Secretary's authority to rely on such organizations in determining whether rural health clinics, laboratories, clinics, rehabilitation agencies, including outpatient rehabilitation facilities, psychiatric hospitals, and public health agencies meet Medicare requirements (and clarifies the Secretary's authority with respect to ambulatory surgical centers).

Senate amendment

The Senate amendment includes a similar provision except that it would not apply to psychiatric hospitals. [See Item 20.]

Conference agreement

The conference agreement follows the House bill. The conferees intend that the standards of an accrediting organization chosen must be at least equivalent to those of the Secretary and it must have a satisfactory record of application of such standards. In deciding which, if any, private accrediting entities will be recognized for the purpose of certifying health care facilities for participation in the Medicare program, the conferees expect that the Secretary will examine the standards applied by such entities to assure that the adoption of such standards will not adversely affect competition in the provision of Medicare health services. Recognition by the Secretary of an accreditation program with unduly restrictive standards would preclude qualified persons from delivering services, thereby increasing Medicare costs, in contravention of Congress' purpose in adopting this provision.

27. Confidentiality of Accreditation Surveys (Section 2345)

Present law

Current law contains certain disclosure safeguards relating to survey information used by the Secretary in connection with the hospital certification process under Medicare. However, the law only specifically refers to surveys conducted by the Joint Commission on the Accreditation of Hospitals (JCAH).

House bill

The House bill extends the disclosure protections given JCAH survey information to similar survey information provided to the Secretary by the American Osteopathic Association or other national accreditation organizations.

Senate amendment

Same as House bill.

28. Thirty Day Coverage for Services Furnished by a Home Health Agency or Hospice Whose Agreement Has Been Terminated (Section 2348)

Present law

If the medicare participation agreement of a home health agency or hospice is terminated, the Secretary is required to continue to pay for services provided to a beneficiary until the end of the calendar year in which the termination took place. This requirement is only applicable to services provided under an individual plan of care established prior to the termination of the agency agreement.

House bill

The House bill would change, from the end of the calendar year to 30 days after termination, the ending of coverage for services provided under a plan of care established prior to the termination date of the participation agreement. The provision would apply to terminations whose effective date falls 60 days after the date of enactment.

Senate amendment

The Senate amendment includes a similar provision which would apply to terminations issued on or after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

29. Termination of Agreements With Institutions and Entities Where Owners or Certain Other Individuals Have Been Convicted of Certain Offenses (Section 2333)

Present law

The Secretary may bar from participation in Medicare (and may direct State agencies to bar from Medicaid) a person convicted of program-related criminal offenses. The Secretary may refuse either to enter into or renew a provider agreement with an entity in which ownership or control is held by a person so convicted.

House bill

The House bill would extend the Secretary's authority by authorizing the Secretary to terminate agreements with any entity in which ownership or controlling interest is held by a person convicted of a program-related criminal offense, or an entity in which an officer, director, agent or managing employee was convicted of such a criminal offense.

Senate amendment

Similar provision. Additionally, the Senate amendment would: (a) require the Secretary to notify State Medicaid agencies and authorizes the Secretary to require such agencies to bar the entity from participation in the program; and (b) require the Secretary to notify the appropriate State licensing or certification agency and request that appropriate investigations be made and that the State agency keep the Secretary and Inspector General informed of any actions taken.

Conference agreement

The conference agreement follows the Senate amendment. The provision would be effective on the date of enactment and shall apply to convictions of persons occurring after such date.

30. Elimination of Health Insurance Benefits Advisory Council (Section 2349)

Present law

The Social Security Act provides for a 19 member panel of health experts (the Health Insurance Benefits Advisory Council or HIBAC) appointed by the Secretary to advise on matters of general policy with respect to the Medicare and Medicaid programs.

House bill

The House bill would repeal the provision.

Senate amendment

Same as House bill.

31. Health Maintenance Organizations (Section 2350)

a. Enrollment periods

Present law

Health maintenance organizations (HMO's) and competitive medical plans (CMP's) are required to have an annual open enrollment period of at least 30 days during which time they must accept Medicare beneficiaries up to the limits of their capacity. If there is more than one HMO in an area, there is no current requirement that the open enrollment periods be coordinated.

House bill

The House bill would require the Secretary (after consultation with such organizations) to designate a single 30-day period each year in which all of the HMO's in an area participating in Medicare must have an open enrollment period. It would permit HMO's to conduct open enrollment at other times during the year.

Senate amendment

Same as House bill.

Conference agreement

The conferees recognize that an HMO will enroll non-medicare persons at other times during the year. The conferees expect the Secretary to take whatever steps are necessary to assure that an appropriate portion of capacity is retained to enroll medicare beneficiaries in the HMO, particularly during the coordinated open enrollment period.

b. Benefit stabilization fund

Present law

An HMO with a risk-sharing contract is required to provide enrollees with either additional health service benefits or reductions in their premiums or other charges, if the adjusted community rate (ACR) for its Medicare enrollees is less than the Medicare payments it receives for those enrollees.

House bill

The House bill would authorize an HMO, with the Secretary's approval, to place a portion of the funds required to be used for additional benefits in a benefit stabilization fund. The fund would be used by the HMO to stabilize additional benefits from year to year.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with an amendment. The bill would allow an HMO, with the Secretary's approval, to request that the Secretary withhold a part of the value of additional benefits for use in subsequent contract periods. These funds would be used to avoid significant premium changes or major fluctuations in benefits to beneficiaries from year to year. They are not to be used to offset losses that the HMO may sustain pursuant to its risk-based contract.

While it would be the HMO's option to request withholding, the amounts withheld would be approved and held by the Secretary. The Secretary would establish limits on the amounts withheld to assure that they do not exceed the minimum levels necessary for reasonable benefit stabilization, taking into account the requirements of individual plans. In any case, an HMO could only use such a fund for a four-year period.

The bill limits to four years the time during which the Secretary may allow an HMO to establish a fund for this purpose. The conferees are interested in having the Secretary review the use of these funds so a determination can be made as to whether or not the continuation of these stabilization funds will be in the best interests of the program and the beneficiaries. The conferees do not believe the results of the one demonstration of this concept is sufficient to warrent a permanent change in the law.

c. Direct reimbursement

Present law

Medicare restricts to hospitals (in the case of risk-sharing HMO's) and to hospitals and nursing homes (in the case of cost-based HMO's) the providers which the program will reimburse directly for services provided to an HMO's Medicare enrollees.

House bill

The House bill would expand the types of providers to whom Medicare can make payment directly for HMO services.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with an amendment limiting application of the provision to hospitals and skilled nursing facilities.

32. Deadline for Report on Including Payment for Physicians' Services to Hospital Inpatients in DRG Payment Amounts (Section 2317)

Present law

The Secretary is required to report to the Congress on the advisability and feasibility of making payments for physician services furnished to hospital inpatients based on a diagnosis-related group system and to make legislative recommendations. The report is to be part of the report made to the Congress during 1985.

House bill

The House bill would require the Secretary to report to Congress not later than July 1, 1985.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

33. Flexible Sanctions for Noncompliance With Requirements for End-Stage Renal Disease Facilities (Section 2352)

Present law

End-stage renal disease (ESRD) facilities that are not in complete compliance with Medicare program requirements are subject to decertification.

House bill

The House bill would authorize the Secretary to apply intermediate sanctions to such facilities, such as denial of reimbursement for some or all patients admitted after the facility is notified of its noncompliance, or graduated reduction in reimbursement for all patients.

Senate amendment

Similar provision.

Conference agreement

The conference agreement follows the Senate amendment. The provision would be effective with respect to determinations made by the Secretary on or after the date of enactment.

34. Repeal of Requirement for End-Stage Renal Disease Networks

Present law

The Secretary is required to establish network organizations to assist in the administration of the End Stage Renal Disease Program. Such organizations are directed to perform a variety of functions, including planning, setting goals and objectives, monitoring patient care, and compiling data on ESRD patients and services that are useful to the Department in administering and evaluating the program.

House bill

The House bill would eliminate the statutory requirement for networks, as well as the various statutory responsibilities imposed on them. Under the House bill, the Secretary would continue to have authority to establish a national end-stage renal disease medical information system.

The provision would be effective on a date established and published by the Secretary, but not earlier than July 1, 1984, on which date the Secretary has in operation an alternative means of data collection to that currently performed by renal disease networks.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House provision. The conferees intend that the Secretary will give additional direction to the networks to facilitate their ability to perform the requisite functions. The conferees are particularly concerned that the data collection capability should be strengthened and note that the collection and maintenance of data is vital to efficient and effective program administration. The conferees further note their concern that the annual ESRD report be submitted to the Congress on a timely basis.

The conferees intend that the Secretary give consideration to consolidating existing network areas. They also intend that the Secretary examine the composition of such entities with a view toward reducing the predominance of facility representation and increasing the representation of beneficiary interests.

35. Definition of Bona Fide Emergency Services for Purposes of Limitations on Payment for Hospital Outpatient Services (Section 2318)

Present law

The Secretary is required to place reasonable limits on hospital costs and physician charges for outpatient services; bona fide emergency services provided in an emergency room are specifically exempted by statute from the limits.

House bill

The House bill would provide a statutory definition of "bona fide emergency services" which includes services provided in a hospital emergency room after the onset of a medical condition manifesting itself by symptoms of sufficient severity that the absence of immediate medical attention could reasonably be expected, by a prudent lay person possessing an average knowledge of health and medicine, to result in: (a) placing the patient's health in jeopardy; (b) serious impairment to bodily functions; (c) serious dysfunction of any bodily organ or part; or (d) development or continuance of severe pain. The provision would be effective on enactment.

Senate amendment

The Senate amendment includes a similar provision except that the definition includes services provided in a hospital emergency room after the sudden onset of a medical condition manifesting itself by acute symptoms of sufficient severity (including severe pain) such that the absence of immediate medical attention could reasonably be expected to result in: (a) placing the patient's health in serious jeopardy; (b) serious impairment to bodily functions; or (c) serious dysfunction of any bodily organ or part. The provision would be effective with respect to services furnished on or after date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

36. Part B Premium (Section 2302)

Present law

The Secretary is required to calculate and announce each September the amount of the monthly premium that will be charged in the following calendar year for people enrolled in the Supplementary Medical Insurance (Part B) portion of the Medicare program. A temporary provision of law requires that for 1984 and 1985 the premium amount be calculated so as to produce premium income equal to 25 percent of program costs for enrollees aged 65 and over.

Beginning with 1986, the premium calculation will revert to an earlier method under which the premium amount is the lower of: (1) an amount sufficient to cover one-half of program costs for the aged; or (2) the current premium amount increased by the percentage by which cash benefits were most recently increased under the cost-of-living adjustment (COLA) provisions of the Social Security program.

House bill

No provision.

Senate amendment

The Senate amendment would make permanent the existing temporary provision which fixes the proportion of the Part B Medicare costs financed by enrollees at 25 percent of program costs. Should no Social Security cost-of-living adjustment take place, the monthly premium would not be increased for that year.

In the case of an individual who has his or her Part B premium deducted from his or her Social Security check, if the cost-of-living adjustment is less than the amount of the increase in the premium, the premium increase would be reduced so as to avoid a reduction in the individuals Social Security check. In certain cases, the monthly premium would not increase for that individual for that year.

	Estimated monthly premium	
	Current law	Senate amendment
1986	$17.70	$19.10
1987	18.60	21.30

Conference agreement

The conference agreement follows the Senate amendment with a modification limiting the extension of the provision to two calendar years, i.e., 1986 and 1987.

37. One month delay in medicare entitlement

Present law

Eligibility for Medicare begins on the first day of the month in which an individual attains age 65.

House bill

No provision.

Senate amendment

The Senate amendment would delay eligibility for Parts A and B of Medicare until the first day of the month following the month the individual attains age 65.

Conference agreement

The conference agreement does not include the Senate amendment.

38. Revaluation of Assets Acquired by Hospitals (Section 2314)

Present law

Medicare currently reimburses hospitals and other providers for their capital-related costs, including depreciation costs and interest. Investor-owned hospitals also receive a return on equity. When hospitals and other providers are sold, their assets are often revalued, thereby increasing reimbursement for these capital-related costs.

House bill

No provision.

Senate amendment

The Senate amendment would limit the increase in capital-related cost reimbursement to a new owner that would result from the revaluation of hospital assets acquired in fiscal year 1985 and thereafter. The capital-related cost of the new owner would be based on the acquisition cost of the asset as entered on the books of the prior owner less any depreciation taken on the asset by the prior owner. In addition, the new owner's capital-related costs must be determined using the same useful life and method of depreciation as used by the prior owner for reimbursement under the Medicare program.

Conference agreement

The Conference agreement follows the Senate amendment with a modification specifying that capital-related costs to the new owner shall be based on the lesser of: (a) historical cost (the cost to the original owner), or (b) the purchase price of the asset.

The Secretary would be required to continue recapture of depreciation as under current reimbursement policy.

The Conferees intend that the Secretary, in implementing this provision will establish an appropriate policy with respect to useful life, the method of depreciation, and the treatment of sale and leaseback arrangements.

The conferees are concerned that Medicare has been paying for the same capital assets more than once. Thus, the provision is intended to limit the revaluation of an asset to the cost of acquisition to the individual or entity who is the owner, for medicare purposes, at the time of enactment of the legislation. Acquisition costs may include capital improvements or other costs which medicare recognizes as increasing the basis of the asset. The purchaser's revaluation would be limited to his own acquisition cost, as recognized by the Secretary, if that cost was less than the previous owner's acquisition cost.

The conferees note that under present law, capital-related costs which are excluded from the prospective payment system and which continue to be reimbursed on a reasonable cost basis also include leases and rentals for the use of depreciable assets. The conferees recognize that the limitation on the revaluation of assets acquired by hospitals or nursing homes could be circumvented by certain sale/lease-back or sale-rental agreements. The conferees expect that the Secretary will determine the reasonableness of any lease or rental costs involving a depreciable asset which has undergone a change in ownership taking into account the limitation on the revaluation of assets.

The conference agreement applies to both hospitals and skilled nursing facilities participating under Medicare.

The conference agreement excludes from the calculation of allowable capital costs those expenses (such as lawyers' fees and feasibility studies) related to acquisitions and mergers.

The conference agreement applies to capital-related costs of capital expenditures obligated on or after the date of enactment.

The conference agreement also limits State Medicaid reimbursement for the costs associated with the sale or transfer of a hospital or nursing home. States would be required to assure the Secretary that the methodologies used to establish rates paid to hospitals, SNF's, or ICF's can reasonably be expected not to increase those rates more than they would increase under Medicare policy as the result of a change of ownership of a facility. The State must demonstrate generally that the statutory standard will be met in the aggregate, although it is not the intention of the conferees that States supply a detailed accounting of how that aggregate is achieved. In evaluating the State's assurances, the Secretary may require the State to demonstrate the application of its methodology in a limited number of instances.

The conferees note that, under current law, States have broad discretion in designing reimbursement methods and standards for hospital, SNF, and ICF services, and have used that discretion to implement a wide variety of payment methodologies. The conferees do not intend to limit that discretion, and anticipate that, in many States, current or planned methodologies would not be affected. States that choose to use the Medicare capital payment methodologies may continue to do so. States which have chosen alternative methods, such as an approach under which payment is made for the fair rental value of the facility, would not be discouraged from doing so.

39. Repeal of Preadmission Diagnostic Testing Provision (Section 2305)

Present law

The Omnibus Reconciliation Act of 1980 authorized 100 percent Part B reimbursement on a reasonable cost or charge basis for preadmission diagnostic testing, either in a hospital's outpatient department or in a physician's office, within seven days prior to a hospital admission.

The final regulation implementing 100 percent reimbursement for preadmission testing was not published.

House bill

No provision.

Senate amendment

The Senate amendment would repeal the provision. It would clarify that repeal shall not be construed as prohibiting program payments (subject to cost-sharing) for preadmission diagnostic testing performed in a physician's office to the extent such testing is otherwise reimbursable. The section would be effective with respect to services performed after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

40. Rounding of Part B Payments

Present law

Medicare carriers compute charge-based payments to the nearest cent.

House bill

No provision.

Senate amendment

The Senate amendment would require Medicare Part B charge-based payments on claims that are not whole dollar amounts to be rounded to the next lower dollar.

Conference agreement

The conference agreement does not include the Senate amendment.

41. Agreements for Medicare Claims Processing (Section 232b)

a. Provider nomination

Present law

Medicare contracts with intermediaries and carriers to perform the day-to-day operational work of the program including reviewing claims and making program payments. Providers are permitted to nominate an intermediary.

The Secretary is permitted to assign or reassign any provider if the Secretary determines that such assignment or reassignment would result in more effective administration of the program.

House bill

No provision.

Senate amendment

The Senate amendment would increase the Secretary's discretion in entering into agreements for Medicare claims processing by eliminating the right of providers of services to nominate intermediaries.

Conference agreement

The conference agreement follows the Senate amendment with a modification. The conference agreement would allow the waiver of provider nomination requirements when a contract is competitively bid and for the duration of the competitively bid contract. Further, the agreement would reduce the number of designated regional intermediaries for home health agencies to no more than 10, to be completed within 3 years.

The conferees believe that the Secretary has sufficient discretion under existing authority to assign or reassign any provider of services to any agency or organization which has entered into an agreement with the Secretary if the Secretary determines, after applying the standards, criteria and procedures set forth in the statute, that such assignment or reassignment would result in the more effective and efficient administration of the program.

The conferees understand that reassigning a provider is a significant administrative burden on the provider and therefore anticipate that this authority would be used only when it is clear that changing to another intermediary would result in the more effective and efficient administration of the program.

The General Accounting Office would be required to study and report on the appropriateness of removing the provider nomination requirements in the statute.

Public Law 96–499 required the designation of regional intermediaries for home health agencies. At that time, the conferees intended that only a few intermediaries be designated as regional intermediaries in order to provide for more consistent and effective management of the home health program. However, the Secretary has by regulation established 47 regional intermediaries. The conferees believe that in order to more effectively manage the home health benefit under the medicare program that the number of regional intermediaries be reduced to no more than 10. The conferees anticipate that the number of designated intermediaries would be reduced as quickly as possible but in no case more than three years from the date of enactment.

b. Cost reimbursement

Present law

Intermediaries and carriers are reimbursed for these activities on the basis of costs that are necessary and proper.

House bill

No provision.

Senate amendment

The Senate amendment would permit the Secretary to enter into various kinds of agreements, not solely those based on cost.

Conference agreement

The Conference agreement follows the Senate amendment with a modification. The Conference agreement would provide that in determining a carrier's or intermediary's necessary and proper cost of administration, the Secretary shall, with respect to each contract, take into account the amount that is reasonable and adequate to meet the costs which must be incurred by an efficiently and economically operated organization in carrying out the terms of its agreement.

The conferees note that the medicare claims processing costs on a per claim basis have fallen considerably over the last years. However, there still appear to be significant disparities between the cost of different intermediaries and carriers (even when adjusted for factors such as difficulty of processing certain claims) which are unexplained. There seems to be little correlation between price per claim and performance as measured by HCFA standards. The conferees are interested in learning:

(1) Whether contractor costs are excessive;

(2) Whether the Secretary's standards for evaluating contractor costs and performance are adequate and properly applied; and

(3) Whether the Secretary's statutory authority, as augmented by this Act, is sufficient to deal with inefficient intermediaries and carriers either through the contract negotiation and budget review process or by replacing them.

The conferees are therefore instructing the General Accounting Office to study these issues and to report its findings to Congress within a year of enactment, together with recommendations on the appropriateness of moving from the cost-based reimbursement system to some other basis of payment for claims processing.

The conferees want to urge that any cost cutting measures be implemented in a careful manner with the understanding that the processing of medicare claims is an important function and that savings measures not undermine beneficiary services, professional relations, productivity investment or program safeguards.

It is the Committee's intent that the rates paid to contractors take account of their individual circumstances. Thus such factors as the relative complexity of the claims to be reviewed, the prevailing wages in the area, the relative need for beneficiary services, and other circumstances that may legitimately vary from contractor to contractor should be taken into account in determining each contractor's reasonable operating costs.

c. Competitive contracting

Present law

Present law permits only on an experimental basis the selection of carriers and intermediaries on the basis of competitive bidding.

House bill

No provision.

Senat amendment

The Senate amendment would broaden the Secretary's authority to experiment with different kinds of contracts by including contracts other than fixed-price or performance-incentive contracts and by permitting competitive bidding.

Conference agreement

The Conference agreement follows the Senate amendment with a modification. The Conference modification would permit the Secretary, in each of the first 2 fiscal years following the year of enactment, to enter into no more than two competitively bid contracts under Part A and two such contracts under Part B. The Secretary would only be allowed to competitively compete to replace intermediaries and contractors who were poor performers, falling into the lowest 20th percentile of all performers, as measured by cost and performance criteria. The agreement requires that intermediaries must be health insuring organizations and perform the full range of intermediary functions. Further, the agreement requires that carriers perform the full range of carrier functions. The Secretary is required to establish standards and criteria for the purpose of evaluating an individual carrier's efficiency and effectiveness and to determine whether a contract is consistent with the efficient and effective administration of the program.

The Conferees are concerned that selection of contractors shall not be based solely on price. Consideration must also be given intermediary or to the ability of the carrier to perform the required functions in an efficient and effective manner. The Conferees emphasize the importance of having health insuring organizations serving as intermediaries and carriers. They further intend that the new authority for competitive contracting not be used to fragment the functions of carriers and intermediaries with respect to claims processing, quality control, and beneficiary services.

d. Publication of Standards

Present law

The Secretary is required to establish by regulation standards and criteria with respect to the efficient and effective administration of Part A of the program by intermediaries.

House bill

No provision.

35-426 O - 84 - 85

Senate amendment

The Senate amendment allows the Secretary to provide for publication of the standards for contractors through normal administration issuances rather than through the regulatory process.

Conference agreement

The Conference agreement follows the Senate amendment with a modification amendment to require that the public be given notice of the standards through the *Federal Register* and that the public be given an opportunity to comment on them prior to their implementation.

42. Lesser of Costs or Charges (Section 2308)

Present law

Medicare pays providers the lesser of costs or charges (LCC). HCFA regulations allow hospitals to calculate the amount of their costs and charges in the aggregate for inpatient and outpatient services.

House bill

No provision.

Senate amendment

The Senate amendment would require the Secretary to issue regulations to isolate the calculation of the lesser of cost or charges for outpatient services from the calculation for inpatient services.

Conference agreement

The conference agreement follows the Senate amendment with a modification.

The conferees are concerned that the disaggregation feature of the amendment may have an adverse effect on certain providers that are unable, due to the mix of patients they serve, to bill charges that are reasonably commensurate with their costs of furnishing outpatient services. Therefore, the conferees are directing the Secretary to modify the current rule, under which public providers determined to have no minimal charges are exempted from the lesser-of-cost, or-charge, provision and are reimbursed their reasonable costs.

The modification in the nominal charge rule would include the following features. First, the nominality test should not continue to be applied to aggregated Part A and Part B costs and charges. Instead, costs and charges should be treated separately for Part A and for Part B, or for inpatient services and for outpatient services, for purposes of applying the nominality test (except for services furnished by home health agencies, if the Secretary concludes that aggregation of Part A and Part B data is still appropriate for such services). Second, for providers that use a sliding scale of charges or a discounted schedule of charges that differentiates among patients based on their ability to pay, the nominality test should use such slidingscale or discounted schedule, rather that deeming the charges to be full customary charges as are actually billed for all patients. (For this purpose, the Secretary shall aggregate charge data for all charge-paying patients.) Third, providers should be exempted from the lesser-of-cost-or-charges provision, and paid reasonable cost, if their billed charges do not exceed 60 percent of their costs, rather than 50 percent as the rule now states.

In addition, the conferees are directing the Secretary to apply the nominal charge rule to providers, that serve a substantial number of indigent patients. The nominal charge rule should be applied to such providers on the same basis as applied to public providers.

43. Coverage of Hemophilia Clotting Factor (Section 2324)

Present law

Part B of Medicare excludes coverage for drugs and biologicals unless they are of the type that cannot be self-administered and are commonly furnished as incident to physician's services.

House bill

No provision.

Senate amendment

The Senate amendment would provide Medicare coverage, subject to utilization controls deemed necessary by the Secretary, for blood clotting factors and the supplies necessary for the self-administration of the clotting factor. The provision would apply to items and services purchased on or after enactment.

Conference agreement

The conference agreement follows the Senate amendment.

44. Indexing of Part B Deductible

Present law

Part B enrollees are subject to an annual deductible of $75 for covered expenses before any benefits are paid.

House bill

No provision.

Senate amendment

The Senate amendment would index the Part B deductible in calendar years 1985, 1986, and 1987 by the Medicare economic index. (The economic index is used to limit increases or decreases in prevailing charge levels under Part B.) It is estimated that the deductible would increase to $78 in 1985, $82 in 1986, and $86 in 1987.

Conference agreement

The conference agreement does not include the Senate amendment.

45. Cost-sharing for Durable Medical Equipment Furnished as a Home Health Benefit (Section 2321)

Present law

Medicare payment for durable medical equipment which is not provided as a covered inpatient service is based on 80 percent of reasonable charges (80 percent of reasonable costs in the case of a provider), with one exception. Payment is based on 100 percent of costs when furnished as part of a coverd home health service.

House bill

No provision.

Senate amendment

The Senate amendment would require 20 percent coinsurance on durable medical equipment provided by home health agencies. It also clarifies the definition of durable medical equipment and the coverage of such equipment when furnished by providers.

Conference agreements

The conference agreement follows the Senate amendment.

The conferees do not intend for this clarification of the definition and coverage of durable medical equipment to result in any reduction or restriction of current coverage under Medicare for medical appliances and equipment.

46. Modification of Working Aged Provision (Section 2301)

Present law

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) changed the Medicare benefits for the working aged. TEFRA amended the Age Discrimination in Employment Act (ADEA) to provide that an employer must offer to an employee age 65 through 69 the same group health plan offered to employees under age 65. As of January 1, 1983, if the employee elects the employer plan, Medicare benefits become secondary to benefits under the employer group health plan for an employed individual between the ages of 65 and 69 (and for the spouse of such employed individual if the spouse is age 65 through 69).

House bill

No provision.

Senate amendment

The Senate amendment would provide that employers must also offer group coverage to an employee who has not reached age 65 in cases where the employee has a spouse age 65 through 69 under the same circumstances as coverage is offered to employees with a spouse under the age of 65. In the case where such employee elects the employer plan, Medicare would be secondary.

Conference agreement

The conference agreement follows the Senate amendment.

The conferees note that under current law, a medicare eligible employee between the ages of 65 and 70 has the option of rejecting the employer health benefit plan with the result that Medicare remains the primary payer. Regulations issued by the Equal Employment Opportunity Commission require that employees be provided notification of their options and be provided the opportunity to make their choice known to the employer in writing. Under the provisions of this bill, there is a similar option to elect the employer plan or medicare. The conferees are concerned that the individual eligible for medicare participate in the decision whether to be covered by the employer plan or medicare. Thus, the conferees wish to make it clear that the non-working spouse between the ages of 65 and 70 should be given notice by the employer and the opportunity to verify, in writing, whether he or she will not be covered by the spousal provision of the employer plan.

47. Transfers to Federal Hospital Insurance Trust Fund

Present Law

No provision.

House Bill

No provision.

Senate Amendment

The Senate amendment would specify that the Part B outlay savings, that accrue to the Federal Government as a result of this bill shall be transferred to the Part A trust fund for each of the fiscal years 1984, 1985, 1986 and 1987.

Conference Agreement

The conference agreement does not include the Senate amendment.

48. Elimination of Part B Deductible for Certain Diagnostic Laboratory Tests (Section 2303)

Present law

Current law authorizes the Secretary to negotiate with a laboratory a payment rate that is considered the full charge for diagnostic tests. The payment, which is made directly to the laboratory, equals 100 percent of the negotiated rate subject to the annual Part B deductible. The beneficiary is not liable for coinsurance payments.

House bill

No provision.

Senate amendment

The Senate amendment would eliminate application of the annual Part B deductible in the case of diagnostic tests performed in a laboratory which has entered a negotiated rate agreement with the Secretary.

Conference agreement

The conference agreement follows the Senate amendment with a modification specifying that the current law provision providing for negotiated agreements only applies to services not paid for under the new fee schedule (see Item 10).

49. Repeal of Exclusion of For-Profit Organizations From Research and Demonstration Grants (Section 2331)

Present law

Current law limits the awarding of grants for the conduct of research and demonstrations to non-profit organizations. Contracts are permitted to be awarded to both for-profit and non-profit organizations.

House bill

No provision.

Senate amendment

The Senate amendment would extend the research and demonstration grant authority to for-profit organizations.

Conference agreement

The conference agreement follows the Senate amendment.

50. Repeal of Authority for Payments to Promote Closing and Conversion of Underutilized Hospital Facilities (Section 2353)

Present law

Section 2101 of the "Omnibus Budget Reconciliation Act of 1981" (Public Law 97-35) authorized the Secretary to make Medicare and Medicaid payments to cover capital and increased operating costs associated with the conversion or closing of underutilized hospital facilities. The provision, which has never been implemented, restricts the number of facilities which may receive these funds to no more than 50 prior to January 1, 1984.

House bill

No provision.

Senate amendment

The Senate amendment would repeal Section 2101 of the Omnibus Reconciliation Act of 1981.

Conference agreement

The conference agreement follows the Senate amendment except that Section 2101 of the Act is retained with a modification deleting its effective date. In addition, the agreement requires the Secretary to provide to the Congress an analysis of the modifications required in Section 1884 of the Social Security Act in order to conform the closure and conversion program established therein to the prospective payment system established under Section 1886 of the Act. The modifications would be for the purpose of enabling the provision of assistance to those hospitals which the Secretary determines might encounter particular problems in converting facilities or parts of facilities from acute care services to other less intensive modes of care, or in closing facilities or portions thereof.

The agreement requires the Secretary to report the findings to Congress no later than March 1985 and to include in the analysis, views as to how and whether implementation of the closure and conversion provision as modified could result in achieving reductions in the total cost of hospital inpatient services and total medicare expenditures.

The conferees expect the Secretary will not implement the provision prior to reporting his findings to the Congress.

51. Judicial Review of Provider Reimbursement Review Board Decisions (Section 2351)

Present law

The "Social Security Amendments of 1983" (Public Law 98–21) permit a group of providers to bring action in the judicial district in which the largest number of them are located. Public Law 98–21 also requires certain administrative and judicial appeals by providers which are under common ownership or control to be made as a group. Providers are entitled to a group appeal before the Provider Reimbursement Review Board if they have a common issue of fact, law or regulation.

These provisions were included in a section of Public Law 98–21 entitled "Conforming Amendments". Therefore, these provisions, together with most of the prospective payment provisions, apply to items and services furnished by a hospital beginning with its first cost reporting period that begins on or after October 1, 1983.

a. Appeals

House bill

The House bill would specify that those providers that brought an administrative appeal as a group because of a common issue of fact, law or regulation must then bring any judicial appeal as a group. The amendment applies to any administrative action or judicial appeal brought on or after enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House provision.

b. Civil actions

House bill

No provision.

Senate amendment

The Senate amendment would clarify that civil action may be taken within 60 days after notification is received (rather than determination is rendered) that the Board determines it does not have authority to decide the question. The amendment would be effective upon enactment.

Conference agreement

The conference agreement follows the Senate amendment.

c. P.L. 98-21 effective dates

House bill

The House bill would specify that the P.L. 98-21 provisions are effective with respect to any action or appeal brought on or after enactment of this bill.

Senate amendment

The Senate amendment would specify that the P.L. 98-21 provisions are effective with respect to actions or appeals brought on or after April 20, 1983.

Conference agreement

The conference agreement specifies that for actions brought by groups of providers in a judicial area where the largest number of them are located, the effective date would be actions brought on or after April 20, 1983. For actions brought by providers under common ownership, the effective date is the date of enactment of this bill.

d. Effective dates

House bill

The House bill would provide that items (a) and (c) apply to appeals or actions brought after enactment of this bill.

Senate amendment

The Senate amendment provides that item (b) would be effective on enactment and item (c) would apply to court actions brought on or after April 20, 1983.

Conference agreement

The conference agreement provides that items (a) and (b) are effective on enactment, and item (c) is effective as specified above.

52. Enrollment and Premium Penalty With Respect to the Working Aged Provision (Section 2338)

Present law

The "Tax Equity and Fiscal Responsibility Act" (TEFRA) required employers to offer their employees aged 65 to 69 the same health benefits plan offered to their younger workers. Medicare payments are secondary with respect to these older workers (and their spouses aged 65-69). Aged employees who elect enrollment in such employer-offered health benefit plans may wish to delay enrollment in Part B because Part B coverage may be duplicative. However, persons who enroll late are currently subject to a penalty. The monthly Part B premium is increased by 10 percent for each full 12 months that an individual delays enrollment in the program beyond his or her initial enrollment period.

a. Enrollment penalty/special enrollment

House bill

The House bill would waive the Part B enrollment penalty for workers and their spouses aged 65 through 69 who elect private coverage under the provision of TEFRA and would establish special enrollment periods for such workers. The waiver would apply for the period during which an individual continued to be covered under an employer's group health benefits plan.

Senate amendment

Same as House bill

b. Effective date: penalty relief provision

House bill

The House bill would provide that the penalty relief provision would be effective with respect to months beginning with January 1983 for premiums for months beginning July 1984.

Senate amendment

The Senate amendment would provide that the penalty relief provision would be effective with respect to months beginning with January 1983 for premiums for months beginning more than 90 days after enactment.

Conference agreement

The conference agreement follows the Senate amendment with a modification specifying that the provision is effective the first calendar month beginning at least 30 days after enactment.

c. Effective date: enrollment periods

House bill

The House bill would provide that the special enrollment provisions would be effective for months beginning with July 1, 1984 except that in the case of any individual who would have had a special period beginning earlier, the enrollment period would be deemed to begin on July 1, 1984.

Senate amendment

The Senate amendment would provide that the special enrollment provisions would be effective for months beginning more than 90 days after enactment except that in the case of any individual who would have had a special enrollment period beginning earlier, the enrollment period would be deemed to begin for the month beginning 90 days after enactment.

Conference agreement

The conference agreement follows the Senate amendment.

53. Waivers for Social Health Maintenance Organizations (Section 2355)

Present law

The Secretary has general authority to conduct experiments and demonstrations. While the Department has provided start-up funding for a social HMO project, waivers allowing the four demonstration sites to become operational have not been approved by the Office of Management and Budget.

House bill

No provision.

Senate amendment

The Senate amendment would require the Secretary to approve certain waivers for a project to demonstrate the concept of a social HMO at four sites within 30 days after submission of a waiver request or within 30 days of enactment in the case of waiver requests submitted prior to enactment.

Conference agreement

The conference agreement follows the Senate provision with a modification which requires submission to the Congress of an interim report on the status of the projects within 45 days of enactment. A final report is due to the Congress forty-two months after enactment.

The conferees are concerned that the Department has failed to implement certain Congressionally mandated demonstration projects on a timely basis. For example, the "Omnibus Reconciliation Act of 1980" (P.L. 96-499) required the Secretary to conduct two demonstration projects and submit reports on these projects to the Congress. One project was to determine both the extent to which the commencement of nutritional therapy in early renal failure could retard or arrest the progression of the disease and the implications of making such therapy generally available under the Part B program. The second study was to determine the implications of making the services of clinical social workers more generally available under the medicare program. P.L. 96-499 required the Secretary to submit reports on these demonstration projects, together with legislative recommendations, within 24 months of enactment, i.e. December 5, 1982. The Congress has not yet received the required reports.

54. Peer Review Organizations (Section 2347)

a. Payments

Present law

Payment of PRO's is made from the Part A trust fund. The Secretary is directed to fund PRO's in amounts determined to be reasonable, but not less than the 1982 funding levels (adjusted for inflation). This provision does not apply to PSRO's.

House bill

The House bill would require hospitals, as a condition of Medicare payment, to enter into an agreement with a PSRO in the area (which was in existence on July 1, 1983) and funds PSRO's out of the Medicare trust fund. The provision would be effective 60 days after enactment.

Senate amendment

The Senate amendment would include a similar provision except that it would not specify PSRO's in existence on July 1, 1983.

Conference agreement

The conference agreement follows the House provision with a modification which would eliminate the July 1, 1983 date.

b. PRO agreements

Present law

P.L. 98–21 required hospitals to enter into an agreement with a peer review organization as a condition of payment under the Medicare program. Such agreements must be entered into by October 1, 1984. Health benefit payer organizations may not qualify as a PRO until after October 1, 1984.

House bill

No provision.

Senate amendment

The Senate amendment would delay the date by which hospitals are required to have an agreement with the PRO from October 1, 1984 to January 1, 1985. The date on which health benefit payer organizations can first qualify as PRO's would be similarly changed.

Conference agreement

The conference agreement follows the Senate amendment with a modification which specifies that November 15, 1984 is the date by which hospitals are required to have an agreement with a PRO. Similarly, November 15, 1984 is the first date on which payer organizations could qualify as PRO's.

c. Effective date

House bill

The House bill would be effective 60 days after enactment.

Senate amendment

The Senate amendment would be effective May 1, 1984.

Conference agreement

The conference agreement is effective on enactment which is the date on which PSRO and PRO funding becomes available through part A. The conferees wish to make it clear that they intend that the Secretary shall continue funding PSROs in all areas where they currently exist until such time as they have been replaced by a PRO.

55. Technical Amendments Relating to the Medicare Prospective Payment System (Section 2315)

a. Blend of rates

Present law

Public Law 98-21 established the new prospective payment system for paying hospitals under Medicare. The program is phased in over a three-year period (fiscal year 1984-fiscal year 1986). During the transition period, payment for a particular hospital discharge consists of a blend of the hospital specific payment rate and the Federal DRG payment rate (which is a blend of national and regional payment rates).

House bill

The House bill would clarify that the blend of the hospital-specific rate and Federal DRG rate is based on the individual hospital's cost reporting period. It would clarify that the blend of national and regional Federal DRG rates is tied to the Federal fiscal year and is therefore updated each October 1.

Senate amendment

No provision.

Conference agreement

The House bill contained a provision intended to clarify the method of paying hospitals under the new prospective payment system. The conferees concluded that the provision contained in the House bill was unnecessary.

b. State systems

Present law

Public Law 98-21 provided that hospitals in a State may be reimbursed according to the State's hospital reimbursement control system rather than under prospective payment, provided certain conditions are met.

House bill

The House bill would require approved State systems to prevent unbundling of services and inappropriate admissions practices.

Senate amendment

Same as House bill.

c. Public comment

Present law

The Secretary is required to publish in the Federal Register for public comment the proposed annual index and the final annual index of DRG's.

House bill

The House bill would clarify that public comment is required only on the proposed annual index.

Senate amendment

Same as House bill.

d. PRO agreements

Present law

Under Public Law 98-21, hospitals paid on the basis of the new prospective payment system are required to have an agreement with a peer review organization.

House bill

The House bill would require hospitals exempt from the Federal payment system to have agreements with PRO's or PSRO's.

Senate amendment

Same as House bill.

e. Effective dates

Present law

The effective date of October 1, 1983 in the prospective payment provisions was incorrectly applied only to the hospitals to which the new prospective payment system applies.

House bill

The House bill contains no clarification provision with respect to the effective date for exempt hospitals and State systems.

The House bill would require publication of proposed regulations by May 1, 1984 and (after a 45-day comment period) final regulations by August 1, 1984 with respect to requirements for State systems.

Senate amendment

The Senate amendment would clarify that the State-program and exempt-hospital provisions of Public Law 98-21 shall also be effective October 1, 1983.

The Senate amendment contains no provision with respect to State system regulations.

Conference agreement

The conference agreement follows the Senate amendment with respect to clarifying the effective date. The conferees do not intend for this amendment to be construed as requiring that the first of the 36-month periods specified in Section 1886(c)(1)(c) shall begin prior to the publication of final regulations implementing that provision.

With respect to the regulations, the conference agreement follows the House bill with an amendment. The amendment changes, to July 1, 1984 and October 1, 1984, the dates by which proposed and final regulations must be published on the rules for State rate setting systems. In addition, the amendment directs the Secretary to develop a definition of hospitals with a "significantly disproportionate number of patients who have low income or are entitled to benefits under part A" and to identify such providers by December 31, 1984, so that a better determination can be made under existing law as to whether payment exceptions or adjustments are appropriate.

The amendment reflects the conferees' concern about the potentially harmful impact of the prospective payment system on public and other hospitals serving a significantly disproportionate number of patients who have low income or who are entitled to benefits under part A. As the Committee on Ways and Means and the Committee on Finance stated in their reports on the original 1983 prospective payment legislation, such hospitals may serve patients who are more severely ill than average and the DRG payment system may not take this factor into account

Additional considerations

The Conferees wish to reaffirm their directive, contained in the 1983 legislation, that the Secretary provide for exceptions and adjustments for such hospitals if she determines them to be appropriate. The Conferees also wish to express their concern about the adequacy of efforts that have been made to date to determine whether such exceptions or adjustments might be needed. In particular , the Conferees note that no effort has been made to develop a definition of "singificantly disporportionate" for the purpose of identifying particular hospitals (or categories of hospitals) so that any special needs can be accurately and specifically assessed.

The Medicare hospital prospective payment legislation provided an exception for rehabilitation hospitals and for rehabilitation units that are distinct parts of hospitals.

In the implementing regulations, the Department imposed a requirement that a rehabilitation unit have a full-time medical director as a condition for its exclusion from the prospective payment system. The legislation itself did not contain such a requirement. The conferees do not believe this regulatory requirement to be necessary. Alternatively, the conferees expect that professionally established standards will be relied upon—for example, those of the Joint Commission on Accreditation of Hospitals or of the Commission on Accreditation of Hospitals or of the Commission on Accreditation of rehabilitation facilities, and these do not contain a full-time medical director requirement.

56. Normalizing Credit of Medicare Taxes in the Hospital Insurance Trust Fund (Section 2337)

Present law

The "Social Security Amendments of 1983" revised the accounting procedures of the Old Age and Survivors, Disability, and Hospital Insurance Trust Funds to provide that the Treasury would credit to the Trust Funds, at the beginning of each month, the amount of payroll taxes estimated to be received during the month. Under prior law, amounts were paid to the Trust Fund from "time to time."

House bill

The House bill would repeal the "normalization" provisions with respect to the Hospital Insurance Trust Fund. Thus, funds would be transferred from the Treasury to the HI Trust Fund as under prior law. The provision would not affect the OASDI Trust Funds.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House provision.

57. Services of a Clinical Psychologist Provided to Members of an HMO (Section 2322)

Present law

Services of physician assistants and nurse practitioners are recognized as "medical and other health services" if they are furnished pursuant to a risk-sharing arrangement with a health maintenance organization.

House bill

No provision.

Senate amendment

The Senate amendment would provide that the services of clinical psychologists, when furnished pursuant to a risk-sharing arrangement with a health maintenance organization, are recognized as "medical and other health services."

Conference agreement

The conference agreement follows the Senate amendment with a modification which would leave to the discretion of the Secretary the identification of the qualifications necessary to be identified as a clinical psychologist.

58. Home Health Services Provided on a Daily Basis

Present law

Home health nursing care and home health aide visits are provided, to the extent permitted in regulations, on a part-time or intermittent basis. The term "intermittent" has been subject to varying interpretations by different intermediaries. Current guidelines define "intermittent" as permitting daily visits for two to three weeks.

House Bill

No provision

Senate Amendment

The Senate amendment would specify that home health nursing care and home health aide services may be provided on a daily basis (with one or more visits per day) to an individual for up to 45 days following a hospital discharge and, may be continued on a daily basis after such period, based on a physician's certification of exceptional circumstances. The amendment would specify that it could not be construed as altering any Medicare provision as in effect prior to enactment with respect to payment for services provided on a daily basis to persons who have not been discharged from a hospital within the preceding 45 days.

The amendment would require a study of the effectiveness of home health care in preventing hospital and skilled nursing facility admissions. The report would be due to Congress January 1, 1985.

Conference Agreement

The Conference agreement does not include the Senate amendment.

The Conferees are concerned about the current lack of uniformity in the interpretation of existing law, which provides for coverage of home health nursing care and home health aide services on a part-time or intermittent basis. The term "intermittent" has been subject to varying interpretation by different intermediaries.

Current guidelines generally define "intermittent" as permitting daily visits for two to three weeks. The conferees understand current policy makes available medicare coverage for medically reasonable and necessary skilled nursing home health care and home health aide services for a short period of time after the initial two to three week period if the intermediary receives medical documentation from the provider supporting and justifying the need for such additional services. The amount of additional daily care need not be for a fixed period of time, but should be dictated by the medical need of the beneficiary.

The Conferees direct the Secretary to move quickly to identify the factors that have given rise to the lack of uniformity in the application of existing policy and to make such clarifications and take such other steps as may be necessary to remedy the problem. This should be more easily accomplished under a separate provision agreed to by the Conferees which provides for moving within three years to no more than 10 regional home health intermediaries (rather than the 47 as now provided for under current policy).

The Conferees wish to make clear their intention that the Secretary is to more uniformly apply *current policy* regarding intermittent care, and is not to respond to this directive in a way that would have the effect of cutting back on medicare home health coverage.

Subtitle B—Medicaid and Maternal and Child Health Amendments

1. Medicaid Coverage for Pregnant Women and Young Children (Section 2361)

Present law

States must provide Medicaid to poor women and children receiving cash assistance under AFDC. They have the option of extending coverage at their current Federal matching rates to, among others, the following additional groups meeting AFDC income and resource requirements: first-time pregnant women; pregnant women in two-parent families where the principal breadwinner is unemployed; pregnant women in two-parent families; and children under age 18 or 21 in two-parent families (Ribicoff children).

a. Coverage requirements

House bill

The House bill would authorize 100 percent Federal matching assistance for services provided at State option to the following population groups meeting AFDC income and resources requirements if coverage was not available to such groups under the State's Medicaid program which was in effect on June 30, 1983: (1) single first-time pregnant women from medical verification of pregnancy; (2) pregnant women in two-parent families where the principal breadwinner is unemployed; (3) beginning in fiscal year 1988, pregnant women in all two-parent families; and (4) Ribicoff children under age 5 born after October 1, 1983.

Senate bill

Requires States to provide Medicaid coverage, beginning with medical verification of pregnancy, to first-time pregnant women meeting AFDC income and resources requirements.

Conference agreement

The conference agreement follows the Senate amendment with modifications as follows: States are required to provide categorically needy Medicaid coverage at regular Federal matching rates to the following groups meeting AFDC income and resources requirements: (1) first-time pregnant women from medical verification of pregnancy; (2) pregnant women in two-parent families where the principal breadwinner is unemployed, from medical verification of pregnancy; and (3) children born on or after October 1, 1983, up to age five, in two-parent families. Thus, coverage for Ribicoff children would proceed in one-year increments: in fiscal year 1985, States would be required to cover those up to one year of age; in fiscal year 1986, up to two years of age; and so on.

This amendment does not alter the current requirement that States may not impose coverage limitations on Ribicoff children based on age (except they must cover the children under 5, as specified). That is, for children between the ages of 5 and 18, age may not be used as a reasonable classification. Of course, States may continue to establish reasonable categories permitted under cur-

35-426 O 84 86

rent regulations, such as children in foster care homes. However, States must cover all children under 5, as specified in this amendment.

The conference agreement provides that these requirements would take effect on October 1, 1984, or, where the Secretary determines State legislation is necessary, the first day of the first calendar quarter after the close of the first regular legislative session after enactment, whether or not the Secretary issues implementing regulations.

b. Federal matching bonus to States

House bill

The House bill provides for a one-half percentage point reduction in the four and one-half percent Federal matching penalty otherwise applicable in fiscal year 1984 for States not eligible for increased matching under the provisions described in a., above.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House provision.

c. Treatment of payments for services

House bill

The House bill provides that reductions in Federal payments and calculation of the State's target rate are to exclude payments made for services to qualified pregnant women and children.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House provision.

2. Deeming of Income and Resources With Respect to Certain Minor Pregnant Women

Present law

States, in determining Medicaid eligibility, may deem family income as available to a pregnant minor only when she is living in her parent's household. Parental deeming is allowed so long as the parent exercises responsibility for the care and control of the child, even if the child is only temporarily absent.

House bill

The House bill would allow States not to deem the income or assets of parents as available to a pregnant woman under 21 who does not have legal custody of other children. It would permit States to apply this nondeeming policy to pregnant adolescents living with parents, or in a custodial institution, or both.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House provision.

3. Clarification of Medicaid Entitlement for Certain Newborns (Section 2362)

Present law

Certain States have established Medicaid application procedures that fail to provide for the automatic addition of a newborn child to a Medicaid beneficiary's family unit for coverage purposes.

House bill

The House bill provides that a child born to a woman eligible for and receiving Medicaid at the time of birth is deemed eligible for one year as long as the woman remains eligible.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

4. Medically Needy Income Levels

Present law

Medically needy income levels for an SSI-related family of two adults with no income or resources, many be set at a level no higher than 133⅓ percent of the AFDC standard for a two-person family with no income or resources.

House bill

The House bill permits States to establish medically needy levels for a family of two adults up to 133⅓ percent of the three-person AFDC standard.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House provision.

5. Recertification of Need for Stays in SNFs and ICFs (Section 2363)

a. Recertifications

Present law

A State's evidence of a satisfactory program of controls over utilization must include evidence that physicians (or a physician assistant or nurse practitioner under the supervision of a physician) recertify the need for continuing skilled nursing facility (SNF) and intermediate care facility (ICF) services every 60 days.

House bill

The House bill would require recertification of SNF patients 30, 60, and 90 days after admission, and every 60 days thereafter. It would require recertification of ICF patients 60 and 180 days after admission; 12, 18, and 24 months after admission; and annually thereafter.

Senate amendment

Similar provision with respect to SNF recertifications. Similar provision with respect to ICF recertifications except requires recertification after 120 days instead of 180 days after initial certification.

Conference agreement

The conference agreement follows the Senate amendment with modifications as follows. The physician recertification requirements for both SNF and ICF patients would become State Medicaid plan requirements. In addition, with respect to ICF recertifications, recertification would be required no later than 180 days after initial certification instead of 120 days.

b. Grace period

Present law

One hundred percent compliance is required.

House bill

The House bill would permit a 10-day grace perod if the State can demonstrate that the physician had good cause for missing the deadline.

Senate amendment

Similar provision.

Conference agreement

The conference agreement follows the Senate amendment.

c. Penalty

Present law

The Federal penalty imposed on States which fail to have an adequate utilization control program is 33⅓ percent times the ratio of the number of patients in facilities with one or more records out of compliance to the total number of patients in facilities in the State.

House bill

The House bill would provide for a penalty equal to 5 percent times the ratio of the number of patient records out of compliance to the number of patient records included in the survey. No penalty would be imposed if the ratio were 3 percent or less.

Senate amendment

The Senate amendment would provide for a penalty equal to 5 percent times the ratio of the number of patients in facilities with one or more records out of compliance to the total number of patients in the State. No penalty would be imposed if less than 3 percent of the surveyed records were out of compliance.

Conference agreement

The conference agreement follows the Senate amendment with modifications as follows. Effective July 1, 1984, the current penalty would not apply to the physician recertification requirement with respect to SNF or ICF patients. However, the current penalty would continue to apply to the requirement that States have an effective program of medical review. The Conferees intend that the Secretary ensure that the States continue to comply with the physician recertification requirements, as revised by this agreement.

It is the understanding of the conferees that the States commonly use one team of health professionals to conduct the required medical reviews, and a separate team to conduct the required survey and certification activities. The conferees would urge the States to improve the coordination of these two important functions by consolidating the two reviews. In the view of the conferees, periodic, hands-on review of nursing home patients by independent teams of health professionals is an important mechanism for assuring quality of care.

d. Secretarial duty

Present law

A U.S. district court has held that the Secretary of Health and Human Services has the authority, but lacks the duty, to assure that nursing homes participating in the Medicaid program provide care consistent with the individual needs of their Medicaid patients. *In Re estate of Smith* v. *O'Halloran,* 557 F. Supp. 289 (D. Colo. 1983).

House bill

The House bill reaffirms the Secretary's existing duty to assure that the standards governing the provision of care to Medicaid patients in SNFs and ICFs, and the enforcement of those standards, are adequate to protect the health and safety of the residents and to promote effective and efficient use of public moneys.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

6. Waiver of Certain Membership Requirements for Certain HMO's (Section 2364)

Present law

The number of Medicare/Medicaid beneficiaries enrolled in a health maintenance organization (HMO) or other prepaid plan delivering Medicaid services on a risk basis cannot exceed 75 percent of the total enrollment. The Secretary may waive the requirements in the case of public HMO's if the Secretary determines that special circumstances warrant and the entity is taking reasonable efforts to enroll non-Medicare/Medicaid beneficiaries.

House bill

The House bill would permit the Secretary to modify or waive the 75 percent enrollment limitation in the case of an HMO that: (1) is nonprofit; (2) has at least 25,000 enrollees; (3) is and has been a Federally-qualified HMO for at least 4 years; (4) provides basic health services through its staff; (5) is located in a medically underserved area; and (6) had previously received a waiver of the 75 percent limitation under section 1115 of the Act. The Secretary may exercise this wavier only if she determines that special circumstances warrant and that the organization has made, and is making, reasonable efforts to enroll non-Medicare/Medicaid beneficiaries.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with modifications as follows. Under current law, Medicaid eligibles enrolled in HMO's may disenroll, without cause, upon one month's notice. The conference agreement would permit States to require Medicaid beneficiaries who choose to enroll in HMO's meeting certain requirements to remain in the HMO for up to 6 months, unless the beneficiary had good cause to disenroll before that time. During the first month of each 6-month period, the beneficiary could disenroll without cause and receive a Medicaid card that did not restrict his or her choice of provider. For the remainder of each 6-month period, the beneficiary would have to satisfy the State that there was good cause for disenrollment, such as poor quality care or lack of access to needed specialty services. States would be expected to establish effective procedures for reviewing requests for disenrollment on a prompt and fair basis. As under current law, enrollment in HMO's would be voluntary; beneficiaries would have freedom of choice among participating HMO's, and between prepaid and free-for-service providers.

The conference agreement limits the ability of States to impose these restrictions on beneficiary freedom of choice to the following two types of entities: (1) Federally-qualified HMO's, and (2) organizations that are receiving, and have at least two years prior to contracting with the Medicaid program received, grants of at least $100,000 under the Migrant Health Center, Community Health Center, and Appalachian Regional Commission programs. In each case, at least 25 percent of the organization's prepaid patients would have to be other than Medicare or Medicaid beneficiaries. The States would be required to notify beneficiaries prior to enrollment, and at least twice a year thereafter, of their disenrollment rights. The current Federal regulatory requirements with respect to prepaid HMO contracts, including those relating to grievance procedures and quality assurance systems, would apply to these special "lock-in" arrangements as well.

7. Prohibiting Medicaid Copayments for Prescribed Drugs

Present law

States are allowed to impose nominal copayments on prescription drugs for most groups of Medicaid beneficiaries. Providers may not deny services on the grounds that a Medicaid patient cannot afford the required copayment.

House bill

The House bill would prohibit the imposition of copayments on prescribed drugs.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House provision.

8. Maximum Amount of Medicaid Payments to Puerto Rico and the Territories (Section 2365)

Present law

Current law established the following annual ceilings on the amount of Federal Medicaid matching payments which certain jurisdictions may receive; Puerto Rico, $45 million; Virgin Islands, $1.5 million; Guam, $1.4 million; Northern Mariana Islands, $350,000; and American Samoa, $750,000.

House bill

The House bill would raise the ceilings to the following levels, effective fiscal year 1984: Puerto Rico, $77.1 million; Virgin Islands, $2.6 million; Guam, $2.4 million; Northern Mariana Islands, $600,000; and American Samoa, $1.3 million.

Senate amendment

The Senate amendment would raise the ceilings to the following levels, effective fiscal year 1984: Puerto Rico, $63.4 million, Virgin Islands, $2.1 million; Guam, $2.0 million; Northern Mariana Islands, $550,000; and American Samoa, $1.15 million.

Conference agreement

The conference agreement follows the Senate amendment.

9. Payment for Psychiatric Hospital Services (Section 2366)

Present law

Special reimbursement limitations apply with respect to hospital inpatients who are awaiting nursing home placement.

House bill

The House bill would delay until July 1, 1985, the application of reimbursement limitations with respect to public psychiatric hospitals. The House bill further provides that the reductions made for the 12-month periods ending June 30, 1986, and June 30, 1987, are one-third and two-thirds, respectively, of the amounts which would otherwise have been required.

Senate amendment

Same as House bill.

10. Miscellaneous Technical Amendments (Section 2373)

Present law

Titles V and XIX of the Social Security Act contain certain technical errors.

House bill

Makes technical corrections to titles V and XIX of the Social Security Act.

Senate bill

No provision.

Conference agreement

The conference agreement follows the House bill with a modification as follows. The conference agreement directs the Secretary not to take any compliance, disallowance, penalty or other regulatory action against a State because a State, in determining eligibility for noncash Medicaid recipients, is using an income or resource standard or methodology that is less restrictive than the applicable cash assistance standard of methodology. The Secretary is further directed to report to Congress within 12 months of enactment on the impact of the application of income and resource standards and methodologies under the cash assistance programs to medically needy recipients and other noncash eligibles. The moratorium on Secretarial action is to run from the date of enactment until 18 months after the date on which the Secretary submits her report.

In the Omnibus Budget Reconciliation Act of 1981, P.L. 97-35 (OBRA), States were given certain flexibility in structuring their medically needy programs. They were allowed to limit coverage to certain categories of medically needy individuals, and to vary the services they offered to the different groups they covered. No change was made or intended with regard to financial eligibility policy. Before OBRA, States could establish income or resource standards or methodologies for their medically needy programs that were, in some cases, less restrictive than those used in the related cash assistance programs.

Effective October 1, 1981, the Secretary issued interim regulations to implement these changes. These regulations made major changes in the pre-OBRA financial eligibility rules, allowing the States to impose more restrictive standards and methodologies than under previous law.

Section 137(a)(8) of the Tax Equity and Fiscal Responsibility Act, P.L. 97-248 (TEFRA), amended the Medicaid statute to clarify that Congress did not intend to change the policies governing the income and resource standards and methodologies for determining eligibility of the medically needy from those in effect before OBRA. This amendment provided in part that the methodology to be used in determining income and resource eligibility for the medically needy must be the "same methodology" used under the relevant cash assistance program.

The Department has not revised the 1981 interim regulations or otherwise published regulations to implement the TEFRA amendment. However, it is the understanding of the conferees that the Department has implemented this provision in an overly literal fashion, without taking into account the intent of the TEFRA clarification.

For example, the Department is treating certain income and resource rules as "methodology" that must strictly follow SSI or AFDC rules, even though all States with medically needy programs have traditionally been permitted to use less restrictive rules in certain areas. Thus, the Department has taken the position that aged, blind, and disabled medically needy applicants who enter nursing homes and who have marginally excess resources on the first day of the month can not attain Medicaid eligibility during the month, even after their resources are sufficiently depleted by medical costs, because SSI rules only allow eligibility from the first of the month. The Department has also indicated that it may impose quality control sanctions against the States that are using eligibility procedures that were allowed before OBRA and which make sense in the context of the medically needy program but which happen to be less restrictive than the relevant cash assistance procedures. Similarly, the Department has taken the position that the "single standard" requirement of the TEFRA amendment prohibits States from establishing less restrictive medically needy income levels for single adults and couples because this would result in differences in medically needy income levels among groups of the same family size depending on the relative numbers of adults and children.

The Department's overly restrictive interpretation of section 137(a)(8) of TEFRA has posed grave administrative problems for the States and threatens to cause great hardship for applicants and beneficiaries. It is also clear to the conferees that the strict application of the cash assistance rules to the medically needy and other noncash groups produces unintended, and in some cases, undesirable, consequences. The conferees have therefore decided to impose a moratorium on the Department's implementation of the TEFRA amendment until the Congress has an opportunity to study and legislate on the matter.

It is the understanding of the conferees that the Department has not yet actually taken a disallowance or quality control penalty against any State. The conferees intend that, during the moratorium, the Secretary not proceed with the imposition of any sanctions, or otherwise suggest to the States that they must use more restrictive cash assistance standards and methodologies in their medically needy or other noncash recipient programs. States may use less restrictive standards and methodologies in their noncash programs, although they are still foreclosed from being more restrictive than the relevant cash assistance programs. It is the expectation of the conferees that the States will be reasonable in establishing less restrictive variations in the cash assistance methodologies and standards.

11. Extension of Medicaid Payment Reductions and Offsets

Present law

The Omnibus Budget Reconciliation Act of 1981, P.L. 97-35, provided that the Federal matching payments to which a State is otherwise entitled were to be reduced by 3 percent in fiscal year 1982, 4 percent in fiscal year 1983, and 4.5 percent in fiscal year 1984. A State may qualify for a percentage point offset to these reductions of up to 3 percent if it has a qualified hospital cost review program, an unemployment rate which exceeds 150 percent of the national average, or fraud and abuse recoveries greater than one percent of Federal expenditures. In addition, States may earn back part or all of the reductions if expenditures remain below specific target amounts.

House bill

No provision.

Senate amendment

The Senate amendment extends the existing reduction and offset provisions for 3 years. The reduction rate would be 3 percent for fiscal years 1985, 1986, and 1987.

Conference agreement

The conference agreement does not include the Senate amendment.

12. Mandatory Assignment of Rights of Payment by Medicaid Recipients (Section 2367)

Present law

States are permitted to require Medicaid applicants to assign to the State their rights to medical support and third party payments for medical care. Approximately 25 States have taken advantage of this option.

House bill

No provision.

Senate amendment

The Senate amendment would mandate States to require Medicaid applicants to assign to the State their rights to third party payments as a condition of eligibility.

Conference agreement

The conference agreement follows the Senate amendment.

13. Requirements for Medical Review and Independent Professional Review (Section 2368)

Present law

Medical review requirements for SNF's and independent professional review requirements for ICF's under Medicaid both call for teams of physicians, registered nurses, and other appropriate personnel to conduct virtually similar kinds of review.

House bill

No provision.

Senate amendment

The Senate amendment would make State plan requirements consistent for medical review and independent professional review for both ICF's and SNF's. The Senate amendment would also correct a technical error to assure that Christian Science sanitoria are excluded from the revised review requirements.

Conference agreement

The conference agreement follows the Senate amendment.

14. Flexibility in Setting Payment Rates for Hospitals Furnishing Long-term Care Services Under Medicaid (Section 2369)

Present law

Special requirements are provided for the establishment of payment rates for small rural hospitals furnishing skilled nursing or intermediate care facility services under Medicaid.

House bill

No provision.

Senate amendment

The Senate amendment would delete the requirements applicable only to hospital-furnished long-term care services. It provides that rates must meet the same general criteria as are applicable to rates for similar services provided by other long-term care institutions, although the actual rate paid may vary.

Conference agreement

The conference agreement follows the Senate amendment with a modification. States would be permitted to pay for long-term care services at the designated hospitals either on the basis of the special payment rates provided under current law or on the basis of the same general criteria that are applicable to hospitals and nursing homes. Whatever payment method a State chose would have to be applied to all the hospitals in question.

15. Authority of Secretary To Issue and Enforce Subpoenas Under Medicaid (Section 2370)

Present law

The Secretary is authorized to issue and seek enforcement of subpoenas under Medicare to obtain information needed in connection with hearings, investigations, and other matters related to fraud and abuse.

House bill

No provision.

Senate amendment

The Senate amendment would authorize the Secretary to issue and seek enforcement of subpoenas under Medicaid to the same extent allowed under Medicare.

Conference agreement

The conference agreement follows the Senate amendment.

16. Medicaid Clinic Administration (Section 2371)

Present law

States may cover clinic services under their Medicaid programs. Regulations issued by the Department of Health and Human Services limit coverage of clinic services to situations in which services are furnished under the direction of a physician. In certain cases, this physician-direction rule has been interpreted as requiring that clinic administrators be physicians.

House bill

No provision.

Senate amendment

The Senate amendment provides that the clinic need not be administered by a physician.

Conference agreement

The Conference agreement follows the Senate amendment.

1. Increase Authorization for Maternal and Child Health Block Grant Program (Section 2372)

Present law

The permanent authorization for the Maternal and Child Health Services (MCH) Block Grant is $373 million. In fiscal year 1983, an additional $105 million was appropriated for the Block Grant, and in fiscal year 1984, an additional $26 million was appropriated.

House bill

No provision.

Senate amendment

The Senate amendment provides for an increase in the permanent authorization level for the MCH Block Grant to $478 million, effective fiscal year 1984.

Conference agreement

The conference agreement follows the Senate amendment.

Under current law, the Secretary is directed to prescribe the content of the annual reports that the States are required to submit regarding the operation of their MCH Block Grant programs. The conferees are concerned that the Secretary has not required, and many States have not submitted, basic data regarding the effectiveness of their programs, including the number of mothers and children served, and the cost of providing services to them. The conferees note that the usefulness of a recent GAO report on the MCH Block Grant (GAO/HRD-84-35) was compromised by the absence of such basic information. The conferees expect that the Secretary will begin immediately to secure and make available to the Congress the information necessary to evaluate and compare the performance of different States assisted under the MCH Block Grant authority with regard to the numbers of people served and the cost-effectiveness of those services.

SUBTITLES C AND D—RECOVERY OF HILL BURTON FUNDS AND UNCOMPENSATED SERVICES PROVIDED BY SKILLED NURSING FACILITIES INTERMEDIATE CARE FACILITIES

1. Recovery of Hill-Burton Funds (Section 2381) and Study (Section 2391)

a. Recovery

Present law

The Federal government is entitled to recover amounts awarded to a facility for construction, modernization, or conversion under Title VI and Title XVI of the Public Health Service Act if, within 20 years, the facility (1) is sold or transferred to a proprietary entity, or (2) undergoes a change in use from that for which the assistance was originally provided.

House bill

The House bill would require that, in the case of Hill-Burton facilities sold or transferred or subject to a change in use after enactment, the transferor or owner must give the Secretary written notice not later than 10 days from the date of the sale, transfer, or change in use, or be subject to an interest penalty. If, within 180 days after notification, the Federal Government has not collected its recovery, an interest penalty would apply.

In the case of Hill-Burton facilities that were sold or transferred or that underwent a change in use before the date of enactment, the House bill provides that an interest penalty would begin to accrue if the recovery had not been agreed to and paid by July 1, 1984. The interest penalty would run until the recovery amount, plus interest, is paid to the Federal government.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with modifications as follows. In the case of facilities that were sold or transferred or underwent a change in use before the date of enactment, the interest penalty would not begin to accrue until 30 days after enactment, but in no case earlier than 180 days from the date of sale, transfer, or change in use. The conferes expect that the Department, upon notification, will expedite recovery proceedings to avoid subjecting facilities to interest charges that might result from Departmental delay. The Secretary may in regulation provide that, where such delays are caused solely by the Department, the resulting interest charges may be waived.

The modification further authorizes the Secretary to waive recovery altogether in the case of the sale or transfer of a facility to a proprietary entity only if the following requirements are met. First, the new owner or manager must agree to assume and comply with the Hill-Burton "community service" obligation, as implemented by current regulations. Secondly, the acquiring entity must have established an irrevocable trust, the corpus and income of which are to be used exclusively for the provision of uncompensated services to persons unable to pay in accordance with current regulations. The trust must be established in an amount equal to the greater of (1) twice the cost of the remaining "uncompensated services" obligation of the Hill-Burton facility, including any deficits to be made up, as determined by the Secretary under current regulations; or (2) the amount the Federal government would be entitled to recover, as determined by the Secretary.

The purpose of this grant of authority to the Secretary to waive recovery is to assure that, in lieu of the Federal government recouping its financial interest in a Hill-Burton facility, the community served by the facility will continue to have access to needed services there. The conferees expect the Secretary to monitor and enforce compliance with the "community service" and "uncompensated service" obligations on the part of the entity receiving a waiver. In cases where these requirements are not being met, the Secretary is expected to withdraw the waiver and effect recovery.

b. Liens

Present law

The Federal recovery right does not constitute a lien upon a Hill-Burton facility prior to judgment.

House bill

The House bill would provide that the right of recovery constitutes a lien on a Hill-Burton facility prior to judgment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with a modification. It retains current law with respect to liens, and also requires the Secretary to conduct a study to determine whether the current regulations should distinguish between hospitals and nursing homes with respect to compliance with the statutory requirement that a Hill-Burton facility provide a reasonable volume of uncompensated services to persons unable to pay. The study is to be transmitted to the Congress no later than January 1, 1985.

Under the Hill-Burton program, hospitals, nursing homes, and other facilities undertook "community service" and "uncompensated services" obligations in exchange for Hill-Burton grants and loans and loan guarantees. In 1979, the Secretary of Health and Human Services published final regulations implementing these important contractual and statutory requirements. These regulations specify the standards which Hill-Burton facilities must meet and the procedures which they must follow in order to comply with their "community service" and "uncompensated services" obligations.

It is the understanding of the conferees that, while the "uncompensated services" regulations are appropriate in a hospital context, they may not give adequate recognition to the different characteristics of nursing homes from the standpoint of determining compliance. The conferees do not intend that, in examining this question, the Secretary reconsider the issue as to whether the difference between the rates paid by Medicaid and the rates paid by private patients can be treated as Hill-Burton "uncompensated care;" Medicaid patients are not, and never have been, "persons unable to pay" for purposes of the Hill-Burton program. Instead, the conferees expect that the Secretary will identify those regulatory changes, if any, that are necessary to more appropriately define and evaluate compliance by Hill-Burton nursing homes with their "uncompensated services" obligations.

The conferees note that the Hill-Burton program is authorized by the Public Health Service Act, which is within the jurisdiction of the Senate Committee on Labor and Human Resources. Though not conferees, the committee of jurisdiction has indicated its agreement to the amendment as modified.

TITLE IV—SMALL BUSINESS PROGRAMS

House amendment

The House Amendment contained a provision relating to Small Business Act Disaster Loans.

Senate amendment

No provision.

Conference agreement

The Senate recedes to the House.

TITLE V—VETERANS' PROGRAMS

PART A—COST SAVINGS UNDER THE VETERANS' ADMINISTRATION PENSION PROGRAM

EFFECTIVE DATE FOR AWARD OF PENSION FOR NON-SERVICE-CONNECTED DISABILITY OR DEATH

House amendment to the Senate amendment

The House amendment would eliminate retroactive awards of non-service-connected disability pension to veterans—currently provided where the application is received within one year from the date on which the veteran became permanently and totally disabled—for the period between the date of disability and the date the veteran filed an application for pension. The House amendment would also shorten the period for retroactive awards of death pension to survivors of war veterans by reducing, from one year to 60 days, the period during which a survivor must file an application for death pension in order to receive a retroactive award for the period between the date of the veteran's death and the date of application. These provisions would take effect with respect to applications received after September 30, 1984.

Senate amendment

No provision.

Conference agreement

The Senate recedes with an amendment reducing the retroactive period for survivors to 45 days and providing an exception to the provision eliminating retroactivity for veterans. The exception would be for a veteran who has a disability that, for a period of at least 30 days beginning on the date of permanent and total disability, prevents him or her from applying for pension. In order to be eligible for this exception, the veteran would be required to include in his or her application a request for a retroactive award.

PART B.—ACTIONS TO INCREASE RECEIPTS AND SAVE COSTS UNDER THE VETERANS' ADMINISTRATION HOME LOAN GUARANTY PROGRAM

INCREASE IN FEE FOR HOME LOANS GUARANTEED BY THE VETERANS' ADMINISTRATION AND EXTENSION OF FEE TO VENDEE LOANS

House amendment to the Senate amendment

The House amendment would, effective with respect to loans closed on or after the date of enactment, provide for receipts from loan orgination fees on home loans guaranteed, made, or insured by the VA to be deposited in the VA Loan Guaranty Revolving Fund. The House amendment also would extend by two years, from September 30, 1985, through September 30, 1987, the period during which such fees are imposed. Effective with respect to loans closed 30 or more days after the date of enactment, the House amendment would increase the fee from one-half of one percent to one percent and impose the fee on loans (known as "vendee loans") made by the VA to finance the purchase from the VA of properties it acquires through the operation of its home loan program.

Senate amendment

No provision. However, S. 2391, passed by the Senate on March 30, 1984, would, effective on the date of enactment, provide for loan origination fee receipts to be deposited in the Loan Guaranty Revolving Fund and, effective with respect to loans closed 14 or more days after enactment, increase the fee to one percent.

Conference agreement

The Senate recedes.

PROPERTY ACQUISITIONS

House amendment to the Senate amendment

The House amendment would, effective October 1, 1984, make certain reforms in the administration of the VA's home loan guaranty program with respect to the acquisition and disposition of properties securing loans which go into default and are liquidated through a foreclosure sale or comparable transaction (hereinafter referred to as a "liquidation sale"). Thus, the House amendment would specify the circumstances under which the VA would be required to acquire or be precluded from acquiring a property after a liquidation sale.

Although current statutory language states that when the Administrator has received notice of a default, the Administrator "shall thereupon pay" to the holder of the loan the amount payable under the guaranty, the VA, pursuant to long-standing practice and regulations, follows an administrative procedure whereby the guaranty generally is not paid until the holder of the loan has liquidated its security interest in the property. Under this procedure, it has been the VA's practice in a very high percentage of cases of liquidation sales (approximately 95 percent) to acquire the property from the lender following the sale. In some cases, however, the VA has acquired properties at prices which, when combined with the costs of owning temporarily and selling the property and any amount remaining payable under the guaranty, have resulted in total VA expenditures in connection with the property exceeding the amount for which the United States was liable under the guaranty. The House amendment was designed to ensure that acquisitions are not made where they would result in net costs to the VA (after re-sale) in excess of what the VA would pay under the guaranty if it did not acquire the property. Thus, the House amendment set forth statutory criteria under which, depending on the estimated net value, the amount of the total indebtedness, and the VA's liability under the guaranty, either the holder of the loan would have the statutory option to see the property to the VA or the VA would not be permitted to acquire it.

The House amendment would also amend the provision in current law (section 1816(a) of title 38, United States Code) requiring the Administrator, upon receiving notice of a default, to pay to the holder of the loan the pro rata portion of the guaranty (which, under section 1803(b) of title 38, decreases or increases in proportion to any decrease or increase in the amount of the unpaid portion of the obligation). That amendment would specify that, subject to the above-noted provisions specifying criteria for liquidation sales, the Administrator would have the authority, but would not be required, to pay the guaranty upon receiving notice of default.

Senate amendment

No provision.

Conference agreement

The Senate recedes with clarifying amendments and amendments adding provisions relating to the use of VA and private attorneys to bring foreclosure and eviction suits in court and requiring a report on the VA's loan guaranty program.

The provisions of the conference agreement regarding property acquisitions are as follows:

Definitions

The term "defaulted loan" would be defined (as in the House bill) so as to limit the scope of the property-acquisition provisions to VA-guaranteed home loans other than those made for manufactured homes and guaranteed under section 1819(a) of title 38.

The term "liquidation sale" would be defined broadly (as in the House bill) to include not only a judicial foreclosure sale but also such other liquidation procedures, for example, a deed in lieu of foreclosure, as may be permitted under the law of the State in which the property is located. Because loan liquidation procedures differ in the various States, and because within any particular State there may be several alternative means of foreclosing on a defaulted loan, the conferees have not attempted to set forth a comprehensive definition of a liquidation sale. It is the conferees' intention that the term would apply to any involuntary or voluntary conveyance, pursuant to applicable State law, of the property securing a defaulted loan for the purpose of liquidating the security interest of the loan holder, with the net proceeds of the conveyance being used to satisfy, at least in part, the indebtedness.

The term "net value" would be defined as fair market value minus the total estimated costs that the VA would incur (other than the purchase price) in connection with acquiring the property after a liquidation sale and thereafter disposing of it. This term is not used in the current VA regulations governing liquidation sales and VA acquisitions following those sales (primarily section 36.4320 of title 38, Code of Federal Regulations). However, the regulations refer to a roughly comparable concept—"the minimum amount which shall be credited to the indebtedness on account of the value of the security to be sold"—and use that concept in a fashion similar to the way "net value" is used in the conference agreement. Thus, the "amount . . . credited . . . on account of the net value of the security" is currently used as an indicator of the price at which the lender may purchase the property at the liquidation sale and re-sell it to the VA, that is, where that amount exceeds the total indebtedness minus the amount payable under the guaranty. In determining net value under the conference agreement, the Administrator would be required to subtract from fair market value all of the estimated costs that the VA would pay in acquiring and disposing of the property.

With respect to the costs of administration—one of the cost categories specified in the conference agreement—the conferees note their intention that this category include in-house costs to the VA that are clearly and directly related to acquiring, holding, and disposing of the property. The VA personnel costs involved would be an example.

In connection with the VA's calculation of the costs of acquiring and disposing of properties, the conferees do not intend to change the VA's current policy of not considering interest costs that the United States would incur if it were necessary for the Government to borrow the funds for a particular acquisition. If the Administrator determines that a change to this policy is warranted, notwithstanding the conferee's position as stated above, the Administrator shall, not later than the February 1 preceding the fiscal year in which a proposed change would take effect, provide the Veterans' Affairs Committees with notice of the change.

The conferees also note their understanding that, in assessing the fair market value of a property, the Administrator obtains appraisals of the property "as is" and of what the property would be worth if certain improvements were made. It is the conferees' intention, in any case in which the costs of improvements are included in the costs being deducted from fair market value to arrive at net value, that the fair market value figure include the estimated addition to the value of the property that would result from those improvements. Of course, where no improvements are planned, an "as is" appraisal would be used and no deduction would be made for estimated costs of any improvements.

The term "total indebtedness" would include (1) the unpaid principal, (2) the interest on the loan as of the liquidation sale, or such earlier date following the expiration of a reasonable period for the sale to occur as the Administrator may specify pursuant to regulations, and (3) other reasonably necessary and proper charges that are specified in the loan instrument and permitted by VA regulations.

The conferees note that, under the last sentence of present section 1816(a) of title 38, United States Code (proposed to be designated as paragraph (3) of section 1816(a) by the conference agreement), the Administrator has the authority to establish a date prior to "the date of judgment and decree of foreclosure or sale, upon which accrual of interest or charges shall cease." It is the conferees' intent that the Administrator, in implementing this authority in conjunction with the above-described definition of "total indebtedness", not impose a cut-off date in a case in which the delay in the liquidation is reasonably attributable to the holder's forbearing with the agreement of the parties to the loan (as provided for in the third sentence of present section 1816(a) (proposed to be included, with the second sentence, in a paragraph (2) of section 1816(a)). However, the conferees do intend that the authority be used when an unreasonable delay in liquidation is the result of other action or inaction on the part of the holder of the loan at the expense of either the United States Government or another party to the loan.

Circumstances for acquisitions

The operative provisions of the conference agreement would cover all cases in which the holder of a defaulted loan undertakes to liquidate the loan by means of a liquidation sale, except where the Administrator, pursuant to the second sentence of present section 1816(a) (proposed to be included with the third sentence in a paragraph (2) of section 1816(a)), elects to pay the holder of the loan the unpaid balance of the loan plus accrued interest and receive an assignment of the loan and security. Before carrying out a liquidation sale, the holder of the loan would be required, in accordance with VA regulations implementing the conference agreement, to notify the Administrator of the proposed sale. After receiving that notice, the Administrator would be required to determine the net value of the property and the total indebtedness and to notify the holder of the loan of the net value determination.

The conference agreement provisions with respect to the circumstances for VA acquisitions—which incorporate the substance of the corresponding House bill provisions with the addition of the provision described at item 1(c), below—are as follows:

1. Where net value exceeds total indebtedness minus the amount guaranteed (which would be the pro rata amount determined under section 1803(b) of title 38, as noted above):

   (a) If the holder acquires the property for an amount not exceeding the lesser of net value or the total indebtedness, the holder would have the option to sell the property to the VA in return for the lesser of net value or total indebtedness and the loan-guaranty liability would be limited to total indebtedness minus net value.

   (b) If the holder either does not acquire the property or acquires it for an amount exceeding the lesser of net value or total indebtedness, the Administrator would not be permitted to accept conveyance of the property, except as noted at item (c), below, and the loan-guaranty liability would be limited to total indebtedness minus the greater of net value or the amount realized by the holder incident to the sale.

   (c) If the holder acquires the property for a liquidation sale price exceeding the lesser of total indebtedness or net value and that price was the minimum price for which, under applicable State law, the property was permitted to be sold at the liquidation sale, the Administrator would have discretionary authority to accept conveyance for a price not exceeding the lesser of the liquidation sale price or the total indebtedness, and the loan-guaranty liability would be limited to total indebtedness minus the greater of net value or the amount realized by the holder incident to the sale.

2. Where net value does not exceed total indebtedness minus the amount guaranteed, the Administrator would not be permitted to accept the conveyance of the property, and the loan-guaranty liability would be limited to the total indebtedness minus the amount realized by the holder incident to the liquidation sale.

The conferees note that it is their intention to make major changes with respect to current VA policies and practices with respect to acquisitions in only the following ways: requiring the VA to take its costs of administration into account in ascertaining the value of a property to the VA (net value) and prohibiting the VA from acquiring the property in certain cases.

These modifications—together with provisions codifying current policies and practices—are designed to maintain the effective functioning of the loan guaranty program and make its operation more economical and, thus, to help ensure that the program will continue to be able to fulfill its basic purpose of assisting eligible veterans to buy homes.

In addition, the conferees note the need for implementing regulations to provide a great deal of detail regarding the transactions involved. For example, the conferees expect that the regulations would specify the terms and conditions for the conveyances of property to the VA permitted in the situtations described at items 1 (a) and (c), above. As another example, the conference agreement provides no specifics regarding the method or deadlines for the provision of any notices. However, it is the conferees' understanding that such notices are provided routinely and effectively at the present time, and the conferees do not intend any undue complication of that process.

Sunset provision

The conference agreement provisions relating to property acquisitions would expire on October 1, 1987.

Use of VA and private attorneys to bring foreclosure actions

The conference agreement would require the Administrator, within 180 days after the date of enactment, to authorize VA attorneys to exercise the right of the United States to bring suit in court to foreclose loans made or acquired by the VA under chapter 37 of title 38, United States Code, relating to home loans made, guaranteed, or insured by the VA, and to recover possession of any property acquired by the Administrator. The Administrator would also be provided with the authority, subject to the concurrence of the Attorney General, to acquire the services of non-VA attorneys to bring such suits. The activities of all attorneys in bringing suit under this provision would be subject to the direction and supervision of the Attorney General and to such terms and conditions as the Attorney General may prescribe. In addition, the conference agreement contains a provision to clarify that this measure would not derogate from the Attorney General's authority to direct and supervise all litigation to which the United States or an agency or officer thereof is a party.

Not later than 180 days after enactment, the Administrator and the Attorney General would be required to submit to the appropriate Congressional committees a joint report describing and explaining the actions they have taken to implement the provision relating to the use of VA and private attorneys, as well as their views on the advisability of the VA's use of private attorneys to bring suits to foreclose on loans and recover possession of property.

The conferees are advised that delays in bringing foreclosure and eviction proceedings are resulting is estimated costs of $2 million annually that could be eliminated through prompt judicial actions.

The conferees expect this provision to be implemented so as to avoid this waste of federal funds.

With respect to the use of private attorneys, the conferees note that, in cases where the property involved is a long distance from the nearest VA-employed attorney's office, it may be in the best interest of the United States to acquire the service of local, private attorneys to bring suit. Thus, the conferees urge that the Administrator and the Attorney General, working together, give every consideration to developing, at a minimum, pilot projects using private attorneys in those circumstances.

Report on administration and functioning of the loan guaranty program

Not later than December 1, 1986, the Administrator would be required to submit to the House and Senate Veterans' Affairs Committees a report on the administration and functioning of the VA's loan guaranty program, and the status of the Loan Guaranty Revolving Fund. The report would be required to include a description of actions taken and planned by the Administrator to maintain the effective functioning of the program and to ensure the solvency of the Fund; the Administrator's evaluation of the effects of the conference agreement provision relating to acquisitions of properties after liquidation sales and to vendee loans; and the Administrator's recommendations regarding any need for administrative or legislative action with respect to the loan guaranty program.

Vendee loans

House bill

The House amendment would, effective on October 1, 1984, require the Administrator to reduce to the maximum extent practicable the number of loans (known as "vendee loans") made by the VA to finance the purchase from it of acquired properties. In addition, the House amendment would prohibit the VA from providing vendee loans for more than 75 percent of such purchases in any fiscal year, except that the Administrator would have the authority to increase that limitation to 80 percent in any fiscal year if the Administrator determined that doing so was necessary in order to protect the interests of the United States.

Senate amendment

No provision.

Conference agreement

The Senate recedes with an amendment.

Limitation on making vendee loans

The conference agreement retains the House provision setting a ceiling on the percentage of purchases of property from the VA which may be financed be vendee loans during any fiscal year. The House provision requiring the Administrator to reduce the number of vendee loans is modified in the conference agreement so as to require the VA to minimize the number of vendee loans to the greatest extent consistent with certain specified limitations and with maintaining the effective functioning of the VA loan guaranty program. In addition, the conference agreement would require that not less than 60 percent of the purchases during any fiscal year of property acquired by the VA be financed by vendee loans. Also, the House provision that would authorize the Administrator to increase the maximum to 80 percent for any fiscal year is modified so that, before exercising the authority, the Administrator would be required to determine that the increase was necessary to maintain the effective functioning of the loan guaranty program.

It is the conferees' intention that, in carrying out this provision, the VA will analyze the properties in its inventory and encourage the procurement of private financing by sales agents and prospective purchasers in cases where the properties appear to be marketable with non-VA financing.

Sale of vendee loans with recourse

In addition, the conference agreement contains a provision, also effective October 1, 1984, relating to VA sales of vendee loans to private investors "with recourse"—that is, with the right to sell back to the VA, at no loss to the investor, a loan that is in default for a specified period of time. Under this provision, the VA would not be permitted to sell vendee loans with recourse unless the Administrator determined that doing so was necessary in order to maintain the effective functioning of the loan guaranty program.

Sunset provision

The conference agreement provisions relating to vendee loans would expire on October 1, 1987.

TABLE OF CONTENTS

TITLE VI—OASDI, SSI, AFDC, AND OTHER PROGRAMS

Subtitle A—Improvements in OASDI Program

Subtitle B—Improvements in SSI and AFDC Programs

Part 1—Improvements in SSI Program

Part 2—Improvements in Aid to Families With Dependent Children and Child Support Enforcement

Subtitle A—Improvements in OASDI Program

1. Tax-Exempt Interest in Calculation of Taxable Social Security Benefits

Present law

Under the 1983 Social Security Amendments, beginning in 1984, a taxpayer adds tax-exempt interest to adjusted gross income and half of social security benefits as the first step in calculating the amount of benefits subject to tax. From this sum is subtracted a $32,000 threshold ($25,000 for single individuals). Half the excess (but never more than half of benefits) is included in adjusted gross income.

House bill

No provision.

Senate amendment

The Senate amendment deletes tax-exempt interest from the formula used to calculate the amount of taxable social security benefits, effecive for taxable years beginning after December 31, 1983.

Conference agreement

The conference agreement follows the House bill.

2. Social Security Treatment of Certain Church Employees

Present law

Under the Social Security Amendments of 1983, employees of religious and other nonprofit organizations (not including ministers or members of religious orders) are subject to mandatory social security coverage, effective January 1, 1984. Prior to these amendments, employees of nonprofit organizations were exempt from social security coverage unless the organization waived, or was deemed to waive, its exemption.

The FICA tax rate is 7 percent each for employees and employers (for a combined 14 percent rate) in 1984, increasing to a combined rate of 15.3 percent in 1990. A credit (0.3 percent of wages) is allowed in 1984 against the employee FICA tax. For employees of tax-exempt oganizations, wages of less than $100 per calendar year are not subject to social security taxes.

The tax rate applicable to self-employed individuals (SECA) equals the combined employee-employer FICA rate. For 1984 through 1989, a self-employment tax credit (2.7 percent in 1984) lowers the effective SECA rate.

House bill

No provision.

Senate amendment

Election of SECA treatment

The Senate amendment allows a one-time irrevocable election by a church or qualifying church-controlled organization to exclude from the FICA tax base remuneration for all services performed for the organization, other than in an unrelated trade or business. The employees of organizations so electing will be liable for self-employment (SECA) taxes with respect to the excluded services.

For employees of electing organizations, wages of less than $100 per calendar year are not subject to SECA taxes and the SECA tax base is generally conformed to the applicable FICA rules.

Electing organizations remain subject to income tax withholding and reporting requirements with respect to all employees. Treasury may revoke an election for continuing failure to provide required information.

This provision is effective for services performed on or after January 1, 1984.

Eligibility to make election

An election is available to: (1) churches (including conventions or associations of churches), (2) elementary or secondary schools controlled, operated, or principally supported by churches (or conventions or associations of churches), and (3) church-controlled tax-exempt organizations (sec. 501(c)(3)), *except* any such organization which both

(A) offers goods, services, or facilities for sale to the general public (e.g., to persons who are not church members), other than on an incidental basis and other than at a nominal charge, and also

(B) normally receives more than 25 percent of its support from the sum of (a) governmental sources, and (b) receipts from admissions, sales of merchandise, performance of services or furnishing of facilities other than in unrelated trades or businesses.

To make an election, an organization must state that it is opposed for religious reasons to payment of social security taxes.

Procedure for making election

An election must be made prior to the first date, more than 90 days after enactment, on which the electing organization's quarterly employment tax return would be due. The election would apply to services performed on or after January 1, 1984.

Conference agreement

The conference agreement follows the Senate amendment.

The conferees agreed to the amendment in order to provide mandatory coverage under social security for employees of churches and at the same time allow the religious convictions of certain employing churches to be reflected in the choice not to be subject to the employer tax. In adopting the amendment, it is not the intention of the conferees to express an opinion on the constitutionality of the original coverage provision of the 1983 amendments.

3. Coverage of Employees Under Social Security and Federal Retirement Systems

a. Breaks in service

Present law

The Social Security Amendments of 1983 provided social security coverage for newly hired Federal civilian employees effective with remuneration paid after December 31, 1983. Persons continuously in the employ of the United States since December 31, 1983 (or with a break in such employment of 365 days or less) will not be covered. Legislative branch employees are covered by social security unless they were covered by the Civil Service Retirement System (CSRS) on December 31, 1983.

Contrary to the intent of P.L. 98-21, there are several gaps and anomalies under current law. First, a person in Federal employment that is already covered by social security, (mainly the armed services, which have been covered since 1956) can retire from military service, enter Federal civilian service, and be exempt from social security. Conversely, a person who only technically severs his Federal civilian employment connection in order to serve a term of duty with an international organization would be treated as having had a break in service upon his return to domestic service, and would be covered under social security if such break exceeded 365 days.

House bill

In order to prevent Federal employees who had been previously covered under social security from losing coverage as a result of a break in service of more than 365 days, the House bill provides that persons transferring from other government service to civilian service will be covered under social security, unless (a) the other service was in an international organization, or (b) the person is returning to civilian service after temporary military or reserve duty and is exercising reemployment rights under chapter 43 of title 38, U.S.C.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

b. Legislative branch employees

Present law

Legislative branch employees who were covered by CSRS on December 31, 1983, can withdraw from CSRS after that date and not be covered by social security of CSRS.

House bill

The House bill provides that legislative branch employees who were covered under either CSRS or another Federal civilian retirement system on December 31, 1983, but who have a break in service of less than a year after that date, will be covered by social security on their return or transfer to legislative employment unless they elect coverage under CSRS within 45 days. This provision will also allow legislative branch employees who take periods of leave without pay of less than a year to return to legislative branch employment without disturbing their participation in the Civil Service Retirement System, as long as they reelect coverage within 45 days.

Senate amendment

The Senate amendment is similar to the House bill, except individuals who elect to receive a refund of CSRS contributions or who have legislative branch employment which is not covered under CSRS would lose their exemption from social security.

Conference agreeement

The conference agreement follows the Senate amendment with a modification.

The conference agreement provides that any legislative branch or other Federal employee who withdraws from the civil service retirement system (CSRS) after June 14, 1984 and takes a refund of his contributions may not thereafter be exempt from social security coverage while employed in the legislative branch. In addition, an individual who has any legislative branch employment after June 14, 1984 which is not subject to the CSRS could not also be exempt from social security coverage (regardless of whether he has applied for a refund of his prior civil service retirement contributions). Employees in the legislative branch who take leaves of absence without taking a refund of their CSRS contributions may (according to the practice of the employing office) continue to be covered under CSRS. If they are not automatically re-covered under CSRS, they will be covered under social security unless they re-join CSRS upon resumption of their legislative branch employment.

Under the conference agreement, the exemption for social security coverage will also cease to be available to any individual who took a refund of CSRS contributions based on a separation or transfer during the period from January 1, 1984 through June 14, 1984 or who has legislative branch employment which was not covered under CSRS during that period. However, any such individual can reestablish the exemption (provided that he was covered under CSRS or another Federal retirement system on December 31, 1983) if he has reentered the CSRS after the point when he last withdrew from it and prior to the 31st day after enactment. For an individual who is not in Federal employment on the date of enactment, the 30-day period will run from the date on which he again becomes a legislative branch employee. An individual will be considered to have reentered the CSRS if he applies to do so within the appropriate time and the coverage subsequently does become effective.

c. Nonprofit organizations

Present law

Effective January 1, 1984, employees of all nonprofit organizations are covered by social security on a mandatory basis. Employees in certain nonprofit organizations (Legal Service Corporations, for example) who are covered on a mandatory basis by the Civil Service Retirement System (CSRS) will thus be covered on a mandatory basis by social security as well. These employees are not provided relief from double-taxation under Title II of the Federal Physicians Comparability Allowance Amendments of 1983 (Public Law 98-168), known as the Federal Employees' Retirement Contribution Temporary Adjustment Act.

House bill

No provision.

Senate amendment

Under the Senate amendment, employees of nonprofit organizations who are covered on a mandatory basis by CSRS would be treated like Federal employees for purposes of social security. They would therefore be covered by social security only if newly hired after January 1, 1984, or if they had a break in Federal service lasting more than 365 days. In such cases, the provisions of P.L. 98-168 would apply to them. This provision would apply to services performed on or after January 1, 1984.

Conference agreement

The conference agreement follows the Senate amendment.

4. Increased Enforcement of Earnings Test

Present law

Social security beneficiaries are not required to file earnings reports until the close of the calendar year.

House bill

The House bill requires the Secretary to implement procedures for obtaining earnings reports earlier than under present law and to make earlier adjustments of benefit amounts on account of excess earnings.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

Subtitle B—Improvements in SSI and AFDC Programs

PART 1.—IMPROVEMENTS IN SSI PROGRAM

1. Increase in Dollar Limitations Under SSI Assets Test

Present law

SSI eligibility is restricted to qualified persons who have countable assets of less than $1,500, or less than $2,250 in the case of married couples. (This amount has not been increased since the SSI program began in 1974.)

In determining assets, a number of items are not included, such as the individual's home; life insurance policies with a total face value of $1,500 or less; and, within reasonable limits set by the Secretary of Health and Human Services, household goods, personal effects and an automobile. Regulations place a limit of $2,000 in equity value on excluded household goods and personal effects and exclude the first $4,500 in current market value of an auto (100 percent of the auto's value if it is used for medical treatment or employment or has been modified for use by a handicapped person). The dollar limits on household goods and personal effects and the limit on the value of the automobile have been increased by regulation once since 1974. In 1976, SSI law was changed to eliminate limitations on the value of a home. Assets, tools and other property essential to self-support are also excluded.

In 1982, a provision was added to also exclude from counted resources the value of burial plots. In addition, to provide SSI applicants and recipients an alternative to the life insurance exclusion previously described, the 1982 amendment allows for the exclusion of up to $1,500 of separately identifiable funds set aside for burial expenses.

House bill

Increase the countable assets limit by $100 a year for an individual and $150 a year for a couple, beginning in calendar year 1985, and each year through calendar year 1989. The limit would be $2,000 for an individual and $3,000 for a couple in 1989 and thereafter. Effective January 1, 1985.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill. The conferees believe that a major purpose of allowing SSI recipients to retain a certain amount of assets is that recipients sometimes incur major costs of an urgent nature which cannot be met from the monthly grant. An example would be the need to replace a furnace or other essential appliance. The managers are concerned that an increase in the assets limit target additional Federal costs on recipients who already have accumulated the maximum allowable reserves against such contingencies rather than on those who may be without any resources to deal with such emergencies. The managers direct the Secretary to examine this problem and report to the Congress by June, 1985 with recommendations on it. If the Secretary is able to recommend a more appropriate way to deal with this problem, the managers intend that the proposed increases for years after 1985 should be replaced by a more targeted approach.

2. Limitation on Recoupment Rate in Case of Overpayments

Present law

The Secretary is authorized to recover SSI overpayments by adjusting future payments or by direct recovery from the individual. Overpayments may be waived under conditions specified in law and regulations. When an overpayment is detected, SSA sends a notice to the recipient. The notice contains information regarding relief from recovery and rights of appeal. In addition it requests a full refund, and, in those cases where the individual is still receiving benefits, it proposes full withholding of the monthly benefit. The notice also indicates that the individual should contact SSA if he disagrees with the proposed rate of recoupment.

House bill

In the case of overpayments, limits the amount of adjustment or recovery in any month to the lesser of: (1) the amount of the benefit for that month; or (2) an amount equal to 10% of the countable income (including the SSI payment) of the individual (or couple) for that month. This limitation would not apply if there is fraud in connection with the overpayment. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with an amendment which allows the recipient to request a different rate at which income may be withheld or recovered. The managers intend that the notice sent to claimants shall clearly indicate that a 10 percent rate of withholding is the norm and that the beneficiary may agree to a faster rate of repayment, but the managers direct that such information not be presented in a manner which would lead recipients to believe that faster repayment is expected or required.

To make clear that the 10 percent applies to the total Federally administered benefit rate, the conference agreement specifically states that State supplementary benefits are included. It is not intended that this reference should give rise to any inference as to whether or not such supplementary payments are intended to be included when the term "benefits under this title" is used elsewhere in the law.

3. Limit on Recovery of Overpayments When Recipient Has Excess Assets

Present law

If, in any month, a recipient's assets exceed the asset limit (currently $1,500 for an individual and $2,250 for a couple) the individual is ineligible for benefits in that month and the entire amount of the benefit paid for that month is considered an overpayment subject to recovery. These overpayments are subject to waiver.

House bill

Limits the amount that may be considered an overpayment (and therefore subject to recovery) in the case of recipients whose assets had exceeded the dollar asset limitations to the lesser of: (1) the amount of the benefit paid; or (2) the greatest amount by which the total value of the assets exceeded the dollar asset limitation for a period of one or more consecutive months during such period. Effective October 1, 1984.

Senate amendment.

No provision.

Conference agreement

The conference agreement follows the House bill with the following modification: instead of the provision in the House bill, in any case where there is an overpayment based on an excess of assets of $50 or less, the recipient would be deemed to be without fault for purposes of waiving the overpayment unless the Secretary finds that the failure to report the excess was knowing and willful on the part of the recipient.

The managers intend that, in cases where an individual is found for the first time to have minimal excess assets of $50 or less, the provision will ordinarily require a waiver of the resultant overpayment just as if the Department had found that the existing law requirements for waiver were fully met. The only exceptions anticipated would be cases where there is blatant evidence that the recipient was fully aware of the requirements of the law and of the existence of the excess assets and chose to conceal them. The managers further intend that where waiver is required under this provision, the Department will undertake to provide adequate instruction and monitoring to minimize the likelihood that an inadvertent overpayment would again occur. The managers recognize that there can be cases where larger amounts of excess assets can exist in circumstances where it would be inappropriate to require full repayment of SSI benefits. However, the managers believe that such situations should be adequately provided for by an existing statutory provision which directs the Secretary to avoid penalizing individuals who are without fault. The Secretary is directed to review the regulations and procedures implementing this statutory provision and to make any necessary changes to assure that a realistic assessment of the culpability of individuals is made.

4. Exclusion of Retroactive Payments From Resources

Present law

For purposes of determining SSI eligibility and benefit amounts, a retroactive SSI check is not counted as income to the recipient. By regulation, SSA has provided that a retroactive SSI check is not counted as a resource for three months beyond the month in which it is received. A title II retroactive check is considered to be unearned income in determining the applicable monthly benefit amount, and is considered a resource if it is retained in months thereafter.

House bill

Provides that SSI and title II retroactive benefit payments may not be considered as a resource for a period of 12 months from the date the payment is received. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with an amendment limiting the exclusion to six months after the month in which the SSI or title II retroactive benefit is received.

5. Adjustments in SSI and OASDI Benefits on Account of Retroactive Benefit Payments

Present law

The SSI statute contains provisions aimed at ensuring that an individual's entitlement under the Old-Age, Survivors, and Disability Insurance (OASDI) and Supplemental Security Income (SSI) programs do not result in windfall benefits. Under present law, OASDI benefits that are paid retroactively following the initial determination of eligibility are reduced by the amount of any excess SSI benefits that have been paid because the OASDI benefits have been received in a lump sum rather than in the months when regularly payable.

House bill

No provision.

Senate amendment

Amends the present law requirement to allow the adjustment of benefits in additional situations:

(1) in the case where retroactive OASDI benefits are paid before the SSI benefits, but for the same period, the retroactive SSI amount otherwise payable would be reduced by the amount that would not have been paid had OASDI been paid when regularly due;

(2) the provision would allow for an adjustment of SSI and OASDI benefits which result from either an initial determination of eligibility or a resumption of payments following a period of suspension or termination of those benefits. In cases where retroactive OASDI benefits result from post-eligibility events, such as earnings recomputations, the Secretary would be authorized to adjust those benefits when it is administratively feasible; and

(3) present law would be amended to coordinate the benefit adjustment provision with the SSI retrospective accounting system. Under present law, it is possible that the two-month lag in counting OASDI income for purposes of determining the SSI benefit amount can result in adjustment for less than the full retroactive period. The proposed change would make it possible to adjust benefits paid for the entire retroactive period. The provision would apply to retroactive benefits (either OASDI or SSI) payable beginning 7 months after enactment.

Conference agreement

The conference agreement follows the Senate amendment.

6. Exclusion From Income of Alaska Bonus Payment

Present law

An amendment to the SSI statute in 1975 provided for the exclusion from countable income of the Alaska "longevity bonus." This exclusion is defined in the SSI law as a monthly payment made by a State under a program established prior to July 1, 1973, if eligibility for the payment is not based on need and is based solely on attainment of age 65 and duration of residence in the State. As the result of an Alaska State Supreme Court decision, Alaska enacted a revision that reduces the residency requirement from 25 years to one year.

The bonus payment is presently $250 monthly per person.

House bill

No provision.

Senate amendment

The conference agreement provides for the continual exclusion from countable income of Alaska's longevity bonuses, even though a change was made in the bonus program to conform it with the Supreme Court decision which may disqualify the program as not having been established before July 1, 1973. Effective on enactment.

Conference agreement

The conference agreement follows the Senate amendment with the modification that continued disregard of the Alaska bonus would apply only to those individuals who, prior to October 1, 1985, meet the 25-year residency requirement of eligibility for the Alaska bonus as it was in effect prior to the recent amendments mandated by the courts. This will avoid an abrupt cut-off for those individuals who have been receiving this disregard for many years or who had, for many years, reason to expect that the disregard would be available.

PART 2.—IMPROVEMENTS IN AID TO FAMILIES WITH DEPENDENT CHILDREN (AFDC) PROGRAM

1. Gross Income Limitation

Present law

Eligibility for AFDC is limited to families with gross incomes (income before application of any disregards) at or below 150 percent of the State's standard of need.

House bill

Sets a new gross income limit of 130% of poverty, updated annually. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with the following modification: the gross income limitation is increased to 185 percent of the State standard of need.

2. Work Expense Deduction

Present law

States are required to disregard to first $75 of monthly earnings for full-time employment (in lieu of itemized work expenses). A lower work expense deduction must be established for part-time workers.

House bill

States would be required to disregard the first $75 of monthly earnings for full- and part-time employment. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

3. Continuation of $30 Disregard From Earned Income

Present law

States are required to disregard the following amount of a recipient's monthly earnings, in the following order: (1) the first $75 (less for part-time work); (2) child care costs up to $160 per child; and (3) plus one-third of earnings not previously disregarded. The $30 plus one-third disregard is allowed only during the first 4 consecutive months in which a recipient has earnings in excess of the standard work expense ($75) and child care disregards.

House bill

Requires the application of the $30 disregard to earnings in months after the first four months in which the $30 plus one-third disregarded is applied. The one-third disregard would continue to be limited to four months. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with the following modification: the $30 disregard would be limited to 12 months. The one-third disregard would continue to be limited to 4 months.

4. Work Transition Allowance

Present law

In determining benefits for AFDC recipients, States must disregard $30 plus one-third of monthly earnings, after also disregarding specified amounts for work expenses and child care. The $30 plus one-third desregard may be applied only for four months.

If a family loses eligibility for AFDC because of the four-month limit on the $30 plus one-third disregard, it also simultaneously loses categorical eligibility for medicaid. Categorical medicaid eligibility is retained after the loss of AFDC eligibility only in the case of families whose earnings increase to the point that they would be ineligible even if the $30 plus one-third disregard were applied. These families are eligible for medicaid for four additional months.

House bill

Establishes an AFDC "work transition allowance" payable to recipients who lose AFDC benefits because they are no longer eligible for the $30 plus one-third disregard of earnings. The allowance is equal to $10 a month for a period of nine months after the family loses AFDC. States may continue the allowance for an additional six months in the case of a family that would be eligible for AFDC if the $30 plus one-third disregard were applied. The allowances are eligible for Federal matching on the same basis as regular AFDC benefits, and recipients of the allowances are considered recipients of AFDC for all purposes of the Social Security Act, including medicaid.

Families eligible for the allowance include those who lose eligibility for regular AFDC benefits in the months following enactment, as well as those who have previously been terminated from the AFDC rolls because of the loss of the $30 plus one-third disregard. Previously terminated families would be limited to those who would otherwise have been eligible for AFDC if the $30 plus one-third disregard had been applied, and who make application for the allowance by October 1, 1985. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with the following modifications: (1) the $10 monthly AFDC check is eliminated; and (2) families who have been previously terminated from AFDC due to the loss of the $30 plus one-third disregard are eligible for the work transition status and Medicaid but must disclose any private health insurance coverage at the time of application, apply within six months from the date regulations become final, and must have been continuously eligible for AFDC if the $30 and one-third disregard were applied. The work transition provision requires States to provide 9 months of Medicaid coverage to families who lose eligibility for AFDC due to the termination of the one-third disregard. States have the option of extending this coverage for an additional 6 months in the case of a family that would be eligible for AFDC if the $30 plus one-third disregard were applied.

5. Clarification of Earned Income Provisions

Present law

The AFDC statute was amended in 1981 to change the way in which earned income is counted for purposes of determining eligibility and benefit amounts. As amended by Public Law 97-35, the law currently requires the States to disregard the following amounts of a family's earned income—

Eligibility Determination: (1) the first $75 of monthly earnings for full-time employment; and (2) the cost of care for a child (or incapacitated adult), up to $160 per child per month.

Benefit Calculation: (1) the first $75 of monthly earnings for full-time employment; (2) child care cost up to $160 per child per month; and (3) one-third of earnings not previously disregarded.

The $30 plus one-third disregard is allowed only during the first 4 consecutive months in which a recipient has earnings in excess of standard work expense and child care disregards.

Courts in several States have been asked to interpret whether the term "earned income" refers to the gross amount earned by an individual before deductions are taken (for income taxes, insurance, FICA, support payments, or other items, regardless of whether the deduction is voluntary or involuntary), or whether the term refers to net earnings, after such deductions are taken. Regulations issued by the Department of Health and Human Services require that the term be interpreted as referring to gross earnings. The 3rd and 4th Circuit Courts of Appeal have ruled in the Department's favor. However, the 9th Circuit Court of Appeals has ruled that the term must be interpreted as referring to net earnings. The Supreme Court recently agreed to hear the case.

House bill

Amends the AFDC statute to make clear that the term "earned income" means the gross amount of earnings, prior to the taking of payroll or other deductions. Effective on enactment.

Senate amendment

Same provision with technical differences.

Conference agreement

The conference agreement follows the Senate amendment.

6. Exclusion of Burial Plots, Funeral Agreements, and Certain Property From Resources Test

Present law

There is no exclusion in the AFDC resource test for burial plots or funeral agreements. Real property is considered as a resource available to the family both when actually available and when the applicant or recipient has a legal interest in a liquidated sum and has the legal ability to make the sum available for support and maintenance.

House bill

Exempt from the AFDC resource limitation, one burial plot per family member, funeral agreements, and real property which the household is making a good faith effort to sell at a reasonable price and which has not been sold. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with a modification establishing an AFDC policy on real property that is similar to SSI policy. The managers intend that by regulation, real property which the family is making a good faith effort to sell would be exempt for six months (with State option for an additional 3 months) but only if the family agrees to use the proceeds from the sale to repay the AFDC paid. Any remaining proceeds would be considered a resource.

7. Federal Matching for CWEP Expenses

Present law

The AFDC statute permits States to operate community work experience programs (CWEP) in which AFDC recipients perform community work as a condition of eligibility. Persons who are required to register for the work incentive (WIN) program would also generally be required to participate in community work experience programs.

States must provide reimbursement to a CWEP participant for transportation and other costs that the State determines are necessary and due to participation in CWEP. For purposes of Federal matching, this amount is limited to $25 a month.

House bill

Requires States to reimburse an AFDC recipient for costs incurred by him where the State is unable to provide directly any necessary transportation and day care services. (Day care costs may be reimbursed up to a limit of $160 per month per child.) These expenditures are eligible for Federal matching as administrative costs. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill but limits reimbursement of day care expenses to those determined by the State agency to be reasonable, necessary and cost effective. In no case could the reimbursement exceed $160 per month per child.

8. Retrospective Budgeting and Monthly Reporting Made Optional

Present law

States are required to determine monthly benefits retrospectively, on the basis of the actual income of the previous month. Eligibility is determined prospectively, on the basis of the current month's circumstances. States must require each family to report monthly on income, family composition, etc. The Secretary may waive the monthly reporting requirement for specified classes of recipients, upon a showing by the State that the administrative cost of monthly reporting for such recipients is not worthwhile. Retrospective budgeting may not be waived.

House bill

Allows rather than requires the States to use a retrospective budgeting and monthly reporting system. Provides Federal matching for State supplements paid under a retrospective budgeting and monthly reporting system, if the State elects to pay such supplements when the system cannot respond promptly to changes in immediate needs. Permits the Secretary to grant waivers to promote compatibility between the AFDC and food stamp monthly reporting and retrospective budgeting systems if a State chooses to operate such a system in AFDC. Prohibits the imposition of any penalty on a State for past failure to comply with the retrospective budgeting and monthly reporting system. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with the following modifications: (1) retrospective budgeting is mandatory for cases filing a monthly report; (2) monthly reporting is used only where cost effective, but is generally required for cases with a recent work history and earned income; (3) the Secretary of Health and Human Services is authorized to grant waivers to promote compatibility between the AFDC and food stamp monthly reporting and retrospective budgeting systems (approved waivers should result in no net cost to the Federal government); and (4) the provision authorizing Federal matching for State supplements paid under a retrospective budgeting and monthly reporting system is deleted.

9. Treatment of Earned Income Tax Credit

Present law

Present law provides an earned income tax credit (EITC) for the working poor. Eligible employees may elect to receive their EITC in the form of advance payments added to their paychecks, or may apply for a refund at the end of the year.

In determining earned income for AFDC, the State must assume that an individual is receiving on an advance monthly basis the EITC payment that he or she is eligible to receive, regardless of whether the person has applied for or received the advance payment, if it is determined that the individual will be eligible for the EITC in the tax year.

House bill

Requires States to disregard the earned income tax credit (EITC) from countable income in determining AFDC eligibility and benefit amounts. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill modified to require that the earned income tax credit is counted only when actually received.

10. Demonstration Projects Testing One-Stop Service Delivery Systems

Present law

No provision.

House bill

Authorizes the appropriation of $8 million to the Secretary of HHS to make grants to assist in the development and operation of pilot projects to demonstrate ways of improving service delivery under various human service programs.

From 3 to 5 Federally assisted demonstration projects (including not more than one statewide project) designed to test the effectiveness and efficiency of integrating the delivery of human services would be established. Periodic reports from the Secretary of HHS as to the progress of selected projects and an independent study of all projects at the end of the 3 year period would be required. The Secretary of HHS would be prohibited from conducting or approving any project that would lower or further restrict the benefit levels or income or resource standards, deductions or exclusions provided under any of the programs, or that would delay benefits. Effective October 1, 1984

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill. These demonstration projects are not intended to permit participating States to assume Social Security Administration responsibilities for accepting applications, making eligibility determinations, or paying benefits under the SSI program. However, State SSI activities could include providing outreach and referrals, coordinating services, and other ancillary services that are not directly part of the SSI claims taking and adjudication process.

11. Demonstration Projects Testing Common AFDC, Medicaid and Food Stamp Rules

Present law

No provision.

House bill

Allows up to five States to establish demonstration projects where AFDC definitions and budgeting procedures are conformed with the Medicaid or Food Stamp programs, or both. The Secretary would be prohibited from conducting or approving any project that would lower or further restrict the benefit levels or income or resource standards, deductions or exclusions provided under any of the programs, or that would delay the provision of benefits. A project may last up to five years. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the Senate amendment.

12. Exempt Pregnant Women From Work Requirements

Present law

All applicants and recipients of AFDC must register for employment and training unless they are: children under age 16 or in school full time; ill, incapacitated, or elderly; too far from a project to participate; or needed at home to care for a person who is ill; a caretaker relative providing care on a substantially full-time basis for a child under age 6; employed at least 30 hours a week; or the parent of a child if the other parent is required to register. There is no special exemption from the requirement for pregnancy.

House bill

Adds to those who are exempted from the work registration requirement any individual who is the third trimester of pregnancy. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

13. Treatment of Child Support Payments for CWEP Participation

Present law

Participants in CWEP may not be required to work in excess of the number of hours which, when multiplied by the greater of the Federal or the applicable State minimum wage, equals the amount of aid payable to the family.

House bill

Excludes that portion of the AFDC payment which is offset by child support collections when computing the maximum number of hours an AFDC recipient may be required to participate in CWEP. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the Senate amendment.

14. Recalculate Lump-Sum Income in Certain Circumstances

Present law

Lump-sum income received in a month is considered available as income in the month it is received and also in future months. Thus, if such income exceeds the standard of need in the month of receipt, the family is ineligible in that month. In addition, any amount of the income that exceeds the initial month's need standard is divided by the monthly need standard, and the family is ineligible for aid for the number of months resulting from that calculation. The ineligibility period may be changed only if a life threatening circumstance occurs.

House bill

Allows States to recalculate the period of ineligibility when: (1) circumstances change in ways that increase a family's financial need; and (2) such recalculation would promote the purposes of the AFDC program. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with a modification limiting the recalculation to one or more of the following: (1) an event occurs which, had the family been receiving aid under the State plan, would have changed the amount of aid payable; or (2) the income received has become unavailable to the family for reasons beyond their control; or (3) the family incurs, becomes responsible for and pays medical expenses (as allowed by the State) which offset the lump-sum income. The agreement also clarifies that the lump-sum provision applies to earned and unearned income.

15. Waiver of Overpayments When Cost of Collection Would Exceed Amount Due

Present Law

States are required to correct overpayments and underpayments. Recovery of overpayments is made from current assistance payments, available income and resources, and, for an individual who no longer receives assistance, through the legal process. In any month when overpayments are being recovered, the AFDC payment, together with the recipient's liquid resources and all income, (without the application of earned income disregards), must equal at least 90 percent of the payment a family without other income would receive.

House bill

Allows States not to recover an overpayment when as determined by the State agency under regulations prescribed by the Secretary, it can be reasonably assumed that the cost to collect the overpayment will exceed the amount owed. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill but permits the HHS Secretary to establish limits on the amount of an overpayment that can be waived. It is the understanding of the managers that these regulations will allow States automatically to waive recoupment of overpayments of less than $35. States would continue to be required to attempt to recover all other overpayments but could subsequently elect not to pursue the overpayment if the cost to collect it would exceed the amount owed.

16. Limit on Recovery of Overpayments When AFDC Recipient Has Excess Assets

Present law

If, in any month, a recipient's assets exceed the asset limits (currently up to $1,000), the individual is ineligible for benefits in that month and the entire amount of the benefit paid for that month is subject to recovery.

House bill

Limits the amount of the overpayment which may be recovered in the case of AFDC recipients whose assets exceed limitations to the lesser of: (1) the amount of the benefit paid; or (2) the greatest amount by which the total value of the assets exceeded the dollar asset limitation during the applicable period. Effective October 1, 1984.

Senate amendment

No provision

Conference agreement

The conference agreement follows the Senate amendment.

17. Protective Payments

Present law

States are required to make protective payments, instead of direct cash payments, on behalf of AFDC recipients under certain specified circumstances. Protective payments must be made when there is failure to cooperate in the work incentive (WIN) program or the community work experience program (CWEP) and if a parent fails to assign child support rights or refuses to cooperate with child support enforcement efforts. In these cases, the parent becomes ineligible for AFDC.

House bill

Allows, rather than requires, States to make protective payments in the following circumstances: when an individual is not in compliance with WIN or CWEP requirements, and when the parent is not in compliance with certain child support requirements. The parent would continue to be ineligible for AFDC but could receive the child's payment. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill and clarifies that States are permitted to make payments to a parent who fails to comply with the above mentioned procedural requirements but only if, after all reasonable efforts have been made, the State is unable to identify a suitable protective payee, and prolonging the search may prove detrimental to the well-being of the child. The amendment does not change the requirement that individuals who do not meet the procedural requirements are subject to the penalty of being removed from the grant. However, there are circumstances in which welfare agencies, after making all reasonable efforts, have been unable to find responsible protective payees to act on behalf of the AFDC unit and receive the AFDC check.

18. Suspension of Error Rate Sanctions

Present law

Prior to TEFRA (P.L. 97–248), States were required to reduce their AFDC payment error rates from fiscal year 1980 levels, to 4 percent by September 30, 1982. Regulations require the States to achieve one-third progress toward this 4-percent payment error rate goal in fiscal year 1981 and two-thirds progress in fiscal year 1982. The 4-percent goal is the standard for fiscal year 1983. An amendment in TEFRA reduced the 4-percent error rate tolerance level to 3 percent, beginning with fiscal year 1984. States may be sanctioned by being required to repay the Federal Government the Federal cost of improperly paid benefits that exceed these goals. The Secretary may waive sanctions where he determines that a State is unable to reach the required reduction in a given year despite a good faith effort.

Twenty-eight States failed to meet their AFDC target error rates for the fiscal year 1981 quality control review period and have been notified that they are subject to sanctions totaling $73.6 million unless the Secretary grants a waiver. Sanctions for fiscal year 1981, 1982, and 1983 are estimated by CBO to total $174 million.

House bill

Provides that prior to October 1, 1985 no action shall be taken to enforce or collect any quality control penalties that may be imposed on a State because of improperly paid benefits, as determined by quality control reviews. This does not absolve States of the obligation. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the Senate amendment.

19. Eligibility Requirements for Aliens

Present law

For purposes of eligibility for benefits, legally admitted aliens who apply for benefits after September 30, 1981 are deemed to have the income and resources of their immigration sponsors available for their support for a period of 3 years after their entry into the United States. The provision does not apply to sponsors of aliens who are agencies or organizations, it applies only to individuals. It also does not apply to certain categories of aliens, including refugees.

House bill

Makes ineligible for benefits an alien with respect to whom an agency or organization has executed an affidavit of support as a sponsor for the alien's entry into the United States, unless the State agency determines that the sponsoring agency or organization is no longer in existence, or that it does not have the financial ability to meet the alien's needs. The determination would be made by the State agency based upon such criteria as it may specify and upon such documentary evidence as it may require. The same categories of aliens are excluded as provided in present law. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

20. Information With Respect to Fugitive Felons

Present law

States may disclose information concerning ADFC applicants and recipients only for purposes connected with: (1) the administration of the child welfare, WIN, child support, SSI, Medicaid, or title XX social services programs; (2) any investigation, prosecution, or criminal or civil proceedings related to the administration of the program; (3) the administration of any other Federally-assisted program which provides assistance or services based on need; or (4) any audit or similar activity conducted in connection with the administration of any such plan or program by an authorized governmental entity.

House bill

Allows the disclosure to law enforcement officers of the name and current address of any AFDE recipients who are fugitive felons if the agency is given the recipient's social security number and satisfactorily demonstrates that the recipient is a fugitive felon. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

21. Payment Schedule for Reimbursement of Back Claims Due to the States

Present law

Two laws have recently been enacted with respect to Federal reimbursement for prior-year expenditures under the AFDC, Medicaid and title XX programs.

P.L. 96-272 provided that a claim for a pre-fiscal year 1980 expenditure may not be paid unless it was filed prior to January 1, 1981. (However, the Act also provided that payment may not be denied with respect to any expenditure involving court-ordered retroactive payments or audit exceptions, or adjustments to prior year costs, whenever filed.)

P.L. 97-276, the 1983 continuing resolution, provided that, notwithstanding P.L. 96-272 or a specified U.S. Circuit Court of Appeals decision, no payment could be made prior to fiscal year 1984 for pre-fiscal year 1979 expenditures unless the claim was filed within one year after the fiscal year in which the expenditure occurred. Beginning in fiscal year 1984, any payment required to be reimbursed by a court decision in any case filed prior to September 10, 1982, must be made in accordance with a schedule to be established under the Social Security Act.

There is disagreement as to whether the 1983 continuing resolution had the effect of permanently overriding the provision in P.L. 96-272 that requires reimbursement for any adjustments to prior year costs (and other specified payments), regardless of when they are filed, thereby extinguishing all claims for reimbursement for pre-fiscal year 1979 expenditures unless they were filed within one year after the fiscal year in which they occurred, or were asserted in a case filed prior to September 30, 1982.

House bill

Establishes the payment schedule called for in P.L. 97-276 with respect to court-ordered reimbursements as follows: for expenditures identified in the U.S. District Court decision State of Connecticut v. Heckler and allowed by the Department of HHS prior to enactment of this bill, payment must be made within 30 days after enactment. For other pre-fiscal year 1979 expenditures identified in that or any other decree in a suit filed prior to September 30, 1982, payment must be made as soon as the expenditure is determined by the Department to be an allowable claim. Effective on enactment.

Senate amendment

Identical provision. Also prohibits reimbursement for pre-fiscal year 1979 claims, whether asserted as an adjustment to prior years costs or otherwise, if not filed by May 15, 1981 (unless they are identified in the above specified court decrees). Effective on enactment.

Conference agreement

The conference agreement follows the House bill.

22. Grant Diversion Program

Present law

AFDC applicants and recipients are required to register for work or training under the work incentive (WIN) program unless they are specifically exempt. States have the option of operating a WIN demonstration program (in lieu of the regular WIN program) which gives them greater flexibility in designing their work and training activities. In addition, they may operate community work experience, employment search, and work supplementation programs. Under a work supplementation program, States may reduce the need standard and/or revise the earned income disregards and use these funds to subsidize jobs for AFDC recipients. The statute limits Federal funding for an AFDC program which includes a work supplementation component and limits the subsidized jobs to those in public or nonprofit organizations.

There is no specific authority to operate grant diversion programs (in which all or part of the AFDC grant is used to supplement wages for jobs provided by public or private employers). These may be operated only under waivers granted by the Secretary.

House bill

Allows States to operate a grant diversion program in all or part of the State. States must enter into contracts with public or private employers in the State under which the employers will provide employment (in the form of on-the-job training or otherwise) for eligible individuals for up to nine months. The payment to each employer with respect to each individual who is employed must be the lesser of: (1) the maximum amount that could have been paid directly to the individual or his family at the time of initial placement on the job, if the individual or family had no income; or (2) 50 percent of the wages paid to the individual for his employment under the program. States are given discretion to determine which employers and job positions are to be included in the program.

To be eligible for the program an individual must be eligible to recieve AFDC at the time of initial placement in a job under the program. Individuals employed in the program must be a given employee status. Wages paid under the program are considered earned income for purposes of any provision of law. For those individuals whose wages otherwise do not make them ineligible for benefits, States are allowed to apply the $30 plus one-third disregard provision to earnings for the duration of the individual's participation in the program. States would not be subject to the funding limitations that apply to a work supplementation program.

Participants in the program (and their households) are eligible for Medicaid. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with modifications. To allow States to operate grant diversion programs, the current work supplementation program would be modified in the following manner: (1) private employers could be used; (2) States would be permitted but not required to offer a $30 plus ⅓ earned income disregard for up to 9 months for participants; (3) federal funding would be limited to the aggregate of 9 months worth of unreduced welfare grants for each participant in the work supplementation program (or less if the person participates for less than 9 months); and (4) a State would be permitted to develop its own method by which AFDC grants are diverted to wages under the grant diversion program and would not be limited to the methods allowed under Section 414(b) (for example, States may choose to divert a grant on an individual case basis or pool the grants of AFDC recipients actually participating in the grant diversion program).

23. Premanent Extension of Provisions for Disregarding In-Kind Assistance

Present law

SSI

In determining income, the law provides for excluding any support or maintenance assistance furnished to or on behalf of an individual which (as determined under regulations of the Secretary by such State agency as the chief executive officer of the State may designate) is based on need for such support or maintenance, including assistance received to assist in meeting the costs of home energy (both heating and cooling), and which is: (a) assistance furnished in-kind by a private nonprofit agency; or (b) assistance furnished by a supplier of home heating oil or gas, or by an entity providing home energy.

AFDC

The same income exclusions may be applied to the AFDC program at the option of the State.

These are temporary provisions of law.

House bill

Repeals the time limitations on these provisions and makes them a permanent part of the law. Effective October 1, 1984.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill but would extend the provisions until October 1, 1987.

24. Parents and Siblings of Dependent Child Included in Filing Unit

Present law

There is no requirement in present law that parents and all siblings be included in the AFDC filing unit. Families applying for assistance may exclude from the filing unit certain family members who have income which might reduce the family benefit. In addition, a mother who is a minor may be excluded if she is supported by her parents. However, if she has no income of her own which may be attributed to her child, the child may qualify for assistance as a one-person unit. The income of the minor parent's parents is not considered in determining the eligibility of the child.

House bill

No provision.

Senate amendment

Requires States to include in the filing unit the parents and all minor siblings living with a dependent child who applies for or receives AFDC. SSI recipients and stepbrothers and stepsisters are excluded from this requirement. In addition, if a minor who is living in the same home as his parents applies for aid as the parent of a needy child, the income of the minor's parents would be counted as available to the filing unit. The rules that would be used in determining the amount of available income would be the same as are currently used in counting the income of stepparents. Effective April 1, 1984.

Conference agreement

The conference agreement follows the Senate amendment with the following modification: amonthly disregard of $50 of child support received by a family is established. The disregard is applied at eligibility determination and benefit calculation. The provision is effective October 1, 1984.

25. Households Headed by Minor Parents

Present law

A minor parent who has a child, and who leaves home, may apply for AFDC as a separate family unit. The income of the parents of the minor parent is not presumed to be available to the minor parent, because they are not sharing the household.

House bill

No provision.

Senate amendment

In the case of a minor parent who is not and has never been married, AFDC may be provided only if the minor parent resides with her parent or legal guardian, unless the State agency determines that: (1) the minor parent has no parent or legal guardian who is living and whose whereabouts are known; (2) the health and safety of the minor parent or the dependent child would be seriously jeopardized if she lived in the same residence with the parent or legal guardian; or (3) the minor parent has lived apart from the parent or legal guardian for a period of at least one year prior to the birth of the child, or before claiming aid, whichever is later.

The State agency would be given authority to make payments to a protective payee with respect to a minor parent affected by the provision, until the individual is no longer considered a minor by the State. Effective April 1, 1984.

Conference agreement

The conference agreement follows the House bill.

26. CWEP Work for Federal Agencies

Present law

States are authorized to conduct community work experience programs (CWEP). Employable recipients may be required to participate in these programs as a condition of eligibility for AFDC.

House bill

No provision.

Senate amendment

Amends the AFDC statute to make clear that participation in a CWEP program may include work performed for a Federal office or agency. Such work would not be considered to constitute Federal employment, and the State agency would be required to provide appropriate workers' compensation and tort claims protection to each participant. Effective on enactment.

Conference agreement

The conference agreement follows the Senate amendment with the following modification: worker's compensation is optional as under the current CWEP law. The agreement makes no change in existing State worker's compensation laws.

27. Earned Income of Full-Time Students

Present law

The AFDC statute provides that eligibility for benefits is limited to families with gross incomes (income before application of any disregards) at or below 150 percent of the State's standard of need. A provision was included in Public Law 97-377, the Job Training Partnership Act, which amended the gross income limitation to allow States to disregard the income of an AFDC youth which is derived from a program carried out under that Act, in such amounts and for such period of time (not to exceed six months with respect to earned income) as the Secretary of Health and Human Services may provide in regulations. The earnings of children in school who are not in a JTPA program are counted toward the 150 percent limit.

House bill

No provision.

Senate amendment

For purposes of applying the gross income limitation, States would be allowed to disregard the income of an AFDC child who is a full-time student, under the same limitation with respect to amounts and periods of time as are applied in the case of youths who participate in a program under the Job Training Partnership Act. Effective on enactment.

Conference agreement

The conference agreement follows the Senate amendment but establishes June 1, 1984 as the effective date for the provision.

28. Regulatory Initiative on Medical Support

Present law

The Child Support Enforcement (CSE) program is a Federal-State partnership under which States are required to have a program which locates absent parents, establishes paternity and obtains and enforces support orders. There is no provision in the child support statute that requires State agencies to undertake efforts to include medial support as part of any child support order.

House bill

No provision.

Senate amendment

Requires the Secretary of HHS to issue regulations which would require State CSE agencies to petition to court to include medical support as part of the child support order whenever health care coverage is available to the absent parent at a reasonable cost. In addition, the regulation would provide for improved information exchange between the CSE and medicaid agencies on the availability of health insurance coverage. Effective on enactment.

Conference agreement

The conference agreement follows the House bill.

Subtitle C—Implementation of Grace Commission Recommendations

1. Income and Eligibility Verification Procedures

Present law

Under present law, IRS wage information furnished by employers to IRS is available to state welfare agencies for use in their AFDC and food stamp programs, and to the Social Security Administration for administering the SSI program. However, IRS unearned income information (field by a financial institution or corporation with respect to payments to individuals in the form of interest, dividends, etc.) is not available to Federal and State agencies for use in the administration of these programs. Quarterly wage information from the unemployment compensation program is available to State welfare agencies in most States.

House bill

The House bill authorizes the IRS to disclose return information with respect to unearned income to Federal, State, or local agencies administering AFDC, SSI, Medicaid, food stamps, and the cash assistance programs administered in Puerto Rico, Guam, and the Virgin Islands. Current law restrictions on unauthorized disclosure of confidential information are applied to agencies receiving the information.

Under the House bill, Federal, State or local agencies that are furnished unearned income return information by the IRS are prohibited from taking action thereon to reduce, suspend, terminate, or deny aid or benefits until the agency has taken steps to independently verify the information. The verification must include: (1) verification of the exact amount of the asset or income involved; (2) an evaluation of whether the individual has access to the asset or income involved for his or her own use; and (3) a determination regarding the time frame involved with regard to when the individual actually had the funds in question.

Senate amendment

The Senate amendment requires, rather than allows, the Secretary of Treasury to disclose unearned income return information upon request of the specified agencies. Disclosure can only be made to agencies that meet the requirements to safeguard this confidential information against disclosure. The Senate amendment contains a provision requiring verification of the unearned income information prior to taking action to reduce or terminate benefits that are similar to the House bill. In addition, the individual must be given notice of the proposed reduction or termination, and an opportunity to refute the information. Further, all applicants for and recipients of benefits under any program must be notified at the time of application, and periodically thereafter, that information verifying their assets and income will be requested and used.

The Senate amendment replaces existing statutory provisions relating to use (for purposes of AFDC) of return and other wage information and use of social security numbers, by adding a new section to the Social Security Act requiring States to have in effect an income and eligibility verification system for use in administering the AFDC, Medicaid, unemployment compensation, and food stamp programs (and the adult assistance programs in the territories). State agencies must request and make use of (1) wage and other income information available under the Internal Revenue Code; and (2) quarterly wage information. Each State is required to maintain a quarterly wage reporting system, although not necessarily through its unemployment compensation system.

The income and eligibility system requires use of standardized data formats to facilitate exchange of information, for the purpose of identifying and reducing ineligibility and incorrect payments. The requirement for standardized formats is intended to assure easy exchange of information by progress within States, and to facilitate the exchange of information among States. This requirement does not require the use by States of identical systems, but only that each State must be able to provide certain essential eligibility data in a format which can be used by the agencies and jurisdictions with which data exchanges are made. Information exchanged by state agencies is protected against unauthorized disclosure for other purposes.

Conference agreement

The conference agreement follows the Senate amendment with the following modifications: (1) the effective date of the requirement that States maintain a system of quarterly wage reporting as part of the income and eligibility verification system is delayed until September 30, 1988; (2) the provision regarding verification of IRS unearned income information is broadened to prohibit denial or suspension of benefits until the agency has taken steps to independently verify the information; (3) the amendment includes a provision describing the steps required to independently verify the information; and (4) that only unearned income from the currrent information file may be disclosed by the IRS.

Because the unemployment compensation program is part of the income verification system, the amendment requires IRS disclosure of wage and unearned income return information to this program. However, the managers expect that the data will be supplied to one agency in each State, and will be shared only with agencies which find it useful. The Conference agreement provides for the State to target the information to those uses most likely to be productive and cost-effective.

Following is a brief outline of what the conferees expect to occur under the unearned income provision.

First, an agency must establish the safeguards against unauthorized disclosure of the information that are required under section 6105 of the Code. These safeguards are also applicable to any other agency to which the information is subsequently disclosed. Once this has been done, the agency may request the unearned income return information. The agency that has requested and received the unearned income return information from the IRS may not deny, terminate, reduce or suspend benefits on the basis of that information alone. First, the agency must independently verify such information as the amount of the asset or income involved, evaluate whether the individual has or had access to the asset or income for his or her own use, and determine whether the individual actually has or had the asset or income during the relevant period of time.

The agency may use one of two approaches to verify unearned income return information that it has received from IRS. It may contact the financial institution or corporation that submitted the information to the IRS, requesting its cooperation in verifying the information. If the institution verifies the information, the agency must send the individual notice of denial, reduction, suspension, or termination of benefits (whichever is applicable), including information on the right to appeal the action. If the action is not appealed, the agency may proceed to take the appropriate action, based on the verified information.

Alternatively, the agency may contact the individual directly by letter informing him of the information that it has received, and requesting that the individual respond within a specified period. The conferees expect that the agency's letter to the recipient will be unintimidating in tone, and will clearly explain the information that the agency has, and the possible relevance of the information to the individual's eligibility for (and amount of) any past or future benefits. If the individual responds by verifying the information, the agency will take the appropriate case action. If the individual indicates that the information is not correct or in incomplete the agency must obtain evidence (from the individual or institution involved or otherwise) to substantiate any negative case action that it may take. If the individual fails to respond after reasonable efforts to contact him, the agency will take steps to close or deny the case on the basis of the individual's failure to cooperate.

In all cases involving reduction, suspension, or termination of benefits, the recipient must be sent notice of the action to be taken, including information on the right to appeal and opportunity for a hearing.

2. Collection and Deposit of Payments to Executive Agencies

Present law

Under present law, Federal agencies may collect nontax debt in a variety of ways. The Department of the Treasury collects a large proportion of nontax receipts through accelerated systems, including the Treasury Federal Communications System, automatic account withdrawals, and lockboxes. However, in 1983 $55 billion in nontax receipts was collected by means other than accelerated systems.

House bill

Authorizes the Secretary of the Treasury to prescribe the mechanisms to be employed by Federal agencies to collect nontax debts and the time frames for deposit of funds. Generally reduces from 30 days to three days the statutory period for timely deposit of funds by custodians. Requires that agencies adopt collection and deposit methods as prescribed by the Secretary.

Agencies not complying with the regulations will be assessed a charge equal to the cost of noncompliance to the general fund. Any such charges will be deposited into a Treasury Cash Management

Improvements Fund to be used for developing and implementing cash management initiatives.

Senate amendment

Same provision, with technical differences.

Conference agreement

The conference agreement follows the Senate provision.

3. Collection of Nontax Debts Owed to Federal Agencies

Present law

Present law does not provide authority for the IRS to offset tax refunds against nontax debts owed to Federal agencies. However, tax refunds must be offset against past-due child and spousal support payments in the case of families receiving AFDC payments.

House bill

No provision.

Senate amendment

Provides that the amount of any IRS refund be reduced by the amount of certified nontax debt to the Federal government. Federal agencies must certify to the Secretary of the Treasury that specific attempts to notify the debtor have been made, and that the debtor does not dispute the debt, has not begun to repay the debt, and exhibits no reasonable intention to repay the debt. The agency must have entered into an agreement with the Secretary providing for the transmission of certified debt information before transmission occurs.

Authorizies the Secretary to test the offset procedures with selected programs before full implementation. Gives the Secretary authority to prescribe terms of agreements with other agencies and the format for transmitting information.

AFDC child support obligations would be subject to offset before other Federal debts. Excludes from offset beneficiary debts under the OASDI programs.

Conference agreeement

The conference agreement follows the Senate amendment.

Subtitle D—Technical Corrections

Subtitle D contains a number of minor technical amendments to the Social Security Act and the Internal Revenue Code, to correct clerical and other minor errors either resulting from the Social Security Amendments of 1983, or already existing in those acts. Most were contained in the House bill, and were accepted as part of the conference agreement. Only the following two provisions require additional explanation.

1. Codification of the Rowan Decision

Present law

The Social Security Amendments of 1983 provided that, with the exception of the value of certain meals and lodging provided for the convenience of the employer, the determination of whether or not amounts are includible in the social security and FUTA wage bases is to be made without regard to whether such amounts are treated in regulations as wages for income tax withholding purposes. This provisions thus prevents the application to compensation, other meals and lodging, of the Supreme Court's reasoning in *Rowan Companies, Inc.* v. *United States,* 452 U.S. 247 (1981). In this case, the Supreme Court held that, because the treatment of certain employer meals and lodging, excluded from gross income under section 119, for income tax withholding and for FICA purposes was not explicitly dealt with in the statutes governing these provisons, Treasury regulations defining wages for purposes of these two provisions had to be consistent. Thus, because one Treasury regulation excluded from wages for income tax withholding purposes the value of meals and lodging excluded from gross income under section 119, another regulation including these amounts in wages for FICA purposes was held to be invalid.

The provision in the Amendments applies to remuneration paid after December 31, 1983, for FICA and social security benefit purposes and to remuneration paid after December 31, 1984, for FUTA purposes. Thus, it is possible that this provision could be cited as demonstrating Congressional intent that the reasoning of the *Rowan* decision should generally apply before these dates to types of remuneration other than meals and lodging excluded under section 119, e.g., to contributions under a salary reduction agreement to tax-sheltered annuities (sec. 403(b)). These contributions have been held by the Treasury Department to be taxable for FICA purposes (Revenue Ruling 65-208) even though they are exempt by regulation from income tax withholding.

House bill

The effective date of the provisions overriding the *Rowan* decision is clarified so that the provision applies for all purposes, other than the treatment of certain employer-provided meals and lodging, both on or before March 4, 1983, and to remuneration paid on or before March 4, 1983, which the employer treated as wages when paid.

Senate amendment

No provisions.

Conference agreement

The conference agreement follows the House bill the conferees intend that the determination of whether an employer treated remuneration as wages when paid will be made on the basis of the interpretations reflected in sec. 3.02 of Rev. Proc. 78-35, 1978-2 C.B. 536 (relating to section 530 of the Revenue Act of 1978). In the event that FICA taxes are withheld or employment tax returns are filed as a result of an audit of prior periods by the IRS, the employer will still be considered to have treated the remuneration as wages when paid. Thus, the conferees do not accept and do not intend to adopt the contrary holding of *Ridgewell's, Inc.* v. *United States,* 655 F. 2d 1098 (Ct. Cl., 1981).

2. Social Security Treatment of Pickups Under State and Local Retirement Plans

Present law

Prior to the Social Security Amendments of 1983, certain employer payments ("pickups) of employee contributions under a State or local retirement plan were treated as wages for social security and unemployment tax purposes only if the payments were made under a salary reduction arrangement. Under the Amendments, all such employer payments are treated as wages.

House bill

The House bill provides that employer pickups are wages, for social security and unemployment tax purposes, only if the pickup is pursuant to a salary reduction agreement (whether evidenced by a written instrument or otherwise).

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment. The conferees intend that the term salary reduction agreement also includes any salary reduction arrangement, regardless of whether there is approval or choice of participation by individual employees or whether such approval or choice is mandated by State statute.

Subtitle E—Trade Adjustment Assistance (Trade Act of 1974) Provisions

1. Limitations on Trade Readjustment Allowances

Present law

Under section 233(a)(3) of the Trade Act of 1974, the 26 weeks of additional trade readjustment allowances (TRA) that an eligible worker may receive while in training can be collected only during the 26 weeks immediately following exhaustion of entitlement to basic TRA.

House bill

Amends section 233(a)(3) of the Trade Act upon enactment to enable workers to collect the extra 26 weeks of TRA beginning with the first week the worker enters training if that training has not been approved until after the last week of entitlement to basic TRA benefits.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

2. Job Search and Relocation Allowances

Present law

Under sections 237 and 238 of the Trade Act of 1974, eligible workers can be reimbursed for 90 percent of necessary job search expenses up to a maximum of $600; relocation allowances consist of 90 percent of reasonable and necessary expenses, plus a lump sum payment of three times the worker's average weekly wage, up to a maximum of $600.

House bill

Amends sections 237 and 238 of the Trade Act upon enactment to increase the maximum job search allowance to $800 and the maximum lump sum relocation allowance to $800.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

3. Assistance to Industry

Present law

Section 265 of the Trade Act of 1974 limits industry-wide technical assistance to improve competitiveness to $2 million annually per industry; only industries in which a substantial number of firms have been certified are eligible.

House bill

Amends section 265 of the Trade Act upon enactment to extend eligibility to industries in which a substantial number of workers have been certified eligible; increases the maximum amount of annual assistance per industry to $10 million.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

4. Cordage Products

Present law

Under the Tariff Schedules of the United States (TSUS), cordage manufactured from a plastics material is classified as either "cordage" under the textiles part of the TSUS, or as a plastics article in a different TSUS part. The difference depends on whether the strips from which the cordage is made exceed certain dimensions. Cordage classified as a plastics article is subject to a lower tariff rate than if it is classified as a textile article.

House bill

No provision.

Senate amendment

Reclassifies cordage (twine, rope, and cables) currently classified as plastics products in TSUS schedule 7 as articles to be classified under schedule 3 (textile products); applicable to articles entered, or withdrawn from warehouse for consumption, on or after the fifteenth day after the date of enactment.

Conference agreement

The conference agreement follows the House bill.

5. "Like Agricultural Products"

Present law

Under section 771(10) of the 1979 Trade Agreements Act, "like product" is defined to mean a product which is "like or in the absence of like, most similar in characteristics and uses with, the article" subject to an countervailing duty or antidumping investigation. A petition for relief under the antidumping or countervailing duty laws must be filed by an "interested party" which, in general, means a representative of an industry producing a "like product" to the allegedly dumped or subsidized article.

House bill

No provision.

Senate amendment

Amends section 771(10) to encompass within the meaning of "like product" agricultural products at earlier stages of processing than imported articles; applicable to articles entered, or withdrawn from warehouse for consumption, on or after the fifteenth day after date of enactment.

Conference agreement

The conference agreement follows the House bill.

6. Fish Nets

Present law

Under the Tokyo round of the Multilateral Trade Negotiations (MTN), the most-favored-nation (MFN) tariff rate on fish netting and nets made of textile materials other than cotton or vegetable fibers is being reduced in stages to 17 percent ad valorem by 1989. The rate currently is 18 cents per pound plus 28.6 percent ad valorem.

House bill

No provision.

Senate amendment

Permits the 17 percent MFN tariff rate to apply immediately to the first 1.75 million pounds of fish nets, or 28 percent of the prior year's domestic consumption, whichever if greater; applicable to articles entered, or withdrawn from warehouse for consumption, on or after the fifteenth day after date of enactment.

Conference agreement

The conference agreement follows the House bill.

7. A Telescope and Its Apparatus

Present law

Under item 851.60 of the Tariff Schedules of the United States (TSUS), scientific instruments and apparatus, and repair components, entered for the use of nonprofit educational institutions may enter duty-free if the Department of Commerce determines domestic equipment of equivalent scientific value is unavailable.

House bill

No provision.

Senate amendment

Directs the Secretary of the Treasury upon enactment to admit duty-free any acticles provided by the Max Planck Radio Astronomy Institute in Germany for a joint project with the University of Arizona.

Conference agreement

The conference agreement follows the House bill.

Subtitle F—Certain Provisions Relating to Puerto Rico and the Virgin Islands

1. Clarification of the Definition of Articles Produced in Puerto Rico and the Virgin Islands

Present law

Federal excise tax revenues derived from articles coming into the United States from Puerto Rico or the Virgin Islands generally are paid to the Treasury of the possession from which the article is brought into the United States (Code sec. 7652). Additionally, excise tax revenues derived from rum imported into the United States from any country are paid to Puerto Rico Rico and the Virgin Islands.

Puerto Rico presently conducts a program under which grain neutral spirits, originally distilled in the United States, are transported to Puerto Rico, redistilled, and returned to the United States. As a result, a Federal excise tax payment is made to the Government of Puerto Rico. Puerto Rico provides government subsidies to participants in this program to induce their participation in the program.

House bill

The House bill provides that excise tax revenues generally will be paid to Puerto Rico or the Virgin Islands with respect to articles brought into the United States from those possessions only if three requirements are satisfied—

(1) In the case of articles containing distilled spirits, only if at least 90 percent of the spirits are originally distilled in Puerto Rico or the Virgin Islands, as the case may be;

(2) In the case of any article from Puerto Rico, only if at least 50 percent of the value of the article is attributable to Puerto Rican input; and

(3) In the case of any article from Puerto Rico or the Virgin Islands, only if no subsidy is provided for the production of the article which is of a kind different from (or in an amount per value or volume greater than) subsidies provided to industry generally.

The House bill exempts rum brought into the United States from these possessions from all three requirements. Cane neutral spirits are exempted from requirements (2) and (3), but only if these spirits are not produced under a program having an effect similar to the present redistillation program.

These provisions generally are effective with respect to articles brought into the United States after February 29, 1984. An exception permits payment of tax not in excess of $130 million with respect to redistilled spirits after June 30, 1983 and before July 1, 1984. An additional exception permits such payments not in excess of $75 million after June 30, 1984 and before July 1, 1985.

Senate amendment

The Senate amendment permits payment of excise tax revenues derived from articles containing distilled spirits brought into the United States from Puerto Rico or the Virgin Islands only if at least 92 percent of the alcoholic content of the articles is rum.

The Senate amendment generally is effective with respect to articles brought into the United States after February 28, 1984. An exception permits payment of taxes not in excess of $130 million with respect to articles containing distilled spirits that do not meet the amendment's requirements after June 30, 1983, and before July 1, 1984. The Senate amendment further provides that this exception will terminate if at any time during the phase-out period, Puerto Rico provides (directly or indirectly) a payment to a U.S. distiller of an amount other than direct costs of transporttion to and from Puerto Rico.

Conference agreement

The conference agreement follows the Senate amendment with respect to articles containing distilled spirits. Therefore, payments of excise tax with respect to such articles will be permitted only if at least 92 percent of the alcoholic content of the articles is rum.

The conference agreement adopts the restrictions of the House bill with respect to articles other than distilled spirits.

The agreement generally is effective for articles brought into the United States after February 29, 1984. As under the Senate bill, payments of tax not exceeding $130 million may be made during the period July 1, 1983-June 30, 1984, with respect to redistilled spirits and cane neutral spirits. A modification of the House bill permits such payments not exceeding $75 million during the period July 1, 1984-December 31, 1984.

The special rule in the Senate amendment regarding incentive payments to U.S. distillers is retained, but with two modifications. First, the rule only applies to articles brought into the U.S. after June 30, 1984. Second, an exception to the rule is provided under which U.S. distillers engaged in redistillation operations may continue to receive so-called "incentive payments" in addition to direct transportation costs during the remaining phase-out period after June 30, 1984. These payments may not, however, exceed $1.5 million per U.S. distiller. The conferees intend that these payments be limited to payments to the two U.S. distillers (i.e., Glenmore Distilleries and Heublien Spirits Group) which were engaged in redistillation operations before February 29, 1984, and who were entitled to such payments under contracts binding on that date.[1]

Finally, the conference agreement provides that any U.S. distiller who receives incentive payments or other disallowed payments in excess of $1.5 million between June 30, 1984, and January 1, 1985 is subject to a penalty equal to the total amount of incentive and other payments (other than direct transportation costs) received during the period. This penalty is in lieu of recapture of excise tax payments to Puerto Rico from the date on which the prohibited payments was made. In determining the amount of incentive payments, the conferees intend that the Treasury Department include the amount of price reductions on other products and other indirect payments made by Puerto Rican companies or the Government of Puerto Rico in other transactions between the parties concerned.

2. Limitation on Excise Tax Payments to Puerto Rico and the Virgin Islands With Respect to Distilled Spirits

Present law

The entire amount of excise tax imposed on distilled spirits (i.e., $10.50 per proof gallon) brought into the United States from Puerto Rico or the Virgin Islands is paid to the possession from which the article comes. Additionally, the entire amount of excise tax imposed on rum imported into the United States from all other countries is paid to those possessions.

House bill

No provision.

Senate amendment

The Senate amendment limits the amount of excise tax that may be paid to Puerto Rico or the Virgin Islands with respect to distilled spirits to a maximum of $10.50 per proof gallon (i.e., the present rate of tax). Therefore, the $2.00 per proof gallon increase in the excise tax on distilled spirits provided for by the Senate amendment will not be paid to Puerto Rico or the Virgin Islands with respect to distilled spirits brought into the United States from those possessions.

This provision is effective with respect to distilled spirits brought into the United States after December 31, 1984.

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[1] For purposes of this restriction, the FTG Corporation is not to be treated as a U.S. distiller.

Conference agreement

The conference agreement follows the Senate amendment.

TITLE VII—COMPETITION IN CONTRACTING

The Senate amendment, which is identical to S. 338, the Competition in Contracting Act of 1983, is designed to increase the use of competition in Government contracting and to impose more stringent restrictions on the awarding of noncompetitive—sole-source—contracts. Agencies are required under the Senate amendment to use competitive procedures, whether by inviting sealed bids or requesting competitive proposals, unless a statutory exception allowing the use of noncompetitive procedures is met. S. 338 had been reported unanimously by the Senate Governmental Affairs and Armed Services Committees and passed unanimously by the Senate.

The Senate amendment builds on the two primary procurement statutes—the Armed Services Procurement Act, which governs the Department of Defense, the Coast Guard, and the National Aeronautics and Space Administration, and the Federal Property and Administrative Services Act, which generally applies to civil agencies—to establish a uniform framework which distinguishes between competitive and noncompetitive procedures. The amendments proposed to both statutes are largely identical.

The conferees adopted a substitute to the Senate amendment which represents a compromise between S. 338 and two House measures—H.R. 5184, the Competition in Contracting Act of 1984, which was ordered reported by the House Government Operations Committee, and H.R. 2545, the Defense Procurement Reform Act of 1983, which is under consideration by the House Armed Services Committee.

The conference substitute retains the major provisions of the Senate amendment, incorporates "full and open" as the required standard for competition, strengthens the justification, approval, and notice requirements to safeguard against unnecessary sole-source contracts, establishes competition advocates to enhance accountability, and strengthens the bid protest process.

While the conference substitute adopts the statutory framework of the Senate amendment, the conferees agree further to amend the Office of Federal Procurement Policy Act and the Budget and Accounting Act. The OFPP Act, a statute which governs all federal agencies, is amended to define certain procurement terms, such as "full and open competition" and "responsible source," to establish notice and reporting requirements, and to create competition advocates in all procuring activities. The Budget and Accounting Act is amended to provide the General Accounting Office with a statutory base for its bid protest function.

MAJOR PROVISIONS

Subtitle A—Amendments to the Federal Property and Administrative Services Act

Section 2711—Procurement Procedures

(1) Competition Requirements

Senate amendment

The Senate amendment establishes "effective" competition as the standard for awarding federal contracts for property or services. In Government contracting, effective competition is a marketplace condition which results when two or more contractors, acting independently of each other and of the Government, submit bids or proposals in an attempt to secure the Government's business.

Conference substitute

The conference substitute uses "full and open" competition as the required standard for awarding contracts in order to emphasize that all responsible sources are permitted to submit bids or proposals for a proposed procurement. The conferees strongly believe that the procurement process should be open to all capable contractors who want to do business with the Government. The conferees do not intend, however, to change the long-standing practice in which contractor responsibility is determined by the agency after offers are received.

The conference substitute retains the requirement from the Senate amendment that executive agencies shall use competitive procedures—whether by soliciting sealed bids and making award without discussions or by requesting competitive proposals and making award with discussions—when entering into a contract for property or services.

In effect, the substitute, like the Senate amendment, removes the restriction from—and the written justification required for—competitive proposal procedures and places them on par with sealed bid procedures. The substitute maintains minimum criteria for sealed bid procedures to ensure their use when appropriate. The purpose served by substituting the new terms "sealed bid" and "competitive proposal" procedures for "formal advertising" and "negotiation" is to eliminate the competitive and noncompetitive connotations associated, respectively, with past terminology.

The substitute defines the term "competitive procedures" to mean procedures under which an executive agency enters into a contract pursuant to full and open competition, thereby permitting all responsible sources to compete. This term also recognizes as competitive the procurement of architectural and engineering services conducted in accordance with title IX of the Federal Property and Administrative Services Act, the competitive selection of basic research proposals, and the General Services Administration (GSA) multiple awards schedule programs.

The selection of architectural and engineering services by the Federal Government is governed by the provisions of 40 U.S.C. 541 *et seq.*, which require the selection to be made on the basis of an evaluation of the design proposals and the qualifications of all offerors. After the selection of the most qualified offeror, the government then negotiates a contract at a fair and reasonable price not to exceed six percent of the estimated cost of the project. If an agency is unable to negotiate such a contract, then the agency is required to negotiate a contract with the next most qualified firm. The principle behind this procedure is to ensure that the government receives quality, up-front design work in its procurement of architectural and engineering services. This is particularly important since such design work has a major impact on the overall cost of the project.

The conferees also recognize the competitive selection of basic research, which is directed toward increasing knowledge of a subject apart from any clear or necessary practical application of that knowledge, to be a competitive procurement procedure. These basic research procurements are unique in that the agency's solicitations are general in nature, identifying areas of research interest, criteria for selecting proposals (including scientific merit), and the method of evaluating proposals. Proposals received are then competitively evaluated through a peer review process before contracts are awarded. By recognizing such procurement of basic research as competitive, the conferees intend to promote the participation of all individuals or companies capable of supporting the government's needs in this important area. Any agency procurement which cannot meet this standard and, in fact, restricts participation, must be justified and approved under the requirements in this substitute for other than competitive procurement procedures.

The substitute also contains a provision that preserves the multiple a wards schedule programs administered by the General Services a administration. Although agency implementation of these programs has been criticized in the past, the conferees believe that schedule contracts are a worthwhile method of meeting agency needs for a broad range of commercial products, while imposing a minimum administrative burden on the using agencies. Schedule contracts should be used when GSA can negotiate quantity-discount contracts, with delivery to be made directly to the using agencies in small quantities at diverse locations. The GSA Federal Supply Schedule is an example of this program.

By providing the GSA multiple awards schedule programs with a statutory base, the conferees intend that any responsible vendor wishing to compete for this business is, in fact, allowed and encouraged to compete. As long as the schedule contracts managed by GSA maintain this objective, GSA is complying with the intent of this substitute and should be supported. The conferees believe, however, that the availability of ADP schedule contracts should not preclude the requirement for agencies to seek lower prices if there are responsible alternative sources available.

The conferees also intend that where competition is conducted among all sources that have been prequalified, in accordance with statute and regulations, and where prequalification is essential to ensure satisfaction of an agency's needs, such procedures shall be considered full and open competitive procedures, provided all responsible sources are given a reasonable opportunity to qualify.

(2) Dual-Sourcing Authority

Senate amendment

The Senate amendment authorizes executive agencies to establish or maintain an alternative source or sources of supply for a particular property or service by using competitive procedures to allow all sources to compete while excluding the incumbent contractor from competition. Executive agencies are authorized to use this "dual-sourcing" authority only when it would (1) increase or maintain competition and likely result in reduced overall costs, (2) be in the interest of national defense in case of a national emergency or industrial mobilization, or (3) be in the interest of national defense in establishing or maintaining an essential engineering, research, or development capability to be provided by an educational or non-profit institution or a federally funded research and development center.

Conference substitute

The conference substitute substantially incorporates the provisions of the Senate amendment.

(3) Small Business Set-Aside Competition

Senate amendment

The Senate amendment recoginzes various existing set-aside programs by authorizing an executive agency to include in its solicitations restrictive provisions which would designate only specified categories of offerors, such as small business concerns, as "authorized by law," for example, the Small Business Act (15 U.S.C. § 631, *et seq.*).

Conference substitute

The conferees seek to give more precise recognition to set-aside programs authorized by statute. For example, Congress has historically provided assistance through the Federal procurement process to small businesses. In recognition of this policy, the conferees include a provision in the conference substitute which authorizes agencies to limit competition to small business concerns or socially and economically disadvantaged small business concerns as long as all such firms within the categories are allowed to compete. The conferees specifically note the Small Business Innovation Research (SBIR) Program, established under P.L. 97-219, as an example of a statutorily authorized small business set-aside program that would be included in this provision.

Further, the set-aside procurements must be made in accordance with the competitive procedures required by the conference substitute and with the statutory requirements of the Small Business Act. Finally, procurements conducted under Section 8(a) of the Small Business Act are exempt from the procurement procedures mandated by the substitute.

(4) Exceptions to Competition Requirement

Senate amendment

The Senate amendment provides six exceptions to competitive procedures which parallel the conditions which the Comptroller General has historically recognized as legitimate conditions for awarding contracts on a sole-source basis. The Senate amendment shifts the emphasis from having to justify the use of negotiation, which can be either competitive or noncompetitive, to concentrate on those contract which are negotiated noncompetitively, thereby restricting sole-source contracting to when it is truly necessary. The award of a contract on a sole-source basis would for the first time constitute a clear violation of statute and would therefore not be authorized unless permitted by one of these exceptions.

These exceptions are considerably more restrictive than the present exceptions to formal advertising which are used inappropriately, in many cases, to justify going sole source. By using the broad exceptions to formal advertising, such as the "impracticable to obtain competition" exception, as a means to negotiate noncompetitive, agencies have avoided stating the actual justification for awarding a sole-source contract. While sole-source contracting may be necessary in certain situations, tighter control and greater visibility are needed to ensure its proper use.

Conference substitute

The conference substitute retains the restrictions imposed on sole-source contracts provided in the Senate amendment, but requires agencies to obtain competition under the second and sixth exception to the maximum extend practicable. For this reason, the term "noncompetitive procedures" used in the Senate amendment has been changed to "procedures other than competitive procedures" in the conference substitute. Agencies are not precluded from awarding a contract noncompetitively under the second or sixth exceptions (which concern urgent and national security situations) when conditions dictate that only one source is available.

In addition, the conference substitute includes a seventh exception which allows the head of an agency, on a non-delegable basis, to determine when it is necessary in the public interest to use procedures other than competitive procedures for a particular procurement. This waiver is to be exercised, if at all, on a case-by-case basis, rather than for a class of procurements. The head of an agency is required to notify both Houses of Congress in writing of his or her intention to use this exception thirty days before the contract is awarded.

The conference agreement also clarifies that sole-source awards resulting from certain unsolicited proposals or "follow-on" contracts fall under the first exception, which permits a sole-source award when the property or services needed by the agency are available from only one responsible source and no other type of property or services will satisfy the agency's needs. In neither case, however, is this exception to be used as a "carte blanche" justification for going sole source.

The use of the first exception for unsolicited proposals and follow-on contracts is limited in both cases to certain specific conditions. In the case of unsolicited proposals. the conference substitute authorizes sole-source awards based on unsolicited research proposals when the agency can determine that the substance of the proposal is not otherwise available to the government, and the proposal does not resemble the substance of a pending competitive procurement.

The conferees do not intend, however, that this provision be used as a loophole by which agencies and contractors can circumvent the competition requirements contained in the substitute. This authorization is strictly limited to state-of-the-art proposals which represent advanced scientific knowledge. Even under these conditions, agencies should seek proposals wherever possible from competing researchers to ensure that the best proposal available is selected. The substitute, like the Senate amendment, therefore, requires that unsolicited proposals be publicized in the *Commerce Business Daily* unless such publication would result in the disclosure of the originality of thought or innovativeness of the proposed research contained in the proposal.

In the case of follow-on contracts, a sole-source award under the first exception may be made for the continued development or production of a major system or highly specialized equipment if award to other than the original source would result in substantial duplication of cost that could not be recovered through the use of competition, or unacceptable delays in fulfilling the agency's needs.

The conferees intend that follow-on contracts be awarded only to incumbent vendors who receive the original contracts following some form of price or technical competition. The conference substitute recognizes that in major systems and highly specialized equipment acquisitions, there are situations where the initial capital investment could cause substantial duplication of cost if the contract were awarded to other than the original source. However, the substitute requires the agency to determine and document that such cost cannot be offset by savings that would result from openly competing the requirement. The conferees believe that a cost/benefit analysis is necessary to make a precise determination.

The conferees further note that follow-on contracts sometimes result when an agency fails to determine its original requirements accurately. The conferees emphasize that better planning should eliminate this problem and the resultant need for a sole-source contract to the incumbent contractor. The language in the conference substitute should not be construed as legitimizing sole-source contracts that are caused by poor planning.

The conferees also do not intend this provision to be used to perpetuate any contract which involves obsolete or outmoded facilities, systems or processes, including computer systems and software.

(5) Justification and Approval Procedures

Senate amendment

The Senate amendment safeguards against unnecessary sole-source contracting by prohibiting agencies from using noncompetitive procedures unless (1) the use of such procedures has been justified in writing, and (2) the agency has provided advance notice of intent to award a sole-source contract in the *Commerce Business*

Daily, inviting bids or proposals from potential competitors, and has considered all bids or proposals received in response to such notice.

Conference substitute

The conference substitute retains the pre-award notification requirements from the Senate amendment which agencies must first meet before a sole-source award can be made.

In retaining the Senate provisions, the conferees emphasize that agencies should, at a minimum, give each bid or proposal received in response to the *Commerce Business Daily* notice sufficient consideration so as to be able to make an informed judgment about the responsibility of the bidder and the responsiveness of the bid.

Agencies are not explicitly required to issue solicitation packages to all contractors who respond to a pre-award notice. This is not to be interpreted to mean that agencies are authorized to deny the distribution of such packages arbitrarily. The purpose of the pre-award notice is to open competition to all offerors who can meet the agency's needs. To serve this purpose, solicitation packages should be available upon request. In situations where competition is not anticipated and solicitation packages have not been prepared, agencies shall provide potential competitors who do respond with solicitation packages or comparable information.

The conference substitute also strengthens the justification procedures in the Senate amendment and establishes new requirements for approvals of sole-source contracts.

The justification statement required for each noncompetitive procurement must be certified as accurate and complete by the contracting officer responsible for awarding the contracts. The justification statement must then be reviewed and approved by either (1) the procuring activity's advocate for competition in the case of contracts over $100,000; (2) the head of the procuring activity in the case of contracts over $1,000,000; or (3) the agency's senior procurement executive in the case of contracts over $10,000,000. Contracting officer certification and review and approval authorities provided by this substitute cannot be delegated, except as specifically authorized under this substitute.

All determinations and decisions required for use of the exceptions to competitive procedures provided in this substitute are to be made on a case-by-case basis. Broad categories or classes of products and services cannot be exempt from competitive procedures.

In the event of an unusual and compelling urgency, the required justification and approvals may be made after the contract has been awarded. Similarly, such justifications and approvals are not required when the head of an agency determines and reports to Congress that it is in the public interest to conduct a noncompetitive procurement, or a procurement is conducted in accordance with the Wagner-O'Day Act (41 U.S.C. § 46 *et seq.*).

The justifications and related documentation are required to be made available to the public. While these disclosures should be made consistent with the provisions of the Freedom of Information Act (5 U.S.C. § 552), the conferees intend that the Act's exemption for internal memoranda not be used to shield these documents from public disclosure. The use of the term "consistent with" is designed merely to ensure that national security, law enforcement, and other sensitive information is not publicly disclosed.

The conference sustitute places additional prohibitions and restrictions on the use of procedures other than competitive procedures. Noncompetitive procurements may not be justified on the basis of concerns regarding the future availability of funding. This prohibition is designed to prevent the year-end spending abuses that occur when agencies are faced with large amounts of unexpended appropriations at the end of the fiscal year. Under this situation, agencies rush to sign a contract with a vendor on a sole-source basis in order to avoid having to turn money back to the Treasury. The conferees find this practice to be unconscionable. Similarly, the substitute prohibits the use of the lack of advance planning as a justification for using noncompetitive practices. The conferees reject the assertions made by some agency procurement officials that this is a legitimate reason to curtail competition. A contrary conclusion would legitimize unacceptable management practices.

The substitute also prohibits an agency from procuring its goods and services from another agency unless that agency has complied with the requirements of the substitute. The substitute includes this prohibition to prevent one agency from acquiring its goods and services from another agency's sole-source contract without having to justify a noncompetitive procurement itself. This restriction is in addition to, not in lieu of, any other restriction provided by law, including the Economy Act of 1932 (31 U.S.C. § 686(a)).

(6) Small Purchase Procedures

Senate amendment

The Senate amendment recognizes that the competitive procedures required of large pruchases may not be appropriate for small purchases. The Senate amendment therefore provides a basis in statute for regulations to establish separate small purchase procedures, allowing agencies to scale down their efforts as long as they obtain reasonable competition.

Conference substitute

The small purchase provisions of the Senate amendment are retained under the conference substitute in a separate subsection. Within this new subsection, agencies are required to promote competition to the maximum extent practicable when using small purchase procedures. The regulations issued pursuant to this subsection are to be incorporated into the government-wide Federal Acquisition Regulation consistent with current statute.

(7) Planning and Solicitation Procedures

Senate amendment

The Senate amendment requires agencies, as part of the affirmative effort to obtain competition, to use advance procurement planning, conduct market research, and develop nonrestrictive specifications.

Conference substitute

The conference substitute retains these requirements contained in the Senate amendment, but applies them as planning requirements for all procurements—competitive and noncompetitive.

The substitute also retains the broad guidelines set forth in the solicitation section of the Senate amendment for agencies to follow in defining their needs in order to maximize, rather than limit, competition. The substitute authorizes agencies to specify their needs in either functional, performance, or detailed design terms, whichever will ensure timely performance and will promote the use of full and open competition.

Wherever practical, the conferees strongly believe that contractors should be told what the Government needs in functional terms. This approach allows the Government to take advantage of the innovative ideas of the private sector.

(8) Evaluation and Award Procedures

Senate amendment

The evaluation and award procedures for sealed bids and competitive proposals set forth in the Senate amendment are largely the same as those currently required in the Armed Services Procurement Act and the Federal Property and Administrative Services Act for formal advertising and negotiation. The amendment clarifies that agencies shall evaluate sealed bids and competitive proposals based solely on the factors specified in the solicitation.

Conference substitute

The conference substitute retains the evaluation and award procedures under the Senate amendment, and modifies the language to reflect the requirement for full and open competition.

Section 2712—Truth in Negotiations

Senate amendment

The Senate amendment extends the statutory requirement in the Armed Services Procurement Act for submitting certified cost or pricing data to cover civilian procurements under the Federal Property and Administrative Services Act, and establishes a uniform threshold in both statutes at $100,000.

Contractors are presently required by statute to submit cost or pricing data and certify that the data are "accurate, complete, and current" prior to the award of any negotiated defense contract over $500,000 and are required by regulation to submit such data for any negotiated civilian contract over $100,000. The purpose of this "truth-in-negotiations" provision is to provide the basis for retroactive price adjustment in the event that data submitted prior to the award of a contract were not accurate, complete, and current, without resorting to costly and time-consuming litigation. Without certification, agencies lack the legal ammunition to deter defective pricing.

Conference substitute

The conference substitute retains the Senate provisions and, in addition, authorizes contracting officers to request cost or pricing data for defense and civilian procurements under $100,000. Obtaining such data for small dollar contracts has proven to be a problem in purchasing spare parts, where excessive over-charges have become legendary.

Section 2713—Automated Data Processing Dispute Resolution

Senate amendment

The Senate amendment contains no provision on automated data processing dispute resolution.

Conference substitute

The conference substitute amends Section 111 of the Federal Property and Administrative Services Act of 1949 to provide an alternate forum for resolving contractual disputes involving procurements of automated data processing (ADP) equipment and services conducted under Public Law 89-306 (the Brooks Act). This provision applies only to those automated data processing procurements conducted under the Brooks Act, and it does not apply to those ADP procurements exempted under the 1982 Department of Defense Authorization Act. ADP procurements conducted by DOD are exempt from the Brooks Act only if the equipment and services are primarily for functions involving intelligence, cryptology, command and control, weapon systems, or similar type systems. Protests over ADP procurements in those areas not covered by the Brooks Act will continue to be heard by the GAO or the courts, as under current practice.

The Brooks Act, enacted in 1965, provides the General Services Administration (GSA) with the sole authority to procure ADP equipment and services for federal agencies either by conducting the procurement on behalf of the agency, or by granting a delegation of procurement authority to the agency to conduct its own procurements. The Brooks Act has opened the federal marketplace to all responsible computer companies. However, due to the increasing number of computer procurements conducted every year, coupled with the complexity of the technology, the current informal process of resolving conflicts between the buying agency and the suppliers has become cumbersome and prolonged. Further, charges have been made by both the agencies and the contractors that GSA's current process does not provide an objective forum for dispute resolution. The conferees believe that it has become increasingly apparent that a new forum is needed to provide a fair, equitable and timely remedy in this area.

The conference substitute provides that remedy by authorizing the GSA Board of Contract Appeals to consider protest cases involving ADP procurements conducted under P.L. 89-306. The Board is well suited to hear protests of this nature. First, the Board can use already established procedures to hold hearings, compel production of documents, obtain testimony of witnesses, and conduct cross-examination under oath. Second, the Board can use the authority which GSA currently has under the Brooks Act to revoke, suspend or modify a delegation of procurement authority. Further, the Board is authorized to suspend any contract which was awarded pursuant to P.L. 89-306.

The conference substitute requires that an initial hearing be held by the Board within ten days of the filed protest, and that the Board then issue its final decision within 45 working days from the date of the protest unless its chairman determines that specific and unique circumstances require a longer period for consideration. Based upon the results of the initial hearing, the Board can suspend the delegation of procurement authority while the protest is pending. The suspension of a solicitation or contract performance shall not be ordered if the agency establishes that urgent and compelling circumstances exist. In addition, the conference substitute authorizes the Board to award the costs of pursuing a protest if such protest action is sustained by the Board.

The conferees recognize that these provisions provide a unique and innovative method of handling protests of a highly technical and complex nature. The conferees believe that the Board is well equipped to provide timely resolution of conflicts between the procuring agencies and the suppliers of computer products and services. To avoid disrupting legitimate procurements, and especially to prevent protest actions taken in bad faith from interrupting contract performance, the Board is authorized to dismiss at any point in the process any protest action that it determines to be frivolous or which, on its face, does not state a valid basis for the protest.

The conference substitute establishes a three-year sunset provision which should allow Congress to make a full and objective evaluation of the Board's operations in resolving ADP contractual disputes prior to the consideration of reauthorization.

Subtitle B—Amendments to the Armed Services Procurement Act

Section 2721—Defense Procurement Policy

Senate amendment

The Senate amendment contains no provisions directly amending the existing policy section in the Armed Services Procurement Act.

Conference substitute

The conference substitute amends the existing policy section in the Armed Services Procurement Act to set forth broad defense procurement policy which, first and foremost, directs the Department of Defense, the military services, the Coast Guard, and the National Aeronautics and Space Administration to use full and open competitive procedures in acquiring property and services. The other policy statements included in the conference substitute are intended to conform with the policies set out in section 2 of the Office of Federal Procurement Policy Act.

Sections 2722 and 2723

Senate amendment and conference substitute

The remaining sections under Subtitle B of the conference substitute parallel sections 2711 and 2712 of Subtitle A and the explanations of the provisions are the same and the conferees' intentions with respect to these provisions are the same.

Subtitle C—Amendments to the Office of Federal Procurement Policy Act

Section 2731—Definitions

Senate amendment

The Senate amendment did not amend the OFPP Act.

Conference substitute

The conference substitute defines the terms "full and open competition" to mean that all responsible sources are permitted to submit sealed bids or competitive proposals; "competitive procedures" to mean the procedures under which an agency enters into a contract pursuant to full and open competition; and "responsible source" to mean a prospective contractor who is capable of satisfying the agency's needs, considering resources, delivery or performance schedule, performance record, integrity and business ethics, organization and experience, equipment and facilities, and any other qualifications. These terms are used throughout the conference substitute.

Section 2732—Procurement Notice and Records; Advocate for Competition

(1) Procurement Notice Requirements

Senate amendment

The Senate amendment establishes notice provisions in the Armed Services Procurement Act and the Federal Property and Administrative Services Act which require a notice to be published in the Commerce Business Daily for (1) prospective competitive and noncompetitive contracts over $10,000, and (2) contract awards over $10,000 for those contracts which are likely to result in the award of subcontracts. The burden is placed on the procuring agency, under this provision, to furnish the information for publication to the Secretary of Commerce, who is responsible for publishing the notice promptly in the Commerce Business Daily.

The Senate amendment establishes time periods for publication, specifies the information which a proper notice should include, and provides exceptions to the notice requirement which are separate but identical in almost all cases to the exceptions for noncompetitive procedures.

Conference substitute

The conference substitute retains, with minor modifications, the notice requirements set forth in the Senate amendment, but consolidates the dual-conforming amendments to the defense and civilian procurement statutes by placing a uniform notice requirement in the Office of Federal Procurement Policy Act.

(2) Record Requirements

Senate amendment

The Senate amendment facilitates congressional oversight of contracting activities by requiring agencies to establish and maintain a record, by fiscal year, of the procurements (other than small purchases) in which noncompetitive procedures are used. The information to be included in the record, which would be transmitted on a quarterly basis to the Federal Procurement Data System, designates the contractor who received the award, the property or services which were obtained, the dollar value, the reason for using noncompetitive procedures, and the positions of the individuals in the procuring agency who required and approved the sole-source award.

Conference substitute

The conference substitute retains the record requirements of the Senate amendment, again consolidating the amendments to the defense and civilian procurement statutes into a uniform provision in the OFPP Act, but expands application of this provision to include all procurements—competitive and noncompetitive—in a computerized file. This file should be indexed in a manner to provide ready access to such information by other agencies, Congress, and the public.

(3) Advocate for Competition

Senate amendment

The Senate amendment establishes in each executive agency the position of advocate for competition with responsibilities for promoting competition in the agency's procurement process. The agency competition advocate is designed to be at a sufficiently high level to directly influence the procurement poilicies and procedures within the agency, while not being directly responsible for the individual procurements. The head of each agency is prohibited from assigning duties to the competition advocate which are inconsistent with the advocate's responsibility to promote competition. As such, the position of competition advocate should not be assigned to any individual who is responsible for the initiation or conduct of any specific agency procurement.

Conference substitute

The conferees recognize the importance of the position of competition advocate and the need to ensure that key Federal officials at all levels are made aware of the benefits of competition and become firmly committed to its use. To further these goals, the conference substitute expands the agency advocate's responsibilities and requires the establishment of an additional advocate for competition in each procuring activity.

The substitute requires the competition advocates to challenge barriers to, and promote full and open competition in, the procurement of property and services. Under the review and approval procedures established by the conference substitute, the procuring activities' competition advocates are responsible for approving all noncompetitive contract awards which involve expenditures exceeding $100,000 but less than $1,000,000. Further, the agency advocate is given the additional responsibilities of recommending to the agency's senior procurement executive (1) goals and plans for increasing competition on a fiscal-year basis, and (2) a system of personal and organizational accountability designed to encourage the procurement workforce to emphasize competition.

The conferees recommend that the performance ratings of procurement personnel include an appraisal of their efforts to promote competition in agency procurements.

(4) Annual Report on Competition

Senate amendment

The Senate amendment requires the head of each executive agency to issue an annual report to Congress on the agency's use of competition in contracting. Specifically, the report should provide an overview of the actions taken by the agency to increase competitive contracting and reduce the number and dollar value of noncompetitive contracts, and the activities and accomplishments of the agency's advocate for competition.

Conference substitute

The conference substitute incorporates the annual report requirement from the Senate amendment and establishes January 31 as the deadline for submission to Congress for fiscal years 1986 through 1990.

(5) Competition Requirement

Senate amendment

The Senate amendment has no comparable provision.

Conference substitute

The conference substitute amends Section 16(1) of the OFPP Act (executive agency responsibilities) to require the use of full and open competition in executive agency procurements of property and services. Language contained in this substitute requires agencies, when using competitive procedures, to establish policies, procedures, and practices necessary to ensure that a sufficient number of sealed bids or competitive proposals are received from responsible sources to fulfill the government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or services procured. This requirement applies to all agency procurements, including those made under set-aside programs.

Subtitle D—Amendments to the Budget and Accounting Act

Section 2751—Procurement Protest System

Senate amendment

The Senate amendment contains no provisions regarding the General Accounting Office bid protest system.

Conference substitute

The conferees believe that a strong enforcement mechanism is necessary to insure that the mandate for competition is enforced and that vendors wrongly excluded from competing for government contracts receive equitable relief. To accomplish this, the conference substitute adds a new subchapter to Chapter 35 of Title 31, United States Code, which codifies and strengthens the bid protest function currently in operation at the General Accounting Office (GAO). The provisions of this section become effective on Janaury 15, 1985.

The conference substitute establishes an enforcement mechanism keyed to the procedures contained in the Senate amendment for solicitation, notice, evaluation, and award. The procurement protest system further relies on record requirements in the Senate amendment, as expanded in the conference substitute, to insure the availability of information needed not only by the Comptroller General to make determinations in procurement protests, but also by interested parties to identify, and initiate action against, solicitations and awards which they believe are unlawful.

The Comptroller General is not given exclusive authority to hear protests. The conferees do not intend, for example, that the GAO decide matters dealing with the Small Business Administration's responsibilities under the Small Business Act to establish industry size standards or to issue Certificates of Competency to small businesses. Finally, interested parties with recourse to the General Services Administration Board of Contract Appeals in disputed computer procurements may not protest the same action to both the GAO and the GSA board.

Any actual or prospective bidder of offeror whose direct economic interest would be affected by the award of or failure to award a procurement contract by an executive agency may challenge the agency's solicitation, award or proposed award by filing a protest with the Comptroller General. Final agency determinations under section 307 of the Federal Property and Administrative Services Act and section 2310 of title 10, United States Code, may be the subjects of protests to GAO, the courts, and where appropriate, the GSA board.

Once a protest has been filed with GAO, the Comptroller General shall notify the executive agency involved within one day of receipt of the protest. The executive agency then has 25 working days (10 if the Comptroller General selects the "express option") to respond. the Comptroller General must issue his opinion within 90 working days (45 calendar days under the express option). The Comptroller General may extend the deadlines when appropriate for specific protests, on a case-by-case basis; the conferees regard such extensions as exceptional, however, and to be used in unique circumstances only.

If, when a protest is filed, the contract in question has not yet been awarded, an award may not be made unless the head of procuring activity responsible finds and reports to the Comptroller General that urgent and compelling circumstances which significantly affect the interests of the United States will not permit awaiting the Comptroller General decision. (This finding may be made only if the award is likely to occur within 30 calendar days.) If a protest is filed within 10 days after award of the contract, performance shall cease and all related activities which may result in additional obligations being incurred by the United States must be suspended, unless the head of the procuring activity informs the Comptroller General that urgent and compelling circumstances which significantly affect interests of the United States will not permit waiting for the Comptroller General's decision, or that performance of the contract is in the best interest of the United States.

Before notifying the Comptroller General that continued performance of a disputed contract is in the government's best interest, however, the head of the procuring activity should consider potential costs to the government from carrying out relief measures as may be recommended by the Comptroller General if the protest is subsequently sustained. This is to insure that if the Comptroller General sustains a protest, such forms of relief as termination, recompetition, or re-award of the contract will be fully considered for recommendation. Agencies in the past have resisted such recommendations on the grounds that the government's best interest would not be served by relief measures of this sort because of the added expenses involved. This provision is designed to preclude that argument in the future, and thus to avoid prejudicing those relief measures in the Comptroller General's review.

If the Comptroller General determines that a protested procurement action has involved government non-compliance with statutes or regulations, the Comptroller General is required to recommend corrective action to the executive agency responsible, and the head of the procuring activity involved must notify the Comptroller General if the agency has not implemented the recommendations within 60 calender days. This provision does not preclude the Comptroller General from requesting the agencies to notify the GAO of the status of any other recommendation. An annual report of all notifications received by the Comptroller General, describing each instance of non-implementation, must be submitted to Congress.

The Comptroller General may grant to a successful protesting party reimbursement for expenses of preparing bids or proposals related to the disputed contracting action and for costs incurred in making the protest. These costs shall be paid from the procurement funds (not necessarily funds for the specified procurement which was challenged) of the executive agency involved.

The conference substitute provides that the Comptroller General may dismiss at any point in the process a filing determined to be frivolous or to lack a valid basis for protest. This provision reflects the intent of the conferees to keep proper contract awards or due performance of contracts from being interrupted by technicalities which interested parties in bad faith might otherwise attempt to exploit. Finally, the conferees expect that the Comptroller General will declare monetary awards only in cases where the agencies have unfairly excluded vendors from procurements, and not in cases involving minor technicalities.

The Comptroller General currently receives from courts and agencies requests concerning the propriety of procurements. The conferees intend that the Comptroller General have the discretion to continue to process these requests in a manner consistent with the one used for bid protests.

The conference substitute also includes a section regarding alternative remedies. The subchapter regarding bid protests does not alter the current rights of any person to seek administrative or judicial review of any alleged violation of a procurement statute or regulation. Further, documents related to a Comptroller General's decision on a procurement and the agency's response to such decision must be made a part of the agency record and be made available to the courts in the event a suit is filed against the agency involving the procurement.

Subtitle E—Effective Date: Regulations; Study

Section 2751—Effective Date

Senate amendment

The Senate amendment applies to any solicitations for bids or proposals issued on or after the date 270 days after enactment.

Conference substitute

The conference substitute establishes April 1, 1985, which is approximately 270 days from the anticipated date of enactment, as the effective date. The substitute also establishes January 15, 1985, which allows approximately 180 days for implementation, as the effective date for the bid protest provision.

Section 2752—Modification of the Federal Acquisition Regulation

Senate amendment

The Senate amendment has no comparable provision.

Conference substitute

The conference substitute requires that the Federal Acquisition Regulation (FAR) shall be modified by March 31, 1985, to conform to the requirements set forth in this substitute. Modification shall also be made to the FAR within this time period to reflect policy directives issued by the Office of Federal Procurement Policy.

The conferees note with considerable concern that the system established to maintain the FAR is not working. Presently, FAR maintenance is jointly vested in two procurement regulatory councils, the Defense Acquisition Regulatory (DAR) Council, established by the Secretary of Defense, and the Civilian Agency Acquisition Council (CAAC), established pursuant to the FAR. Under the maintenance procedures prescribed by the FAR, both councils must consider and approve each proposed modification or addition to the FAR.

Given this cumbersome maintenance system, the conferees note that, to date, the regulatory councils have failed to implement both statutory changes and OFPP policy directives. Given the currently limited role accorded to OFPP in the FAR maintenance system, the conferees are concerned that the continuing lack of leadership for the FAR maintenance system will perpetuate the untimely implementation of FAR changes required by statute or OFPP policy directives.

By statute, the OFPP Administrator is empowered to issue procurement regulations, procedures or forms when the two regulatory councils are unable to agree or fail to take action. In the event that conflict or inaction precludes the two councils from meeting the April 1, 1985, deadline for implementing the modifications to the FAR pursuant to this substitute, the OFPP Administrator must intervene to issue the regulations by this deadline. Further, the conferees believe that the OFPP Administrator should be accorded a greater role in managing the FAR maintenance process on a continuing basis.

Section 2753—Study

Senate amendment

The Senate amendment has no comparable provision.

Conference substitute

The conference substitute requires the Office of Federal Procurement Policy to recommend to Congress a plan for increasing the use of full and open competition in the procurement of professional, technical and managerial services. This category of procurements often involves the use of evaluation criteria, other than price, in the selection of the winning vendor.

The Office of Federal Procurement Policy is directed to recommend competitive selection procedures for procurements where price is not a significant factor and the agency has determined a legitimate need for the best or highest quality proposal. Such a plan should include requirements for the agencies to follow to ensure that all responsible vendors are allowed to compete for the above procurements and that fair and reasonable prices are paid for the service. OFPP should consider, as a possible alternative prior to designing a plan, a system in which all qualified persons capable of providing specified services are placed on a list maintained by the government, in which each of those persons is encouraged to submit a competitive proposal in response to each solicitation for such services, and in which the award is made to the bidder on the list who can perform the service for the lowest overall cost.

The Office of Federal Procurement Policy should also, in conducting the study, consult with experts in such fields as soil engineering, real estate appraising, surveying and mapping, and other professional services which do not fit within the traditional concept of Federal procurement procedures.

TITLE VIII—FEDERAL CREDIT UNION ACT AMENDMENTS

Recapitalization of the National Credit Union Administration Share Insurance Fund (Sections 2801-2812)

Sections 2801-2812 authorizes the National Credit Union Administration (NCUA) to impose a capital assessment on insured credit unions equal to 1 percent of their insured share accounts, thereby raising the capital of the fund to 1.3 percent.

The recapitalization of NCUA's insurance fund restructures one of the three federal deposit insurance funds in a significant manner. The conferees agree that there is a need for thorough Congressional review of deposit insurance generally, of the deposit insurance reports submitted by the federal insuring agencies pursuant to the Garn-St Germain Act and of deposit insurance reform proposals urged by various deposit insurance experts and the federal insuring agencies. However, in view of the Senate's position on sections 2801-2812 and the need to expedite completion of the Omnibus Reduction Act Conference, the House receded to the Senate.

Tax Exemption of the NCUA Central Liquidity Facility (Section 2813)

Established in 1978 by Public Law 95-630, the Financial Institutions and Interest Rate Control Act, the CLF is the "central bank" for credit unions. The CLF is a mixed ownership corporation (stock owned by credit unions), is on-budget, and is located within and manged by the NCUA. Section 2813 corrects an oversight in the enactment of P.L. 95-630 which provided that the CLF be similar to Federal Reserve Banks and Federal Home Loan Banks but did not explicitly exempt the CLF from taxation. Section 2813 corrects this oversight and explicitly exempts the CLF from taxation. The effective date of this provision would be retroactive to October 1, 1979. Therefore, the House receded to the Senate.

Elimination of Treasury Fees on Payroll Allotment (Section 2814)

Section 2814 eliminates the fee which Treasury charges financial institutions for depositing payroll allotments of civilian federal employees. The House passed a similar bill in 1982; and a similar bill, H.R. 3879, was approved by the House under suspension on April 2, 1984. The House receded to the Senate.

TITLE IX—MISCELLANEOUS PROVISIONS

Section 2901. Cost Savings by Administrative Action

House amendment

The House amendment contains no provision relating to reduction of obligations for various types of administrative activities.

Senate amendment

Section 1603 of the Senate amendment requires that the total amount which may be obligated for various administrative purposes in FY 1985 be reduced by specified amounts below the total appropriated for such purposes for FY 1984. These purposes and amounts are:

Section 1603(a)—Certain Travel and Transportation	$750 million.
Section 1603(b)—Consultant Services	$1 billion.
Section 1603(c)—Public Affairs, Public Relations, Public Information and Advertising	$100 million.
Section 1603(d)—Publishing, Printing, Reproduction, and Audiovisual Activities	$250 million.
Section 1603(f)—Certain Motor Vehicle Operations	$160 million.

Section 1603(e) requires OMB to "effect savings of $2,100,000,000 through enhanced identification and recovery and collection of Federal overpayments, delinquencies, and indebtedness . . . most recently considered to be uncollectible." This is the amount that the President's FY 1985 budget estimated would be collected through increased efforts.

The provisions of Section 1603 of the Senate amendment were designed to reduce the costs of administrative activities by providing that total FY 1985 obligations for those activities would be reduced by certain amounts below comparable levels in FY 1984 appropriations. All reductions would be allocated by the Director of the Office of Management and Budget among the agencies, but, in some instances, certain key functions, such as law enforcement and emergency national defense activities, would be exempt from bearing a share of the allocated reductions.

Conference agreement

The conferees agreed to the Senate provision with an amendment.

The conferees agree that significant savings can be achieved in these areas of Federal expenditures. However, the conferees are concerned that there is insufficient data to implement the provision, that the amounts of the reductions may be inappropriate, and that the language of the provision would probably not result in savings to the government.

There are no firm estimates concerning the baseline costs to the government of the categories of expenditures specified in the amendment. The government accounts do not separately identify the specific costs of administrative components such as travel and transportation, consultant services, public affairs, public relations and advertising, publishing, and motor vehicle operations. Without a firm, agreed upon base from which to measure the costs of these activities, it would be nearly impossible to determine the real savings which might result from the provisions of section 1603 (a) through (f)(1) of the Senate amendment.

While monies for travel and transportation are not separately appropriated and obligated, statistics on these expenditures have been developed. These statistics suggest that the size of the reduction required in this area by the Senate amendment could severely hamper important government activities. Evidence supplied by OMB in a letter to Chairman Roth suggests that the travel and transportation activities not exempted in the Senate provision would have to be reduced by about 26 percent to carry out the requirements of the provision. OMB went on to conclude that if other important activities such as transportation of Commodity Credit Corporation commodities, coal for TVA's power plants, stockpile commodities, and travel for VA beneficiaries, FAA and other transportation safety staff, audit staff, diplomatic officials and staff, and Department of Defense staff, are also excluded from the reduction, the reduction required for remaining activities would be about two-thirds.

Furthermore, the conferees agree with OMB that the provision would not result in savings to the government. This is because the language does not reduce appropriated funds, but rather limits expenditures for specific activities such as public affairs of reproduction expenses. According to OMB, any "savings" resulting from reductions in expenditures for those administrative activities, would by law have to be made available for other purposes. Otherwise, the funds would be withheld from obligation contrary to the provisions of the Impoundment Control Act.

To solve these problems, the conferees agreed on an amendment that would require the development by OMB of baseline data, a determination of possible savings, and a plan to achieve these savings.

Section 2901(a) expresses the sense of Congress that costs for administrative activities can be reduced and that better management of such activities must remain a high priority of the Congress and the executive branch.

Subsection (b) of section 2901 includes provisions designed to provide Congress and the public with more substantial and clearly defined information on the baseline costs for administrative activities. This subsection requires the Director of the Office of Management and Budget to report to Congress baseline estimates of the costs for each of the specified administrative activities in FY 1984. In addition, OMB would be required to explain what savings can reasonably be expected in these areas in FY 1985 through management improvements and how those savings would be achieved. OMB is also directed to submit draft legislation where necessary to achieve savings in the costs of these administrative activities.

Subsection (c) requires that in the event OMB estimates of possible savings are less than that required in the Senate provision, then the report to Congress must include an explanation of why the higher figure is not achievable.

As agreed to by the conferees, section 2901(a)(1)(C) no longer refers to "public information activities" as one of the areas in which reductions are to be identified. Conferees concluded that reductions are appropriate in the areas of public relations and advertising by agencies. However, they agreed that providing information on the operations of government generally, or pursuant to the Freedom of Information Act specifically, should not be affected by this section.

Section 2902. Disposal of Certain Land at Montauk Air Force Base

House amendment

The House amendment contains no provision related to the disposal of land at Montauk Air Force Base.

Senate amendment

Section 1605 of the Senate amendment provides that the Administrator of General Services shall assign to the Secretary of the Interior for use as a public park or recreation area, 278 acres of the Montauk Air Force Station in East Hampton Township, Suffolk County, New York, that were declared surplus on December 21, 1981. This section also provides that, in exchange for the transfer of title to 125 acres of property owned by the State of New York at Fire Island, New York, to the Secretary of the Interior, the Secretary shall convey the Montauk Point property to the State of New York for public park or recreation uses in accordance with section 203(k)(2) of the Federal Property and Administrative Services Act of 1949.

Conference agreement

The conferees agreed to the Senate provision with an amendment.

In 1981, the General Services Administration determined that the designated Montauk Point property was surplus and that its highest and best use was for residential development. On October 21, 1983, the Acting Secretary of the Interior reaffirmed to GSA the high park and recreation values of the property, asking for a reconsideration of a decision not to assign the property for park and recreation use. However, on February 8, 1984, GSA proceeded to auction the property. Acceptance of the high bid and award have been held in abeyance because of a court order.

On April 27, 1984, the Secretary of the Interior advised the Acting Administrator of General Services that he had approved a revised application which the State of New York had submitted for a public benefit discount conveyance of the Montauk Point property pursuant to section 203(k)(2) of the Federal Property and Administrative Services Act. That provision authorizes such conveyances of surplus real property for public park or public recreational purposes. The Secretary urged GSA to assign the property to the Department so that it might be transferred to the State for those purposes. New York's revised application includes projected State developments to cost an estimated $2,010,000.

The Secretary stressed the property's unique natural characteristics and recreation potential. At the same time, he advised GSA that the Governor of New York had formally offered to donate to the Federal government 125 acres of State-owned land within the boundaries of the Fire Island National Seashore. This includes the unnamed unit of Robert Moses State Park that was included within the boundaries of the national seashore by Public Law 95-625 (Act of November 10, 1978, section 322(a)).

On April 23, 1984, the Secretary formally asked, through the Director of the Office of Management and Budget, that the Administration throughly explore these two mutually advantageous transfers. As yet, the Administration has disclosed no position on this matter.

The conferees believe that unique park and recreational values inhere in the Montauk Point property and that the best interest of the United States would be served through public benefit discount transfer to the State of New York, whose application for acquisition and planned park and recreational development has the Secretary of the Interior's strong endorsement.

Nevertheless, the conferees are concerned that this provision, as included in the Senate amendment, overrides the Federal Property Act's statutory structure for disposal of surplus property and would set a precedent for ad hoc disposals of surplus Federal property—a problem that the establishment of an administrative structure for the evaluation and disposal of surplus property was intended to avoid.

In order to reconcile concerns for the proper disposal of this piece of property and the need to maintain a uniform surplus property disposal structure, the conferees adopted a provision stating that the Congress finds that the highest and best use of the Montauk lands is use as a park or recreational area. The provision also recognizes the State of New York's willingness to convey the Fire Island lands. The conference agreement states that the Administrator of GSA should assign the Montauk property to the Secretary of the Interior and that the Secretary should, simultaneous with the acceptance of the Fire Island property, convey the Montauk land to the State of New York for use as a public park or recreational area through a public discount conveyance under section 203(k)(2) of the Federal Property and Administrative Services Act.

The conference agreement thus does not supplant the processes provided under section 203(k)(2). The conferees expect that the General Services Administration and the Department of the Interior will proceed expeditiously to accomplish this objective and also that the Secretary of the Interior will accept the offer by the State of New York to donate the 125 acres of State-owned lands to the United States to be administered as part of the Fire Island National Seashore.

Section 2903. Cost Savings Report by the President

House amendment

The House amendment contains no provision relating to a review of cost savings by administrative action.

Senate amendment

Section 1609 of the Senate amendment requires the Administration to review the recommendations of the President's Private Sector Survey on Cost Control (the Grace Commission) which require administrative or presidential action and commit to adopting a sufficient quantity to achieve cost savings of $4 billion in fiscal year 1985, $6 billion in FY 1986, and $10 billion in FY 1987. The provision in the Senate amendment also would require the Administration to expedite and administer provisions of the recommendations and subsequent changes in laws to implement cost savings pursuant to the provision.

Conference agreement

The conferees were concerned that the language of the Senate amendment might be construed as constituting an endorsement by the Congress of one specific group of recommendations as to cost savings in the Federal government, to the exclusion of numerous other studies in this area. For that reason, the conferees agreed to expand the coverage of the provision to require the President to review recommendations for management improvement and cost control opportunities, including those made by congressional committees, executive and legislative branch agencies, educational and research organizations, and public and private bodies, task forces, councils, panels, and study groups. A report on this review is to be submitted along with the budget in January 1985. The report is to contain a list of the recommendations the President has reviewed, the source of those recommendations, the actions which the President proposes to take or has taken, and the amount of cost savings expected to result from implementation of these recommendations in FY 1985, 1986, and 1987.

The conferees expect all the recommendations in the studies that are reviewed to be specifically addressed, either in the affirmative or the negative, in this report.

Cost savings by committee (section 2904)

Section 1608 of the Senate amendment would require all authorizing committees of the Senate and House to review savings recommendations of the President's Private Sector on Cost Control, and, based on that review, make recommendations to the Budget Committees by September 30, 1984.

The House amendment contains no comparable provision.

The Conference substitute modifies the Senate amendment to require authorizing committees to review the report required under section 2903, as agreed to by the Conference, and to submit recommendations for cost savings to the Budget Committees by March 15, 1985 as part of each committee's report submitted pursuant to section 301(c) of the Congressional Budget and Impoundment Control Act of 1974, as amended.

Analyses of budget assumptions (section 2905)

Section 1610 requires the Director of the Congressional Budget Office to analyze executive departments and agencies, so as to determine the nature and reliability of the assumptions that are used in the preparation and submission of budget estimates for the Congress.

The House amendment contains no comparable provision.

The House recedes to the Senate with modifications. Section 2905(a) is modified to require the Director of the Congressional Budget Office to study and report on reasons for differences in projected and actual budget figures, identify systematic biases in estimates, and examine alternative forecasting methods. Section 2905(b) is modified to require CBO and GAO to review budget estimates prepared by the Department of Defense and one other civilian agency. Section 2905(c) is deleted in the Conference agreement. The report would be due June 1, 1985.

Formula approach to Federal budgeting (section 2906)

Section 1315 of the Senate amendment states Congressional findings concerning the growth in Federal deficits and the need to control such growth. Section 1316 of the Senate amendment requires the Director of the Congressional Budget Office and Director of the Office of Management and Budget to conduct a study using alternative formulas for the entire Federal budget.

The House amendment contains no comparable provisions.

The Senate recedes to the House on section 1315.

The House recedes to the Senate amendment with a modification to section 1316.

Mining of Nicaraguan ports (section 2907)

Section 1001 of the Senate amendment states it is the Sense of the Congress that no funds be appropriated in any Act of the Congress for the purpose of mining of the ports or territorial waters of Nicaragua.

The House amendment contains no comparable provision.

The House recedes to the Senate.

National Commission

Section 1602 of the Senate amendment states it is the Sense of the Senate that a National Commission on Federal Spending Reform should be established.

The House amendment contains no comparable provision.

The Senate recedes to the House.

National Commission on Deficit Reduction

Section 1601 of the Senate amendment states it is the Sense of the Congress that a bipartisan National Commission on Deficit Reduction be established.

The House amendment contains no comparable provision.

The Senate recedes to the House.

Solely for consideration of titles I through VIII, section 1002, and title XI of the Senate amendment, and division A of the House amendment to the Senate amendment:

From the Committee on Ways and Means:

DAN ROSTENKOWSKI,
SAM GIBBONS,
J.J. PICKLE,
C.B. RANGEL,
PETE STARK,
BARBER B. CONABLE, Jr.,
JOHN J. DUNCAN,
BILL ARCHER,
Managers on the Part of the House.

From the Committee on Finance, to consider those matters within its jurisdiction:

BOB DOLE,
BOB PACKWOOD,
W.V. ROTH, Jr.,
JOHN C. DANFORTH,
JOHN H. CHAFEE,
RUSSELL B. LONG,
LLOYD BENTSEN,
SPARK M. MATSUNAGA,

MAX BAUCUS,
Managers on the Part of the Senate.

Solely for consideration of sections 921 through 926, 943, 944, 952, and 958 of the Senate amendment and title III, parts B and C of division B of the House amendment to the Senate amendment:

From the Committee on Energy and Commerce:

JOHN D. DINGELL,
HENRY A. WAXMAN,
JAMES H. SCHEUER,
TOM LUKEN,
DOUG WALGREN,
BARBARA A. MIKULSKI,
Managers on the Part of the House.

From the Committee on Finance, to consider those matters within its jurisdiction:

BOB DOLE,
BOB PACKWOOD,
W.V. ROTH, Jr.,
JOHN C. DANFORTH,
JOHN H. CHAFEE,
RUSSELL B. LONG,
LLOYD BENTSEN,
SPARK M. MATSUNAGA,
MAX BAUCUS,
Managers on the Part of the Senate.

Solely for consideration of sections 905, 909, 917, 919, 951, 955, 956, 957, subsections (a), (b), and (c) of section 965, 966, 971 through 976, 981 through 985, and 992 through 997 of title IX of the Senate amendment and title III, sections 308 (2308), 339 (2339), 340 (2340), 342 (2342), and title VI (except for sections 650 (2650) and 661 (2661)) of division B of the House amendment to the Senate amendment:

From the Committee on Ways and Means:

DAN ROSTENKOWSKI,
ANDREW JACOBS, Jr.,
C.B. RANGEL,
MARTY RUSSO,
HAROLD FORD,
PETE STARK,
DONALD J. PEASE,
BARBER B. CONABLE,
JOHN J. DUNCAN,
W. HENSON MOORE,
Managers on the Part of the House.

From the Committee on Finance, to consider those matters within its jurisdiction:

BOB DOLE,
BOB PACKWOOD,
W.V. ROTH, Jr.,
JOHN C. DANFORTH,
JOHN H. CHAFEE,

RUSSELL B. LONG,
LLOYD BENTSEN,
SPARK M. MATSUNAGA,
MAX BAUCUS,
Managers on the Part of the Senate.

Solely for consideration of title IX (except for sections 905, 909, 917, 919, 921 through 926, 943, 944, 951, 952, 955 through 958, subsections (a), (b), and (c) of section 965, 966, 971 through 976, 981 through 985, and 992 through 997)) and section 1611 of the Senate amendment and title III (except for sections 308 (2308), 339 (2339), 340 (2340), and 342 (2342)) of division B of the House amendment to the Senate amendment and sections 650 (2650) and 661 (2661) of division B of the House amendment to the Senate amendment:

From the Committee on Energy and Commerce:

JOHN D. DINGELL,
HENRY A. WAXMAN,
JAMES H. SCHEUER,
TOM LUKEN,
DOUG WALGREN,
BARBARA A. MIKULSKI,

From the Committee on Ways and Means:

DAN ROSTENKOWSKI,
ANDREW JACOBS, Jr.,
C.B. RANGEL,
MARTY RUSSO,
HAROLD FORD,
PETE STARK,
DONALD J. PEASE,
BARBER B. CONABLE,
JOHN J. DUNCAN,
W. HENSON MOORE,
Managers on the Part of the House.

From the Committee on Finance, to consider those matters within its jurisdiction:

BOB DOLE,
BOB PACKWOOD,
W.V. ROTH,
JOHN C. DANFORTH,
JOHN H. CHAFEE,
RUSSELL B. LONG,
LLOYD BENTSEN,
SPARK M. MATSUNAGA,
MAX BAUCUS,
Managers on the Part of the Senate.

Solely for consideration of title XIV and section 1606 of the Senate amendment:

From the Committee on Appropriations:

JAMIE L. WHITTEN,
EDWARD P. BOLAND,
SILVIO O. CONTE,
JOSEPH M. MCDADE,

Solely for consideration of title XIV except for section 1401(f) of the Senate amendment:

From the Committee on Rules:

CLAUDE PEPPER,
GILLIS LONG,
ANTHONY C. BEILENSON,
MARTIN FROST,
Managers on the Part of the House.

From the Committee on Appropriations, to consider those matters within its jurisdiction:

MARK O. HATFIELD,
TED STEVENS,

From the Committee on Governmental Affairs, to consider those matters within its jurisdiction:

W.V. ROTH, Jr.,
BILL COHEN,
TOM EAGLETON,

From the Committee on the Budget:

PETE V. DOMENICI,
WILLIAM L. ARMSTRONG,
NANCY LANDON KASSEBAUM,
RUDY BOSCHWITZ,
JOHN TOWER,
Managers on the Part of the Senate.

Solely for Consideration of title XII and Sections 1604 and 1607 of the Senate amendment, and title II of Division B of the House amendment to the Senate Amendment:

From the Committee on Post Office and Civil Service:

WILLIAM D. FORD,
WILLIAM CLAY,
ROBERT GARCIA,
MICKEY LELAND,
DAN ALBOSTA,
MARY ROSE OAKAR,
GENE TAYLOR,
BENJAMIN A. GILMAN,
TOM CORCORAN,
JIM COURTER,

Solely for consideration of such portions of section 1201 of the Senate amendment and section 201 of division B of the House amendment to the Senate amendment as related to cost-of-living adjustments for military retirees:

From the Committee on Armed Services:

MELVIN PRICE,
BILL NICHOLS,
WM. L. DICKINSON,
ELWOOD HILLIS,

Solely for consideration of section 1604 of the Senate amendment:

From the Committee on the Judiciary:

PETER W. RODINO, Jr.,
JACK BROOKS,

HAMILTON FISH, Jr.,
Managers on the Part of the House.

From the Committee on Governmental Affairs, to consider those matters within its jurisdiction:

W.V. ROTH, Jr.,
CHARLES McC. MATHIAS, Jr.,
BILL COHEN,
TOM EAGLETON,
JEFF BINGAMAN,
Managers on the Part of the Senate.

Solely for consideration of title XV of the House amendment:
From the Committee on Government Operations:

JACK BROOKS,
DON FUQUA,
CARDISS COLLINS,
GLENN ENGLISH,
ELLIOTT H. LEVITAS,
FRANK HORTON,
JOHN N. ERLENBORN,
W. CLINGER,
Managers on the Part of the House.

From the Committee on Armed Services, to consider those matters within its jurisdiction:

BILL COHEN,
DAN QUAYLE,
JEFF BINGAMAN,
CARL LEVIN,

From the Committee on Governmental Affairs, to consider those matters within its jurisdiction:

W.V. ROTH, Jr.,
BILL COHEN,
TOM EAGLETON,
CARL LEVIN,
Managers on the Part of the Senate.

Solely for consideration of sections 1301 through 1314 of the Senate amendment:
From the Committee on Banking, Finance and Urban Affairs:

FERNAND J. ST GERMAIN,
FRANK ANNUNZIO,
CARROLL HUBBARD,
DOUG BARNARD, Jr.,
MARY ROSE OAKAR,
CHALMERS P. WYLIE,
STEWART B. McKINNEY,
Managers on the Part of the House.

From the Committee on Banking, Housing, and Urban Affairs, to consider those matters within its jurisdiction:

JAKE GARN,
JOHN TOWER,

BILL PROXMIRE,
Managers on the Part of the Senate.

Solely for consideration of title IV of division B of the House amendment to the Senate amendment:

From the Committee on Small Business:

PARREN J. MITCHELL,
JOSEPH P. ADDABBO,
JOSEPH M. MCDADE,
Managers on the Part of the House.

From the Committee on Small Business, solely for consideration of title IV of division B of the House amendment to the Senate amendment:

LOWELL P. WEICKER, Jr.,
SLADE GORTON,
DALE BUMPERS,
Managers on the Part of the Senate.

Solely for consideration of title V of division B of the House amendment to the Senate amendment:

From the Committee on Veterans' Affairs:

G.V. MONTGOMERY,
DON EDWARDS,
BOB EDGAR,
DOUGLAS APPLEGATE,
MARVIN LEATH,
RICHARD SHELBY,
JOHN PAUL HAMMERSCHMIDT,
CHALMERS P. WYLIE,
ELWOOD HILLIS,
Managers on the Part of the House.

From the Committee on Veterans' Affairs, solely for consideration of title V of division B of the House amendment to the Senate amendment:

ALAN K. SIMPSON,
STROM THURMOND,
ALAN CRANSTON,
Managers on the Part of the Senate.

Solely for consideration of sections 1603, 1605, 1609, and subsection (b) of section 1610 of the Senate amendment:

From the Committee on Government Operations:

JACK BROOKS,
DON FUQUA,
CARDISS COLLINS,
GLENN ENGLISH,
ELLIOTT H. LEVITAS,
FRANK HORTON,
JOHN N. ERLENBORN,
W. CLINGER,
Managers on the Part of the House.

From the Committee on Governmental Affairs, to consider those matters within its jurisdiction:

W.V. ROTH, Jr.,
BILL COHEN,
TOM EAGLETON,
CARL LEVIN,

From the Committee on the Budget:

PETE V. DOMENICI,
WILLIAM L. ARMSTRONG,
NANCY LANDON KASSEBAUM,
RUDY BOSCHWITZ,
JOHN TOWER,
Managers on the Part of the Senate.

Solely for consideration of title IX, section 1001, and titles XII through XVI of the Senate amendment, and division B of the House amendment to the Senate amendment:

From the Committee on the Budget:

JAMES JONES,
LEON E. PANETTA,
RICHARD GEPHARDT,
BILL NELSON,
BRIAN DONNELLY,
BUTLER DERRICK,
PAT WILLIAMS,
Managers on the Part of the House.

For consideration of the entire bill:

From the Committee on the Budget:

PETE V. DOMENICI,
WILLLIAM L. ARMSTRONG,
NANCY LANDON KASSEBAUM,
RUDY BOSCHWITZ,
JOHN TOWER,
Managers on the Part of the Senate.

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