102D CONGRESS
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HOUSE OF REPRESENTATIVES

REPORT
102-461

TAX FAIRNESS AND ECONOMIC GROWTH ACT OF 1992

CONFERENCE REPORT

TO ACCOMPANY

H.R. 4210

MARCH 20, 1992.—Ordered to be printed

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

CONFERENCE REPORT

[To accompany H.R. 4210]

The committee of conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 4210) to amend the Internal Revenue Code of 1986 to provide incentives for increased economic growth and to provide tax relief for families, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement 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 Senate amendment, insert the following:

SECTION 1. SHORT TITLE, ETC.

(a) SHORT TITLE.—This Act may be cited as the "Tax Fairness and Economic Growth Act of 1992".

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(c) SECTION 15 NOT TO APPLY.—No amendment made by this Act shall be treated as a change in a rate of tax for purposes of section 15 of the Internal Revenue Code of 1986.

(d) UNDERPAYMENT OF ESTIMATED TAX.—No addition to tax shall be made under section 6654 or 6655 of the Internal Revenue Code of 1986 for the 1st required installment for any taxable year beginning in 1992 with respect to any underpayment to the extent such underpayment was created or increased by any amendment made by this

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TITLE I—MIDDLE CLASS TAX RELIEF

SEC. 1001. WORKING FAMILY CREDIT.

(a) GENERAL RULE.—Subpart A of part IV of subchapter A of chapter 1 (relating to nonrefundable personal credits) is amended by inserting after section 22 the following new section:

"SEC. 23. FAMILY-RELATED CREDIT.

"(a) TEMPORARY CREDIT FOR PORTION OF SOCIAL SECURITY TAX.—

"(1) ALLOWANCE OF CREDIT.—In the case of an individual, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to 20 percent of the taxpayer's social security taxes for the taxable year.

"(2) LIMITATION.—The amount of the credit allowable under paragraph (1) to any taxpayer for any taxable year shall not exceed $150 ($300 in the case of a joint return).

"(3) CREDIT REFUNDABLE FOR TAXPAYERS WITH CHILDREN.—In the case of any individual who has a qualifying child (as defined in subsection (e)(2) without regard to subparagraph (B) thereof)—

"(A) the limitation of section 26 shall not apply to the credit allowable under paragraph (1), and

"(B) for purposes of this title, such credit shall be treated as a credit allowable under subpart C (relating to refundable credits).

"(4) YEARS TO WHICH SUBSECTION APPLIES.—This subsection shall only apply to taxable years beginning after December 31, 1991, and before January 1, 1994.

"(b) PERMANENT CREDIT FOR CHILDREN.—

"(1) IN GENERAL.—In the case of an eligible individual, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to $300 multiplied by the number of qualifying children of the taxpayer for the taxable year.

"(2) YEARS TO WHICH SUBSECTION APPLIES.—This subsection shall only apply to taxable years beginning after December 31, 1993.

"(c) PHASE-OUT OF CREDIT.—

"(1) IN GENERAL.—In the case of an eligible individual with an adjusted gross income in excess of $50,000 for any taxable year, the amount of the credit allowed under subsection (a) or (b) (whichever applies) shall be reduced (but not below zero) by the amount determined under paragraph (2).

"(2) AMOUNT OF REDUCTION.—The amount determined under this paragraph equals the amount which bears the same ratio to the credit (determined without regard to this subsection) as—

"(A) the excess of—

"(i) the taxpayer's adjusted gross income for such taxable year, over

"(ii) $50,000, bears to

"(B) $20,000.

Any amount determined under this subparagraph which is not a multiple of $10 shall be rounded to the next lowest $10.

"(2) ADJUSTED GROSS INCOME.—For purposes of paragraph (1), adjusted gross income of any taxpayer shall be increased by any amount excluded from gross income under section 135 or 911.

"(3) SPECIAL RULE FOR YEARS BEFORE 1994.—In the case of any taxable year to which subsection (a) applies, in applying this subsection to any return other than a joint return—

"(A) paragraphs (1) and (2)(A)(ii) shall be applied by substituting '$35,000' for '$50,000', and

"(B) paragraph (2)(B) shall be applied by substituting '$15,000' for '$20,000'.

"(d) SOCIAL SECURITY TAXES.—For purposes of this section—

"(1) IN GENERAL.—The term 'social security taxes' means, with respect to any taxpayer for any taxable year—

"(A) the amount of the taxes imposed by subsections (a) and (b) of section 3101 on amounts received by the taxpayer during the calendar year in which the taxable year begins,

"(B) the amount of the taxes imposed by section 3201(a) on amounts received by the taxpayer during the calendar year in which the taxable year begins,

"(C) 50 percent of the taxes imposed by subsections (a) and (b) of section 1401 on the self-employment income of the taxpayer for the taxable year, and

"(D) 50 percent of the taxes imposed by section 3211(a)(1) on amounts received by the taxpayer during the calendar year in which the taxable year begins.

"(2) TREATMENT OF CERTAIN GOVERNMENTAL PLANS.—The term 'social security taxes' includes any employee contribution under a plan established and maintained for its employees by any State or political subdivision thereof.

"(3) COORDINATION WITH SPECIAL REFUND OF SOCIAL SECURITY TAXES.—The term 'social security taxes' shall not include any taxes to the extent the taxpayer is entitled to a special refund of such taxes under section 6413(c).

"(4) SPECIAL RULE.—Any amounts paid pursuant to an agreement under section 3121(l) (relating to agreements entered into by American employers with respect to foreign affiliates) which are equivalent to the taxes referred to in paragraph (1)(A) shall be treated as taxes referred to in such paragraph.

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

"(1) ELIGIBLE INDIVIDUAL.—The term 'eligible individual' has the meaning given to such term by section 32(c)(1) (determined without regard to subparagraph (B)).

"(2) QUALIFYING CHILD.—The term 'qualifying child' has the meaning given to such term by section 32(c)(3), determined—

"(A) without regard to subparagraph (C)(ii) thereof, and

"(B) by substituting '16' for '19' in subparagraph (C)(iii) thereof.

"(3) CERTAIN OTHER RULES APPLY.—Subsections (d) and (e) of section 32 shall apply.

"(f) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 1994, the dollar amount contained in subsection (b)(1) shall be increased by an amount equal to—

"(1) such dollar amount, multiplied by

"(2) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins by substituting 'calendar year 1993' for 'calendar year 1991' in subparagraph (B) thereof.

If any increase determined under the preceding sentence is not a multiple of $50, such increase shall be rounded to the next lowest multiple of $50."

(b) CLERICAL AMENDMENT.—The table of sections for subpart A of part IV of subchapter A of chapter 1 is amended by inserting after the item relating to section 22 the following new item:

"Sec. 23. Family-related credit."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1991.

SEC. 1002. SIMPLIFICATION AND EXPANSION OF EARNED INCOME TAX CREDIT.

(a) EARNED INCOME TAX CREDIT INCREASED.—Subparagraph (C) of section 32(b)(1) (relating to basic earned income credit) is amended to read as follows:

"(C) PERCENTAGES.—For purposes of this paragraph—

"(i) IN GENERAL.—Except as provided in clause (ii), the percentages shall be determined as follows:

"In the case of an eligible individual with:	The credit percentage is:	The phaseout percentage is:
1 qualifying child	23	16.43
2 or more qualifying children	26	18.56

"(ii) TRANSITION PERCENTAGES.—

"(I) For taxable years beginning in 1992, the percentages are:

"In the case of an eligible individual with:	The credit percentage is:	The phaseout percentage is:
1 qualifying child	17.6	12.57
2 or more qualifying children	18.9	13.49

"(II) For taxable years beginning in 1993:

"In the case of an eligible individual with:	The credit percentage is:	The phaseout percentage is:
1 qualifying child	18.5	13.21
2 or more qualifying children	20.5	14.64."

(b) REPEAL OF INTERACTION WITH MEDICAL EXPENSE DEDUCTION.—Section 213 (relating to medical, dental, etc., expenses) is amended by striking subsection (f).

(c) REPEAL OF INTERACTION WITH DEDUCTION FOR HEALTH INSURANCE COSTS OF SELF-EMPLOYED.—Paragraph (3) of section 162(l) is amended to read as follows:

"(3) COORDINATION WITH MEDICAL DEDUCTION.—Any amount paid by a taxpayer for insurance to which paragraph (1) applies

shall not be taken into account in computing the amount allowable to the taxpayer as a deduction under section 213(a)."

(d) Repeal of Supplemental Young Child Credit.—

(1) In General.—Section 32(b)(1) (relating to supplemental young child credit) is amended by striking subparagraph (D).

(2) Conforming Amendment.—Clause (i) of section 3507(C)(2)(B) (relating to advance amount tables) is amended by striking "(without regard to subparagraph (D) thereof)".

(e) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 1991.

SEC. 1003. CREDIT FOR INTEREST ON EDUCATION LOANS.

(a) In General.—Subpart A of part IV of subchapter A of chapter 1 (relating to nonrefundable personal credits), as amended by section 1001, is amended by inserting after section 23 the following new section:

"SEC. 24. INTEREST ON EDUCATION LOANS.

"(a) Allowance of Credit.—In the case of an individual, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to 25 percent of the interest paid by the taxpayer during the taxable year on any qualified education loan.

"(b) Maximum Credit.—

"(1) In general.—The credit allowed by subsection (a) for the taxable year shall not exceed $400 with respect to each individual whose qualified higher education expenses were financed by any qualified education loan to which such interest relates.

"(2) Phaseout of benefit.—

"(A) In general.—If the modified adjusted gross income of the taxpayer for the taxable year exceeds the applicable limit, the dollar limitation otherwise applicable under this subsection for the taxable year shall be reduced (but not below zero) by the amount which bears the same ratio to such limit as such excess bears to $25,000 ($12,500 in the case of a married individual filing a separate return).

"(B) Applicable limit.—For purposes of subparagraph (A), the applicable limit is—

"(i) $40,000, in the case of a return of an unmarried individual,

"(ii) $60,000, in the case of a joint return, and

"(iii) $30,000 in the case of a married individual filing a separate return.

"(3) Credit not to exceed tax on earned income for taxpayers under age 23.—If the taxpayer has not attained age 23 (or, in the case of a joint return, if neither the husband or wife have attained age 23) before the close of the calendar year ending with or within the taxable year, the credit allowed by subsection (a) for such taxable year shall not exceed the amount equal to the percentage of the taxpayer's regular tax liability for such taxable year which is the same as the percentage of the taxpayer's modified adjusted gross income for such taxable year which is attributable to earned income (as defined in section 911(d)(2)).

"(c) LIMITATION ON TAXPAYERS ELIGIBLE FOR CREDIT.—No credit shall be allowed by this section to an individual for the taxable year if a deduction under section 151 with respect to such individual is allowed to another taxpayer for the taxable year beginning in the calendar year in which such individual's taxable year begins.

"(d) LIMIT ON PERIOD CREDIT ALLOWED.—

"(1) TAXPAYER AND TAXPAYER'S SPOUSE.—Except as provided in paragraph (2), a credit shall be allowed under this section only with respect to interest paid on any qualified education loan which is allocable to the first 48 months during which interest accrued on such loan. For purposes of this paragraph, any loan and all refinancings of such loan shall be treated as 1 loan.

"(2) DEPENDENT.—If the qualified education loan was used to pay education expenses of an individual other than the taxpayer or the taxpayer's spouse, a credit shall be allowed under this section for any taxable year with respect to such loan only if—

"(A) a deduction under section 151 with respect to such individual is allowed to the taxpayer for such taxable year, and

"(B) such individual is at least a half-time student with respect to such taxable year.

"(e) DEFINITIONS.—For purposes of this section—

"(1) QUALIFIED EDUCATION LOAN.—The term 'qualified education loan' means any indebtedness incurred to pay qualified higher education expenses—

"(A) which are paid or incurred within a reasonable period of time before or after the indebtedness is incurred, and

"(B) which are attributable to education furnished during a period during which the recipient was at least a half-time student.

Such term includes indebtedness used to refinance indebtedness which qualifies as a qualified education loan. The term 'qualified education loan' shall not include any indebtedness owed to a person who is related (within the meaning of section 267(b) or 707(b)(1)) to the taxpayer.

"(2) QUALIFIED HIGHER EDUCATION EXPENSES.—

"(A) IN GENERAL.—The term 'qualified higher education expenses' means qualified tuition and related expenses of the taxpayer, his spouse, or a dependent for attendance at an eligible educational institution (as defined in section 135(c)(3)), reduced by the amount excluded from gross income under section 135 by reason of such expenses.

"(B) QUALIFIED TUITION AND RELATED EXPENSES.—The term 'qualified tuition and related expenses' has the meaning given such term by section 117(b), except that such term shall include any reasonable living expenses while away from home.

"(3) MODIFIED ADJUSTED GROSS INCOME.—The term 'modified adjusted gross income' has the meaning given to such term by section 86(b)(2).

"(4) HALF-TIME STUDENT.—The term 'half-time student' means any individual who would be a student as defined in section 151(c)(4) if 'half-time' were substituted for 'full-time' each place it appears in such section.

"(5) DEPENDENT.—The term 'dependent' has the meaning given such term by section 152.

"(f) SPECIAL RULES.—

"(1) DENIAL OF DOUBLE BENEFIT.—No credit shall be allowed under this section for any amount for which a deduction is allowable under any other provision of this chapter.

"(2) MARITAL STATUS.—Marital status shall be determined in accordance with section 7703."

(b) CLERICAL AMENDMENT.—The table of sections for such subpart A is amended by inserting after the item relating to section 23 the following new item:

"Sec. 24. Interest on education loans."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to qualified education loans (as defined in section 24(e) of the Internal Revenue Code of 1986) the first payment on which is due in taxable years beginning after December 31, 1991.

SEC. 1004. INCOME EXCLUSION FOR EDUCATION BONDS EXPANDED.

(a) IDENTIFYING INFORMATION REQUIRED.—Section 135(b)(2) is amended to read as follows:

"(2) IDENTIFYING INFORMATION REQUIRED WITH RESPECT TO INDIVIDUAL FOR WHOM EXPENSES PAID.—No amount shall be allowed as an exclusion under subsection (a) unless the taxpayer includes the name, address, and taxpayer identification number of the person for whom qualified higher education expenses were paid on the return on which the exclusion is claimed."

(b) ELIMINATION OF AGE RESTRICTION.—Section 135(c)(1) (defining qualified United States savings bonds) is amended—

(1) by striking subparagraph (B),

(2) by inserting "and" at the end of subparagraph (A), and

(3) by redesignating subparagraph (C) as subparagraph (B).

(c) EXCLUSION EXPANDED TO ALL INDIVIDUALS.—Subparagraph (A) of section 135(c)(2) (defining qualified higher education expenses) is amended to read as follows:

"(A) IN GENERAL.—The term 'qualified higher education expenses' means tuition and fees required for enrollment or attendance of any individual at an eligible educational institution."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to bonds redeemed after December 31, 1991.

SEC. 1005. MODIFICATIONS OF ONE-TIME EXCLUSION OF GAIN FROM SALE OF PRINCIPAL RESIDENCE.

(a) AGE LIMITATION NOT APPLICABLE TO DISABLED INDIVIDUALS.—

(1) IN GENERAL.—Paragraph (1) of section 121(a) (relating to one-time exclusion from sale of principal residence by an individual who has attained age 55) is amended to read as follows:

"(1)(A) the taxpayer has attained the age of 55 before the date of such sale or exchange, or (B) the taxpayer is permanently and

totally disabled (as defined in section 22(e)(3)) as of such date, and".

(2) CONFORMING AMENDMENT.—Paragraph (1) of section 121(d) is amended by striking "the age, holding, and use requirements" and inserting "the requirements".

(b) INDEXATION OF DOLLAR LIMIT.—Subsection (b) of section 121 (relating to limitations) is amended by adding at the end thereof the following new paragraph:

"(4) COST-OF-LIVING ADJUSTMENTS.—In the case of a sale or exchange in a calendar year beginning after 1991—

"(A) the $125,000 amount set forth in paragraph (1) shall be increased by an amount equal to such dollar amount multiplied by the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting 'calendar year 1990' for 'calendar year 1991' in subparagraph (B) thereof, and

"(B) the $62,500 amount set forth in paragraph (1) shall be increased by ½ of the increase determined under subparagraph (A).

If any increase determined under subparagraph (A) is not a multiple of $100, such increase shall be rounded to the nearest multiple of $100."

(c) TREATMENT OF FARMLAND SOLD WITH RESIDENCE.—Subsection (d) of section 121 is amended by adding at the end thereof the following new paragraph:

"(10) TREATMENT OF FARMLAND SOLD WITH RESIDENCE.—If—

"(A) a parcel of farmland on which is located a residence with respect to which the taxpayer meets the holding and use requirements of subsection (a) is sold with such residence,

"(B) the taxpayer meets the holding requirements of subsection (a) with respect to such farmland, and

"(C) the taxpayer meets requirements similar to the requirements of section 2032A(b)(1)(C) with respect to such farmland,

notwithstanding paragraph (5), the taxpayer shall be treated as meeting the use requirements of subsection (a) with respect to so much of such parcel as does not exceed 160 acres."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to sales or exchanges after December 31, 1991.

SEC. 1006. TREATMENT OF EMPLOYER-PROVIDED TRANSPORTATION BENEFITS.

(a) EXCLUSION.—Subsection (a) of section 132 (relating to exclusion of certain fringe benefits) is amended by striking "or" at the end of paragraph (3), by striking the period at the end of paragraph (4) and inserting ", or", and by adding at the end thereof the following new paragraph:

"(5) qualified transportation fringe."

(b) QUALIFIED TRANSPORTATION FRINGE.—Section 132 is amended by redesignating subsections (f), (g), (h), (i), (j), and (k) as subsections (g), (h), (i), (j), (k), and (l), respectively, and by inserting after subsection (e) the following new subsection:

"(f) QUALIFIED TRANSPORTATION FRINGE.—

"(1) IN GENERAL.—For purposes of this section, the term 'qualified transportation fringe' means any of the following provided by an employer to an employee:

"(A) Transportation in a commuter highway vehicle if such transportation is in connection with travel between the employee's residence and place of employment.

"(B) Any transit pass.

"(C) Qualified parking.

"(2) LIMITATION ON EXCLUSION.—The amount of the fringe benefits which are provided by an employer to any employee and which may be excluded from gross income under subsection (a)(5) shall not exceed—

"(A) $60 per month in the case of the aggregate of the benefits described in subparagraphs (A) and (B) of paragraph (1), and

"(B) $160 per month in the case of qualified parking.

"(3) BENEFIT NOT IN LIEU OF COMPENSATION.—Subsection (a)(5) shall not apply to any qualified transportation fringe unless such benefit is provided in addition to (and not in lieu of) any compensation otherwise payable to the employee.

"(4) DEFINITIONS.—For purposes of this subsection—

"(A) TRANSIT PASS.—The term 'transit pass' means any pass, token, farecard, voucher, or similar item entitling a person to transportation (or transportation at a reduced price) if such transportation is—

"(i) on mass transit facilities (whether or not publicly owned), or

"(ii) provided by any person in the business of transporting persons for compensation or hire if such transportation is provided in a vehicle meeting the requirements of subparagraph (B)(i).

"(B) COMMUTER HIGHWAY VEHICLE.—The term 'commuter highway vehicle' means any highway vehicle—

"(i) the seating capacity of which is at least 6 adults (not including the driver), and

"(ii) at least 80 percent of the mileage use of which can reasonably be expected to be—

"(I) for purposes of transporting employees in connection with travel between their residences and their place of employment, and

"(II) on trips during which the number of employees transported for such purposes is at least ½ of the adult seating capacity of such vehicle (not including the driver).

"(C) QUALIFIED PARKING.—The term 'qualified parking' means parking provided to an employee on or near the business premises of the employer or on or near a location from which the employee commutes to work by transportation described in subparagraph (A), in a commuter highway vehicle, or by carpool.

"(D) TRANSPORTATION PROVIDED BY EMPLOYER.—Transportation referred to in paragraph (1)(A) shall be considered to be provided by an employer if such transportation is fur-

nished in a commuter highway vehicle operated by or for the employer.

"(E) EMPLOYEE.—For purposes of this subsection, the term 'employee' does not include an individual who is an employee within the meaning of section 401(c)(1).

"(5) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 1992, the dollar amounts contained in paragraph (2)(A) and (B) shall be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins.

If any increase determined under the preceding sentence is not a multiple of $1, such increase shall be rounded to the next lowest multiple of $1.

"(6) COORDINATION WITH OTHER PROVISIONS.—For purposes of this section, the terms 'working condition fringe' and 'de minimis fringe' shall not include any qualified transportation fringe (determined without regard to paragraph (2))."

(c) CONFORMING AMENDMENT.—Subsection (i) of section 132 (as redesignated by subsection (b)) is amended by striking paragraph (4) and redesignating the following paragraphs accordingly.

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to benefits provided after December 31, 1991.

(2) PARKING LIMIT.—The limitation of subparagraph (B) of section 132(f)(2) of the Internal Revenue Code of 1986 (as amended by this section) shall only apply to benefits provided for months beginning after the date of the enactment of this Act.

TITLE II—PROMOTION OF LONG-TERM ECONOMIC GROWTH

Subtitle A—Increased Savings

PART I—RETIREMENT SAVINGS INCENTIVES

Subpart A—Restoration of IRA Deduction

SEC. 2001. RESTORATION OF IRA DEDUCTION.

(a) IN GENERAL.—Section 219 (relating to deduction for retirement savings) is amended by striking subsection (g) and by redesignating subsection (h) as subsection (g).

(b) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Subsection (f) of section 219 is amended by striking paragraph (7).

(2) Paragraph (5) of section 408(d) is amended by striking the last sentence.

(3) Section 408(o) is amended by adding at the end thereof the following new paragraph:

"(5) TERMINATION.—This subsection shall not apply to any designated nondeductible contribution for any taxable year beginning after December 31, 1992."

(4) Subsection (b) of section 4973 is amended by striking the last sentence.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1992.

SEC. 2002. INFLATION ADJUSTMENT FOR DEDUCTIBLE AMOUNT.

(a) IN GENERAL.—Section 219, as amended by section 2001, is amended by redesignating subsection (g) as subsection (h) and by inserting after subsection (f) the following new subsection:

"(g) COST-OF-LIVING ADJUSTMENTS.—

"(1) IN GENERAL.—If the cost-of-living amount for any calendar year is equal to or greater than $500, then each applicable dollar amount (as previously adjusted under this subsection) for any taxable year beginning in any subsequent calendar year shall be increased by $500.

"(2) COST-OF-LIVING AMOUNT.—The cost-of-living amount for any calendar year is the excess (if any) of—

"(A) $2,000, increased by the cost-of-living adjustment for such calendar year, over

"(B) the applicable dollar amount in effect under subsection (b)(1)(A) for taxable years beginning in such calendar year.

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

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

"(i) the CPI for such calendar year, exceeds

"(ii) the CPI for 1991.

"(B) CPI FOR ANY CALENDAR YEAR.—The CPI for any calendar year shall be determined in the same manner as under section 1(f)(4).

"(4) APPLICABLE DOLLAR AMOUNT.—For purposes of this subsection, the term 'applicable dollar amount' means the dollar amount in effect under any of the following provisions:

"(A) Subsection (b)(1)(A).

"(B) Subsection (c)(2)(A)(i).

"(C) The last sentence of subsection (c)(2)."

(b) CONFORMING AMENDMENTS.—

(1) Section 408(a)(1) is amended by striking "in excess of $2,000 on behalf of any individual" and inserting "on behalf of any individual in excess of the amount in effect for such taxable year under section 219(b)(1)(A)".

(2) Section 408(b)(2)(B) is amended by striking "$2,000" and inserting "the dollar amount in effect under section 219(b)(1)(A)".

(3) Section 408(j) is amended by striking "$2,000".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1992.

SEC. 2003. COORDINATION OF IRA DEDUCTION LIMIT WITH ELECTIVE DEFERRAL LIMIT.

(a) IN GENERAL.—Section 219(b) (relating to maximum amount of deduction) is amended by adding at the end thereof the following new paragraph:

"(4) COORDINATION WITH ELECTIVE DEFERRAL LIMIT.—The amount determined under paragraph (1) or subsection (c)(2) with respect to any individual for any taxable year shall not exceed the excess (if any) of—

"(A) the maximum amount of elective deferrals of the individual which are excludable from gross income for the taxable year under section 402(g)(1), over

"(B) the amount so excluded."

(b) CONFORMING AMENDMENT.—Section 219(c) is amended by adding at the end thereof the following new paragraph:

"(3) CROSS REFERENCE.—

"For reduction in paragraph (2) amount, see subsection (b)(4)."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1992.

Subpart B—Nondeductible Tax-Free IRAs

SEC. 2011. ESTABLISHMENT OF NONDEDUCTIBLE TAX-FREE INDIVIDUAL RETIREMENT ACCOUNTS.

(a) IN GENERAL.—Subpart A of part I of subchapter D of chapter 1 (relating to pension, profit-sharing, stock bonus plans, etc.) is amended by inserting after section 408 the following new section:

"SEC. 408A. SPECIAL INDIVIDUAL RETIREMENT ACCOUNTS.

"(a) GENERAL RULE.—Except as provided in this section, a special individual retirement account shall be treated for purposes of this title in the same manner as an individual retirement plan.

"(b) SPECIAL INDIVIDUAL RETIREMENT ACCOUNT.—For purposes of this title, the term 'special individual retirement account' means an individual retirement plan which is designated at the time of establishment of the plan as a special individual retirement account.

"(c) TREATMENT OF CONTRIBUTIONS.—

"(1) NO DEDUCTION ALLOWED.—No deduction shall be allowed under section 219 for a contribution to a special individual retirement account.

"(2) CONTRIBUTION LIMIT.—The aggregate amount of contributions for any taxable year to all special individual retirement accounts maintained for the benefit of an individual shall not exceed the excess (if any) of—

"(A) the maximum amount allowable as a deduction under section 219 with respect to such individual for such taxable year, over

"(B) the amount so allowed.

"(3) SPECIAL RULES FOR QUALIFIED TRANSFERS.—

"(A) IN GENERAL.—No rollover contribution may be made to a special individual retirement account unless it is a qualified transfer.

"(B) LIMIT NOT TO APPLY.—The limitation under paragraph (2) shall not apply to a qualified transfer to a special individual retirement account.

"(d) TAX TREATMENT OF DISTRIBUTIONS.—

"(1) IN GENERAL.—Except as provided in this subsection, any amount paid or distributed out of a special individual retirement account shall not be included in the gross income of the distributee.

"(2) EXCEPTION FOR EARNINGS ON CONTRIBUTIONS HELD LESS THAN 5 YEARS.—

"(A) IN GENERAL.—Any amount distributed out of a special individual retirement account which consists of earnings allocable to contributions made to the account during the 5-year period ending on the day before such distribution shall be included in the gross income of the distributee for the taxable year in which the distribution occurs.

"(B) ORDERING RULE.—

"(i) FIRST-IN, FIRST-OUT RULE.—Distributions from a special individual retirement account shall be treated as having been made—

"(I) first from the earliest contribution (and earnings allocable thereto) remaining in the account at the time of the distribution, and

"(II) then from other contributions (and earnings allocable thereto) in the order in which made.

"(ii) ALLOCATIONS BETWEEN CONTRIBUTIONS AND EARNINGS.—Any portion of a distribution allocated to a contribution (and earnings allocable thereto) shall be treated as allocated first to the earnings and then to the contribution.

"(iii) ALLOCATION OF EARNINGS.—Earnings shall be allocated to a contribution in such manner as the Secretary may by regulations prescribe.

"(iv) CONTRIBUTIONS IN SAME YEAR.—Under regulations, all contributions made during the same taxable year may be treated as 1 contribution for purposes of this subparagraph.

"(C) CROSS REFERENCE.—

"For additional tax for early withdrawal, see section 72(t).

"(3) QUALIFIED TRANSFER.—

"(A) IN GENERAL.—Paragraph (2) shall not apply to any distribution which is transferred in a qualified transfer to another special individual retirement account.

"(B) CONTRIBUTION PERIOD.—For purposes of paragraph (2), the special individual retirement account to which any contributions are transferred shall be treated as having held such contributions during any period such contributions were held (or are treated as held under this subparagraph) by the special individual retirement account from which transferred.

"(4) SPECIAL RULES RELATING TO CERTAIN TRANSFERS.—

"(A) IN GENERAL.—Notwithstanding any other provision of law, in the case of a qualified transfer to a special indi-

vidual retirement account from an individual retirement plan which is not a special individual retirement account—

"(i) there shall be included in gross income any amount which, but for the qualified transfer, would be includible in gross income, but

"(ii) section 72(t) shall not apply to such amount.

"(B) TIME FOR INCLUSION.—In the case of any qualified transfer which occurs before January 1, 1994, any amount includible in gross income under subparagraph (A) with respect to such contribution shall be includible ratably over the 4-taxable year period beginning in the taxable year in which the amount was paid or distributed out of the individual retirement plan.

"(e) QUALIFIED TRANSFER.—For purposes of this section, the term 'qualified transfer' means a transfer to a special individual retirement account from another such account or from an individual retirement plan but only if such transfer meets the requirements of section 408(d)(3)."

(b) EARLY WITHDRAWAL PENALTY.—Section 72(t), as amended by section 2021, is amended by adding at the end thereof the following new paragraph:

"(7) RULES RELATING TO SPECIAL INDIVIDUAL RETIREMENT ACCOUNTS.—In the case of a special individual retirement account under section 408A—

"(A) this subsection shall only apply to distributions out of such account which consist of earnings allocable to contributions made to the account during the 5-year period ending on the day before such distribution, and

"(B) paragraph (2)(A)(i) shall not apply to any distribution described in subparagraph (A)."

(c) EXCESS CONTRIBUTIONS.—Section 4973(b) is amended by adding at the end thereof the following new sentence: "For purposes of paragraphs (1)(B) and (2)(C), the amount allowable as a deduction under section 219 shall be computed without regard to section 408A."

(d) CONFORMING AMENDMENT.—The table of sections for subpart A of part I of subchapter D of chapter 1 is amended by inserting after the item relating to section 408 the following new item:

"Sec. 408A. Special individual retirement accounts."

(e) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 1992.

(2) QUALIFIED TRANSFERS IN 1992.—The amendments made by this section shall apply to any qualified transfer during any taxable year beginning in 1992.

PART II—PENALTY-FREE DISTRIBUTIONS

SEC. 2021. PENALTY-FREE WITHDRAWALS FOR FIRST HOME PURCHASE, HIGHER EDUCATION EXPENSES, MEDICAL EXPENSES, AND EXPENSES OF UNEMPLOYED INDIVIDUALS.

(a) FIRST HOME PURCHASE.—

(1) IN GENERAL.—Paragraph (2) of section 72(t) (relating to exceptions to 10-percent additional tax on early distributions from qualified retirement plans) is amended by adding after subparagraph (C) the following new subparagraph:

"(D) DISTRIBUTION FROM INDIVIDUAL RETIREMENT PLAN FOR FIRST HOME PURCHASE.—A distribution to an individual from an individual retirement plan with respect to which the requirements of paragraph (6) are met."

(2) DEFINITIONS.—Subsection (t) of section 72 is amended by adding after paragraph (5) the following new paragraph:

"(6) REQUIREMENTS APPLICABLE TO FIRST HOME PURCHASE DISTRIBUTION.—For purposes of paragraph (2)(D)—

"(A) IN GENERAL.—The requirements of this paragraph are met with respect to a distribution if the distribution meets the requirements of clauses (i), (ii), and (iii).

"(i) DOLLAR LIMIT.—A distribution meets the requirements of this clause to the extent that the amount of the distribution does not exceed the excess (if any) of—

"(I) $10,000, over

"(II) the sum of the distributions to which paragraph (2)(D) previously applied with respect to the residence (whether or not such distributions were from the individual retirement plan of the owner).

"(ii) USE OF DISTRIBUTION.—A distribution meets the requirements of this clause if the distribution—

"(I) is made to or on behalf of a qualified first home purchaser, and

"(II) is applied within 60 days of the date of distribution to the purchase or construction of a principal residence of such purchaser.

"(iii) ELIGIBLE PLANS.—A distribution meets the requirements of this clause if the distribution is not made from an individual retirement plan—

"(I) which is an inherited individual retirement plan (within the meaning of section 408(d)(3)(C)(ii)), or

"(II) any part of the contributions to which were excludable from income under section 402(c), 403(a)(4), or 403(b)(8).

"(B) QUALIFIED FIRST HOME PURCHASER.—For purposes of this paragraph, the term 'qualified first home purchaser' means the individual who is the owner of the individual retirement plan, the spouse of such owner, or the child (as defined in section 151(c)(3)) or grandchild of such owner, but only if—

"(i) such individual (and, if married, such individual's spouse) had no present ownership interest in a residence at any time within the 36-month period ending on the date on which the distribution is applied pursuant to subparagraph (A)(ii), and

"(ii) subsection (h) or (k) of section 1034 did not suspend the running of any period of time specified in section 1034 with respect to such individual on the day

before the date the distribution is applied pursuant to subparagraph (A)(ii).

"(C) SPECIAL RULE WHERE DELAY IN ACQUISITION.—If any distribution from an individual retirement plan fails to meet the requirements of subparagraph (A) solely by reason of a delay or cancellation of the purchase or construction of the residence, the amount of the distribution may be contributed to an individual retirement plan as provided in section 408(d)(3)(A)(i) (determined by substituting '120 days' for '60 days' in such section), except that—

"(i) section 408(d)(3)(B) shall not be applied to such contribution, and

"(ii) such amount shall not be taken into account—

"(I) in determining whether section 408(d)(3)(A)(i) applies to any other amount, or

"(II) for purposes of subclause (II) of subparagraph (A)(i).

"(D) PRINCIPAL RESIDENCE.—For purposes of this paragraph, the term 'principal residence' has the meaning given such term by section 1034.

"(E) OWNER.—For purposes of this paragraph, the term 'owner' means, with respect to any individual retirement plan, the individual with respect to whom such plan was established."

(b) EDUCATIONAL EXPENSES.—Paragraph (2) of section 72(t) is amended by adding after subparagraph (D) the following new subparagraph:

"(E) DISTRIBUTION FROM INDIVIDUAL RETIREMENT PLAN FOR HIGHER EDUCATION EXPENSES.—A distribution from an individual retirement plan (other than a plan referred to in subclause (I) or (II) of paragraph (6)(A)(iii)) to the owner of such plan if such distribution is used within 60 days of the date of the distribution to pay qualified tuition and related expenses (as defined in section 117(b)) of the owner, the owner's spouse, or the child (as defined in section 151(c)(3)) or grandchild of the owner, except that such expenses shall—

"(i) be reduced by any amount excluded from gross income under section 135 by reason of such expenses, and

"(ii) include any reasonable living expenses while away from home."

(c) MEDICAL EXPENSES.—

(1) IN GENERAL.—Subparagraph (A) of section 72(t)(3) is amended by striking ", (B),".

(2) CERTAIN LINEAL DESCENDANTS AND ANCESTORS TREATED AS DEPENDENTS.—Subparagraph (B) of section 72(t)(2) is amended by striking "medical care" and all that follows and inserting "medical care determined—

"(i) without regard to whether the employee itemizes deductions for such taxable year, and

"(ii) by treating such employee's dependents as including—

"(I) all children and grandchildren of the employee or such employee's spouse, and

"(II) all ancestors of the employee or such employee's spouse."

(3) CONFORMING AMENDMENT.—Subparagraph (B) of section 72(t)(2) is amended by striking "or (C)" and inserting ", (C), (D), or (E)".

(d) PENALTY-FREE DISTRIBUTIONS FOR CERTAIN UNEMPLOYED INDIVIDUALS.—Paragraph (2) of section 72(t) is amended by adding at the end thereof the following new subparagraph:

"(F) DISTRIBUTIONS TO UNEMPLOYED INDIVIDUALS.—A distribution from an individual retirement plan (other than a plan referred to in subclause (I) or (II) of paragraph (6)(A)(iii)) to an individual after separation from employment, if—

"(i) such individual has received unemployment compensation for 12 consecutive weeks under any Federal or State unemployment compensation law by reason of such separation, and

"(ii) such distributions are made during any taxable year during which such unemployment compensation is paid or the succeeding taxable year."

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to payments and distributions on and after February 1, 1992.

SEC. 2022. CONTRIBUTIONS MUST BE HELD AT LEAST 5 YEARS IN CERTAIN CASES.

(a) IN GENERAL.—Section 72(t), as amended by section 2011(b), is amended by adding at the end thereof the following new paragraph:

"(8) CERTAIN CONTRIBUTIONS MUST BE HELD 5 YEARS.—

"(A) IN GENERAL.—Paragraph (2)(A)(i) shall not apply to any amount distributed out of an individual retirement plan (other than a special individual retirement account) which is allocable to contributions made to the plan during the 5-year period ending on the date of such distribution (and earnings on such contributions).

"(B) ORDERING RULE.—For purposes of this paragraph, distributions shall be treated as having been made—

"(i) first from the earliest contribution (and earnings allocable thereto) remaining in the account at the time of the distribution, and

"(ii) then from other contributions (and earnings allocable thereto) in the order in which made.

Earnings shall be allocated to contributions in such manner as the Secretary may prescribe.

"(C) SPECIAL ACCOUNTS.—For rules applicable to special individual retirement accounts under section 408A, see paragraph (7)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to contributions (and earnings allocable thereto) which are made after December 31, 1992.

Subtitle B—Capital Gain Provisions

PART I—PROGRESSIVE CAPITAL GAIN RATES

SEC. 2101. PROGRESSIVE CAPITAL GAIN RATES.

(a) IN GENERAL.—Section 1(h) (relating to maximum capital gains rate) is amended to read as follows:

"(h) PROGRESSIVE CAPITAL GAINS RATE.—

"(1) IN GENERAL.—If a taxpayer has qualified capital gain for any taxable year, then the tax imposed by this section shall be equal to the sum of—

"(A) a tax computed at the rates and in the same manner as if this subsection had not been enacted on taxable income reduced by the amount of qualified capital gain, plus

"(B) the excess (if any) of—

"(i) a tax computed under the substitute table on taxable income, over

"(ii) a tax computed under the substitute table on taxable income reduced by the amount of qualified capital gain.

"(2) SUBSTITUTE TABLES.—

"(A) IN GENERAL.—In the case of any taxable year ending after January 31, 1992, the Secretary shall prescribe a substitute table for each of the tables under subsections (a), (b), (c), (d), and (e).

"(B) METHOD OF PRESCRIBING TABLES.—The tables under subparagraph (A) for any taxable year shall be the tables in effect without regard to this subsection, adjusted by—

"(i) substituting the capital gain rates for the rates of tax contained therein, and

"(ii) modifying the amounts setting forth the tax to the extent necessary to reflect the adjustments under clause (i).

"(C) CAPITAL GAIN RATES.—For purposes of subparagraph (B)(i), the capital gain rates shall be determined as follows:

"If the rate of tax is:	*The capital gain rate is:*
15 percent	*0 percent*
28 percent	*14 percent*
31 percent	*21 percent*
36 percent	*28 percent.*

"(3) QUALIFIED CAPITAL GAIN.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'qualified capital gain' means net capital gain determined without regard to any gain taken into account in computing the exclusion under section 1202 (relating to gain from sale of small business stock).

"(B) TRANSITION RULE.—In the case of any taxable year beginning before February 1, 1992, and ending on or after such date, qualified capital gain shall be equal to the lesser of—

"(i) net capital gain, or

"(ii) net capital gain determined by taking into account only gain or loss properly taken into account for the portion of the taxable year after January 31, 1992.

If the amount under clause (i) exceeds the amount under clause (ii) for such taxable year, the rate of tax under this section shall not exceed 28 percent with respect to such excess.

"(C) SPECIAL RULE FOR PASS-THRU ENTITIES.—

"(i) IN GENERAL.—In applying subparagraph (B) with respect to any pass-thru entity, the determination of when gain is properly taken into account shall be made at the entity level.

"(ii) PASS-THRU ENTITY DEFINED.—For purposes of clause (i), the term 'pass-thru entity' means—

"(I) a regulated investment company,

"(II) a real estate investment trust,

"(III) an S corporation,

"(IV) a partnership,

"(V) an estate or trust, and

"(VI) a common trust fund."

(b) TREATMENT OF COLLECTIBLES.—

(1) IN GENERAL.—Section 1222 is amended by inserting after paragraph (11) the following new paragraph:

"(12) SPECIAL RULE FOR COLLECTIBLES.—

"(A) IN GENERAL.—Any gain or loss from the sale or exchange of a collectible shall be treated as a short-term capital gain or loss (as the case may be), without regard to the period such asset was held. The preceding sentence shall apply only to the extent the gain or loss is taken into account in computing taxable income.

"(B) TREATMENT OF CERTAIN SALES OF INTEREST IN PARTNERSHIP, ETC.—For purposes of subparagraph (A), any gain from the sale or exchange of an interest in a partnership, S corporation, or trust which is attributable to unrealized appreciation in the value of collectibles held by such entity shall be treated as gain from the sale or exchange of a collectible. Rules similar to the rules of section 751(f) shall apply for purposes of the preceding sentence.

"(C) COLLECTIBLE.—For purposes of this paragraph, the term 'collectible' means any capital asset which is a collectible (as defined in section 408(m) without regard to paragraph (3) thereof)."

(2) CHARITABLE DEDUCTION NOT AFFECTED.—

(A) Paragraph (1) of section 170(e) is amended by adding at the end thereof the following new sentence: "For purposes of this paragraph, section 1222 shall be applied without regard to paragraph (12) thereof (relating to special rule for collectibles)."

(B) Clause (iv) of section 170(b)(1)(C) is amended by inserting before the period at the end thereof the following: "and section 1222 shall be applied without regard to paragraph (12) thereof (relating to special rule for collectibles)".

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendment made by subsection (a) shall apply to taxable years ending after January 31, 1992.

(2) COLLECTIBLES.—The amendments made by subsection (b) shall apply to dispositions after January 31, 1992.

SEC. 2102. INCREASE IN HOLDING PERIOD REQUIRED FOR LONG-TERM CAPITAL GAIN TREATMENT.

(a) IN GENERAL.—

(1) CAPITAL GAIN.—Paragraphs (1) and (3) of section 1222 (relating to other terms relating to capital gains and losses) are each amended by striking "1 year" and inserting "2 years".

(2) CAPITAL LOSSES.—Paragraphs (2) and (4) of section 1222 are each amended by striking "1 year" and inserting "2 years".

(b) CONFORMING AMENDMENTS.—The following provisions are each amended by striking "1 year" each place it appears and inserting "2 years":

(1) Section 166(d)(1)(B).

(2) Section 422(a)(1).

(3) Section 421(a)(1).

(4) Section 584(c).

(5) Subsections (a), (b), and (c) of section 631.

(6) Section 642(c)(3).

(7) Paragraphs (1) and (2) of section 702(a).

(8) Section 818(b)(1).

(9) Section 852(b)(3)(B).

(10) Section 856(c)(4)(A).

(11) Section 857(b)(3)(B).

(12) Paragraphs (11) and (12) of section 1223.

(13) Subsections (b), (d), and subparagraph (A) of subchapter (e)(4) of section 1233.

(14) Section 1234(b)(1).

(15) Section 1235(a).

(16) Subsections (b) and (g)(2)(C) of section 1248.

(c) TECHNICAL AMENDMENTS.—

(1) Section 7518(g)(3)(B) is amended by striking "6 months" and inserting "2 years".

(2) Section 1231 (b)(3)(B) is amended by striking "12 months" and inserting "24 months".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1992.

SEC. 2103. RECAPTURE UNDER SECTION 1250 OF TOTAL AMOUNT OF DEPRECIATION.

(a) GENERAL RULE.—Subsections (a) and (b) of section 1250 (relating to gain from disposition of certain depreciable realty) are amended to read as follows:

"(a) GENERAL RULE.—Except as otherwise provided in this section, if section 1250 property is disposed of, the lesser of—

"(1) the depreciation adjustments in respect of such property, or

"(2) the excess of—

"(A) the amount realized (or, in the case of a disposition other than sale, exchange, or involuntary conversion, the fair market value of such property), over

"(B) the adjusted basis of such property,

shall be treated as gain which is ordinary income. Such gain shall be recognized notwithstanding any other provision of this subtitle.

"(b) DEPRECIATION ADJUSTMENTS.—For purposes of this section, the term 'depreciation adjustments' means, in respect of any property, all adjustments attributable to periods after December 31, 1963, reflected in the adjusted basis of such property on account of deductions (whether in respect of the same or other property) allowed or allowable to the taxpayer or to any other person for exhaustion, wear and tear, obsolescence, or amortization (other than amortization under section 168 (as in effect before its repeal by the Tax Reform Act of 1976), 169, 185 (as in effect before its repeal by the Tax Reform Act of 1986), 188 (as in effect before its repeal by the Revenue Reconciliation Act of 1990), 190, or 193). For purposes of the preceding sentence, if the taxpayer can establish by adequate records or other sufficient evidence that the amount allowed as a deduction for any period was less than the amount allowable, the amount taken into account for such period shall be the amount allowed."

(b) MAXIMUM RATE ON RECAPTURE AMOUNT.—Section 1 (relating to tax imposed) is amended by adding at the end the following new section:

"(i) MAXIMUM RATE OF TAX ON SECTION 1250 RECAPTURE AMOUNTS.—If a taxpayer has any amount treated as ordinary income under section 1250 for any taxable year, then the tax imposed by this section shall not exceed the sum of—

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

"(A) taxable income reduced by the amount treated as ordinary income under section 1250, or

"(B) the amount of taxable income taxed at a rate below 28 percent, plus

"(2) a tax of 28 percent of the amount of taxable income in excess of the amount determined under paragraph (1)."

(c) LIMITATION IN CASE OF INSTALLMENT SALES.—Subsection (i) of section 453 is amended—

(1) by striking "1250" the first place it appears and inserting "1250 (as in effect on December 31, 1991)", and

(2) by striking "1250" the second place it appears and inserting "1250 (as so in effect)".

(d) CONFORMING AMENDMENTS.—

(1) Subparagraph (E) of section 1250(d)(4) is amended—

(A) by striking "additional depreciation" and inserting "amount of the depreciation adjustments", and

(B) by striking "ADDITIONAL DEPRECIATION" in the subparagraph heading and inserting "DEPRECIATION ADJUSTMENTS".

(2) Subparagraph (B) of section 1250(d)(6) is amended to read as follows:

"(B) DEPRECIATION ADJUSTMENTS.—In respect of any property described in subparagraph (A), the amount of the depreciation adjustments attributable to periods before the distribution by the partnership shall be—

"(i) the amount of gain to which subsection (a) would have applied if ·such property had been sold by the

partnership immediately before the distribution at its fair market value at such time, reduced by

"(ii) the amount of such gain to which section 751(b) applied."

(3) Subsection (d) of section 1250 is amended by striking paragraph (10).

(4) Section 1250 is amended by striking subsections (e) and (f) and by redesignating subsections (g) and (h) as subsections (e) and (f), respectively.

(5) Paragraph (4) of section 50(c) is amended to read as follows:

"(4) RECAPTURE OF REDUCTION.—For purposes of sections 1245 and 1250, any reduction under this subsection shall be treated as a deduction allowed for depreciation."

(6) Clause (i) of section 267(e)(5)(D) is amended by striking "section 1250(a)(1)(B)" and inserting "section 1250(a)(1)(B) (as in effect on December 31, 1991)".

(7)(A) Subsection (a) of section 291 is amended by striking paragraph (1) and redesignating paragraphs (2), (3), (4), and (5) as paragraphs (1), (2), (3), and (4), respectively.

(B) Subsection (c) of section 291 is amended to read as follows:

"(c) SPECIAL RULE FOR POLLUTION CONTROL FACILITIES.—Section 168 shall apply with respect to that portion of the basis of any property not taken into account under section 169 by reason of subsection (a)(4)."

(C) Section 291 is amended by striking subsection (d) and redesignating subsection (e) as subsection (d).

(D) Paragraph (2) of section 291(d) (as redesignated by subparagraph (C)) is hereby repealed.

(E) Subparagraph (A) of section 265(b)(3) is amended by striking "291(e)(1)(B)" and inserting "291(d)(1)(B)".

(F) Subsection (c) of section 1277 is amended by striking "291(e)(1)(B)(ii)" and inserting "291(d)(1)(B)(ii)".

(8) Subsection (d) of section 1017 is amended to read as follows:

"(d) RECAPTURE OF DEDUCTIONS.—For purposes of sections 1245 and 1250—

"(1) any property the basis of which is reduced under this section and which is neither section 1245 property nor section 1250 property shall be treated as section 1245 property, and

"(2) any reduction under this section shall be treated as a deduction allowed for depreciation."

(9) Paragraph (5) of section 7701(e) is amended by striking "(relating to low-income housing)" and inserting "(as in effect on December 31, 1991)".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to dispositions after January 31, 1992, in taxable years ending after such date.

PART II—SMALL BUSINESS STOCK

SEC. 2111. 50-PERCENT EXCLUSION FOR GAIN FROM CERTAIN SMALL BUSINESS STOCK.

(a) GENERAL RULE.—Part I of subchapter P of chapter 1 (relating to capital gains and losses) is amended by adding at the end thereof the following new section:

"SEC. 1202. 50-PERCENT EXCLUSION FOR GAIN FROM CERTAIN SMALL BUSINESS STOCK.

"(a) GENERAL RULE.—Gross income shall not include 50 percent of any gain from the sale or exchange of qualified small business stock held for more than 5 years.

"(b) QUALIFIED SMALL BUSINESS STOCK.—For purposes of this section—

"(1) IN GENERAL.—Except as otherwise provided in this section, the term 'qualified small business stock' means any stock in a corporation which is originally issued on or after February 1, 1992, if—

"(A) as of the date of issuance, such corporation is a qualified small business, and

"(B) except as provided in subsections (d) and (e), such stock is acquired by the taxpayer at its original issue (directly or through an underwriter)—

"(i) in exchange for money or other property (not including stock), or

"(ii) as compensation for services (other than services performed as an underwriter of such stock).

"(2) ACTIVE BUSINESS REQUIREMENT.—Stock in a corporation shall not be treated as qualified small business stock unless, during substantially all of the taxpayer's holding period for such stock, such corporation meets the active business requirements of subsection (d).

"(3) CERTAIN PURCHASES BY CORPORATION OF ITS OWN STOCK.—

"(A) IN GENERAL.—Stock issued by a corporation shall not be treated as qualified small business stock if such corporation has purchased or purchases any of its stock within the 2-year period beginning 1 year before the date of the issuance of such stock.

"(B) EXCEPTION WHERE BUSINESS PURPOSE.—Subparagraph (A) shall not apply where the issuing corporation establishes that there was a business purpose for the purchase of the stock and such purchase is not inconsistent with the purposes of this section.

"(C) MEMBERS OF AFFILIATED GROUP.—For purposes of this paragraph, the purchase by any corporation which is a member of the same affiliated group (within the meaning of section 1504) as the issuing corporation of any stock in any corporation which is a member of such group shall be treated as a purchase by the issuing corporation of its stock.

"(c) QUALIFIED SMALL BUSINESS.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified small business' means any domestic corporation if—

"(A) the aggregate capitalization of such corporation (or any predecessor thereof) at all times on or after February 1, 1992, and before the issuance did not exceed $100,000,000, and

"(B) the aggregate capitalization of such corporation immediately after the issuance (determined by taking into account amounts to be received in the issuance) does not exceed $100,000,000.

"(2) AGGREGATE CAPITALIZATION.—For purposes of paragraph (1), the term 'aggregate capitalization' means the excess of—

"(A) the amount of cash and the aggregate adjusted bases of other property held by the corporation, over

"(B) the aggregate amount of the short-term indebtedness of the corporation.

For purposes of the preceding sentence, the term 'short-term indebtedness' means any indebtedness which, when incurred, did not have a term in excess of 1 year.

"(3) LOOK-THRU IN CASE OF SUBSIDIARIES.—In determining whether a corporation meets the requirements of this subsection—

"(A) stock and debt of any subsidiary (as defined in subsection (d)(4)(C)) held by such corporation shall be disregarded, and

"(B) such corporation shall be treated as holding its ratable share of the assets of such subsidiary and as being liable for its ratable share of the indebtedness of such subsidiary.

"(d) ACTIVE BUSINESS REQUIREMENT.—For purposes of this section—

"(1) IN GENERAL.—For purposes of subsection (b)(2), the requirements of this subsection are met for any period if during such period—

"(A) the corporation is engaged in the active conduct of a trade or business,

"(B) substantially all of the assets of such corporation are used in the active conduct of a trade or business, and

"(C) such corporation is an eligible corporation.

"(2) SPECIAL RULE FOR CERTAIN ACTIVITIES.—For purposes of paragraph (1), if, in connection with any future trade or business, a corporation is engaged in—

"(A) start-up activities described in section 195(c)(1)(A),

"(B) activities resulting in the payment or incurring of expenditures which may be treated as research and experimental expenditures under section 174, or

"(C) activities with respect to in-house research expenses described in section 41(b)(4),

such corporation shall be treated with respect to such activities as engaged in (and assets used in such activities shall be treated as used in) the active conduct of a trade or business. Any determination under this paragraph shall be made without regard to whether a corporation has any gross income from such activities at the time of the determination.

"(3) ELIGIBLE CORPORATION.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'eligible corporation' means any domestic corporation; except that such term shall not include—

"(i) any corporation predominantly engaged in a disqualified business,

"(ii) any corporation the principal activity of which is the performance of personal services,

"(iii) a DISC,

"(iv) a corporation with respect to which an election under 936 is in effect,

"(v) any regulated investment company, real estate investment trust, or REMIC,

"(vi) any cooperative, and

"(vii) in the case of a corporate shareholder, any corporation which at any time was a subsidiary (as defined in paragraph (4)(C)) of such corporate shareholder.

"(B) DISQUALIFIED BUSINESS.—The term 'disqualified business' means—

"(i) any banking, insurance, financing, or similar business,

"(ii) any farming business (other than the business of raising or harvesting trees),

"(iii) any business involving the production or extraction of products of a character with respect to which a deduction is allowable under section 613 or 613A, and

"(iv) any business of operating a hotel, motel, or restaurant or similar business.

"(4) STOCK IN OTHER CORPORATIONS.—

"(A) LOOK-THRU IN CASE OF SUBSIDIARIES.—For purposes of this subsection, stock and debt in any subsidiary corporation shall be disregarded and the parent corporation shall be deemed to own its ratable share of the subsidiary's assets, and to conduct its ratable share of the subsidiary's activities.

"(B) PORTFOLIO STOCK OR SECURITIES.—A corporation shall be treated as failing to meet the requirements of paragraph (1) for any period during which more than 10 percent of the value of its assets (in excess of liabilities) consist of stock or securities in other corporations which are not subsidiaries of such corporation (other than assets described in paragraph (5)).

"(C) SUBSIDIARY.—For purposes of this paragraph, a corporation shall be considered a subsidiary if the parent owns more than 50 percent of the combined voting power of all classes of stock entitled to vote, or more than 50 percent in value of all outstanding stock, of such corporation.

"(5) WORKING CAPITAL.—For purposes of paragraph (1)(B), any assets which—

"(A) are held for investment, and

"(B) are to be used to finance future research and experimentation or working capital needs of the corporation,

shall be treated as used in the active conduct of a trade or business.

"(6) MAXIMUM REAL ESTATE HOLDINGS.—A corporation shall not be treated as meeting the requirements of paragraph (1) for any period during which more than 10 percent of the total value of its assets is real property which is not used in the active conduct of a trade or business. For purposes of the preceding sentence, the ownership of, dealing in, or renting of real property shall not be treated as the active conduct of a trade or business.

"(7) COMPUTER SOFTWARE ROYALTIES.—For purposes of paragraph (1), rights to computer software which produces income described in section 543(d) shall be treated as an asset used in the active conduct of a trade or business.

"(e) STOCK ACQUIRED ON CONVERSION OF PREFERRED STOCK.—If any stock is acquired through the conversion of other stock which is qualified small business stock in the hands of the taxpayer—

"(1) the stock so acquired shall be treated as qualified small business stock in the hands of the taxpayer, and

"(2) the stock so acquired shall be treated as having been held during the period during which the converted stock was held.

"(f) TREATMENT OF PASS-THRU ENTITIES.—

"(1) IN GENERAL.—Any amount included in income by reason of holding an interest in a pass-thru entity shall be treated as gain described in subsection (a) if such amount meets the requirements of paragraph (2).

"(2) REQUIREMENTS.—An amount meets the requirements of this paragraph if—

"(A) such amount is attributable to gain on the sale or exchange by the pass-thru entity of stock which is qualified small business stock in the hands of such entity and which was held by such entity for more than 5 years, and

"(B) such amount is includible in the gross income of the taxpayer by reason of the holding of an interest in such entity which was held by the taxpayer on the date on which such pass-thru entity acquired such stock and at all times thereafter before the disposition of such stock by such pass-thru entity.

"(3) LIMITATION BASED ON INTEREST ORIGINALLY HELD BY TAXPAYER.—Paragraph (1) shall not apply to any amount to the extent such amount exceeds the amount to which paragraph (1) would have applied if such amount were determined by reference to the interest the taxpayer held in the pass-thru entity on the date the qualified small business stock was acquired.

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

"(A) any partnership,

"(B) any S corporation,

"(C) any regulated investment company, and

"(D) any common trust fund.

"(g) CERTAIN TAX-FREE AND OTHER TRANSFERS.—For purposes of this section—

"(1) IN GENERAL.—In the case of a transfer of stock to which this subsection applies, the transferee shall be treated as—

"(A) having acquired such stock in the same manner as the transferor, and

"(B) having held such stock during any continuous period immediately preceding the transfer during which it was held (or treated as held under this subsection) by the transferor.

"(2) TRANSFERS TO WHICH SUBSECTION APPLIES.—This subsection shall apply to any transfer—

"(A) by gift,

"(B) at death,

"(C) from a partnership to a partner of stock with respect to which the requirements of subsection (f) are met at the time of the transfer (without regard to the 5-year holding requirement), or

"(D) to the extent that the basis of the property in the hands of the transferee is determined by reference to the basis of the property in the hands of the transferor by reason of section 334(b), but only if requirements similar to the requirements of subsection (f) are met with respect to the stock.

"(3) CERTAIN RULES MADE APPLICABLE.—Rules similar to the rules of section 1244(d)(2) shall apply for purposes of this section.

"(4) INCORPORATIONS AND REORGANIZATIONS INVOLVING NONQUALIFIED STOCK.—

"(A) IN GENERAL.—In the case of a transaction described in section 351 or a reorganization described in section 368, if a qualified small business stock is transferred for other stock, such transfer shall be treated as a transfer to which this subsection applies solely with respect to the person receiving such other stock.

"(B) LIMITATION.—This section shall apply to the sale or exchange of stock treated as qualified small business stock by reason of subparagraph (A) only to the extent of the gain (if any) which would have been recognized at the time of the transfer described in subparagraph (A) if section 351 or 368 had not applied at such time.

"(C) SUCCESSIVE APPLICATION.—For purposes of this paragraph, stock treated as qualified small business stock under subparagraph (A) shall be so treated for subsequent transactions or reorganizations, except that the limitation of subparagraph (B) shall be applied as of the time of the first transfer to which subparagraph (A) applied.

"(D) CONTROL TEST.—Except in the case of a transaction described in section 368, this paragraph shall apply only if, immediately after the transaction, the corporation issuing the stock owns directly or indirectly stock representing control (within the meaning of section 368(c)) of the corporation whose stock was transferred.

"(h) BASIS RULES.—

"(1) STOCK EXCHANGED FOR PROPERTY.—For purposes of this section, in the case where the taxpayer transfers property (other than money or stock) to a corporation in exchange for stock in such corporation—

"(A) such stock shall be treated as having been acquired by the taxpayer on the date of such exchange, and

"(B) the basis of such stock in the hands of the taxpayer shall in no event be less than the fair market value of the property exchanged.

"(2) BASIS OF S CORPORATION STOCK.—For purposes of this section, the adjusted basis of stock in an S corporation shall in no event be less than its adjusted basis determined without regard to any adjustment to the basis of such stock under section 1367.

"(i) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this section, including regulations to prevent the avoidance of the purposes of this section through split-ups or otherwise."

(b) EXCLUSION TREATED AS PREFERENCE FOR MINIMUM TAX.—

(1) IN GENERAL.—Subsection (a) of section 57 (relating to items of tax preference) is amended by adding at the end thereof the following new paragraph:

"(8) EXCLUSION FOR GAINS ON SALE OF CERTAIN SMALL BUSINESS STOCK.—An amount equal to the amount excluded from gross income for the taxable year under section 1202."

(2) CONFORMING AMENDMENT.—Subclause (II) of section 53(d)(2)(B)(ii) is amended by striking "and (6)" and inserting "(6), and (8)".

(c) CONFORMING AMENDMENTS.—

(1)(A) Section 172(d)(2) (relating to modifications with respect to net operating loss deduction) is amended to read as follows:

"(2) CAPITAL GAINS AND LOSSES OF TAXPAYERS OTHER THAN CORPORATIONS.—In the case of a taxpayer other than a corporation—

"(A) the amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the amount includable on account of gains from sales or exchanges of capital assets; and

"(B) the exclusion provided by section 1202 shall not be allowed."

(B) Subparagraph (B) of section 172(d)(4) is amended by inserting ", (2)(B)," after "paragraph (1)".

(2) Paragraph (4) of section 642(c) is amended to read as follows:

"(4) ADJUSTMENTS.—To the extent that the amount otherwise allowable as a deduction under this subsection consists of gain described in section 1202(a), proper adjustment shall be made for any exclusion allowable to the estate or trust under section 1202. In the case of a trust, the deduction allowed by this subsection shall be subject to section 681 (relating to unrelated business income)."

(3) Paragraph (3) of section 643(a) is amended by adding at the end thereof the following new sentence: "The exclusion under section 1202 shall not be taken into account."

(4) Paragraph (4) of section 691(c) is amended by striking "1201, and 1211" and inserting "1201, 1202, and 1211".

(5) The second sentence of paragraph (2) of section 871(a) is amended by inserting "such gains and losses shall be determined without regard to section 1202 and" after "except that".

(6) The table of sections for part I of subchapter P of chapter 1 is amended by adding after the item relating to section 1201 the following new item:

"Sec. 1202. 50-percent exclusion for gain from certain small business stock."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to stock issued on or after February 1, 1992.

Subtitle C—Investment in Real Estate

PART I—MODIFICATION OF PASSIVE LOSS RULES

SEC. 2201. MODIFICATION OF PASSIVE LOSS RULES.

(a) GENERAL RULE.—Section 469 (relating to passive activity losses and credits limited) is amended by redesignating subsections (l) and (m) as subsections (m) and (n), respectively, and by inserting after subsection (k) the following new subsection:

"(l) SPECIAL RULES FOR REAL ESTATE ACTIVITIES.—

"(1) CERTAIN ACTIVITIES TREATED AS NOT PASSIVE.—

"(A) IN GENERAL.—If the taxpayer meets the requirements of paragraph (2) for the taxable year, all—

"(i) activities consisting of the performance of qualified real estate services, and

"(ii) rental activities with respect to qualified real property,

shall be treated as a single activity which is not a passive activity.

"(B) EXCEPTION.—

"(i) IN GENERAL.—Paragraph (1) shall not apply with respect to any activity with respect to any real property originally placed in service after the date of the enactment of this subsection (whether or not by the taxpayer).

"(ii) SUBSTANTIAL RENOVATIONS.—For purposes of clause (i), any real property substantially renovated after the date of the enactment of this subsection shall be treated as originally placed in service after such date. For purposes of this clause, property shall be treated as substantially renovated if, during any 24-month period beginning after such date, additions to basis with respect to the property exceed an amount equal to the adjusted basis of the property at the beginning of the 24-month period.

"(C) LIMITATION ON INCOME WHICH RENTAL ACTIVITY LOSSES OR CREDITS MAY OFFSET.—The aggregate losses from all activities described in subparagraph (A)(ii) for which a deduction is allowed for any taxable year shall not exceed the sum of—

"(i) the aggregate income from such activities, plus

"(ii) the net income from passive activities to which this subsection does not apply, plus

"(iii) an amount equal to 80 percent of the lesser of—

"(I) the net income from activities described in subparagraph (A)(i), or

"(II) the taxable income of the taxpayer determined without regard to this subsection, without regard to any item of income, gain, loss, or deduction allocable to activities described in subparagraph (A)(ii), and without regard to any net income described in clause (ii).

Any passive activity credits from activities described in subparagraph (A)(ii) shall not be allowed to the extent such credits exceed the regular tax liability of the taxpayer allocable to the amounts described in clauses (i), (ii), and (iii).

"(D) TREATMENT OF SUSPENDED LOSSES AND CREDITS.—In the case of any unused deductions or credits from activities described in subparagraph (A)(ii)—

"(i) subsection (f) shall not apply, but

"(ii) such deductions or credits shall be treated as deductions or credits allocable to such activities for the succeeding taxable year.

"(2) REQUIREMENTS.—A taxpayer meets the requirements of this paragraph for any taxable year if the taxpayer materially participates during such taxable year in activities referred to in clauses (i) and (ii) of paragraph (1)(A) (as determined under subsection (h) by treating all of such activities as a single activity).

"(3) QUALIFIED REAL ESTATE SERVICES.—For purposes of this subsection, the term 'qualified real estate services' means services—

"(A) in the construction, substantial renovation, and management of real property, or

"(B) in the leasing and brokerage of real property, except that such services shall not be taken into account for any taxable year unless the taxpayer performs at least 500 hours of such services.

"(4) QUALIFIED REAL PROPERTY.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'qualified real property' means any real property if during the taxable year the taxpayer actively participates in rental activities with respect to such property.

"(B) ACTIVE PARTICIPATION.—For purposes of subparagraph (A), active participation shall be determined under subsection (i)(6), except that subparagraph (A) thereof shall be applied by substituting 'a de minimis portion' for 'less than 10 percent (by value)'.

"(5) SPECIAL RULE.—For purposes of this subsection—

"(A) NON-OWNER EMPLOYEES.—Qualified real estate services described in paragraph (3)(A) shall not include any services performed by an individual as an employee unless the employee owns more than a de minimis interest in the employer.

"(B) CLOSELY HELD C CORPORATIONS.—This subsection shall not apply to any interests held by a closely held C corporation."

(b) CONFORMING AMENDMENT.—Clause (iv) of section 469(i)(3)(E) is amended by inserting "or any loss allowable by reason of subsection (l)" after "loss".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1991.

PART II—PROVISIONS RELATING TO REAL ESTATE INVESTMENTS BY PENSION FUNDS

SEC. 2211. REAL ESTATE PROPERTY ACQUIRED BY A QUALIFIED ORGANIZATION.

(a) MODIFICATIONS OF EXCEPTIONS.—Paragraph (9) of section 514(c) (relating to real property acquired by a qualified organization) is amended by adding at the end thereof the following new subparagraphs:

"(G) SPECIAL RULES FOR PURPOSES OF THE EXCEPTIONS.—Except as otherwise provided by regulations—

"(i) SMALL LEASES DISREGARDED.—For purposes of clauses (iii) and (iv) of subparagraph (B), a lease to a person described in such clause (iii) or (iv) shall be disregarded if no more than 20 percent of the leasable floor space in a building is covered by the lease and if the lease is on commercially reasonable terms.

"(ii) COMMERCIALLY REASONABLE FINANCING.—Clause (v) of subparagraph (B) shall not apply if the financing is on commercially reasonable terms.

"(H) QUALIFYING SALES BY FINANCIAL INSTITUTIONS.—

"(i) IN GENERAL.—In the case of a qualifying sale by a financial institution, except as provided in regulations, clauses (i) and (ii) of subparagraph (B) shall not apply with respect to financing provided by such institution for such sale.

"(ii) QUALIFYING SALE.—For purposes of this clause, there is a qualifying sale by a financial institution where—

"(I) a qualified organization acquires property described in clause (iii) from a financial institution and the property is not a capital asset in the hands of the financial institution,

"(II) the stated principal amount of the financing provided by the financial institution does not exceed the amount of the outstanding indebtedness (including accrued but unpaid interest) of the financial institution with respect to the property described in clause (iii) immediately before the acquisition referred to in clause (iii) or (v), whichever is applicable, and

"(III) the value (determined as of the time of the sale) of the amount pursuant to the financing that is determined by reference to the revenue, income, or profits derived from the property does not exceed 30 percent of the value of the property (determined as of such time).

"(iii) PROPERTY TO WHICH SUBPARAGRAPH APPLIES.—Property is described in this clause if such property is foreclosure property, or is real property which—

"(I) was acquired by the qualified organization from a financial institution which is in conservatorship or receivership, or from the conservator or receiver of such an institution, and

"(II) was held by the financial institution at the time it entered into conservatorship or receivership.

"(iv) FINANCIAL INSTITUTION.—For purposes of this subparagraph, the term 'financial institution' means—

"(I) any financial institution described in section 581 or 591(a),

"(II) any other corporation which is a direct or indirect subsidiary of an institution referred to in subclause (I) but only if, by virtue of being affiliated with such institution, such other corporation is subject to supervision and examination by a Federal or State agency which regulates institutions referred to in subclause (I), and

"(III) any person acting as a conservator or receiver of an entity referred to in subclause (I) or (II).

"(v) FORECLOSURE PROPERTY.—For purposes of this subparagraph, the term 'foreclosure property' means any real property acquired by the financial institution as the result of having bid on such property at foreclosure, or by operation of an agreement or process of law, after there was a default (or a default was imminent) on indebtedness which such property secured."

(b) CONFORMING AMENDMENT.—Paragraph (9) of section 514(c) is amended—

(1) by adding the following new sentence at the end of subparagraph (A): "For purposes of this paragraph, an interest in a mortgage shall in no event be treated as real property.", and

(2) by striking the last sentence of subparagraph (B).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to acquisitions on or after February 1, 1992.

SEC. 2212. SPECIAL RULES FOR INVESTMENTS IN PARTNERSHIPS.

(a) MODIFICATION TO ANTI-ABUSE RULES.—Paragraph (9) of section 514(c) (as amended by section 2211) is amended by adding at the end thereof the following new subparagraph:

"(J) PARTNERSHIPS NOT INVOLVING TAX AVOIDANCE.—

"(i) DE MINIMIS RULE FOR CERTAIN LARGE PARTNERSHIPS.—The provisions of subparagraph (B) shall not apply to an investment in a partnership having at least 250 partners if—

"(I) interests in such partnership were offered for sale in an offering registered with the Securities and Exchange Commission,

"(II) at least 50 percent of each class of interests in such partnership is owned by individuals who are not disqualified persons, and

"(III) the principal purpose of partnership allocations is not tax avoidance.

The Secretary may disregard inadvertent failures to meet the requirements of subclause (II).

"(ii) DISQUALIFIED PERSONS.—For purposes of this subparagraph, the term 'disqualified person' means any person described in clause (iii) or (iv) of subparagraph (B) and any person who is not a United States person."

(b) REPEAL OF SPECIAL TREATMENT OF PUBLICLY TRADED PARTNERSHIPS.—Subsection (c) of section 512 is amended—

(1) by striking paragraph (2),

(2) by redesignating paragraph (3) as paragraph (2), and

(3) by striking "paragraph (1) or (2)" in paragraph (2) (as so redesignated) and inserting "paragraph (1)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to partnership interests acquired on or after February 1, 1992.

SEC. 2213. TITLE-HOLDING COMPANIES PERMITTED TO RECEIVE SMALL AMOUNTS OF UNRELATED BUSINESS TAXABLE INCOME.

(a) GENERAL RULE.—Paragraph (25) of section 501(c) is amended by adding at the end thereof the following new subparagraph:

"(G)(i) An organization shall not be treated as failing to be described in this paragraph merely by reason of the receipt of any income which is incidentally derived from the holding of real property.

"(ii) Clause (i) shall not apply if the amount of gross income described in such clause exceeds 10 percent of the organization's gross income for the taxable year unless the organization establishes to the satisfaction of the Secretary that the receipt of gross income described in clause (i) in excess of such limitation was inadvertent and reasonable steps are being taken to correct the circumstances giving rise to such income."

(b) CONFORMING AMENDMENT.—Paragraph (2) of section 501(c) is amended by adding at the end thereof the following new sentence: "Rules similar to the rules of subparagraph (G) of paragraph (25) shall apply for purposes of this paragraph."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1991.

SEC. 2214. EXCLUSION FROM UNRELATED BUSINESS TAX OF GAINS FROM CERTAIN PROPERTY.

(a) GENERAL RULE.—Subsection (b) of section 512 (relating to modifications) is amended by adding at the end thereof the following new paragraph:

"(16)(A) Notwithstanding paragraph (5)(B), there shall be excluded all gains or losses from the sale, exchange, or other disposition of any real property described in subparagraph (B) if—

"(i) such property was acquired by the organization from—

"(I) a financial institution described in section 581 or 591(a) which is in conservatorship or receivership, or

"(II) the conservator or receiver of such an institution,

"(ii) such property is designated by the organization within the 6-month period beginning on the date of its acquisition as property held for sale, except that not more than one-third (by value determined as of such date) of property acquired in a single transaction may be so designated,

"(iii) such sale, exchange, or disposition occurs before the later of—

"(I) the date which is 30 months after the date of the acquisition of such property, or

"(II) the date specified by the Secretary in order to assure an orderly disposition of property held by·persons described in subparagraph (A), and

"(iv) while such property was held by the organization, such property was not substantially improved or renovated and there were no significant development activities with respect to such property.

"(B) Property is described in this subparagraph if it is real property which—

"(i) was held by the financial institution at the time it entered into conservatorship or receivership, or

"(ii) was foreclosure property (as defined in section 514(c)(9)(H)(v)) which secured indebtedness held by the financial institution at such time.

For purposes of this subparagraph, real property includes an interest in a mortgage."

(b) Effective Date.—The amendment made by subsection (a) shall apply to property acquired on or after February 1, 1992.

SEC. 2215. EXCLUSION FROM UNRELATED BUSINESS TAX OF CERTAIN FEES AND OPTION PREMIUMS.

(a) Loan Commitment Fees.—Paragraph (1) of section 512(b) (relating to modifications) is amended by inserting "amounts received or accrued as consideration for entering into agreements to make loans," before "and annuities".

(b) Option Premiums.—The second sentence of section 512(b)(5) is amended by inserting "or real property" before the period.

(c) Effective Date.—The amendments made by this section shall apply to amounts received on or after February 1, 1992.

SEC. 2216. TREATMENT OF PENSION FUND INVESTMENTS IN REAL ESTATE INVESTMENT TRUSTS.

(a) General Rule.—Subsection (h) of section 856 (relating to closely held determinations) is amended by adding at the end thereof the following new paragraph:

"(3) Treatment of trusts described in section 401(a).—

"(A) Look-thru treatment.—

"(i) In general.—Except as provided in clause (ii), in determining whether the stock ownership requirement of section 542(a)(2) is met for purposes of paragraph (1)(A), any stock held by a qualified trust shall be treated as held directly by its beneficiaries in proportion to their actuarial interests in such trust and shall not be treated as held by such trust.

"(ii) CERTAIN RELATED TRUSTS NOT ELIGIBLE.—Clause (i) shall not apply to any qualified trust if one or more disqualified persons (as defined in section 4975(e)(2), without regard to subparagraphs (B) and (I) thereof) with respect to such qualified trust hold in the aggregate 5 percent or more in value of the interests in the real estate investment trust and such real estate investment trust has accumulated earnings and profits attributable to any period for which it did not qualify as a real estate investment trust.

"(B) COORDINATION WITH PERSONAL HOLDING COMPANY RULES.—If any entity qualifies as a real estate investment trust for any taxable year by reason of subparagraph (A), such entity shall not be treated as a personal holding company for such taxable year for purposes of part II of subchapter G of this chapter.

"(C) TREATMENT FOR PURPOSES OF UNRELATED BUSINESS TAX.—If any qualified trust holds more than 10 percent (by value) of the interests in any pension-held REIT at any time during a taxable year, the trust shall be treated as having for such taxable year gross income from an unrelated trade or business in an amount which bears the same ratio to the aggregate dividends paid (or treated as paid) by the REIT to the trust for the taxable year of the REIT with or within which the taxable year of the trust ends (the 'REIT year') as—

"(i) the gross income of the REIT for the REIT year from unrelated trades or businesses (determined as if the REIT were a qualified trust), bears to

"(ii) the gross income of the REIT for the REIT year.

This subparagraph shall apply only if the ratio determined under the preceding sentence is at least 5 percent.

"(D) PENSION-HELD REIT.—The purposes of subparagraph (C)—

"(i) IN GENERAL.—A real estate investment trust is a pension-held REIT if such trust would not have qualified as a real estate investment trust but for the provisions of this paragraph and if such trust is predominantly held by qualified trusts.

"(ii) PREDOMINANTLY HELD.—For purposes of clause (i), a real estate investment trust is predominantly held by qualified trusts if—

"(I) at least 1 qualified trust holds more than 25 percent (by value) of the interests in such real estate investment trust, or

"(II) 1 or more qualified trusts (each of whom own more than 10 percent by value of the interests in such real estate investment trust) hold in the aggregate more than 50 percent (by value) of the interests in such real estate investment trust.

"(E) QUALIFIED TRUST.—For purposes of this paragraph, the term 'qualified trust' means any trust described in section 401(a) and exempt from tax under section 501(a)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1991.

Subtitle D—Temporary Investment Incentives

SEC. 2301. SPECIAL DEPRECIATION ALLOWANCE FOR CERTAIN EQUIPMENT ACQUIRED IN 1992.

(a) IN GENERAL.—Section 168 (relating to accelerated cost recovery system) is amended by adding at the end the following new subsection:

"(j) SPECIAL ALLOWANCE FOR CERTAIN EQUIPMENT ACQUIRED IN 1992.—

"(1) ADDITIONAL ALLOWANCE.—In the case of any qualified equipment—

"(A) the depreciation deduction provided by section 167(a) for the taxable year in which such equipment is placed in service shall include an allowance equal to 10 percent of the adjusted basis of the qualified equipment, and

"(B) the adjusted basis of the qualified equipment shall be reduced by the amount of such deduction before computing the amount otherwise allowable as a depreciation deduction under this chapter for such taxable year and any subsequent taxable year.

Of the aggregate deduction allowable under this paragraph 50 percent shall be allowed for the taxable year in which the property is placed in service and 50 percent shall be allowed for the succeeding taxable year. If the taxpayer disposes of qualified equipment in the taxable year in which placed in service, no deduction shall be allowed under this section for the succeeding taxable year and the adjusted basis of such equipment shall be increased by the amount disallowed.

"(2) QUALIFIED EQUIPMENT.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'qualified equipment' means property to which this section applies—

"(i) which is section 1245 property (within the meaning of section 1245(a)(3)),

"(ii) the original use of which commences with the taxpayer on or after February 1, 1992,

"(iii) which is—

"(I) acquired by the taxpayer on or after February 1, 1992, and before January 1, 1993, but only if no written binding contract for the acquisition was in effect before February 1, 1992, or

"(II) acquired by the taxpayer pursuant to a written binding contract which was entered into on or after February 1, 1992, and before January 1, 1993, and

"(iv) which is placed in service by the taxpayer before July 1, 1993.

"(B) EXCEPTIONS.—

"(i) ALTERNATIVE DEPRECIATION PROPERTY.—The term 'qualified equipment' shall not include any prop-

erty to which the alternative depreciation system under subsection (g) applies, determined—

"(I) without regard to paragraph (7) of subsection (g) (relating to election to have system apply), and

"(II) after application of section 280F(b) (relating to listed property with limited business use).

"(ii) ELECTION OUT.—If a taxpayer makes an election under this clause with respect to any class of property for any taxable year, this subsection shall not apply to all property in such class placed in service during such taxable year.

"(iii) REPAIRED OR RECONSTRUCTED PROPERTY.—Except as otherwise provided in regulations, the term 'qualified equipment' shall not include any repaired or reconstructed property.

"(C) SPECIAL RULES RELATING TO ORIGINAL USE.—

"(i) SELF-CONSTRUCTED PROPERTY.—In the case of a taxpayer manufacturing, constructing, or producing property for the taxpayer's own use, the requirements of clause (iii) of subparagraph (A) shall be treated as met if the taxpayer begins manufacturing, constructing, or producing the property on and after February 1, 1992, and before January 1, 1993.

"(ii) SALE-LEASEBACKS.—For purposes of subparagraph (A)(ii), if property—

"(I) is originally placed in service on or after February 1, 1992, by a person, and

"(II) is sold and leased back by such person within 3 months after 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 leaseback referred to in subclause (II).

"(D) COORDINATION WITH SECTION 280F.—For purposes of section 280F—

"(i) AUTOMOBILES.—In the case of a passenger automobile (as defined in section 280F(d)(5)) which is qualified equipment, the Secretary shall increase the limitation under section 280F(a)(1)(A)(i), and decrease each other limitation under subparagraphs (A) and (B) of section 280F(a)(1), to appropriately reflect the amount of the deduction allowable under paragraph (1).

"(ii) LISTED PROPERTY.—The deduction allowable under paragraph (1) shall be taken into account in computing any recapture amount under section 280F(b)(2)."

(b) ALLOWANCE AGAINST ALTERNATIVE MINIMUM TAX.—

(1) IN GENERAL.—Section 56(a)(1)(A) (relating to depreciation adjustment for alternative minimum tax) is amended by adding at the end the following new clause:

"(iii) ADDITIONAL ALLOWANCE FOR EQUIPMENT ACQUIRED IN 1992.—The deduction under section 168(j) shall be allowed."

(2) CONFORMING AMENDMENT.—Clause (i) of section 56(a)(1)(A) is amended by inserting "or (iii)" after "(ii)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to property placed in service on or after February 1, 1992, in taxable years ending on or after such date.

SEC. 2302. TEMPORARY INCREASE IN AMOUNT OF EXPENSING FOR SMALL BUSINESSES.

Subsection (b) of section 179 is amended by adding at the end thereof the following new paragraph:

"(5) TEMPORARY INCREASE IN LIMITATION.—In the case of any taxable year beginning in 1992 or 1993, paragraph (1) shall be applied by substituting '$20,000' for '$10,000'."

Subtitle E—Extension of Certain Expiring Tax Provisions

SEC. 2401. RESEARCH CREDIT.

(a) IN GENERAL.—Subsection (h) of section 41 (relating to credit for increasing research activities) is amended—

(1) by striking "June 30, 1992" and inserting "June 30, 1993", and

(2) by striking "July 1, 1992" and inserting "July 1, 1993".

(b) CONFORMING AMENDMENT.—Paragraph (1) of section 28(b) is amended by striking "June 30, 1992" and inserting "June 30, 1993".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after June 30, 1992.

SEC. 2402. LOW-INCOME HOUSING CREDIT.

(a) CREDIT MADE PERMANENT.—

(1) IN GENERAL.—Section 42 (relating to low-income housing credit) is amended by striking subsection (o).

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to periods after June 30, 1992.

(b) MODIFICATIONS.—

(1) CARRYFORWARD RULES.—

(A) IN GENERAL.—Clause (ii) of section 42(h)(3)(D) (relating to unused housing credit carryovers allocated among certain States) is amended by striking "the excess" and all that follows and inserting "the excess (if any) of the unused State housing credit ceiling for the year preceding such year over the aggregate housing credit dollar amount allocated for such year."

(B) CONFORMING AMENDMENT.—The second sentence of section 42(h)(3)(C) (relating to State housing credit ceiling) is amended by striking "clauses (i) and (iii)" and inserting "clauses (i) through (iv)".

(2) 10-YEAR ANTI-CHURNING RULE WAIVER EXPANDED.—Clause (ii) of section 42(d)(6)(B) (defining federally assisted building) is amended by inserting ", 221(d)(4)," after "221(d)(3)".

(3) LIMITATION ON ELIGIBLE BASIS OF UNITS.—Paragraph (5) of section 42(d) (relating to special rules for determining eligible basis) is amended by adding at the end thereof the following new subparagraph:

"(D) MAXIMUM LIMIT PER UNIT.—

"(i) IN GENERAL.—Notwithstanding any other provision of this section, and before the application of subparagraph (C), the eligible basis of each unit of any building shall not exceed $124,875.

"(ii) INFLATION ADJUSTMENT.—For any calendar year beginning after 1992, the dollar amount referred to in clause (i) shall be increased by an amount equal to—

"(I) such dollar amount, multiplied by

"(II) the cost-of-living adjustment determined under section 1(f)(3), for such calendar year.

If any dollar amount after being increased under paragraph (1) is not a multiple of $10, such dollar amount shall be rounded to the nearest multiple of $10 (or, if such dollar amount is a multiple of $5, such dollar amount shall be increased to the next higher multiple of $10)."

(4) UNITS WITH CERTAIN FULL-TIME STUDENTS NOT DISQUALIFIED.—Subparagraph (D) of section 42(i) (relating to definitions and special rules) is amended to read as follows:

"(D) CERTAIN STUDENTS NOT TO DISQUALIFY UNIT.—A unit shall not fail to be treated as a low-income unit merely because it is occupied—

"(i) by an individual who is—

"(I) a student and receiving assistance under title IV of the Social Security Act, or

"(II) enrolled in a job training program receiving assistance under the Job Training Partnership Act or under other similar Federal, State, or local laws, or

"(ii) entirely by full-time students if such students are—

"(I) single parents and their children and such parents and children are not dependents (as defined in section 152) of another individual, or

"(II) married and file a joint return."

(5) TREASURY WAIVERS OF CERTAIN DE MINIMIS ERRORS AND RECERTIFICATIONS.—Subsection (g) of section 42 (relating to qualified low-income housing projects) is amended by adding at the end thereof the following new paragraph:

"(8) WAIVER OF CERTAIN DE MINIMIS ERRORS AND RECERTIFICATIONS.—On application by the taxpayer, the Secretary may waive—

"(A) any recapture under subsection (j) in the case of any de minimis error in complying with paragraph (1), or

"(B) any annual recertification of tenant income for purposes of this subsection, if the entire building is occupied by low-income tenants."

(6) BASIS OF COMMUNITY SERVICE AREAS INCLUDED IN ADJUSTED BASIS.—Paragraph (4) of section 42(d) (relating to special rules relating to determination of adjusted basis) is amended—

(A) by striking "subparagraph (B)" in subparagraph (A) and inserting "subparagraphs (B) and (C)",

(B) by redesignating subparagraph (C) as subparagraph (D), and

(C) by inserting after subparagraph (B) the following new subparagraph:

"(C) BASIS OF PROPERTY IN COMMUNITY SERVICE AREAS INCLUDED.—The adjusted basis of any building located in a qualified census tract shall be determined by taking into account the adjusted basis of property (of a character subject to the allowance for depreciation) used in functionally related and subordinate community activity facilities if—

"(i) the size of the facilities is commensurate with tenant needs,

"(ii) the use of such facilities is predominantly by tenants and employees of the building owner, and

"(iii) not more than 20 percent of the building's eligible basis is attributable to the aggregate basis of such facilities."

(7) EFFECTIVE DATES.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the amendments made by this subsection shall apply to—

(i) determinations under section 42 of the Internal Revenue Code of 1986 with respect to housing credit dollar amounts allocated from State housing credit ceilings after June 30, 1992, or

(ii) buildings placed in service after June 30, 1992, to the extent paragraph (1) of section 42(h) of such Code does not apply to any building by reason of paragraph (4) thereof, but only with respect to bonds issued after such date.

(B) WAIVER AUTHORITY.—The amendments made by paragraphs (2) and (5) shall take effect on the date of the enactment of this Act.

(c) ELECTION TO DETERMINE RENT LIMITATION BASED ON NUMBER OF BEDROOMS.—In the case of a building to which the amendments made by section 7108(e)(1) of the Revenue Reconciliation Act of 1989 did not apply, the taxpayer may elect to have such amendments apply to such building but only with respect to tenants first occupying any unit in the building after the date of the election. Such an election may be made only during the 180 day period beginning on the date of the enactment of this Act, and, once made, shall be irrevocable.

SEC. 2403. TARGETED JOBS CREDIT.

(a) IN GENERAL.—Paragraph (4) of section 51(c) (relating to amount of targeted jobs credit) is amended by striking "June 30, 1992" and inserting "June 30, 1993".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to individuals who begin work for the employer after June 30, 1992.

SEC. 2404. QUALIFIED MORTGAGE BONDS.

(a) IN GENERAL.—Subparagraph (B) of section 143(a)(1) (defining qualified mortgage bond) is amended by striking "June 30, 1992" and inserting "June 30, 1993".

(b) MORTGAGE CREDIT CERTIFICATES.—Subsection (h) of section 25 is amended by striking "June 30, 1992" and inserting "June 30, 1993".

(c) TREATMENT OF RESALE PRICE CONTROL AND SUBSIDY LIEN PROGRAMS.—Subsection (k) of section 143 is amended by adding at the end thereof the following new paragraph:

"(10) TREATMENT OF RESALE PRICE CONTROL AND SUBSIDY LIEN PROGRAMS.—

"(A) IN GENERAL.—In the case of a residence which is located in a high housing cost area (as defined in section 143(f)(5)), the interest of a governmental unit in such residence by reason of financing provided under any qualified program shall not be taken into account under this section (other than subsection (m)), and the acquisition cost of the residence which is taken into account under subsection (e) shall be such cost reduced by the amount of such financing.

"(B) QUALIFIED PROGRAM.—For purposes of subparagraph (A), the term 'qualified program' means any governmental program providing second mortgage loans—

"(i) which restricts the resale of the residence to a purchaser qualifying under this section and to a price determined by an index that reflects less than the full amount of any appreciation in the residence's value, or

"(ii) which provides for deferred or reduced interest payments on such financing and grants the governmental unit a share in the appreciation of the residence,

but only if such financing is not provided directly or indirectly through the use of any private activity bond."

(d) EFFECTIVE DATES.—

(1) BONDS.—The amendment made by subsection (a) shall apply to bonds issued after June 30, 1992.

(2) CERTIFICATES.—The amendment made by subsection (b) shall apply to elections for periods after June 30, 1992.

(3) PROGRAMS.—The amendment made by subsection (c) shall apply to qualified mortgage bonds issued and mortgage credit certificates provided on or after the date of the enactment of this Act.

SEC. 2405. QUALIFIED SMALL ISSUE BONDS.

(a) IN GENERAL.—Subparagraph (B) of section 144(a)(12) (relating to termination dates) is amended by striking "June 30, 1992" and inserting "June 30, 1993".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to bonds issued after June 30, 1992.

SEC. 2406. EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE.

(a) IN GENERAL.—Subsection (d) of section 127 (relating to educational assistance programs) is amended by striking "June 30, 1992" and inserting "June 30, 1993".

(b) CONFORMING AMENDMENT.—Paragraph (2) of section 103 of the Tax Extension Act of 1991 is amended by striking "1992" each place it appears and inserting "1993".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after June 30, 1992.

SEC. 2407. EXCISE TAX ON CERTAIN VACCINES.

(a) TAX.—Paragraphs (2) and (3) of section 4131(c) (relating to tax on certain vaccines) are each amended by striking "1992" each place it appears and inserting "1994".

(b) TRUST FUND.—Paragraph (1) of section 9510(c) (relating to expenditures from Vaccine Injury Compensation Trust Fund) is amended by striking "1992" and inserting "1994".

(c) STUDY.—The Secretary of the Treasury, in consultation with the Secretary of Health and Human Services, shall conduct a study of—

(1) the estimated amount that will be paid from the Vaccine Injury Compensation Trust Fund with respect to vaccines administered after September 30, 1988, and before October 1, 1994,

(2) the rates of vaccine-related injury or death with respect to the various types of such vaccines,

(3) new vaccines and immunization practices being developed or used for which amounts may be paid from such Trust Fund,

(4) whether additional vaccines should be included in the vaccine injury compensation program, and

(5) the appropriate treatment of vaccines produced by State governmental entities.

The report of such study shall be submitted not later than January 1, 1994, to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate.

SEC. 2408. EMPLOYER-PROVIDED GROUP LEGAL SERVICES PLANS.

(a) IN GENERAL.—Subsection (e) of section 120 (relating to amounts received under qualified group legal services plans) is amended by striking "June 30, 1992" and inserting "June 30, 1993".

(b) CONFORMING AMENDMENT.—Paragraph (2) of section 104 of the Tax Extension Act of 1991 is amended by striking "1992" each place it appears and inserting "1993".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after June 30, 1992.

SEC. 2409. EXTENSION OF ENERGY INVESTMENT CREDIT FOR SOLAR AND GEOTHERMAL PROPERTY.

(a) IN GENERAL.—Subparagraph (B) of section 48(a)(2) (relating to energy percentage) is amended by striking "June 30, 1992" and inserting "June 30, 1993".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to property placed in service after June 30, 1992.

SEC. 2410. EXTENSION OF TAX CREDIT FOR ORPHAN DRUG CLINICAL TESTING EXPENSES.

(a) IN GENERAL.—Subsection (e) of section 28 (relating to clinical testing expenses for certain drugs for rare diseases or conditions) is amended by striking "June 30, 1992" and inserting "June 30, 1993".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years ending after June 30, 1992.

SEC. 2411. HEALTH INSURANCE COSTS OF SELF-EMPLOYED INDIVIDUALS.

(a) IN GENERAL.—Paragraph (6) of section 162(l) (relating to special rules for health insurance costs of self-employed individuals) is amended by striking "June 30, 1992" and inserting "June 30, 1993".

(b) CONFORMING AMENDMENT.—Paragraph (2) of section 110 of the Tax Extension Act of 1991 is amended by striking "1992" each place it appears and inserting "1993".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after June 30, 1992.

SEC. 2412. CERTAIN TRANSFERS TO RAILROAD RETIREMENT ACCOUNT.

Subsection (c)(1)(A) of section 224 of the Railroad Retirement Solvency Act of 1983 (relating to section 72(r) revenue increase transferred to certain railroad accounts) is amended by striking "with respect to benefits received before October 1, 1992".

SEC. 2413. DISCLOSURES OF INFORMATION FOR VETERANS BENEFITS.

(a) IN GENERAL.—Section 6103(l)(7)(D) (relating to program to which rule applies) is amended by striking "September 30, 1992" in the last sentence and inserting "September 30, 1997".

(b) CONFORMING AMENDMENT.—Section 5317(g) of title 38, United States Code, is amended by striking "September 30, 1992" and inserting "September 30, 1997".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on September 30, 1992.

Subtitle F—Modifications to Minimum Tax

SEC. 2501. TEMPORARY REPEAL OF PREFERENCE FOR CHARITABLE CONTRIBUTIONS OF APPRECIATED PROPERTY.

(a) TEMPORARY REPEAL.—

(1) IN GENERAL.—Paragraph (6) of section 57(a) is amended by adding at the end thereof the following new subparagraph:

"(C) APPPLICATION OF PARAGRAPH.—This paragraph shall not apply to any contribution made after December 31, 1991, and before July 1, 1993."

(2) CONFORMING AMENDMENT.—Subparagraph (B) of section 57(a)(6) is amended by striking the last sentence.

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years ending after December 31, 1991.

(b) ADVANCE DETERMINATION OF VALUE OF CHARITABLE GIFTS.—

(1) IN GENERAL.—The Secretary of the Treasury or his delegate shall develop a procedure under which taxpayers may elect to seek an agreement with the Secretary as to the value of tangible personal property prior to the donation of such property to a qualifying charitable organization if the time limits for the do-

nation and other conditions contained in the agreement are satisfied.

(2) REPORT.—Not later than December 31, 1992, the Secretary of the Treasury shall report to the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives on the development of the procedure referred to in paragraph (1), including the setting of possible threshold amounts for claimed value (and the payment of fees) by a taxpayer in order to seek agreement under the procedure, possible limitations on applying the procedure only to items with significant artistic or cultural value, recommendations for legislative action needed to implement the proposed procedure, and a projected timetable for its implementation.

(c) STUDY OF CORPORATE SPONSORSHIP PAYMENTS.—

(1) IN GENERAL.—The Secretary of the Treasury or his delegate shall conduct a study of the tax treatment of corporate sponsorship payments received by tax-exempt organizations in connection with athletic and other events, including the ramifications of Announcement 92–15, 1992—5 I.R.B. 51.

(2) REPORT.—Not later than 1 year after the date of the enactment of this Act, the Secretary 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 under paragraph (1).

SEC. 2502. ELIMINATION OF ACE DEPRECIATION ADJUSTMENT.

(a) IN GENERAL.—Clause (i) of section 56(g)(4)(A) (relating to depreciation adjustments for computing adjusted current earnings) is amended by adding at the end the following new sentence: "The preceding sentence shall not apply to property placed in service on or after February 1, 1992, and the depreciation deduction with respect to such property shall be determined under the rules of subsection (a)(1)(A)."

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to property placed in service on or after February 1, 1992, in taxable years ending after such date.

(2) COORDINATION WITH TRANSITIONAL RULES.—The amendments made by this section shall not apply to any property to which paragraph (1) of section 56(a) of the Internal Revenue Code of 1986 does not apply by reason of subparagraph (C)(i) of such paragraph (1).

SEC. 2503. MINIMUM TAX TREATMENT OF CERTAIN ENERGY PREFERENCES.

(a) MODIFICATION OF ADJUSTED CURRENT EARNINGS.—Clause (i) of section 56(g)(4)(D) is amended by striking "The" and inserting "In the case of an integrated oil company (as defined in section 291(b)(4)), the".

(b) MODIFICATIONS OF ENERGY PREFERENCE ADJUSTMENT.—

(1) IN GENERAL.—Subparagraph (A) of section 56(h)(3) is amended to read as follows:

"(A) 50 percent of the intangible drilling cost preference, plus".

(2) CONFORMING AMENDMENTS.—

(A) Paragraph (1) of section 56(h) is amended by inserting "(as defined in section 291(b)(4))" after "company".

(B) Paragraph (4) of section 56(h) is amended to read as follows:

"(4) INTANGIBLE DRILLING COST PREFERENCE.—For purposes of this subsection, the term 'intangible drilling cost preference' means the amount by which alternative minimum taxable income would be reduced if it were computed without regard to section 57(a)(2)."

(C) Section 56(h) is amended by striking paragraph (6) and by redesignating paragraphs (7) and (8) as paragraphs (6) and (7).

(c) NET INCOME LIMITATION.—Subparagraph (A) of section 57(a)(2) is amended by adding at the end the following new sentence: "In the case of a taxpayer other than an integrated oil company (as defined in section 291(b)(4)), the preceding sentence shall be applied by substituting '70 percent' for '65 percent' ".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1991.

Subtitle G—Repeal of Certain Luxury Excise Taxes; Imposition of Tax on Diesel Fuel Used in Noncommercial Boats

SEC. 2601. REPEAL OF LUXURY EXCISE TAXES OTHER THAN ON PASSENGER VEHICLES.

(a) IN GENERAL.—Subchapter A of chapter 31 (relating to retail excise taxes) is amended to read as follows:

"Subchapter A—Luxury Passenger Automobiles

"Sec. 4001. Imposition of tax.
"Sec. 4002. 1st retail sale; uses, etc. treated as sales; determination of price.
"Sec. 4003. Special rules.

"SEC. 4001. IMPOSITION OF TAX.

"(a) IMPOSITION OF TAX.—There is hereby imposed on the 1st retail sale of any passenger vehicle a tax equal to 10 percent of the price for which so sold to the extent such price exceeds $30,000.

"(b) PASSENGER VEHICLE.—

"(1) IN GENERAL.—For purposes of this subchapter, the term 'passenger vehicle' means any 4-wheeled vehicle—

"(A) which is manufactured primarily for use on public streets, roads, and highways, and

"(B) which is rated at 6,000 pounds unloaded gross vehicle weight or less.

"(2) SPECIAL RULES.—

"(A) TRUCKS AND VANS.—In the case of a truck or van, paragraph (1)(B) shall be applied by substituting 'gross vehicle weight' for 'unloaded gross vehicle weight'.

"(B) LIMOUSINES.—In the case of a limousine, paragraph (1) shall be applied without regard to subparagraph (B) thereof.

"(c) EXCEPTIONS FOR TAXICABS, ETC.—The tax imposed by this section shall not apply to the sale of any passenger vehicle for use by the purchaser exclusively in the active conduct of a trade or business of transporting persons or property for compensation or hire.

"(d) EXEMPTION FOR LAW ENFORCEMENT USES, ETC.—No tax shall be imposed by this section on the sale of any passenger vehicle—

"(1) to the Federal Government, or a State or local government, for use exclusively in police, firefighting, search and rescue, or other law enforcement or public safety activities, or in public works activities, or

"(2) to any person for use exclusively in providing emergency medical services.

"(e) INFLATION ADJUSTMENT.—

"(1) IN GENERAL.—In the case of any calendar year after 1991, the $30,000 amount in subsection (a) and section 4003(a) shall be increased by an amount equal to—

"(A) $30,000, multiplied by

"(B) the cost-of-living adjustment under section 1(f)(3) for such calendar year, determined by substituting 'calendar year 1990' for 'calendar year 1991' in subparagraph (B) thereof.

"(2) ROUNDING.—If any amount as adjusted under paragraph (1) is not a multiple of $100, such amount shall be rounded to the nearest multiple of $100 (or, if such amount is a multiple of $50 and not of $100, such amount shall be rounded to the next highest multiple of $100).

"(f) TERMINATION.—The tax imposed by this section shall not apply to any sale or use after December 31, 1999.

"SEC. 4002. 1ST RETAIL SALE; USES, ETC. TREATED AS SALES; DETERMINATION OF PRICE.

"(a) 1ST RETAIL SALE.—For purposes of this subchapter, the term '1st retail sale' means the 1st sale, for a purpose other than resale, after manufacture, production, or importation.

"(b) USE TREATED AS SALE.—

"(1) IN GENERAL.—If any person uses a passenger vehicle (including any use after importation) before the 1st retail sale of such vehicle, then such person shall be liable for tax under this subchapter in the same manner as if such vehicle were sold at retail by him.

"(2) EXEMPTION FOR FURTHER MANUFACTURE.—Paragraph (1) shall not apply to use of a vehicle as material in the manufacture or production of, or as a component part of, another vehicle taxable under this subchapter to be manufactured or produced by him.

"(3) EXEMPTION FOR DEMONSTRATION USE.—Paragraph (1) shall not apply to any use of a passenger vehicle as a demonstrator for a potential customer while the potential customer is in the vehicle.

"(4) EXCEPTION FOR USE AFTER IMPORTATION OF CERTAIN VEHICLES.—Paragraph (1) shall not apply to the use of a vehicle after importation if the user or importer establishes to the satisfaction of the Secretary that the 1st use of the vehicle occurred before January 1, 1991, outside the United States.

"(5) COMPUTATION OF TAX.—In the case of any person made liable for tax by paragraph (1), the tax shall be computed on the price at which similar vehicles are sold at retail in the ordinary course of trade, as determined by the Secretary.

"(c) LEASES CONSIDERED AS SALES.—For purposes of this subchapter—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, the lease of a vehicle (including any renewal or any extension of a lease or any subsequent lease of such vehicle) by any person shall be considered a sale of such vehicle at retail.

"(2) SPECIAL RULES FOR LONG-TERM LEASES.—

"(A) TAX NOT IMPOSED ON SALE FOR LEASING IN A QUALIFIED LEASE.—The sale of a passenger vehicle to a person engaged in a passenger vehicle leasing or rental trade or business for leasing by such person in a long-term lease shall not be treated as the 1st retail sale of such vehicle.

"(B) LONG-TERM LEASE.—For purposes of subparagraph (A), the term 'long-term lease' means any long-term lease (as defined in section 4052).

"(C) SPECIAL RULES.—In the case of a long-term lease of a vehicle which is treated as the 1st retail sale of such vehicle—

"(i) DETERMINATION OF PRICE.—The tax under this subchapter shall be computed on the lowest price for which the vehicle is sold by retailers in the ordinary course of trade.

"(ii) PAYMENT OF TAX.—Rules similar to the rules of section 4217(e)(2) shall apply.

"(iii) NO TAX WHERE EXEMPT USE BY LESSEE.—No tax shall be imposed on any lease payment under a long-term lease if the lessee's use of the vehicle under such lease is an exempt use (as defined in section 4003(b)) of such vehicle.

"(d) DETERMINATION OF PRICE.—

"(1) IN GENERAL.—In determining price for purposes of this subchapter—

"(A) there shall be included any charge incident to placing the article in condition ready for use,

"(B) there shall be excluded—

"(i) the amount of the tax imposed by this subchapter,

"(ii) if stated as a separate charge, the amount of any retail sales tax imposed by any State or political subdivision thereof or the District of Columbia, whether the liability for such tax is imposed on the vendor or vendee, and

"(iii) the value of any component of such article if—

"(I) such component is furnished by the 1st user of such article, and

"(II) such component has been used before such furnishing, and

"(C) the price shall be determined without regard to any trade-in.

"(2) OTHER RULES.—Rules similar to the rules of paragraphs (2) and (4) of section 4052(b) shall apply for purposes of this subchapter.

"SEC. 4003. SPECIAL RULES.

"(a) SEPARATE PURCHASE OF VEHICLE AND PARTS AND ACCESSORIES THEREFOR.—Under regulations prescribed by the Secretary—

"(1) IN GENERAL.—Except as provided in paragraph (2), if—

"(A) the owner, lessee, or operator of any passenger vehicle installs (or causes to be installed) any part or accessory on such vehicle, and

"(B) such installation is not later than the date 6 months after the date the vehicle was 1st placed in service,

then there is hereby imposed on such installation a tax equal to 10 percent of the price of such part or accessory and its installation.

"(2) LIMITATION.—The tax imposed by paragraph (1) on the installation of any part or accessory shall not exceed 10 percent of the excess (if any) of—

"(A) the sum of—

"(i) the price of such part or accessory and its installation,

"(ii) the aggregate price of the parts and accessories (and their installation) installed before such part or accessory, plus

"(iii) the price for which the passenger vehicle was sold, over

"(B) $30,000.

"(3) EXCEPTIONS.—Paragraph (1) shall not apply if—

"(A) the part or accessory installed is a replacement part or accessory,

"(B) the part or accessory is installed to enable or assist an individual with a disability to operate the vehicle, or to enter or exit the vehicle, by compensating for the effect of such disability, or

"(C) the aggregate price of the parts and accessories (and their installation) described in paragraph (1) with respect to the vehicle does not exceed $200 (or such other amount or amounts as the Secretary may by regulation prescribe).

"(4) INSTALLERS SECONDARILY LIABLE FOR TAX.—The owners of the trade or business installing the parts or accessories shall be secondarily liable for the tax imposed by this subsection.

"(b) IMPOSITION OF TAX ON SALES, ETC., WITHIN 2 YEARS OF VEHICLES PURCHASED TAX-FREE.—

"(1) IN GENERAL.—If—

"(A) no tax was imposed under this subchapter on the 1st retail sale of any passenger vehicle by reason of its exempt use, and

"(B) within 2 years after the date of such 1st retail sale, such vehicle is resold by the purchaser or such purchaser makes a substantial nonexempt use of such vehicle,

then such sale or use of such vehicle by such purchaser shall be treated as the 1st retail sale of such vehicle for a price equal to its fair market value at the time of such sale or use.

"(2) EXEMPT USE.—For purposes of this subsection, the term 'exempt use' means any use of a vehicle if the 1st retail sale of such vehicle is not taxable under this subchapter by reason of such use.

"(c) PARTS AND ACCESSORIES SOLD WITH TAXABLE ARTICLE.—Parts and accessories sold on, in connection with, or with the sale of any passenger vehicle shall be treated as part of the vehicle.

"(d) PARTIAL PAYMENTS, ETC.—In the case of a contract, sale, or arrangement described in paragraph (2), (3), or (4) of section 4216(c), rules similar to the rules of section 4217(e)(2) shall apply for purposes of this subchapter."

(b) TECHNICAL AMENDMENTS.—

(1) Subsection (c) of section 4221 is amended by striking "4002(b), 4003(c), 4004(a)" and inserting "4001(d)".

(5) Subsection (d) of section 4222 is amended by striking "4002(b), 4003(c), 4004(a)" and inserting "4001(d)".

(3) The table of subchapters for chapter 31 is amended by striking the item relating to subchapter A and inserting the following:

"Subchapter A. Luxury passenger vehicles."

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on January 1, 1992.

SEC. 2602. TAX ON DIESEL FUEL USED IN NONCOMMERCIAL BOATS.

(a) GENERAL RULE.—

(1) Paragraph (2) of section 4092(a) (defining diesel fuel) is amended by striking "or a diesel-powered train" and inserting ", a diesel-powered train, or a diesel-powered boat".

(2) Paragraph (1) of section 4041(a) is amended—

(A) by striking "diesel-powered highway vehicle" each place it appears and inserting "diesel-powered highway vehicle or diesel-powered boat", and

(B) by striking "such vehicle" and inserting "such vehicle or boat".

(3) Subparagraph (B) of section 4092(b)(1) is amended by striking "commercial and noncommercial vessels" each place it appears and inserting "vessels for use in an off-highway business use (as defined in section 6421(e)(2)(B))".

(b) EXEMPTION FOR USE IN FISHERIES OR COMMERCIAL NAVIGATION.—Subparagraph (B) of section 6421(e)(2) is amended to read as follows:

"(B) USES IN BOATS.—The term 'off-highway business use' does not include any use in a motorboat; except that such term shall include any use in—

"(i) a vessel employed in the fisheries or in the whaling business, and

"(ii) in the case of diesel fuel, a boat in the active conduct of—

"(I) a trade or business of commercial fishing or transporting persons or property for compensation or hire, or

"(II) any other trade or business unless the boat is used predominantly in any activity which is of a type generally considered to constitute entertainment, amusement or recreation."

(c) RETENTION OF TAXES IN GENERAL FUND.—

(1) TAXES IMPOSED AT HIGHWAY TRUST FUND FINANCING RATE.—Paragraph (4) of section 9503(b) (relating to transfers to Highway Trust Fund) is amended—

(A) by striking "and" at the end of subparagraph (A),

(B) by striking the period at the end of subparagraph (B) and inserting ", and", and

(C) by adding at the end thereof the following new subparagraph:

"(C) there shall not be taken into account the taxes imposed by sections 4041 and 4091 on diesel fuel sold for use or used as fuel in a diesel-powered boat."

(2) TAXES IMPOSED AT LEAKING UNDERGROUND STORAGE TANK TRUST FUND FINANCING RATE.—Subsection (b) of section 9508 (relating to transfers to Leaking Underground Storage Tank Trust Fund) is amended by adding at the end thereof the following new sentence: "For purposes of this subsection, there shall not be taken into account the taxes imposed by sections 4041 and 4091 on diesel fuel sold for use or used as fuel in a diesel-powered boat."

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect on July 1, 1992.

Subtitle H—Urban Tax Enterprise Zones and Rural Development Investment Zones

SEC. 2701. STATEMENT OF PURPOSE.

It is the purpose of this subtitle to establish a demonstration program of providing incentives for the creation of tax enterprise zones in order—

(1) to revitalize economically and physically distressed areas, primarily by encouraging the formation of new businesses and the retention and expansion of existing businesses,

(2) to promote meaningful employment for tax enterprise zone residents, and

(3) to encourage individuals to reside in the tax enterprise zones in which they are employed.

PART I—DESIGNATION AND TAX INCENTIVES

SEC. 2702. DESIGNATION AND TREATMENT OF URBAN TAX ENTERPRISE ZONES AND RURAL DEVELOPMENT INVESTMENT ZONES.

(a) IN GENERAL.—Chapter 1 (relating to normal taxes and surtaxes) is amended by inserting after subchapter T the following new subchapter:

"Subchapter U—Designation and Treatment of Tax Enterprise Zones

"Part I. Designation of tax enterprise zones.
"Part II. Incentives for tax enterprise zones.

"PART I—DESIGNATION OF TAX ENTERPRISE ZONES

"Sec. 1391. Designation procedure.
"Sec. 1392. Eligibility and selection criteria.
"Sec. 1393. Definitions and special rules.

"SEC. 1391. DESIGNATION PROCEDURE.

"(a) IN GENERAL.—For purposes of this title, the term 'tax enterprise zone' means any area which is, under this part—

"(1) nominated by 1 or more local governments and the State in which it is located for designation as a tax enterprise zone, and

"(2) designated by—

"(A) the Secretary of Housing and Urban Development in the case of an urban tax enterprise zone, and

"(B) the Secretary of Agriculture, in consultation with the Secretary of Commerce, in the case of a rural development investment zone.

"(b) NUMBER OF DESIGNATIONS.—

"(1) AGGREGATE LIMIT.—The appropriate Secretaries may designate in the aggregate 35 nominated areas as tax enterprise zones under this section, subject to the availability of eligible nominated areas. Not more than 10 urban tax enterprise zones may be designated and not more than 25 rural development investment zones may be designated. At least 1 of the designated rural development investment zones shall be within an Indian reservation. Such designations may be made only during the calendar years 1993, 1994, and 1995.

"(2) ANNUAL LIMITS.—

"(A) URBAN TAX ENTERPRISE ZONES.—The number of urban tax enterprise zones designated under paragraph (1)—

"(i) in calendar year 1993 shall not exceed 5,

"(ii) in calendar year 1994 shall not exceed the sum of 3 plus the carryover amount for such year, and

"(iii) in calendar year 1995 shall not exceed the sum of 2 plus the carryover amount for such year.

"(B) RURAL DEVELOPMENT INVESTMENT ZONES.—The number of rural development investment zones designated under paragraph (1)—

"(i) in calendar year 1993 shall not exceed 12,

"(ii) in calendar year 1994 shall not exceed the sum of 7 plus the carryover amount for such year, and

"(iii) in calendar year 1995 shall not exceed the sum of 6 plus the carryover amount for such year.

"(C) CARRYOVER AMOUNT.—For purposes of subparagraphs (A) and (B), the carryover amount for any calendar year shall be equal to the amount by which—

"(i) the limitation under such subparagraph for the preceding calendar year, exceeds

"(ii) the number of designations made under paragraph (1) for the type of tax enterprise zone to which such subparagraph relates in such preceding calendar year.

"(3) ADVANCE DESIGNATIONS PERMITTED.—For purposes of this subchapter, a designation during any calendar year shall be treated as made on January 1 of the following calendar year if the appropriate Secretary, in making such designation, specifies that such designation is effective as of such January 1.

"(c) LIMITATIONS ON DESIGNATIONS.—The appropriate Secretary may not make any designation under subsection (a) unless—

"(1) the local governments and the State in which the nominated area is located have the authority—

"(A) to nominate the area for designation as a tax enterprise zone, and

"(B) to provide assurances satisfactory to the appropriate Secretary that the commitments under section 1392(c) will be fulfilled,

"(2) the local governments and the State in which the nominated area is located—

"(A) have designated a governmental official with responsibility for making allocations under section 1397A (relating to overall limitation on zone incentives), and

"(B) have established procedures to ensure that allocations under section 1397A are made in a manner designed primarily to increase economic activity in the tax enterprise zone over that which would otherwise have occurred,

"(3) a nomination of the area is submitted in a reasonable time before the calendar year for which designation as a tax enterprise zone is sought,

"(4) the appropriate Secretary determines that any information furnished is reasonably accurate, and

"(5) the State and local governments certify that no portion of the area nominated is already included in a tax enterprise zone or in an area otherwise nominated to be a tax enterprise zone.

"(d) PERIOD FOR WHICH DESIGNATION IS IN EFFECT.—

"(1) IN GENERAL.—Any designation of an area as a tax enterprise zone shall remain in effect during the period beginning on the date of the designation and ending on the earliest of—

"(A) December 31 of the 15th calendar year following the calendar year in which such date occurs,

"(B) the termination date designated by the State and local governments as provided for in their nomination, or

"(C) the date the appropriate Secretary revokes the designation under paragraph (2).

"(2) REVOCATION OF DESIGNATION.—

"(A) IN GENERAL.—The appropriate Secretary shall revoke the designation of an area as a tax enterprise zone if such Secretary determines that the local government or the State in which it is located—

"(i) has significantly modified the boundaries of the area, or

"(ii) is not complying substantially with the State and local commitments pursuant to section 1392(c).

"(B) Applicable procedures.—A designation may be revoked by the appropriate Secretary under subparagraph (A) only after a hearing on the record involving officials of the State or local government involved.

"SEC. 1392. ELIGIBILITY AND SELECTION CRITERIA.

"(a) In General.—The appropriate Secretary may make a designation of any nominated area under section 1391 only on the basis of the eligibility and selection criteria set forth in this section.

"(b) Eligibility Criteria.—

"(1) Urban tax enterprise zones.—A nominated area which is not a rural area shall be eligible for designation under section 1391 only if it meets the following criteria:

"(A) Population.—The nominated area has a population (as determined by the most recent census data available) of not less than 4,000.

"(B) Distress.—The nominated area is one of pervasive poverty, unemployment, and general distress.

"(C) Size.—The nominated area—

"(i) does not exceed 12 square miles,

"(ii) has a boundary which is continuous, or consists of not more than 3 noncontiguous parcels, and

"(iii) is located entirely within 1 State.

"(D) Unemployment rate.—The unemployment rate (as determined by the appropriate available data) is not less than 1.5 times the national unemployment rate.

"(E) Poverty rate.—The poverty rate (as determined by the most recent census data available) for not less than 90 percent of the population census tracts (or where not tracted, the equivalent county divisions as defined by the Bureau of the Census for the purposes of defining poverty areas) within the nominated area is not less than 20 percent.

"(F) Course of action.—There has been adopted for the nominated area a course of action which meets the requirements of subsection (c).

"(2) Rural development investment zones.—A nominated area which is a rural area shall be eligible for designation under section 1391 only if it meets the following criteria:

"(A) Population.—The nominated area has a population (as determined by the most recent census data available) of not less than 1,000.

"(B) Distress.—The nominated area is one of general distress.

"(C) Size.—The nominated area—

"(i) does not exceed 10,000 square miles,

"(ii) consists of areas within not more than 4 contiguous counties,

"(iii) has a boundary which is continuous, or consists of not more than 3 noncontiguous parcels, and

"(iv) except in the case of nominated areas located in 1 or more Indian reservations, is located entirely within 1 State.

"(D) ADDITIONAL CRITERIA.—Not less than 2 of the following criteria:

"(i) UNEMPLOYMENT RATE.—The criterion set forth in paragraph (1)(D).

"(ii) POVERTY RATE.—The criterion set forth in paragraph (1)(E).

"(iii) JOB LOSS.—The amount of wages attributable to employment in the area, and subject to tax under section 3301 during the preceding calendar year, is not more than 95 percent of such wages during the 5th preceding calendar year.

"(iv) OUT-MIGRATION.—The population of the area decreased (as determined by the most recent census data available) by 10 percent or more between 1980 and 1990.

"(E) COURSE OF ACTION.—There has been adopted for the nominated area a course of action which meets the requirements of subsection (c).

"(c) REQUIRED STATE AND LOCAL COURSE OF ACTION.—

"(1) IN GENERAL.—No nominated area may be designated as a tax enterprise zone unless the local government and the State in which it is located agree in writing that, during any period during which the area is a tax enterprise zone, the governments will follow a specified course of action designed to reduce the various burdens borne by employers or employees in the area.

"(2) COURSE OF ACTION.—The course of action under paragraph (1) may be implemented by both governments and private nongovernmental entities, may not be funded from proceeds of any Federal program, and may include—

"(A) a reduction of tax rates or fees applying within the tax enterprise zone,

"(B) an increase in the level, or efficiency of delivery, of local public services within the tax enterprise zone,

"(C) actions to reduce, remove, simplify, or streamline government paperwork requirements applicable within the tax enterprise zone,

"(D) the involvement in the program by public authorities or private entities, organizations, neighborhood associations, and community groups, particularly those within the nominated area, including a written commitment to provide jobs and job training for, and technical, financial, or other assistance to, employers, employees, and residents of the nominated area,

"(E) the giving of special preference to contractors owned and operated by members of any minority,

"(F) the gift (or sale at below fair market value) of surplus land in the tax enterprise zone to neighborhood organizations agreeing to operate a business on the land,

"(G) the establishment of a program under which employers within the tax enterprise zone may purchase health insurance for their employees on a pooled basis,

"(H) the establishment of a program to encourage local financial institutions to satisfy their obligations under the Community Reinvestment Act of 1977 (12 U.S.C. 2901 et seq.) by making loans to tax enterprise zone businesses, with emphasis on startup and other small-business concerns (as defined in section 3(a) of the Small Business Act (15 U.S.C. 632(a)),

"(I) the giving of special preference to qualified low-income housing projects located in tax enterprise zones, in the allocation of the State housing credit ceiling applicable under section 42, and

"(J) the giving of special preference to facilities located in tax enterprise zones, in the allocation of the State ceiling on private activity bonds applicable under section 146.

"(3) RECOGNITION OF PAST EFFORTS.—In evaluating courses of action agreed to by any State or local government, the appropriate Secretary shall take into account the past efforts of the State or local government in reducing the various burdens borne by employers and employees in the area involved.

"(4) PROHIBITION OF ASSISTANCE FOR BUSINESS RELOCATIONS.—

"(A) IN GENERAL.—The course of action implemented under paragraph (1) may not include any action to assist any establishment in relocating from 1 area to another area.

"(B) EXCEPTION.—The limitation established in subparagraph (A) shall not be construed to prohibit assistance for the expansion of an existing business entity through the establishment of a new branch, affiliate, or subsidiary if the appropriate Secretary—

"(i) finds that the establishment of the new branch, affiliate, or subsidiary will not result in an increase in unemployment in the area of original location or in any other area where the existing business entity conducts business operations, and

"(ii) has no reason to believe that the new branch, affiliate, or subsidiary is being established with the intention of closing down the operations of the existing business entity in the area of its original location or in any other area where the existing business entity conducts business operations.

"(d) SELECTION CRITERIA.—From among the nominated areas eligible for designation under subsection (b) by the appropriate Secretary, such appropriate Secretary shall make designations of tax enterprise zones on the basis of the following factors (each of which is to be given equal weight):

"(1) STATE AND LOCAL CONTRIBUTIONS.—The strength and quality of the contributions which have been promised as part of the course of action relative to the fiscal ability of the nominating State and local governments.

"(2) IMPLEMENTATION OF COURSE OF ACTION.—The effectiveness and enforceability of the guarantees that the course of action will actually be carried out.

"(3) PRIVATE COMMITMENTS.—The level of commitments by private entities of additional resources and contributions to the economy of the nominated area, including the creation of new or expanded business activities.

"(4) AVERAGE RANKINGS.—The average ranking with respect to—

"(A) the criteria set forth in subparagraphs (D) and (E) of subsection (b)(1), in the case of an area which is not a rural area, or

"(B) the 2 criteria set forth in subsection (b)(2)(D) that give the area a higher average ranking, in the case of a rural area.

"(5) REVITALIZATION POTENTIAL.—The potential for the revitalization of the nominated area as a result of zone designation, taking into account particularly the number of jobs to be created and retained.

"SEC. 1393. DEFINITIONS AND SPECIAL RULES.

For purposes of this subchapter—

"(1) URBAN TAX ENTERPRISE ZONE.—The term 'urban tax enterprise zone' means a tax enterprise zone which meets the requirements of section 1392(b)(1).

"(2) RURAL DEVELOPMENT INVESTMENT ZONE.—The term 'rural development investment zone' means a tax enterprise zone which meets the requirements of section 1392(b)(2).

"(3) GOVERNMENTS.—If more than 1 local government seeks to nominate an area as a tax enterprise zone, any reference to, or requirement of, this subchapter shall apply to all such governments.

"(4) LOCAL GOVERNMENT.—The term 'local government' means—

"(A) any county, city, town, township, parish, village, or other general purpose political subdivision of a State, and

"(B) any combination of political subdivisions described in subparagraph (A) recognized by the appropriate Secretary.

"(5) NOMINATED AREA.—

"(A) IN GENERAL.—The term 'nominated area' means an area which is nominated by 1 or more local governments and the State in which it is located for designation as a tax enterprise zone under this subchapter.

"(B) INDIAN RESERVATIONS.—In the case of a nominated area on an Indian reservation, the reservation governing body (as determined by the Secretary of the Interior) shall be deemed to be both the State and local governments with respect to the area.

"(6) RURAL AREA.—The term 'rural area' means any area which is—

"(A) outside of a metropolitan statistical area (within the meaning of section 143(k)(2)(B)), or

"(B) determined by the Secretary of Agriculture, after consultation with the Secretary of Commerce, to be a rural area.

"(7) APPROPRIATE SECRETARY.—The term 'appropriate Secretary' means—

"(A) the Secretary of Housing and Urban Development in the case of urban tax enterprise zones, and

"(B) the Secretary of Agriculture in the case of rural development investment zones.

"(8) STATE-CHARTERED DEVELOPMENT CORPORATIONS.—An area shall be treated as nominated by a State and a local government if it is nominated by an economic development corporation chartered by the State.

"PART II—INCENTIVES FOR TAX ENTERPRISE ZONES

"SUBPART A. Enterprise zone employment credit.
"SUBPART B. Investment incentives.
"SUBPART C. General provisions.

"Subpart A—Enterprise Zone Employment Credit

"Sec. 1394. Enterprise zone employment credit.
"Sec. 1395. Other definitions and special rules.

"SEC. 1394. ENTERPRISE ZONE EMPLOYMENT CREDIT.

"(a) AMOUNT OF CREDIT.—

"(1) IN GENERAL.—For purposes of section 38, the amount of the enterprise zone employment credit determined under this section with respect to any small employer for any taxable year is 7.5 percent of the qualified zone wages paid or incurred during such taxable year.

"(2) LIMITATION.—The amount of the enterprise zone employment credit of any small employer for any taxable year with respect to any tax enterprise zone shall not exceed the employment credit amount allocated to such employer for such taxable year under section 1397A with respect to such zone.

"(b) QUALIFIED ZONE WAGES.—

"(1) IN GENERAL.—For purposes of this section, the term 'qualified zone wages' means any wages paid or incurred by a small employer for services performed by an employee while such employee is a qualified zone employee.

"(2) COORDINATION WITH TARGETED JOBS CREDIT.—The term 'qualified wages' shall not include wages attributable to service rendered during the 1-year period beginning with the day the individual begins work for the employer if any portion of such wages are qualified wages (as defined in section 51(b)).

"(c) QUALIFIED ZONE EMPLOYEE.—For purposes of this section—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, the term 'qualified zone employee' means, with respect to any period, any employee of a small .employer if—

"(A) substantially all of the services performed during such period by such employee for such employer are performed within a tax enterprise zone in a trade or business of the employer, and

"(B) the principal place of abode of such employee while performing such services is within such tax enterprise zone.

"(2) CREDIT ALLOWED ONLY FOR FIRST 5 YEARS.—An employee shall not be treated as a qualified zone employee for any period after the date 5 years after the day on which such employee first began work for the employer (whether or not in a tax enterprise zone).

"(3) INDIVIDUALS RECEIVING WAGES IN EXCESS OF $30,000 NOT ELIGIBLE.—An employee shall not be treated as a qualified zone employee for any taxable year of the employer if the total amount of the wages paid or incurred by such employer to such employee during such taxable year (whether or not for services in a tax enterprise zone) exceeds the amount determined at an annual rate of $30,000. The Secretary shall adjust the $30,000 amount contained in the preceding sentence for years beginning after 1992 at the same time and in the same manner as under section 415(d).

"(4) CERTAIN INDIVIDUALS NOT ELIGIBLE.—The term 'qualified zone employee' shall not include—

"(A) any individual described in subparagraph (A), (B), or (C) of section 51(i)(1), and

"(B) any 5-percent owner (as defined in section 416(i)(1)(B)).

"(d) SMALL EMPLOYER.—For purposes of this section, the term 'small employer' means, with respect to any taxable year, any employer if the average number of individuals employed full-time (within the meaning of the last sentence of section 44(b)) during such taxable year by such employer does not exceed 100.

"(e) EARLY TERMINATION OF EMPLOYMENT BY EMPLOYER.—

"(1) IN GENERAL.—If the employment of any employee is terminated by the taxpayer before the day 1 year after the day on which such employee began work for the employer—

"(A) no wages with respect to such employee shall be taken into account under subsection (a) for the taxable year in which such employment is terminated, and

"(B) the tax under this chapter for the taxable year in which such employment is terminated shall be increased by the aggregate credits (if any) allowed under section 38(a) for prior taxable years by reason of wages taken into account with respect to such employee.

"(2) CARRYBACKS AND CARRYOVERS ADJUSTED.—In the case of any termination of employment to which paragraph (1) applies, the carrybacks and carryovers under section 39 shall be properly adjusted.

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

"(A) IN GENERAL.—Paragraph (1) shall not apply to—

"(i) a termination of employment of an employee who voluntarily leaves the employment of the taxpayer,

"(ii) a termination of employment of an individual who before the close of the period referred to in paragraph (1) becomes disabled to perform the services of such employment unless such disability is removed before the close of such period and the taxpayer fails to offer reemployment to such individual, or

"(iii) a termination of employment of an individual if it is determined under the applicable State unemployment compensation law that the termination was due to the misconduct of such individual.

"(B) CHANGES IN FORM OF BUSINESS.—For purposes of paragraph (1), the employment relationship between the taxpayer and an employee shall not be treated as terminated—

"(i) by a transaction to which section 381(a) applies if the employee continues to be employed by the acquiring corporation, or

"(ii) by reason of a mere change in the form of conducting the trade or business of the taxpayer if the employee continues to be employed in such trade or business and the taxpayer retains a substantial interest in such trade or business.

"(4) SPECIAL RULE.—Any increase in tax under paragraph (1) shall not be treated as a tax imposed by this chapter for purposes of—

"(A) determining the amount of any credit allowable under this chapter, and

"(B) determining the amount of the tax imposed by section 55.

"SEC. 1395. OTHER DEFINITIONS AND SPECIAL RULES.

"(a) WAGES.—For purposes of this subpart, the term 'wages' has the same meaning as when used in section 51 except that paragraph (4) of section 51(c) shall not apply.

"(b) CONTROLLED GROUPS.—For purposes of this subpart—

"(1) all employers treated as a single employer under subsection (a) or (b) of section 52 shall be treated as a single employer for purposes of this subpart, and

"(2) the credit (if any) determined under section 1394 with respect to each such employer shall be its proportionate share of the wages giving rise to such credit.

"(c) CERTAIN OTHER RULES MADE APPLICABLE.—For purposes of this subpart, rules similar to the rules of section 51(k) and subsections (c), (d), and (e) of section 52 shall apply.

"Subpart B—Investment Incentives

"Sec. 1396. Enterprise zone stock.
"Sec. 1397. Additional first-year depreciation allowance.

"SEC. 1396. ENTERPRISE ZONE STOCK.

"(a) GENERAL RULE.—In the case of an individual, there shall be allowed as a deduction an amount equal to the aggregate amount paid in cash by the taxpayer during the taxable year for the purchase of enterprise zone stock.

"(b) LIMITATIONS.—

"(1) CEILING.—

"(A) IN GENERAL.—The maximum amount allowed as a deduction under subsection (a) to a taxpayer shall not exceed whichever of the following is the least for the taxable year:

"(i) $25,000.

"(ii) The enterprise zone stock amount allocated under section 1397A to the taxpayer for such taxable year.

"(iii) The excess of $250,000 over the amount allowed as a deduction under this section to the taxpayer for all prior taxable years.

"(B) EXCESS AMOUNTS.—If the amount otherwise deductible by any person under subsection (a) exceeds the limitation under subparagraph (A)—

"(i) the amount of such excess shall be treated as an amount paid to which subsection (a) applies during the next taxable year, and

"(ii) the deduction allowed for any taxable year shall be allocated among the enterprise zone stock purchased by such person in accordance with the purchase price per share.

"(2) AGGREGATION WITH FAMILY MEMBERS.—The taxpayer and members of the taxpayer's family (as defined in section 267(c)(4)) shall be treated as one person for purposes of clauses (i) and (iii) of paragraph (1)(A), and the limitations contained in such clauses shall be allocated among the taxpayer and such members in accordance with their respective purchases of enterprise zone stock.

"(c) DISPOSITIONS OF STOCK.—

"(1) GAIN TREATED AS ORDINARY INCOME.—Except as otherwise provided in regulations, if a taxpayer disposes of any enterprise zone stock with respect to which a deduction was allowed under subsection (a), the amount realized on such disposition—

"(A) shall be recognized notwithstanding any other provision of this subtitle, and

"(B) to the extent such amount does not exceed the amount allowed as a deduction under subsection (a) with respect to such stock, shall be treated as ordinary income.

"(2) INTEREST CHARGED IF DISPOSITION WITHIN 5 YEARS OF PURCHASE.—

"(A) IN GENERAL.—If a taxpayer disposes of any enterprise zone stock with respect to which a deduction was allowed under subsection (a) before the end of the 5-year period beginning on the date such stock was purchased by the taxpayer, the tax imposed by this chapter for the taxable year in which such disposition occurs shall be increased by the amount determined under subparagraph (B).

"(B) ADDITIONAL AMOUNT.—For purposes of subparagraph (A), the additional amount shall be equal to the amount of interest (determined at the rate applicable under section 6621(a)(2)) that would accrue—

"(i) during the period beginning on the date the stock was purchased by the taxpayer and ending on the date such stock was disposed of by the taxpayer,

"(ii) on an amount equal to the aggregate decrease in tax of the taxpayer resulting from the deduction allowed under this subsection (a) with respect to the stock so disposed of.

"(C) Special rule.—Any increase in tax under subparagraph (A) shall not be treated as a tax imposed by this chapter for purposes of—

"(i) determining the amount of any credit allowable under this chapter, and

"(ii) determining the amount of the tax imposed by section 55.

"(3) Exception for transfers at death.—This subsection shall not apply to a transfer at death.

"(d) Disqualification.—

"(1) Issuer or stock ceases to qualify.—If, during the 10-year period beginning on the date enterprise zone stock was purchased by the taxpayer—

"(A) the issuer of such stock ceases to be a qualified issuer (determined without regard to subsection (f)(1)(C)), or

"(B) the proceeds from the issuance of such stock fail or otherwise cease to be invested by the issuer in qualified enterprise zone property,

then, notwithstanding any provision of this subtitle other than paragraph (2), the taxpayer shall be treated for purposes of subsection (c) as disposing of such stock during the taxable year during which such cessation or failure occurs at its fair market value as of 1st day of such taxable year.

"(2) Cessation of enterprise zone status not to cause recapture.—A corporation shall not fail to be treated as a qualified issuer for purposes of paragraph (1) solely by reason of the termination or revocation of a tax enterprise zone designation.

"(e) Enterprise Zone Stock.—For purposes of this section,

"(1) In general.—The term 'enterprise zone stock' means stock of a corporation if—

"(A) such stock was acquired on original issue from the corporation, and

"(B) such corporation was, at the time of issue, a qualified issuer.

"(2) Proceeds must be invested in qualified enterprise zone property.—Such term shall include such stock only to the extent that the amount of proceeds of such issuance are used by such issuer during the 12-month period beginning on the date of issuance to acquire qualified enterprise zone property.

"(3) $5,000,000 limit.—Not more than $5,000,000 of stock of such corporation and all related persons may be enterprise zone stock.

"(f) Qualified Issuer.—For purposes of this section—

"(1) In general.—The term 'qualified issuer' means any domestic C corporation if—

"(A) such corporation does not have more than one class of stock,

"(B) such corporation meets the enterprise zone business requirements of paragraph (2),

"(C) the sum of—

"(i) the money,

"(ii) the aggregate unadjusted bases of property owned by such corporation, and

"(iii) the value of property leased to the corporation (as determined under regulations prescribed by the Secretary),

does not exceed $5,000,000, and

"(D) more than 20 percent of the total voting power, and 20 percent of the total value, of the stock of such corporation is owned by individuals or estates or indirectly by individuals through partnerships or trusts.

"(2) ENTERPRISE ZONE BUSINESS REQUIREMENTS.—

"(A) IN GENERAL.—A corporation meets the enterprise zone business requirements of this paragraph for any taxable year if—

"(i) at least 80 percent of the total gross income of such corporation for the taxable year is derived from the active conduct of a trade or business within a tax enterprise zone,

"(ii) less than 10 percent of the average of the aggregate unadjusted bases of the property of the corporation during such taxable year is attributable to securities (as defined in section 165(g)(2)),

"(iii) substantially all of the use of the tangible property of the corporation (whether owned or leased) is within a tax enterprise zone,

"(iv) substantially all of the services performed for the corporation by the employees of such corporation are performed in a tax enterprise zone, and

"(v) no more than an insubstantial portion of the property of the corporation constitutes collectibles (as defined in section 408(m)(2)), unless such collectibles constitute property held primarily for sale to customers in the ordinary course of such trade or business.

"(B) SPECIAL RULES.—

"(i) RENTAL REAL PROPERTY.—For purposes of subparagraph (A), real property located within a tax enterprise zone and held for use by customers other than related persons shall be treated as the active conduct of a trade or business.

"(ii) EXCESSIVE PROPERTY OR SERVICES PROVIDED TO OR BY RELATED PERSONS.—A corporation shall cease to meet the requirements of this paragraph if—

"(I) more than 50 percent (by value) of the property or services acquired by the corporation during the taxable year are acquired from related persons which do not meet the requirements of this paragraph; or

"(II) more than 50 percent of the gross income of the corporation for the taxable year is attributable to property or services provided to related persons which do not meet the requirements of this paragraph.

"(iii) NEW CORPORATIONS.—In the case of a new corporation, clauses (i) and (ii) of subparagraph (A) shall not apply to the 1st taxable year of such corporation.

"(3) QUALIFIED ENTERPRISE ZONE PROPERTY.—The term 'qualified enterprise zone property' means property to which section 168 applies—

"(A) the original use of which commences with the qualified issuer, and

"(B) substantially all of the use of which is in a tax enterprise zone.

"(4) RELATED PERSON.—A person shall be treated as related to another person if—

"(A) the relationship of such persons is described in section 267(b) or 707(b)(1), or

"(B) such persons are engaged in trades or businesses under common control (within the meaning of subsections (a) and (b) of section 52).

For purposes of subparagraph (A), in applying section 267(b) or 707(b)(1), '33 percent' shall be substituted for '50 percent'.

"(g) BASIS ADJUSTMENT.—For purposes of this subtitle, the taxpayer's basis (without regard to this subsection) for the enterprise zone stock shall be reduced by the deduction allowed under subsection (a) with respect to such stock.

"SEC. 1397. ADDITIONAL FIRST-YEAR DEPRECIATION ALLOWANCE.

"(a) IN GENERAL.—In the case of any qualified zone property—

"(1) the depreciation deduction provided by section 167(a) for the taxable year in which such property is placed in service shall include an allowance equal to 25 percent of the adjusted basis of such property, and

"(2) the adjusted basis of such property shall be reduced by the amount of such allowance before computing the amount otherwise allowable as a depreciation deduction under this chapter for such taxable year and any subsequent taxable year.

"(b) QUALIFIED ZONE PROPERTY.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified zone property' means any property to which section 168 applies—

"(A) which is section 1245 property (as defined in section 1245(a)(3)),

"(B) the original use of which commences with the taxpayer in a tax enterprise zone, and

"(C) substantially all of the use of which is in a tax enterprise zone and is in the active conduct of a trade or business by the taxpayer in such zone.

"(2) EXCEPTION FOR ALTERNATIVE DEPRECIATION PROPERTY.—The term 'qualified zone property' does not include any property to which the alternative depreciation system under section 168(g) applies, determined—

"(A) without regard to section 168(g)(7) (relating to election to use alternative depreciation system), and

"(B) after application of section 280F(b) (relating to listed property with limited business use).

"(c) LIMITATION.—The aggregate adjusted bases of property which may be taken into account under subsection (a) by any taxpayer for any taxable year with respect to any tax enterprise zone shall not exceed the additional first-year depreciation amount allocated to

such taxpayer for such taxable year under section 1397A with respect to such zone.

"(d) SPECIAL RULES FOR SALE-LEASEBACKS.—For purposes of subsection (b)(1)(B), if property is sold and leased back by the taxpayer within 3 months after 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 leaseback.

"(e) COORDINATION WITH SECTION 280F.—

"(1) AUTOMOBILES.—In the case of a passenger automobile (within the meaning of section 280F(d)(5)) which is qualified zone property, the Secretary shall increase the limitation under section 280F(a)(1)(A)(i), and decrease each other limitation under subparagraphs (A) and (B) of section 280F(a)(1), to appropriately reflect the amount of the allowance under subsection (a).

"(2) LISTED PROPERTY.—The allowance under subsection (a) shall be taken into account in computing any recapture amount under section 280F(b)(2).

"(f) COORDINATION WITH SECTION 169(j).—In the case of property for which a deduction would (but for this subsection) be allowable under section 168(j) and this section, section 168(j) shall not apply and this section shall be applied by substituting '40 percent' for '25 percent' in subsection (a).

"Subpart C—General Provisions

"Sec. 1397A. Overall limitation on zone incentives.
"Sec. 1397B. Regulations.

"SEC. 1397A. OVERALL LIMITATION ON ZONE INCENTIVES.

"(a) GENERAL RULE.—The allocating official of each tax enterprise zone shall make allocations of—

"(1) employment credit amounts,

"(2) enterprise zone stock amounts, and

"(3) additional first-year depreciation amounts.

"(b) LIMITATION ON AGGREGATE AMOUNTS ALLOCATED.—

"(1) LIMITATION.—

"(A) IN GENERAL.—No amount may be allocated under subsection (a) by the allocating official of any tax enterprise zone if such allocation would result in the zone limit for the calendar year of the allocation (or any succeeding calendar year) being reduced below zero.

"(B) COORDINATION WITH INCREASE.—For purposes of applying subparagraph (A) to an allocation during any calendar year, it shall be assumed that no increase in the zone limit will be made under paragraph (2)(B) for any succeeding calendar year unless—

"(i) the allocating official provides assurances satisfactory to the Secretary that the zone will be entitled to such an increase for such succeeding calendar year, and

"(ii) the allocating official agrees to such recapture provisions as the Secretary may require in cases where the zone is not entitled to such increase.

"(2) ZONE LIMIT.—For purposes of this section—

"(A) BASIC AMOUNT.—Except as otherwise provided in this paragraph, the zone limit for any tax enterprise zone for any calendar year is—

"(i) $13,000,000 in the case of an urban tax enterprise zone, and

"(ii) $5,000,000 in the case of a rural development investment zone.

"(B) INCREASE IN LIMIT FOR CERTAIN STATE OR LOCAL EXPENDITURES.—

"(i) IN GENERAL.—The amount of the zone limit for any tax enterprise zone for any calendar year shall be increased by the lesser of—

"(I) 10 percent of the limit determined under subparagraph (A), or

"(II) the amount determined under clause (ii) with respect to such zone for such calendar year.

"(ii) AMOUNT OF INCREASE.—For purposes of clause (i), the amount determined under this clause with respect to any tax enterprise zone for any calendar year is the sum of—

"(I) the State and local business incentives with respect to such zone for the preceding calendar year, and

"(II) the qualified State and local governmental expenditures with respect to such zone for the preceding calendar year.

"(C) CARRYOVER OF UNUSED AMOUNTS.—

"(i) IN GENERAL.—Before the end of any calendar year, the allocating official of any tax enterprise zone may elect—

"(I) to reduce the zone limit applicable to such zone for such year, and

"(II) to increase the zone limit applicable to such zone for the succeeding calendar year by an amount equal to such reduction.

"(ii) LIMITATION.—The increase in a zone limit under clause (i)(II) for any calendar year shall not exceed 70 percent of the zone limit otherwise applicable to the tax enterprise zone for such year.

"(3) DEFINITIONS.—For purposes of this subsection—

"(A) STATE AND LOCAL BUSINESS INCENTIVES.—The State and local business incentives with respect to any tax enterprise zone for any calendar year is the sum of—

"(i) the aggregate of property tax or sales tax abatements provided during State or local fiscal years ending in such calendar year with respect to otherwise taxable property or sales in such tax enterprise zone,

"(ii) the aggregate grants made by any State or local government during such fiscal years to startup and

other small business concerns in such tax enterprise zone, plus

"(iii) 5 percent of the total outstanding balance (as of the close of such fiscal years) of loans made by any State or local government to startup and other small business concerns in such tax enterprise zone.

No amount shall be taken into account under the preceding sentence if such amount consists of assistance which would be prohibited under section 1392(c)(4) (relating to prohibition of assistance for business relocations). No loan shall be taken into account under clause (iii) unless the State or local government bears the risk of any default with respect to such loan.

"(B) QUALIFIED STATE AND LOCAL GOVERNMENTAL EXPENDITURES.—

"(i) IN GENERAL.—The qualified State and local governmental expenditures with respect to any tax enterprise zone for any calendar year shall be the excess (if any) of—

"(I) the specified expenditures during State or local fiscal years ending in such calendar year with respect to such zone, over

"(II) the adjusted base period expenditures for such zone.

"(ii) SPECIFIED EXPENDITURES.—For purposes of this subparagraph, the term 'specified expenditures' means—

"(I) any expenditures by any State or local government for the acquisition, construction, repair, or maintenance of public improvements or facilities in the tax enterprise zone, plus

"(II) any expenditures by any State or local government for police or fire protection to the extent allocable to the tax enterprise zone.

"(iii) ADJUSTED BASE PERIOD EXPENDITURES.—For purposes of this subparagraph, the term 'adjusted base period expenditures' means, with respect to any calendar year—

"(I) the aggregate specified expenditures during State or local fiscal years ending in calendar year 1991 with respect to the tax enterprise zone, increased by

"(II) the cost-of-living adjustment for the calendar year for which the increase is being determined (as determined under section 1(f)(3) by substituting 'calendar year 1990' for 'calendar year 1991' in subparagraph (B) of such section).

"(iv) ADJUSTMENT FOR CERTAIN CAPITAL EXPENDITURES.—For purposes of clause (iii)(I), the appropriate Secretary may disregard any expenditures if such Secretary determines that such expenditures were unusual and not recurring and that inclusion of such expendi-

tures would not be consistent with the purposes of this section.

"(C) DETERMINATIONS BY APPROPRIATE SECRETARY.—The amount of the State and local business incentives and qualified State or local governmental expenditures with respect to any tax enterprise zone for any calendar year shall be determined by the appropriate Secretary with respect to such zone and certified to the Secretary of the Treasury or his delegate.

"(D) SMALL BUSINESS CONCERN.—The term 'small business concern' has the meaning given such term by section 3(a) of the Small Business Act (15 U.S.C. 632(a)).

"(c) ALLOCATION PREFERENCE FOR SMALL BUSINESS CONCERNS.—In making allocations under subsection (a), the allocating official of each tax enterprise zone shall give preference to small business concerns (as defined in subsection (b)(3)(D)).

"(d) OPERATING RULES.—For purposes of this section—

"(1) EMPLOYMENT CREDIT AMOUNT.—Any allocation of an employment credit amount—

"(A) shall specify the employer and taxable year to which such allocation applies, and

"(B) shall reduce the zone limit for the calendar year in which such taxable year begins by 67 cents for each dollar of the amount so allocated.

"(2) ENTERPRISE ZONE STOCK AMOUNT.—Any allocation of an enterprise zone stock amount—

"(A) shall specify the stock purchases to which the allocation relates, and

"(B) shall reduce the zone limit for the calendar year in which such taxable year begins by 35 cents for each dollar of the amount so allocated.

"(3) ADDITIONAL FIRST-YEAR DEPRECIATION AMOUNT.—Any allocation of an additional first-year depreciation amount—

"(A) shall specify the adjusted basis of the property to which such allocation applies, and

"(B) shall reduce the zone limit for the calendar year in which the property is placed in service by 1.5 cents for each dollar so allocated.

"(e) RETROACTIVE ALLOCATIONS NOT EFFECTIVE.—

"(1) IN GENERAL.—No retroactive allocation under subsection (a) shall be effective.

"(2) RETROACTIVE ALLOCATION.—For purposes of subsection (a), the term 'retroactive allocation' means any allocation of—

"(A) an employment credit amount after the beginning of the taxable year to which such allocation applies,

"(B) an enterprise zone stock amount after the stock involved is acquired, or

"(C) an additional first-year depreciation amount after the property involved is placed in service.

"(f) ALLOCATING OFFICIAL.—For purposes of this section, the term 'allocating official' means the official designated as provided in section 1391(c)(2) as the official responsible for making allocations under this section.

"SEC. 1397B. REGULATIONS.

"The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this part, including—

"(1) regulations limiting the benefit of this part in circumstances where such benefits, in combination with benefits provided under other Federal programs, would result in an activity being 100 percent or more subsidized by the Federal Government, and

"(2) regulations preventing avoidance of the provisions of this part."

(b) CLERICAL AMENDMENT.—The table of subchapters for chapter 1 is amended by inserting after the item relating to subchapter T the following new item:

"Subchapter U. Designation and treatment of tax enterprise zones."

SEC. 2703. TECHNICAL AND CONFORMING AMENDMENTS.

(a) ALTERNATIVE MINIMUM TAX.—

(1) ENTERPRISE ZONE STOCK.—Subsection (b) of section 56 (relating to adjustments to the alternative minimum taxable income of individuals) is amended by adding at the end thereof the following new paragraph:

"(4) ENTERPRISE ZONE STOCK.—Section 1396 shall not apply."

(2) ADDITIONAL FIRST-YEAR DEPRECIATION.—Subparagraph (A) of section 56(a)(1) (relating to adjustments in computing alternative minimum taxable income), as amended by section 2002, is amended—

(A) in clause (i), by striking "or (iii)" and inserting ", (iii), or (iv)", and

(B) by adding at the end thereof the following new clause:

"(iv) ADDITIONAL FIRST-YEAR DEPRECIATION FOR QUALIFIED TAX ENTERPRISE ZONE PROPERTY.—The allowance provided by section 1397(a) for qualified zone property shall be allowed."

(b) ENTERPRISE ZONE EMPLOYMENT CREDIT PART OF GENERAL BUSINESS CREDIT.—Subsection (b) of section 38 (relating to current year business credit) is amended by striking "plus" at the end of paragraph (6), by striking the period at the end of paragraph (7) and inserting ", plus", and by adding at the end the following new paragraph:

"(8) in the case of a small employer (as defined in section 1394(d)), the enterprise zone employment credit determined under section 1394(a)."

(c) DENIAL OF DEDUCTION FOR PORTION OF WAGES EQUAL TO ENTERPRISE ZONE EMPLOYMENT CREDIT.—

(1) Subsection (a) of section 280C (relating to rule for targeted jobs credit) is amended—

(A) by striking "the amount of the credit determined for the taxable year under section 51(a)" and inserting "the sum of the credits determined for the taxable year under sections 51(a) and 1394(a)", and

(B) by striking "TARGETED JOBS CREDIT" in the subsection heading and inserting "EMPLOYMENT CREDITS".

(2) Subsection (c) of section 196 (relating to deduction for certain unused business credits) is amended by striking "and" at the end of paragraph (4), by striking the period at the end of paragraph (5) and inserting ", and", and by adding at the end the following new paragraph:

"(6) the enterprise zone employment credit determined under section 1394(a)."

(d) OTHER AMENDMENTS.—

(1) Subsection (c) of section 381 (relating to carryovers in certain corporate acquisitions) is amended by adding at the end the following new paragraph:

"(26) ENTERPRISE ZONE PROVISIONS.—The acquiring corporation shall take into account (to the extent proper to carry out the purposes of this section and subchapter U, and under such regulations as may be prescribed by the Secretary) the items required to be taken into account for purposes of subchapter U in respect of the distributor or transferor corporation."

(2) Paragraph (1) of section 1371(d) (relating to coordination with investment credit recapture) is amended by inserting before the period at the end the following "and for purposes of sections 1394(e)(3)".

(3) Subsection (a) of section 1016 (relating to adjustments to basis) is amended by striking "and" at the end of paragraph (23); by striking the period at the end of paragraph (24) and inserting "; and"; and by adding at the end thereof the following new paragraph:

"(25) to the extent provided in section 1396(g), in the case of stock with respect to which a deduction was allowed under section 1396(a).".

SEC. 2704. EFFECTIVE DATE.

(a) GENERAL RULE.—The amendments made by this part shall take effect on the date of the enactment of this Act.

(b) REQUIREMENT FOR REGULATIONS.—Not later than the date 4 months after the date of the enactment of this Act, the appropriate Secretaries shall issue regulations—

(1) establishing the procedures for nominating areas for designation as tax enterprise zones,

(2) establishing a method for comparing the factors listed in section 1392(d) of the Internal Revenue Code of 1986 (as added by this part), and

(3) establishing recordkeeping requirements necessary or appropriate to assist the studies required by part III.

PART II—STUDIES

SEC. 2711. STUDIES OF EFFECTIVENESS OF TAX ENTERPRISE ZONE INCENTIVES.

(a) IN GENERAL.—The Secretary of the Treasury and the Comptroller General shall each conduct studies of the effectiveness of the incentives provided by this subtitle in achieving the purposes of this subtitle in tax enterprise zones.

(b) REPORTS.—The Secretary of the Treasury and the Comptroller General shall each submit to the Committee on Ways and Means of

the House of Representatives and the Committee on Finance of the Senate—

(1) not later than July 1, 1996, an interim report setting forth the findings as a result of such studies, and

(2) not later than July 1, 2001, a final report setting forth the findings as a result of such studies.

TITLE III—REVENUE PROVISIONS

Subtitle A—Treatment of Wealthy Individuals

SEC. 3001. INCREASE IN TOP MARGINAL RATE UNDER SECTION 1.

(a) GENERAL RULE.—Section 1 (relating to tax imposed) is amended by striking subsections (a) through (e) and inserting the following:

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

"(1) every married individual (as defined in section 7703) who makes a single return jointly with his spouse under section 6013, and

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

a tax determined in accordance with the following table:

"If taxable income is:	The tax is:
Not over $35,800	15% of taxable income.
Over $35,800 but not over $86,500	$5,370, plus 28% of the excess over $35,800.
Over $86,500 but not over $140,000	$19,566, plus 31% of the excess over $86,500.
Over $140,000	$36,151, plus 36% of the excess over $140,000.

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

"If taxable income is:	The tax is:
Not over $28,750	15% of taxable income.
Over $28,750 but not over $74,150	$4,312.50, plus 28% of the excess over $28,750.
Over $74,150 but not over $127,500	$17,024.50, plus 31% of the excess over $74,150.
Over $127,500	$33,563, plus 36% of the excess over $127,500.

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

"If taxable income is:	The tax is:
Not over $21,450	15% of taxable income.
Over $21,450 but not over $51,900	$3,217.50, plus 28% of the excess over $21,450.
Over $51,900 but not over $115,000	$11,743.50, plus 31% of the excess over $51,900.
Over $115,000	$31,304.50, plus 36% of the excess over $115,000.

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

"If taxable income is:	The tax is:
Not over $17,900	15% of taxable income.
Over $17,900 but not over $43,250	$2,685, plus 28% of the excess over $17,900.
Over $43,250 but not over $70,500	$9,783, plus 31% of the excess over $43,250.
Over $70,500	$18,075.50, plus 36% of the excess over $87,500.

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

"(1) every estate, and

"(2) every trust,

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

"If taxable income is:	The tax is:
Not over $3,000	15% of taxable income.
Over $3,000	$450, plus 28% of the excess over $3,000.
Over $5,000 but not over $7,000	$1,010, plus 31% of the excess over $5,000.
Over $7,000	$1,630, plus 36% of the excess over $7,000.

(b) CONFORMING AMENDMENTS.—

(1) Section 541 is amended by striking "28 percent" and inserting "36 percent".

(2)(A) Subsection (f) of section 1 is amended—

(i) by striking "1990" in paragraph (1) and inserting "1992", and

(ii) by striking "1989" in paragraph (3)(B) and inserting "1991".

(B) Subparagraph (B) of section 32(i)(1) is amended by striking "1989" and inserting "1991".

(C) Subparagraph (C) of section 41(e)(5) is amended by striking "1989" each place it appears and inserting "1991".

(D) Subparagraph (B) of section 63(c)(4) is amended by striking "1989" and inserting "1991".

(E) Subparagraph (B) of section 68(b)(2) is amended by striking "1989" and inserting "1991".

(F) Subparagraphs (A)(ii) and (B)(ii) of section 151(d)(4) are each amended by striking "1989" and inserting "1991".

(G) Clause (ii) of section 513(h)(2)(C) is amended by striking "1989" and inserting "1991".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1991.

SEC. 3002. SURTAX ON INDIVIDUALS WITH INCOMES OVER $1,000,000.

(a) GENERAL RULE.—Subchapter A of chapter 1 (relating to determination of tax liability) is amended by adding at the end thereof the following new part:

"PART VIII—SURTAX ON INDIVIDUALS WITH INCOMES OVER $1,000,000

"Sec. 59B. Surtax on section 1 tax.
"Sec. 59C. Surtax on minimum tax.
"Sec. 59D. Special rules.

"SEC. 59B. SURTAX ON SECTION 1 TAX.

"In the case of an individual who has taxable income for the taxable year in excess of $1,000,000, the amount of the tax imposed under section 1 for such taxable year shall be increased by 10 percent of the amount which bears the same ratio to the tax imposed under section 1 (determined without regard to this section) as—

"(1) the amount by which the taxable income of such individual for such taxable year exceeds $1,000,000, bears to

"(2) the total amount of such individual's taxable income for such taxable year.

"SEC. 59C. SURTAX ON MINIMUM TAX.

"In the case of an individual who has alternative minimum taxable income for the taxable year in excess of $1,000,000, the amount of the tentative minimum tax determined under section 55 for such taxable year shall be increased by 2.4 percent of the amount by which the alternative minimum taxable income of such taxpayer for the taxable year exceeds $1,000,000.

"SEC. 59D. SPECIAL RULES.

"(a) SURTAX TO APPLY TO ESTATES AND TRUSTS.—For purposes of this part, the term 'individual' includes any estate or trust taxable under section 1.

"(b) TREATMENT OF MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—In the case of a married individual (within the meaning of section 7703) filing a separate return for the taxable year, sections 59B and 59C shall be applied by substituting '$500,000' for '$1,000,000'.

"(c) COORDINATION WITH OTHER PROVISIONS.—The provisions of this part—

"(1) shall be applied after the application of section 1(h), but

"(2) before the application of any other provision of this title which refers to the amount of tax imposed by section 1 or 55, as the case may be."

(b) CLERICAL AMENDMENT.—The table of parts for subchapter A of chapter 1 is amended by adding at the end the following new item:

"Part VIII. Surtax on individuals with incomes over $1,000,000."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1991.

SEC. 3003. 2-YEAR EXTENSION OF OVERALL LIMITATION ON ITEMIZED DEDUCTIONS FOR HIGH-INCOME TAXPAYERS.

Subsection (f) of section 68 (relating to overall limitation on itemized deductions) is amended by striking "1995" and inserting "1997".

SEC. 3004. EXTENSION OF PHASEOUT OF PERSONAL EXEMPTION OF HIGH-INCOME TAXPAYERS.

Section 151(d)(3) (relating to phaseout of personal exemption) is amended by striking subparagraph (E).

SEC. 3005. DISALLOWANCE OF DEDUCTION FOR CERTAIN EMPLOYEE REMUNERATION IN EXCESS OF $1,000,000.

(a) GENERAL RULE.—Section 162 (relating to trade or business expenses) is amended by redesignating subsection (m) as subsection (n) and by inserting after subsection (l) the following new subsection:

"(m) CERTAIN EXCESSIVE EMPLOYEE REMUNERATION.—

"(1) IN GENERAL.—No deduction shall be allowed under this chapter for employee remuneration with respect to any covered employee to the extent that the amount of such remuneration for the taxable year with respect to such employee exceeds $1,000,000.

"(2) COVERED EMPLOYEE.—For purposes of this subsection—

"(A) IN GENERAL.—Except as otherwise provided in this paragraph, the term 'covered employee' means any employee of the taxpayer who is an officer of the taxpayer.

"(B) EXCEPTION FOR EMPLOYEE-OWNERS OF PERSONAL SERVICE CORPORATIONS.—The term 'covered employee' shall not include any employee-owner (as defined in section 269A(b)) of a personal service corporation (as defined in section 269A(b)).

"(C) FORMER EMPLOYEES.—The term 'covered employee' includes any former employee who had been a covered employee at any time while performing services for the taxpayer.

"(3) EMPLOYEE REMUNERATION.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'employee remuneration' means, with respect to any covered employee for any taxable year, the aggregate amount allowable as a deduction under this chapter for such taxable year (determined without regard to this subsection) for remuneration for services performed by such employee (whether or not during the taxable year).

"(B) REMUNERATION.—For purposes of subparagraph (A), the term 'remuneration' includes any remuneration (including benefits) in any medium other than cash, but shall not include—

"(i) any payment referred to in so much of section 3121(a)(5) as precedes subparagraph (E) thereof,

"(ii) amounts referred to in section 3121(a)(19), and

"(iii) 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 gross income under section 132.

"(4) TREATMENT OF CERTAIN EMPLOYERS.—

"(A) IN GENERAL.—All employers treated as a single employer under subsection (a) or (b) of section 52 or subsection (m) or (n) of section 414 shall be treated as a single employer for purposes of this subsection.

"(B) CLARIFICATION OF OFFICER DEFINITION.—Any officer of any of the employers treated as a single employer under subparagraph (A) shall be treated as an officer of such single employer."

(b) Effective Date.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1991.

SEC. 3006. ELIMINATION OF DEDUCTION FOR CLUB MEMBERSHIP FEES.

(a) In General.—Section 162 (relating to trade or business expenses), as amended by sections 3005 and title IV, is amended by redesignating subsection (o) as subsection (p) and by inserting after subsection (n) the following new subsection:

"(o) Club Membership Dues.—No deduction shall be allowed under this chapter for amounts paid or incurred for membership in any club organized for business, pleasure, recreation, or other social purpose."

(b) Effective Date.—The amendment made by this section shall apply to dues paid after the date of the enactment of this Act.

Subtitle B—Administrative Provisions

SEC. 3101. INDIVIDUAL ESTIMATED TAX PROVISIONS.

(a) General Rule.—Paragraph (1) of section 6654(d) (relating to amount of required installment) is amended—

(1) by striking "100 percent" in subparagraph (B)(ii) and inserting "115 percent", and

(2) by striking subparagraphs (C), (D), (E), and (F).

(b) Effective Date.—

(1) In general.—The amendments made by subsection (a) shall apply to taxable years beginning after December 31, 1991.

(2) Special rule for 1st installment in 1992.—The amendment made by subsection (a) shall not apply for purposes of determining the amount of the 1st required installment for any taxable year beginning in 1992. Any reduction in an installment by reason of the preceding sentence shall be recaptured by increasing the amount of the 1st succeeding required installment by the amount of such reduction.

SEC. 3102. CORPORATE ESTIMATED TAX PROVISIONS.

(a) General Rule.—Subsection (d) of section 6655 (relating to amount of required installments) is amended—

(1) by striking "90 percent" each place it appears in paragraph (1)(B)(i) and inserting "95 percent",

(2) by striking "90 percent" in the heading of paragraph (2) and inserting "95 percent", and

(3) by striking paragraph (3).

(b) Conforming Amendments.—

(1) Clause (ii) of section 6655(e)(2)(B) is amended by striking the table contained therein and inserting in lieu thereof:

"In the case of the following required installments:	***The applicable percentage is:***
1st	*23.75*
2nd	*47.5*
3rd	*71.25*
4th	*95."*

(2) Clause (i) of section 6655(e)(3)(A) is amended by striking "90 percent" and inserting "95 percent".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1994.

SEC. 3103. DISALLOWANCE OF INTEREST ON CERTAIN OVERPAYMENTS OF TAX.

(a) GENERAL RULE.—Subsection (e) of section 6611 is amended to read as follows:

"(e) DISALLOWANCE OF INTEREST ON CERTAIN OVERPAYMENTS.—

"(1) REFUNDS WITHIN 45 DAYS AFTER RETURN IS FILED.—If any overpayment of tax imposed by this title is refunded within 45 days after the last day prescribed for filing the return of such tax (determined without regard to any extension of time for filing the return) or, in the case of a return filed after such last date, is refunded within 45 days after the date the return is filed, no interest shall be allowed under subsection (a) on such overpayment.

"(2) REFUNDS AFTER CLAIM FOR CREDIT OR REFUND.—If—

"(A) the taxpayer files a claim for a credit or refund for any overpayment of tax imposed by this title, and

"(B) such overpayment is refunded within 45 days after such claim is filed,

no interest shall be allowed on such overpayment from the date the claim is filed until the day the refund is made.

"(3) IRS INITIATED ADJUSTMENTS.—Notwithstanding any other provision, if an adjustment, initiated by or on behalf of the Secretary, results in a refund or credit of an overpayment, interest on such overpayment shall be computed by subtracting 45 days from the number of days interest would otherwise be allowed with respect to such overpayment."

(b) EFFECTIVE DATES.—

(1) Paragraph (1) of section 6611(e) of the Internal Revenue Code of 1986 (as amended by subsection (a)) shall apply in the case of returns the due date for which (determined without regard to extensions) is on or after July 1, 1992.

(2) Paragraph (2) of section 6611(e) of such Code (as so amended) shall apply in the case of claims for credit or refund of any overpayment filed on or after July 1, 1992 regardless of the taxable period to which such refund relates.

(3) Paragraph (3) of section 6611(e) of such Code (as so amended) shall apply in the case of any refund paid on or after July 1, 1992 regardless of the taxable period to which such refund relates.

SEC. 3104. INFORMATION REPORTING WITH RESPECT TO CERTAIN SELLER-PROVIDED FINANCING.

(a) GENERAL RULE.—Section 6109 (relating to identifying numbers) is amended by adding at the end thereof the following new subsection:

"(f) IDENTIFYING INFORMATION REQUIRED WITH RESPECT TO CERTAIN SELLER-PROVIDED FINANCING.—

"(1) PAYOR.—If any taxpayer claims a deduction under section 163 for qualified residence interest on any seller-provided financing, such taxpayer shall include on the return claiming such deduction the name, address, and TIN of the person to whom such interest is paid or accrued.

"(2) RECIPIENT.—If any person receives or accrues interest referred to in paragraph (1), such person shall include on the return for the taxable year in which such interest is so received or accrued the name, address, and TIN of the person liable for such interest.

"(3) FURNISHING OF INFORMATION BETWEEN PAYOR AND RECIPIENT.—If any person is required to include the TIN of another person on a return under paragraph (1) or (2), such other person shall furnish his TIN to such person.

"(4) SELLER-PROVIDED FINANCING.—For purposes of this subsection, the term 'seller-provided financing' means any indebtedness incurred in acquiring any residence if the person to whom such indebtedness is owed is the person from whom such residence was acquired.".

(b) PENALTY.—Paragraph (3) of section 6724(d) (relating to specified information reporting requirement) is amended by striking "and" at the end of subparagraph (C), by striking the period at the end of subparagraph (D) and inserting ", and", and by adding at the end thereof the following new subparagraph:

"(E) any requirement under section 6109(f) that—

"(i) a person include on his return the name, address, and TIN of another person, or

"(ii) a person furnish his TIN to another person."

(c) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years beginning after December 31, 1991.

Subtitle C—Other Revenue Provisions

SEC. 3201. CLARIFICATION OF TREATMENT OF CERTAIN FSLIC FINANCIAL ASSISTANCE.

(a) GENERAL RULE.—For purposes of chapter 1 of the Internal Revenue Code of 1986—

(1) any FSLIC assistance with respect to any loss of principal, capital, or similar amount upon the disposition of any asset shall be taken into account as compensation for such loss for purposes of section 165 of such Code, and

(2) any FSLIC assistance with respect to any debt shall be taken into account for purposes of section 166, 585, or 593 of such Code in determining whether such debt is worthless (or the extent to which such debt is worthless) and in determining the amount of any addition to a reserve for bad debts arising from the worthlessness or partial worthlessness of such debts.

(b) FSLIC ASSISTANCE.—For purposes of this section, the term "FSLIC assistance" means any assistance (or right to assistance) with respect to a domestic building and loan association (as defined in section 7701(a)(19) of such Code without regard to subparagraph (C) thereof) under section 406(f) of the National Housing Act or section 21A of the Federal Home Loan Bank Act (or under any similar provision of law).

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection—

(A) The provisions of this section shall apply to taxable years ending after March 4, 1991, but only with respect to FSLIC assistance not credited before March 4, 1991.

(B) If any FSLIC assistance not credited before March 4, 1991, is with respect to a loss sustained or charge-off in a taxable year ending before March 4, 1991, for purposes of determining the amount of any net operating loss carryover to a taxable year ending after on or after March 4, 1991, the provisions of this section shall apply to such assistance for purposes of determining the amount of the net operating loss for the taxable year in which such loss was sustained or debt written off. Except as provided in the preceding sentence, this section shall not apply to any FSLIC assistance with respect to a loss sustained or charge-off in a taxable year ending before March 4, 1991.

(2) Exceptions.—The provisions of this section shall not apply to any assistance to which the amendments made by section 1401(a)(3) of the Financial Institution Reform, Recovery, and Enforcement Act of 1989 apply.

SEC. 3202. INCREASE IN RECOVERY PERIOD FOR REAL PROPERTY.

(a) General Rule.—Paragraph (1) of section 168(c) is amended by striking the items relating to residential rental property and nonresidential real property and inserting the following:

"Low income housing	27.5 years
Residential rental property other than low income housing	31 years
Nonresidential real property	40 years."

(b) Conforming Amendment.—Paragraph (2) of section 168(e) is amended by adding at the end thereof the following new subparagraph:

"(C) Low income housing.—The term 'low income housing' means any property with respect to which the credit under section 42 is allowable."

(c) Effective Date.—

(1) In general.—Except as provided in paragraph (2), the amendments made by this section shall apply to property placed in service by the taxpayer after February 12, 1992.

(2) Exception.—The amendments made by this section shall not apply to property placed in service by the taxpayer before January 1, 1995, if—

(A) the taxpayer or a qualified person entered into a binding written contract to purchase or construct such property before February 13, 1992, or

(B) the construction of such property was commenced by or for the taxpayer or a qualified person before February 13, 1992.

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 the property is not placed in service by such person before such rights are transferred to the taxpayer.

SEC. 3203. MODIFICATIONS TO DEDUCTION FOR MOVING EXPENSES.

(a) Increase in Mileage Requirements.—Paragraph (1) of section 217(c) (relating to conditions for allowance of moving expense *deduction) is amended by striking "35 miles" each place it appears and inserting "75 miles".*

(b) SIMPLIFICATION OF DOLLAR LIMITATIONS.—

(1) IN GENERAL.—Paragraph (3) of section 217(b) is amended by striking subparagraphs (A) and (B) and inserting the following:

"(A) DOLLAR LIMIT.—The aggregate amount allowable as a deduction under subsection (a) in connection with a commencement of work which is attributable to expenses described in subparagraph (C), (D), or (E) of paragraph (1) shall not exceed $3,000.

"(B) HUSBAND AND WIFE.—If a husband and wife both commence work at a new principal place of work within the same general location, subparagraph (A) shall be applied as if there was only 1 commencement of work. In the case of a husband and wife filing separate returns, subparagraph (A) shall be applied by substituting '$1,500' for '$3,000'."

(2) CONFORMING AMENDMENT.—Paragraph (1) of section 217(h) is amended—

(A) by striking "by substituting '$4,500' for '$1,000' and" in subparagraph (B), and

(B) by striking "by substituting "$2,250' for '$4,500', and" in subparagraph (C).

(c) REIMBURSED MOVING EXPENSES ALLOWABLE IN COMPUTING ADJUSTED GROSS INCOME.—

(1) IN GENERAL.—Subsection (a) of section 62 is amended by inserting after paragraph (13) the following new paragraph:

"(14) REIMBURSED MOVING EXPENSES.—The deduction allowed under section 217 for expenses in connection with any commencement of work by the taxpayer to the extent that the deduction so allowed for such expenses does not exceed the reimbursements (or other payments) included in gross income under section 82 with respect to expenses in connection with such commencement of work."

(2) UNREIMBURSED EXPENSES SUBJECT TO 2 PERCENT FLOOR.—Subsection (b) of section 67 is amended by striking paragraph (6) and redesignating the following paragraphs accordingly.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to expenses paid or incurred after the date of the enactment of this Act.

SEC. 3204. MARK TO MARKET INVENTORY METHOD FOR SECURITIES DEALERS.

(a) GENERAL RULE.—Subpart D of part II of subchapter E of chapter 1 (relating to inventories) is amended by adding at the end thereof the following new section:

"SEC. 475. MARK TO MARKET ACCOUNTING METHOD FOR DEALERS IN SECURITIES.

"(a) GENERAL RULE.—Notwithstanding any other provision of this subpart, the following rules shall apply to securities held by a dealer in securities:

"(1) Any security which is inventory in the hands of the dealer shall be included in inventory at its fair market value.

"(2) In the case of any security which is not inventory in the hands of the dealer and which is held at the close of any taxable year—

"(A) the dealer shall recognize gain or loss as if such security were sold for its fair market value on the last business day of such taxable year, and

"(B) any gain or loss shall be taken into account for such taxable year.

Proper adjustment shall be made in the amount of any gain or loss subsequently realized for gain or loss taken into account under the preceding sentence. The Secretary may provide by regulations for the application of this paragraph at times other than the times provided in this paragraph.

"(b) EXCEPTIONS.—

"(1) IN GENERAL.—Subsection (a) shall not apply to—

"(A) any security held for investment,

"(B) any security described in subsection (c)(2)(C) which is originated or acquired by the taxpayer in the ordinary course of a trade or business of the taxpayer and which is not held for sale, and

"(C) any security which is a hedge with respect to—

"(i) a security to which subsection (a) does not apply, or

"(ii) a position, right to income, or a liability which is not a security in the hands of the taxpayer.

Subparagraph (C) shall not apply to any security held by a person in its capacity as a dealer in securities.

"(2) IDENTIFICATION REQUIRED.—Any security shall not be treated as described in subparagraph (A), (B), or (C) of paragraph (1), as the case may be, unless such security is clearly identified in the dealer's records as being described in such subparagraph before the close of the day on which it was acquired, originated, or entered into (or such other time as the Secretary may by regulations prescribe).

"(3) SECURITIES SUBSEQUENTLY NOT EXEMPT.—If a security ceases to be described in paragraph (1) at any time after it was identified as such under paragraph (2), subsection (a) shall apply to such security as of the time such cessation occurs.

"(4) SPECIAL RULE FOR PROPERTY HELD FOR INVESTMENT.—To the extent provided in regulations, subparagraph (A) of paragraph (1) shall not apply to any security described in subparagraph (D) or (E) of subsection (c)(2) which is held by a dealer in such securities.

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

"(1) DEALER IN SECURITIES DEFINED.—The term 'dealer in securities' means a taxpayer who—

"(A) regularly purchases securities from or sells securities to customers in the ordinary course of a trade or business; or

"(B) regularly offers to enter into, assume, offset, assign or otherwise terminate positions in securities with customers in the ordinary course of a trade or business.

"(2) SECURITY DEFINED.—The term 'security' means any—

"(A) share of stock in a corporation;

"(B) partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust;

"(C) note, bond, debenture, or other evidence of indebtedness;

"(D) interest rate, currency, or equity notional principal contract;

"(E) evidence of an interest in, or a derivative financial instrument in, any security described in subparagraph (A), (B), (C), or (D), or any currency, including any option, forward contract, short position, and any similar financial instrument in such a security or currency (but not including any contract to which section 1256(a) applies); and

"(F) position which—

"(i) is not a security described in subparagraph (A), (B), (C), (D), or (E),

"(ii) is a hedge with respect to such a security, and

"(iii) is clearly identified in the dealer's records as being described in this subparagraph before the close of the day on which it was acquired or entered into (or such other time as the Secretary may by regulations prescribe).

"(3) Hedge.—The term 'hedge' means any position which reduces the dealer's risk of interest rate or price changes or currency fluctuations.

"(d) Special Rules.—For purposes of this section—

"(1) Certain rules not to apply.—The rules of sections 263(g) and 263A shall not apply to securities to which subsection (a) applies.

"(2) Improper identification.—If a taxpayer—

"(A) identifies any security under subsection (b)(2) as being described in subsection (b)(1) and such security is not so described, or

"(B) fails under subsection (c)(2)(F)(iii) to identify any position which is described in such subsection at the time such identification is required,

the provisions of subsection (a) shall apply to such security or position, except that any loss under this section prior to the disposition of the security or position shall be recognized only to the extent of gain previously recognized under this section (and not previously taken into account under this paragraph) with respect to such security or position.

"(3) Anticipatory hedges.—Any security which is reasonably expected to become a hedge within 60 days after the acquisition of the security shall be treated as a hedge.

"(e) Regulatory Authority.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including rules—

"(1) to prevent the use of year-end transfers, related parties, or other arrangements to avoid the provisions of this section, and

"(2) to provide for the application of this section to any security which is a hedge which cannot be identified with a specific security, position, right to income, or liability."

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 988(d) is amended—

(A) by striking "section 1256" and inserting "section 475 or 1256", and

(B) by striking "1092 and 1256" and inserting "475, 1092, and 1256".

(2) The table of sections for subpart D of part II of subchapter E of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 475. Mark to market accounting method for dealers in securities."

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to all taxable years ending on or after December 31, 1992.

(2) CHANGE IN METHOD OF ACCOUNTING.—In the case of any taxpayer required by this section to change its method of accounting for any taxable year—

(A) such change shall be treated as initiated by the taxpayer,

(B) such change shall be treated as made with the consent of the Secretary, and

(C) the net amount of the adjustments required to be taken into account by the taxpayer under section 481 of the Internal Revenue Code of 1986 shall be taken into account ratably over the 10-taxable year period beginning with the first taxable year ending on or after December 31, 1992.

If the net amount determined under subparagraph (C) exceeds the net amount which would have been determined under subparagraph (C) if the taxpayer had been required by this section to change its method of accounting for its last taxable year beginning before March 20, 1992, subparagraph (C) shall be applied with respect to such excess by substituting "4-taxable year" for "10-taxable year".

SEC. 3205. INCREASED BASE TAX RATE ON OZONE-DEPLETING CHEMICALS.

(a) IN GENERAL.—Subparagraph (B) of section 4681(b)(1) (relating to amount of tax) is amended to read as follows:

"(B) BASE TAX AMOUNT.—The base tax amount for purposes of subparagraph (A) with respect to any sale or use during a calendar year before 1996 with respect to any ozone-depleting chemical is the amount determined under the following table for such calendar year:

"Calendar year:	*Base tax amount:*
1992	*$1.85*
1993	*2.75*
1994	*3.65*
1995	*4.55."*

(b) CONFORMING AMENDMENTS.—

(1) RATES RETAINED FOR CHEMICAL USED IN RIGID FOAM INSULATION.—The table in subparagraph (B) of section 4682(g)(2) (relating to chemicals used in rigid foam insulation) is amended—

(A) by striking "15" and inserting "13.5", and

(B) by striking "10" and inserting "9.6".

(2) FLOOR STOCK TAXES.—

(A) Subparagraph (C) of section 4682(h)(2) (relating to other tax-increase dates) is amended by striking "1993, and 1994" and inserting "1993, 1994, and 1995, and July 1, 1992".

(B) Paragraph (3) of section 4682(h) (relating to due date) is amended—

(i) by inserting "or July 1" after "January 1", and

(ii) by inserting "or December 31, respectively," after "June 30".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable chemicals sold or used on or after July 1, 1992.

TITLE IV—SIMPLIFICATION PROVISIONS

Subtitle A—Provisions Relating to Individuals

SEC. 4101. SIMPLIFICATION OF RULES ON ROLLOVER OF GAIN ON SALE OF PRINCIPAL RESIDENCE.

(a) RULES RELATING TO MULTIPLE SALES WITHIN ROLLOVER PERIOD.—

(1) Section 1034 (relating to rollover of gain on sale of principal residence) is amended by striking subsection (d).

(2) Paragraph (4) of section 1034(c) is amended to read as follows:

"(4) If the taxpayer, during the period described in subsection (a), purchases more than 1 residence which is used by him as his principal residence at some time within 2 years after the date of the sale of the old residence, only the first of such residences so used by him after the date of such sale shall constitute the new residence."

(3) Subsections (h)(1) and (k) of section 1034 are each amended by striking "(other than the 2 years referred to in subsection (c)(4))".

(b) TREATMENT IN CASE OF DIVORCES.—Subsection (c) of section 1034 is amended by adding at the end thereof the following new paragraph:

"(5) If—

"(A) a residence is sold by an individual pursuant to a divorce or marital separation, and

"(B) the taxpayer used such residence as his principal residence at any time during the 2-year period ending on the date of such sale,

for purposes of this section, such residence shall be treated as the taxpayer's principal residence at the time of such sale."

(c) 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 1986) after the date of the enactment of this Act.

SEC. 4102. DE MINIMIS EXCEPTION TO PASSIVE LOSS RULES.

(a) GENERAL RULE.—Section 469 (relating to passive activity losses and credits limited) is amended—

(1) by striking subsection (m),

(2) by redesignating subsection (l) as subsection (m), and

(3) by inserting after subsection (k) the following new subsection:

"(l) DE MINIMIS EXCEPTION.—

"(1) IN GENERAL.—In the case of a natural person, subsection (a) shall not apply to the passive activity loss for any taxable year if the amount of such loss does not exceed $200.

"(2) EXCEPTION FOR ITEMS ATTRIBUTABLE TO PUBLICLY TRADED PARTNERSHIPS.—This subsection shall not apply to items treated separately under subsection (k) (and such items shall not be taken into account in determining whether paragraph (1) applies to the taxpayer for the taxable year with respect to other items).

"(3) ESTATES ELIGIBLE.—For purposes of this subsection, an estate shall be treated as a natural person with respect to any taxable year ending less than 2 years after the death of the decedent.

"(4) MARRIED INDIVIDUALS FILING SEPARATELY.—

"(A) IN GENERAL.—This subsection shall not apply to a taxpayer who—

"(i) is a married individual filing a separate return for the taxable year, and

"(ii) does not live apart from his spouse at all times during such taxable year.

"(B) LIMITATION.—Paragraph (1) shall be applied by substituting '$100' for '$200' in the case of a married individual who files a separate return for the taxable year and to whom this subsection applies after the application of subparagraph (A)."

(b) CONFORMING AMENDMENTS.—

(1) Subsection (b) of section 58 is amended by inserting "and" at the end of paragraph (1), by striking paragraph (2), and by redesignating paragraph (3) as paragraph (2).

(2) Paragraph (4) of section 163(d) is amended by striking subparagraph (E).

(3) Subsection (d) of section 163 is amended by striking paragraph (6).

(4) Subsection (h) of section 163 is amended by striking paragraph (5).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1991.

SEC. 4103. PAYMENT OF TAX BY CREDIT CARD.

(a) GENERAL RULE.—Section 6311 is amended to read as follows:

"SEC. 6311. PAYMENT BY CHECK, MONEY ORDER, OR OTHER MEANS.

"(a) AUTHORITY TO RECEIVE.—It shall be lawful for the Secretary to receive for internal revenue taxes (or in payment for internal revenue stamps) checks, money orders, or any other commercially acceptable means that the Secretary deems appropriate, including payment by use of credit cards, to the extent and under the conditions provided in regulations prescribed by the Secretary.

"(b) ULTIMATE LIABILITY.—If a check, money order, or other method of payment so received is not duly paid, the person by whom such check, or money order, or other method of payment has been

tendered shall remain liable for the payment of the tax or for the stamps, and for all legal penalties and additions, to the same extent as if such check, money order, or other method of payment had not been tendered.

"(c) LIABILITY OF BANKS AND OTHERS.—If any certified, treasurer's, or cashier's check (or other guaranteed draft), or any money order, or any other means of payment that has been guaranteed by a financial institution (such as a guaranteed credit card transaction) so received is not duly paid, the United States shall, in addition to its right to exact payment from the party originally indebted therefor, have a lien for—

"(1) the amount of such check (or draft) upon all assets of the financial institution on which drawn,

"(2) the amount of such money order upon all the assets of the issuer thereof, or

"(3) the guaranteed amount of any other transaction upon all the assets of the institution making such guarantee,

and such amount shall be paid out of such assets in preference to any other claims whatsoever against such financial institution, issuer, or guaranteeing institution, except the necessary costs and expenses of administration and the reimbursement of the United States for the amount expended in the redemption of the circulating notes of such financial institution.

"(d) PAYMENT BY OTHER MEANS.—

"(1) AUTHORITY TO PRESCRIBE REGULATIONS.—The Secretary shall prescribe such regulations as the Secretary deems necessary to receive payment by commercially acceptable means, including regulations that—

"(A) specify which methods of payment by commercially acceptable means will be acceptable,

"(B) specify when payment by such means will be considered received,

"(C) identify types of nontax matters related to payment by such means that are to be resolved by persons ultimately liable for payment and financial intermediaries, without the involvement of the Secretary, and

"(D) ensure that tax matters will be resolved by the Secretary, without the involvement of financial intermediaries.

"(2) AUTHORITY TO ENTER INTO CONTRACTS.—Notwithstanding section 3718(f) of title 31, United States Code, the Secretary is authorized to enter into contracts to obtain services related to receiving payment by other means where cost beneficial to the government and is further authorized to pay any fees required by such contracts.

"(3) SPECIAL PROVISIONS FOR USE OF CREDIT CARDS.—If use of credit cards is accepted as a method of payment of taxes pursuant to subsection (a)—

"(A) except as provided by regulations, subject to the provisions of section 6402, any refund due a person who makes a payment by use of a credit card shall be made directly to such person, notwithstanding any other provision of law or any contract made pursuant to paragraph (2),

"(B) any credit card transaction shall not be considered a 'sales transaction' under the Federal Truth-in-Lending Act (15 U.S.C. 1601 et seq.),

"(C) all nontax matters as defined by regulations prescribed under paragraph (1)(C), including billing errors as defined in section 161(b) of such Act, shall be resolved by the person tendering the credit card and the credit card issuer, without the involvement of the Secretary, and

"(D) the provisions of sections 161(e) and 170 of such Act shall not apply."

(b) CLERICAL AMENDMENT.—The table of sections for subchapter B of chapter 64 is amended by striking the item relating to section 6311 and inserting the following:

"Sec. 6311. Payment by check, money order, or other means."

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

SEC. 4104. MODIFICATIONS TO ELECTION TO INCLUDE CHILD'S INCOME ON PARENT'S RETURN.

(a) ELIGIBILITY FOR ELECTION.—Clause (ii) of section 1(g)(7)(A) (relating to election to include certain unearned income of child on parent's return) is amended to read as follows:

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

(b) COMPUTATION OF TAX.—Subparagraph (B) of section 1(g)(7) (relating to income included on parent's return) is amended—

(1) by striking "$1,000" in clause (i) and inserting "twice the amount described in paragraph (4)(A)(ii)(I)", and

(2) by amending subclause (II) of clause (ii) to read as follows:

"(II) for each such child, 15 percent of the lesser of the amount described in paragraph (4)(A)(ii)(I) or the excess of the gross income of such child over the amount so described, and".

(c) MINIMUM TAX.—Subparagraph (B) of section 59(j)(1) is amended by striking "$1,000" and inserting "twice the amount in effect for the taxable year under section 63(c)(5)(A)".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1991.

SEC. 4105. SIMPLIFIED FOREIGN TAX CREDIT LIMITATION FOR INDIVIDUALS.

(a) GENERAL RULE.—Section 904 (relating to limitations on foreign tax credit) is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) SIMPLIFIED LIMITATION FOR CERTAIN INDIVIDUALS.—

"(1) IN GENERAL.—In the case of an individual to whom this subsection applies for any taxable year, the limitation of subsection (a) shall be the lesser of—

"(A) 25 percent of such individual's gross income for the taxable year from sources without the United States, or

"(B) the amount of the creditable foreign taxes paid or accrued by the individual during the taxable year (determined without regard to subsection (c)).

No taxes paid or accrued by the individual during such taxable year may be deemed paid or accrued in any other taxable year under subsection (c).

"(2) Individuals to whom subsection applies.—This subsection shall apply to an individual for any taxable year if—

"(A) the entire amount of such individual's gross income for the taxable year from sources without the United States consists of qualified passive income,

"(B) the amount of the creditable foreign taxes paid or accrued by the individual during the taxable year does not exceed $200, and

"(C) such individual elects to have this subsection apply for the taxable year.

"(3) Definitions.—For purposes of this subsection—

"(A) Qualified passive income.—The term 'qualified passive income' means any item of gross income if—

"(i) such item of income is passive income (as defined in subsection (d)(2)(A) without regard to clause (iii) thereof), and

"(ii) such item of income is shown on a payee statement furnished to the individual.

"(B) Creditable foreign taxes.—The term 'creditable foreign taxes' means any taxes for which a credit is allowable under section 901; except that such term shall not include any tax unless such tax is shown on a payee statement furnished to such individual.

"(C) Payee statement.—The term 'payee statement' has the meaning given to such term by section 6724(d)(2).

"(D) Estates and trusts not eligible.—This subsection shall not apply to any estate or trust."

(b) Effective Date.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1991.

SEC. 4106. TREATMENT OF PERSONAL TRANSACTIONS BY INDIVIDUALS UNDER FOREIGN CURRENCY RULES.

(a) General Rule.—Subsection (e) of section 988 (relating to application to individuals) is amended to read as follows:

"(e) Application to Individuals.—

"(1) In general.—The preceding provisions of this section shall not apply to any section 988 transaction entered into by an individual which is a personal transaction.

"(2) Exclusion for certain personal transactions.—If—

"(A) nonfunctional currency is disposed of by an individual in any transaction, and

"(B) such transaction is a personal transaction,

no gain shall be recognized for purposes of this subtitle by reason of changes in exchange rates after such currency was acquired by such individual and before such disposition. The preceding sentence shall not apply if the gain which would otherwise be recognized exceeds $200.

"(3) Personal transactions.—For purposes of this subsection, the term 'personal transaction' means any transaction entered into by an individual, except that such term shall not include any transaction to the extent that expenses properly allo-

cable to such transaction meet the requirements of section 162 or 212 (other than that part of section 212 dealing with expenses incurred in connection with taxes)."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1991.

SEC. 4107. EXCLUSION OF COMBAT PAY FROM WITHHOLDING LIMITED TO AMOUNT EXCLUDABLE FROM GROSS INCOME.

(a) IN GENERAL.—Paragraph (1) of section 3401(a) (defining wages) is amended by inserting before the semicolon the following: "to the extent remuneration for such service is excludable from gross income under such section".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to remuneration paid after December 31, 1992.

SEC. 4108. EXPANDED ACCESS TO SIMPLIFIED INCOME TAX RETURNS.

(a) GENERAL RULE.—The Secretary of the Treasury or his delegate shall take such actions as may be appropriate to expand access to simplified individual income tax returns and otherwise simplify the individual income tax returns.

(b) REPORT.—Not later than the date 1 year after the date of the enactment of this Act, the Secretary of the Treasury or his delegate shall submit a report to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate, a report on his actions under subsection (a), together with such recommendations as he may deem advisable.

SEC. 4109. TREATMENT OF CERTAIN REIMBURSED EXPENSES OF RURAL MAIL CARRIERS.

(a) IN GENERAL.—Section 162 (relating to trade or business expenses) is amended by redesignating subsection (m) as subsection (n) and by inserting after subsection (l) the following new subsection:

"(m) TREATMENT OF CERTAIN REIMBURSED EXPENSES OF RURAL MAIL CARRIERS.—

"(1) GENERAL RULE.—In the case of any employee of the United States Postal Service who performs services involving the collection and delivery of mail on a rural route and who receives qualified reimbursements for the expenses incurred by such employee for the use of a vehicle in performing such services—

"(A) the amount allowable as a deduction under this chapter for the use of a vehicle in performing such services shall be equal to the amount of such qualified reimbursements; and

"(B) such qualified reimbursements shall be treated as paid under a reimbursement or other expense allowance arrangement for purposes of section 62(a)(2)(A) (and section 62(c) shall not apply to such qualified reimbursements).

"(2) DEFINITION OF QUALIFIED REIMBURSEMENTS.—For purposes of this subsection, the term 'qualified reimbursements' means the amounts paid by the United States Postal Service to employees as an equipment maintenance allowance under the 1991 collective bargaining agreement between the United States Postal Service and the National Rural Letter Carriers' Association. Amounts paid as an equipment maintenance allowance by such Postal Service under later collective bargaining agreements

that supersede the 1991 agreement shall be considered qualified reimbursements if such amounts do not exceed the amounts that would have been paid under the 1991 agreement, adjusted for changes in the Consumer Price Index (as defined in section 1(f)(5)) since 1991."

(b) TECHNICAL AMENDMENT.—Section 6008 of the Technical and Miscellaneous Revenue Act of 1988 is hereby repealed.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1991.

SEC. 4110. EXEMPTION FROM LUXURY EXCISE TAX FOR CERTAIN EQUIPMENT INSTALLED ON PASSENGER VEHICLES FOR USE BY DISABLED INDIVIDUALS.

(a) IN GENERAL.—Paragraph (3) of section 4004(b) of the Internal Revenue Code of 1986 (relating to separate purchase of article and parts and accessories therefor) is amended—

(1) by striking "or" 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) the part or accessory is installed on a passenger vehicle to enable or assist an individual with a disability to operate the vehicle, or to enter or exit the vehicle, by compensating for the effect of such disability, or".

(b) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the amendments made by section 11221(a) of the Omnibus Budget Reconciliation Act of 1990.

Subtitle B—Pension Simplification

PART I—SIMPLIFIED DISTRIBUTION RULES

SEC. 4201. TAXABILITY OF BENEFICIARY OF QUALIFIED PLAN.

(a) IN GENERAL.—So much of section 402 (relating to taxability of beneficiary of employees' trust) as precedes subsection (g) thereof is amended to read as follows:

"SEC. 402. TAXABILITY OF BENEFICIARY OF EMPLOYEES' TRUST.

"(a) TAXABILITY OF BENEFICIARY OF EXEMPT TRUST.—Except as otherwise provided in this section, any amount actually distributed to any distributee by any employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to the distributee, in the taxable year of the distributee in which distributed, under section 72 (relating to annuities).

"(b) TAXABILITY OF BENEFICIARY OF NONEXEMPT TRUST.—

"(1) CONTRIBUTIONS.—Contributions to an employees' trust made by an employer during a taxable year of the employer which ends with or within a taxable year of the trust for which the trust is not exempt from tax under section 501(a) shall be included in the gross income of the employee in accordance with section 83 (relating to property transferred in connection with performance of services), except that the value of the employee's

interest in the trust shall be substituted for the fair market value of the property for purposes of applying such section.

"(2) DISTRIBUTIONS.—The amount actually distributed or made available to any distributee by any trust described in paragraph (1) shall be taxable to the distributee, in the taxable year in which so distributed or made available, under section 72 (relating to annuities), except that distributions of income of such trust before the annuity starting date (as defined in section 72(c)(4)) shall be included in the gross income of the employee without regard to section 72(e)(5) (relating to amounts not received as annuities).

"(3) GRANTOR TRUSTS.—A beneficiary of any trust described in paragraph (1) shall not be considered the owner of any portion of such trust under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners).

"(4) FAILURE TO MEET REQUIREMENTS OF SECTION 410(b).—

"(A) HIGHLY COMPENSATED EMPLOYEES.—If 1 of the reasons a trust is not exempt from tax under section 501(a) is the failure of the plan of which it is a part to meet the requirements of section 401(a)(26) or 410(b), then a highly compensated employee shall, in lieu of the amount determined under this subsection, include in gross income for the taxable year with or within which the taxable year of the trust ends an amount equal to the vested accrued benefit of such employee (other than the employee's investment in the contract) as of the close of such taxable year of the trust.

"(B) FAILURE TO MEET COVERAGE TESTS.—If a trust is not exempt from tax under section 501(a) for any taxable year solely because such trust is part of a plan which fails to meet the requirements of section 401(a)(26) or 410(b), this subsection shall not apply by reason of such failure to any employee who was not a highly compensated employee during—

"(i) such taxable year, or

"(ii) any preceding period for which service was creditable to such employee under the plan.

"(C) HIGHLY COMPENSATED EMPLOYEE.—For purposes of this paragraph, the term 'highly compensated employee' has the meaning given such term by section 414(q).

"(c) RULES APPLICABLE TO ROLLOVERS FROM EXEMPT TRUSTS.—

"(1) EXCLUSION FROM INCOME.—If—

"(A) any portion of the balance to the credit of an employee in a qualified trust is paid to the employee in an eligible rollover distribution,

"(B) the distributee transfers any portion of the property received in such distribution to an eligible retirement plan, and

"(C) in the case of a distribution of property other than money, the amount so transferred consists of the property distributed,

then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid.

"(2) MAXIMUM AMOUNT WHICH MAY BE ROLLED OVER.—In the case of any eligible rollover distribution, the maximum amount transferred to which paragraph (1) applies shall not exceed the portion of such distribution which is includible in gross income (determined without regard to paragraph (1)).

"(3) TRANSFER MUST BE MADE WITHIN 60 DAYS OF RECEIPT.—Paragraph (1) shall not apply to any transfer of a distribution made after the 60th day following the day on which the distributee received the property distributed.

"(4) ELIGIBLE ROLLOVER DISTRIBUTION.—For purposes of this subsection, the term 'eligible rollover distribution' means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified trust; except that such term shall not include—

"(A) any distribution which is part of a series of substantially equal periodic payments (not less frequently than annually) made—

"(i) for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or

"(ii) for a specified period of 10 years or more, and

"(B) any distribution to the extent such distribution is required under section 401(a)(9).

"(5) TRANSFER TREATED AS ROLLOVER CONTRIBUTION UNDER SECTION 408.—For purposes of this title, a transfer resulting in any portion of a distribution being excluded from gross income under paragraph (1) to an eligible retirement plan described in clause (i) or (ii) of paragraph (8)(B) shall be treated as a rollover contribution described in section 408(d)(3).

"(6) SALES OF DISTRIBUTED PROPERTY.—For purposes of this subsection—

"(A) TRANSFER OF PROCEEDS FROM SALE OF DISTRIBUTED PROPERTY TREATED AS TRANSFER OF DISTRIBUTED PROPERTY.—The transfer of an amount equal to any portion of the proceeds from the sale of property received in the distribution shall be treated as the transfer of property received in the distribution.

"(B) PROCEEDS ATTRIBUTABLE TO INCREASE IN VALUE.—The excess of fair market value of property on sale over its fair market value on distribution shall be treated as property received in the distribution.

"(C) DESIGNATION WHERE AMOUNT OF DISTRIBUTION EXCEEDS ROLLOVER CONTRIBUTION.—In any case where part or all of the distribution consists of property other than money, the taxpayer may designate—

"(i) the portion of the money or other property which is to be treated as attributable to amounts not included in gross income, and

"(ii) the portion of the money or other property which is to be treated as included in the rollover contribution.

Any designation under this subparagraph for a taxable year shall be made not later than the time prescribed by law for filing the return for such taxable year (including *extensions thereof). Any such designation, once made, shall be irrevocable.*

"(D) TREATMENT WHERE NO DESIGNATION.—In any case where part or all of the distribution consists of property other than money and the taxpayer fails to make a designation under subparagraph (C) within the time provided therein, then—

"(i) the portion of the money or other property which is to be treated as attributable to amounts not included in gross income, and

"(ii) the portion of the money or other property which is to be treated as included in the rollover contribution,

shall be determined on a ratable basis.

"(E) NONRECOGNITION OF GAIN OR LOSS.—In the case of any sale described in subparagraph (A), to the extent that an amount equal to the proceeds is transferred pursuant to paragraph (1), neither gain nor loss on such sale shall be recognized.

"(7) SPECIAL RULE FOR FROZEN DEPOSITS.—

"(A) IN GENERAL.—The 60-day period described in paragraph (3) shall not—

"(i) include any period during which the amount transferred to the employee is a frozen deposit, or

"(ii) end earlier than 10 days after such amount ceases to be a frozen deposit.

"(B) FROZEN DEPOSITS.—For purposes of this subparagraph, the term 'frozen deposit' means any deposit which may not be withdrawn because of—

"(i) the bankruptcy or insolvency of any financial institution, or

"(ii) any requirement imposed by the State in which such institution is located by reason of the bankruptcy or insolvency (or threat thereof) of 1 or more financial institutions in such State.

A deposit shall not be treated as a frozen deposit unless on at least 1 day during the 60-day period described in paragraph (3) (without regard to this paragraph) such deposit is described in the preceding sentence.

"(8) DEFINITIONS.—For purposes of this subsection—

"(A) QUALIFIED TRUST.—The term 'qualified trust' means an employees' trust described in section 401(a) which is exempt from tax under section 501(a).

"(B) ELIGIBLE RETIREMENT PLAN.—The term 'eligible retirement plan' means—

"(i) an individual retirement account described in section 408(a),

"(ii) an individual retirement annuity described in section 408(b) (other than an endowment contract),

"(iii) a qualified trust, and

"(iv) an annuity plan described in section 403(a).

"(9) ROLLOVER WHERE SPOUSE RECEIVES DISTRIBUTION AFTER DEATH OF EMPLOYEE.—If any distribution attributable to an employee is paid to the spouse of the employee after the employ-

ee's death, the preceding provisions of this subsection shall apply to such distribution in the same manner as if the spouse were the employee; except that a trust or plan described in clause (iii) or (iv) of paragraph (8)(B) shall not be treated as an eligible retirement plan with respect to such distribution.

"(d) TAXABILITY OF BENEFICIARY OF CERTAIN FOREIGN SITUS TRUSTS.—For purposes of subsections (a), (b), and (c), a stock bonus, pension, or profit-sharing trust which would qualify for exemption from tax under section 501(a) except for the fact that it is a trust created or organized outside the United States shall be treated as if it were a trust exempt from tax under section 501(a).

"(e) OTHER RULES APPLICABLE TO EXEMPT TRUSTS.—

"(1) ALTERNATE PAYEES.—

"(A) ALTERNATE PAYEE TREATED AS DISTRIBUTEE.—For purposes of subsection (a) and section 72, an alternate payee who is the spouse or former spouse of the participant shall be treated as the distributee of any distribution or payment made to the alternate payee under a qualified domestic relations order (as defined in section 414(p)).

"(B) ROLLOVERS.—If any amount is paid or distributed to an alternate payee who is the spouse or former spouse of the participant by reason of any qualified domestic relations order (within the meaning of section 414(p)), subsection (c) shall apply to such distribution in the same manner as if such alternate payee were the employee.

"(2) DISTRIBUTIONS BY UNITED STATES TO NONRESIDENT ALIENS.—The amount includible under subsection (a) in the gross income of a nonresident alien with respect to a distribution made by the United States in respect of services performed by an employee of the United States shall not exceed an amount which bears the same ratio to the amount includible in gross income without regard to this paragraph as—

"(A) the aggregate basic pay paid by the United States to such employee for such services, reduced by the amount of such basic pay which was not includible in gross income by reason of being from sources without the United States, bears to

"(B) the aggregate basic pay paid by the United States to such employee for such services.

In the case of distributions under the civil service retirement laws, the term 'basic pay' shall have the meaning provided in section 8331(3) of title 5, United States Code.

"(3) CASH OR DEFERRED ARRANGEMENTS.—For purposes of this title, contributions made by an employer on behalf of an employee to a trust which is a part of a qualified cash or deferred arrangement (as defined in section 401(k)(2)) shall not be treated as distributed or made available to the employee nor as contributions made to the trust by the employee merely because the arrangement includes provisions under which the employee has an election whether the contribution will be made to the trust or received by the employee in cash.

"(4) NET UNREALIZED APPRECIATION.—

"(A) AMOUNTS ATTRIBUTABLE TO EMPLOYEE CONTRIBUTIONS.—For purposes of subsection (a) and section 72, the

amount actually distributed to any distributee from a trust described in subsection (a) shall not include any net unrealized appreciation in securities of the employer corporation attributable to amounts contributed by the employee (other than deductible employee contributions within the meaning of section 72(o)(5)). This subparagraph shall not apply to a partial distribution to which subsection (c) applies.

"(B) AMOUNTS ATTRIBUTABLE TO EMPLOYER CONTRIBUTIONS.—In the case of any lump sum distribution which includes securities of the employer corporation, subparagraph (A) shall apply to the net unrealized appreciation attributable to that part of the distribution which consists of securities of the employer corporation attributable to amounts other than the amounts contributed by the employee. In accordance with rules prescribed by the Secretary, a taxpayer may elect, on the return of tax on which a lump sum distribution is required to be included, not to have this subparagraph and subparagraph (A) apply to such distribution.

"(C) DETERMINATION OF AMOUNTS AND ADJUSTMENTS.—For purposes of subparagraphs (A) and (B), net unrealized appreciation and the resulting adjustments to basis shall be determined in accordance with regulations prescribed by the Secretary.

"(D) LUMP SUM DISTRIBUTION.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'lump sum distribution' means the distribution or payment within one taxable year of the recipient of the balance to the credit of an employee which becomes payable to the recipient—

"(I) on account of the employee's death,

"(II) after the employee attains age 59½,

"(III) on account of the employee's separation from service, or

"(IV) after the employee has become disabled (within the meaning of section 72(m)(7)),

described in section 401(a) and which is exempt from tax under section 501 or from a plan described in section 403(a). Subclause (III) of this clause shall be applied only with respect to an individual who is an employee without regard to section 401(c)(1), and subclause (IV) shall be applied only with respect to an employee within the meaning of section 401(c)(1). For purposes of this clause, a distribution to two or more trusts shall be treated as a distribution to one recipient. For purposes of this paragraph, the balance to the credit of the employee does not include the accumulated deductible employee contributions under the plan (within the meaning of section 72(o)(5)).

"(ii) AGGREGATION OF CERTAIN TRUSTS AND PLANS.—For purposes of determining the balance to the credit of an employee under clause (i)—

"(I) all trusts which are part of a plan shall be treated as a single trust, all pension plans main-

tained by the employer shall be treated as a single plan, all profit-sharing plans maintained by the employer shall be treated as a single plan, and all stock bonus plans maintained by the employer shall be treated as a single plan, and

"(II) trusts which are not qualified trusts under section 401(a) and annuity contracts which do not satisfy the requirements of section 404(a)(2) shall not be taken into account.

"(iii) COMMUNITY PROPERTY LAWS.—The provisions of this paragraph shall be applied without regard to community property laws.

"(iv) AMOUNTS SUBJECT TO PENALTY.—This paragraph shall not apply to amounts described in subparagraph (A) of section 72(m)(5) to the extent that section 72(m)(5) applies to such amounts.

"(v) BALANCE TO CREDIT OF EMPLOYEE NOT TO INCLUDE AMOUNTS PAYABLE UNDER QUALIFIED DOMESTIC RELATIONS ORDER.—For purposes of this paragraph, the balance to the credit of an employee shall not include any amount payable to an alternate payee under a qualified domestic relations order (within the meaning of section 414(p)).

"(vi) TRANSFERS TO COST-OF-LIVING ARRANGEMENT NOT TREATED AS DISTRIBUTION.—For purposes of this paragraph, the balance to the credit of an employee under a defined contribution plan shall not include any amount transferred from such defined contribution plan to a qualified cost-of-living arrangement (within the meaning of section 415(k)(2)) under a defined benefit plan.

"(vii) LUMP-SUM DISTRIBUTIONS OF ALTERNATE PAYEES.—If any distribution or payment of the balance to the credit of an employee would be treated as a lump-sum distribution, then, for purposes of this paragraph, the payment under a qualified domestic relations order (within the meaning of section 414(p)) of the balance to the credit of an alternate payee who is the spouse or former spouse of the employee shall be treated as a lump-sum distribution. For purposes of this clause, the balance to the credit of the alternate payee shall not include any amount payable to the employee.

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

"(i) SECURITIES.—The term 'securities' means only shares of stock and bonds or debentures issued by a corporation with interest coupons or in registered form.

"(ii) SECURITIES OF THE EMPLOYER.—The term 'securities of the employer corporation' includes securities of a parent or subsidiary corporation (as defined in subsections (e) and (f) of section 425) of the employer corporation.

"(f) WRITTEN EXPLANATION TO RECIPIENTS OF DISTRIBUTIONS ELIGIBLE FOR ROLLOVER TREATMENT.—

"(1) IN GENERAL.—The plan administrator of any plan shall, when making an eligible rollover distribution, provide a written explanation to the recipient of the provisions under which such distribution will not be subject to tax if transferred to an eligible retirement plan within 60 days after the date on which the recipient received the distribution.

"(2) DEFINITIONS.—For purposes of this subsection—

"(A) ELIGIBLE ROLLOVER DISTRIBUTION.—The term 'eligible rollover distribution' has the same meaning as when used in subsection (c) of this section or paragraph (4) of section 403(a).

"(B) ELIGIBLE RETIREMENT PLAN.—The term 'eligible retirement plan' has the meaning given such term by subsection (c)(8)(B)."

(b) REPEAL OF $5,000 EXCLUSION OF EMPLOYEES' DEATH BENEFITS.—Subsection (b) of section 101 is hereby repealed.

(c) CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 55(c) is amended by striking "shall not include any tax imposed by section 402(e) and".

(2) Paragraph (8) of section 62(a) (relating to certain portion of lump-sum distributions from pension plans taxed under section 402(e)) is hereby repealed.

(3) Paragraph (4) of section 72(o) (relating to special rule for treatment of rollover amount) is amended by striking "sections 402(a)(5), 402(a)(7)" and inserting "sections 402(c)".

(4) Paragraph (2) of section 219(d) (relating to recontributed amount) is amended by striking "section 402(a)(5), 402(a)(7)" and inserting "section 402(c)".

(5) Paragraph (20) of section 401(a) is amended by striking "qualified total distribution described in section 402(a)(5)(E)(i)(I)" and inserting "distribution to a distributee on account of a termination of the plan of which the trust is a part, or in the case of a profit-sharing or stock bonus plan, a complete discontinuance of contributions under such plan".

(6) Section 401(a)(28)(B) (relating to coordination with distribution rules) is amended by striking clause (v).

(7) Subclause (IV) of section 401(k)(2)(B)(i) is amended by striking "section 402(a)(8)" and inserting "section 402(e)(3)".

(8) Subparagraph (B)(ii) of section 401(k)(10) (relating to distributions that must be lump-sum distributions) is amended to read as follows:

"(ii) LUMP SUM DISTRIBUTION.—For purposes of this subparagraph, the term 'lump sum distribution' means any distribution of the balance to the credit of an employee immediately before the distribution."

(9) Section 402(g)(1) is amended by striking "subsections (a)(8)" and inserting "subsections (e)(3)".

(10) Section 402(i) is amended by striking ", except as otherwise provided in subparagraph (A) of subsection (e)(4)".

(11) Subsection (j) of section 402 is amended by striking "(a)(1) or (e)(4)(J)" and inserting "(e)(4)".

(12)(A) Clause (i) of section 403(a)(4)(A) is amended by inserting "in an eligible rollover distribution (within the meaning of section 402(c)(4))" before the comma at the end thereof.

(B) Subparagraph (B) of section 403(a)(4) is amended to read as follows:

> *"(B) CERTAIN RULES MADE APPLICABLE.—Rules similar to the rules of paragraphs (2) through (7) of section 402(c) shall apply for purposes of subparagraph (A)."*

(13)(A) Clause (i) of section 403(b)(8)(A) is amended by inserting "in an eligible rollover distribution (within the meaning of section 402(c)(4))" before the comma at the end thereof.

(B) Paragraph (8) of section 403(b) is amended by striking subparagraphs (B), (C), and (D) and inserting the following:

> *"(B) CERTAIN RULES MADE APPLICABLE.—Rules similar to the rules of paragraphs (2) through (7) of section 402(c) shall apply for purposes of subparagraph (A)."*

(14) Section 406(c) (relating to termination of status as deemed employee not to be treated as separation from service for purposes of limitation of tax) is hereby repealed.

(15) Section 407(c) (relating to termination of status as deemed employee not to be treated as separation from service for purposes of limitation of tax) is hereby repealed.

(16) Paragraph (1) of section 408(a) is amended by striking "section 402(a)(5), 402(a)(7)" and inserting "section 402(c)".

(17) Clause (ii) of section 408(d)(3)(A) is amended to read as follows:

> *"(ii) no amount in the account and no part of the value of the annuity is attributable to any source other than a rollover contribution (as defined in section 402) from an employee's trust described in section 401(a) which is exempt from tax under section 501(a) or from an annuity plan described in section 403(a) (and any earnings on such contribution), and the entire amount received (including property and other money) is paid (for the benefit of such individual) into another such trust or annuity plan not later than the 60th day on which the individual receives the payment or the distribution; or".*

(18) Subparagraph (B) of section 408(d)(3) (relating to limitations) is amended by striking the second sentence thereof.

(19) Subparagraph (F) of section 408(d)(3) (relating to frozen deposits) is amended by striking "section 402(a)(6)(H)" and inserting "section 402(c)(7)".

(20) Subclause (I) of section 414(n)(5)(C)(iii) is amended by striking "section 402(a)(8)" and inserting "section 402(e)(3)".

(21) Clause (i) of section 414(q)(7)(B) is amended by striking "402(a)(8)" and inserting "402(e)(3)".

(22) Paragraph (2) of section 414(s) (relating to employer may elect to treat certain deferrals as compensation) is amended by striking "402(a)(8)" and inserting "402(e)(3)".

(23) Subparagraph (A) of section 415(b)(2) (relating to annual benefit in general) is amended by striking "sections 402(a)(5)" and inserting "sections 402(c)".

(24) Subparagraph (B) of section 415(b)(2) (relating to adjustment for certain other forms of benefit) is amended by striking "sections 402(a)(5)" and inserting "sections 402(c)".

(25) Paragraph (2) of section 415(c) (relating to annual addition) is amended by striking "sections 402(a)(5)" and inserting "sections 402(c)".

(26) Subparagraph (B) of section 457(c)(2) is amended by striking "section 402(a)(8)" in clause (i) thereof and inserting "section 402(e)(3)".

(27) Section 691(c) (relating to coordination with section 402(e)) is amended by striking paragraph (5).

(28) Subparagraph (B) of section 871(a)(1) (relating to income other than capital gains) is amended by striking "402(a)(2), 403(a)(2), or".

(29) Paragraph (1) of section 871(b) (relating to imposition of tax) is amended by striking "section 1, 55, or 402(e)(1)" and inserting "section 1 or 55".

(30) Paragraph (1) of section 871(k) is amended by striking "section 402(a)(4)" and inserting "section 402(e)(2)".

(31) Subsection (b) of section 877 (relating to alternative tax) is amended by striking "section 1, 55, or 402(e)(1)" and inserting "section 1 or 55".

(32) Subsection (b) of section 1441 (relating to income items) is amended by striking "402(a)(2), 403(a)(2), or".

(33) Paragraph (5) of section 1441(c) (relating to special items) is amended by striking "402(a)(2), 403(a)(2), or".

(34) Subparagraph (A) of section 3121(v)(1) is amended by striking "section 402(a)(8)" and inserting "section 402(e)(3)".

(35) Subparagraph (A) of section 3306(r)(1) is amended by striking "section 402(a)(8)" and inserting "section 402(e)(3)".

(36) Subsection (a) of section 3405 is amended by striking "PENSIONS, ANNUITIES, ETC.—" from the heading thereof and inserting "PERIODIC PAYMENTS.—".

(37) Subsection (b) of section 3405 (relating to nonperiodic distribution) is amended—

(A) by striking "the amount determined under paragraph (2)" from paragraph (1) thereof and inserting "an amount equal to 10 percent of such distribution"; and

(B) by striking paragraph (2) (relating to amount of withholding) and redesignating paragraph (3) as paragraph (2).

(38) Paragraph (4) of section 3405(d) (relating to qualified total distributions) is hereby repealed.

(39) Paragraph (8) of section 3405(d) (relating to maximum amounts withheld) is amended to read as follows:

"(8) MAXIMUM AMOUNT WITHHELD.—The maximum amount to be withheld under this section on any designated distribution shall not exceed the sum of the amount of money and the fair market value of other property (other than securities of the employer corporation) received in the distribution. No amount shall be required to be withheld under this section in the case of any designated distribution which consists only of securities of the employer corporation and cash (not in excess of $200) in lieu of financial shares. For purposes of this paragraph, the term 'securities of the employer corporation' has the meaning given such term by section 402(e)(4)(E)."

(40) Subparagraph (A) of section 4973(b)(1) is amended by striking "sections 402(a)(5), 402(a)(7)" and inserting "sections 402(c)".

(41) Paragraph (4) of section 4980A(c) (relating to special rule where taxpayer elects income averaging) is amended to read as follows:

"(4) ONE-TIME ELECTION FOR CERTAIN DISTRIBUTIONS.—If the taxpayer elects the application of this paragraph for any calendar year, paragraph (1) shall be applied for such calendar year as if the limitation under paragraph (1) were equal to 5 times such limitation determined without regard to this paragraph. No election may be made under this paragraph by any taxpayer if this paragraph applied to the taxpayer for any preceding calendar year."

(42) Subparagraph (C) of section 7701(j)(1) is amended by striking "section 402(a)(8)" and inserting "section 402(e)(3)".

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 1992.

(2) RETENTION OF CERTAIN TRANSITION RULES.—Notwithstanding any other provision of this section, the amendments made by this section shall not apply to distributions to employees described in section 1122 (h)(3) or (h)(5) of the Tax Reform Act of 1986.

SEC. 4202. SIMPLIFIED METHOD FOR TAXING ANNUITY DISTRIBUTIONS UNDER CERTAIN EMPLOYER PLANS.

(a) GENERAL RULE.—Subsection (d) of section 72 (relating to annuities; certain proceeds of endowment and life insurance contracts) is amended to read as follows:

"(d) SPECIAL RULES FOR QUALIFIED EMPLOYER RETIREMENT PLANS.—

"(1) SIMPLIFIED METHOD OF TAXING ANNUITY PAYMENTS.—

"(A) IN GENERAL.—In the case of any amount received as an annuity under a qualified employer retirement plan—

"(i) subsection (b) shall not apply, and

"(ii) the investment in the contract shall be recovered as provided in this paragraph.

"(B) METHOD OF RECOVERING INVESTMENT IN CONTRACT.—

"(i) IN GENERAL.—Gross income shall not include so much of any monthly annuity payment under a qualified employer retirement plan as does not exceed the amount obtained by dividing—

"(I) the investment in the contract (as of the annuity starting date), by

"(II) the number of anticipated payments determined under the table contained in clause (iii) (or, in the case of a contract to which subsection (c)(3)(B) applies, the number of monthly annuity payments under such contract).

"(ii) CERTAIN RULES MADE APPLICABLE.—Rules similar to the rules of paragraphs (2) and (3) of subsection (b) shall apply for purposes of this paragraph.

"(iii) *NUMBER OF ANTICIPATED PAYMENTS.*—

"If the age of the primary annuitant on the annuity starting date is:	The number of anticipated payments is:
Not more than 55	*300*
More than 55 but not more than 60	*260*
More than 60 but not more than 65	*240*
More than 65 but not more than 70	*170*
More than 70	*120*

"(C) ADJUSTMENT FOR REFUND FEATURE NOT APPLICABLE.—For purposes of this paragraph, investment in the contract shall be determined under subsection (c)(1) without regard to subsection (c)(2).

"(D) SPECIAL RULE WHERE LUMP SUM PAID IN CONNECTION WITH COMMENCEMENT OF ANNUITY PAYMENTS.—If, in connection with the commencement of annuity payments under any qualified employer retirement plan, the taxpayer receives a lump sum payment—

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

"(ii) the investment in the contract for purposes of this paragraph shall be determined as if such payment had been so received.

"(E) EXCEPTION.—This paragraph shall not apply in any case where the primary annuitant has attained age 75 on the annuity starting date unless there are fewer than 5 years of guaranteed payments under the annuity.

"(F) ADJUSTMENT WHERE ANNUITY PAYMENTS NOT ON MONTHLY BASIS.—In any case where the annuity payments are not made on a monthly basis, appropriate adjustments in the application of this paragraph shall be made to take into account the period on the basis of which such payments are made.

"(G) QUALIFIED EMPLOYER RETIREMENT PLAN.—For purposes of this paragraph, the term 'qualified employer retirement plan' means any plan or contract described in paragraph (1), (2), or (3) of section 4974(c).

"(2) TREATMENT OF EMPLOYEE CONTRIBUTIONS UNDER DEFINED CONTRIBUTION PLANS.—For purposes of this section, employee contributions (and any income allocable thereto) under a defined contribution plan may be treated as a separate contract."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply in cases where the annuity starting date is after December 31, 1992.

SEC. 4203. REQUIREMENT THAT QUALIFIED PLANS INCLUDE OPTIONAL TRUSTEE-TO-TRUSTEE TRANSFERS OF ELIGIBLE ROLLOVER DISTRIBUTIONS.

(a) GENERAL RULE.—Subsection (a) of section 401 (relating to requirements for qualification) is amended by inserting after paragraph (30) the following new paragraph:

"(31) OPTIONAL DIRECT TRANSFER OF ELIGIBLE ROLLOVER DISTRIBUTIONS.—

"(A) IN GENERAL.—A trust shall not constitute a qualified trust under this section unless the plan of which such

trust is a part provides that if the distributee of any eligible rollover distribution—

"(i) elects to have such distribution paid directly to an eligible retirement plan, and

"(ii) specifies the eligible retirement plan to which such distribution is to be paid (in such form and at such time as the plan administrator may prescribe),

such distribution shall be made in the form of a direct trustee-to-trustee transfer to the eligible retirement plan so specified.

"(B) LIMITATION.—Subparagraph (A) shall apply only to the extent that the eligible rollover distribution would be includible in gross income if not transferred as provided in subparagraph (A) (determined without regard to sections 402(c) and 403(a)(4)).

"(C) ELIGIBLE ROLLOVER DISTRIBUTION.—For purposes of this paragraph, the term 'eligible rollover distribution' has the meaning given such term by section 402(f)(2)(A).

"(D) ELIGIBLE RETIREMENT PLAN.—For purposes of this paragraph, the term 'eligible retirement plan' has the meaning given such term by section 402(c)(8)(B), except that a qualified trust shall be considered an eligible retirement plan only if it is a defined contribution plan, the terms of which permit the acceptance of rollover distributions."

(b) EMPLOYEE'S ANNUITIES.—Paragraph (2) of section 404(a) (relating to employee's annuities) is amended by striking "and (27)" and inserting "(27), and (31)".

(c) EXCLUSION FROM INCOME.—

(1) QUALIFIED TRUSTS.—Subsection (e) of section 402 (relating to taxability of beneficiary of employees' trust), as amended by section 4201, is amended by adding at the end the following new paragraph:

"(4) DIRECT TRUSTEE-TO-TRUSTEE TRANSFERS.—Any amount transferred in a direct trustee-to-trustee transfer in accordance with section 401(a)(31) shall not be includible in gross income for the taxable year of such transfer."

(2) EMPLOYEE ANNUITIES.—Subsection (a) of section 403 is amended by adding at the end the following new paragraph:

"(5) DIRECT TRUSTEE-TO-TRUSTEE TRANSFER.—Any amount transferred in a direct trustee-to-trustee transfer in accordance with section 401(a)(31) shall not be includible in gross income for the taxable year of such transfer."

(d) WRITTEN EXPLANATION.—Paragraph (1) of section 402(f) (as amended by section 4201) is amended to read as follows:

"(1) IN GENERAL.—The plan administrator of any plan shall, before making an eligible rollover distribution, provide a written explanation to the recipient of—

"(A) the optional direct transfer provisions provided pursuant to section 401(a)(31), and

"(B) the provisions under which such distribution will not be subject to tax if transferred to an eligible retirement plan within 60 days after the date on which the recipient received the distribution."

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions in plan years beginning after December 31, 1993.

SEC. 4204. REQUIRED DISTRIBUTIONS.

(a) IN GENERAL.—Section 401(a)(9)(C) (defining required beginning date) is amended to read as follows:

"(C) REQUIRED BEGINNING DATE.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'required beginning date' means April 1 of the calendar year following the later of—

"(I) the calendar year in which the employee attains age 70½,

"(II) the calendar year in which the employee retires.

"(ii) EXCEPTION.—Subclause (II) of clause (i) shall not apply—

"(I) except as provided in section 409(d), in the case of an employee who is a 5-percent owner (as defined in section 416) with respect to the plan year ending in the calendar year in which the employee attains age 70½, or

"(II) for purposes of section 408(a)(6) or (b)(3).

"(iii) ACTUARIAL ADJUSTMENT.—In the case of an employee to whom clause (i)(II) applies who retires in a calendar year after the calendar year in which the employee attains age 70½, the employee's accrued benefit shall be actuarially increased to take into account the period after age 70½ in which the employee was not receiving any benefits under the plan.

"(iv) EXCEPTION FOR GOVERNMENTAL AND CHURCH PLANS.—Clauses (ii) and (iii) shall not apply in the case of a governmental plan or church plan. For purposes of this clause, the term 'church plan' means a plan maintained by a church for church employees, and the term 'church' means any church (as defined in section 3121(w)(3)(A)) or qualified church-controlled organization (as defined in section 3121(w)(3)(B))."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to years beginning after December 31, 1992.

PART II—INCREASED ACCESS TO PENSION PLANS

SEC. 4211. MODIFICATIONS OF SIMPLIFIED EMPLOYEE PENSIONS.

(a) INCREASE IN NUMBER OF ALLOWABLE PARTICIPANTS FOR SALARY REDUCTION ARRANGEMENTS.—Section 408(k)(6)(B) is amended by striking "25" each place it appears in the text and heading thereof and inserting "100".

(b) REPEAL OF PARTICIPATION REQUIREMENT.—

(1) IN GENERAL.—Section 408(k)(6)(A) is amended by striking clause (ii) and by redesignating clauses (iii) and (iv) as clauses (ii) and (iii), respectively.

(2) CONFORMING AMENDMENTS.—

(A) Clause (ii) of section 408(k)(6)(C) is amended by striking "subparagraph (A)(iii)" and inserting "subparagraph (A)(ii)".

(B) Clause (ii) of section 408(k)(6)(F) is amended by striking "subparagraph (A)(iii)" and inserting "subparagraph (A)(ii)".

(c) Alternative Test.—Clause (ii) of section 408(k)(6)(A), as redesignated by subsection (b)(1), is amended by adding at the end thereof the following new flush sentence:

"The requirements of the preceding sentence are met if the employer makes contributions to the simplified employee pension meeting the requirements of sections 401(k)(11) (B) or (C), 401(k)(11)(D), and 401(m)(10)(B)."

(d) Effective Date.—The amendments made by this section shall apply to years beginning after December 31, 1992.

SEC. 4212. TAX EXEMPT ORGANIZATIONS ELIGIBLE UNDER SECTION 401(k).

(a) General Rule.—Subparagraph (B) of section 401(k)(4) is amended to read as follows:

"(B) State and local governments not eligible.—A cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement if it is part of a plan maintained by a State or local government or political subdivision thereof, or any agency or instrumentality thereof. This subparagraph shall not apply to a rural cooperative plan."

(b) Effective Date.—The amendment made by this section shall apply to plan years beginning on or after December 31, 1992, but shall not apply to any cash or deferred arrangement to which clause (i) of section 1116(f)(2)(B) of the Tax Reform Act of 1986 applies.

SEC. 4213. DUTIES OF SPONSORS OF CERTAIN PROTOTYPE PLANS.

(a) In General.—The Secretary of the Treasury may, as a condition of sponsorship, prescribe rules defining the duties and responsibilities of sponsors of master and prototype plans, regional prototype plans, and other Internal Revenue Service preapproved plans.

(b) Duties Relating to Plan Amendment, Notification of Adopters, and Plan Administration.—The duties and responsibilities referred to in subsection (a) may include—

(1) the maintenance of lists of persons adopting the sponsor's plans, including the updating of such lists not less frequently than annually,

(2) the furnishing of notices at least annually to such persons and to the Secretary or his delegate, in such form and at such time as the Secretary shall prescribe,

(3) duties relating to administrative services to such persons in the operation of their plans, and

(4) other duties that the Secretary considers necessary to ensure that—

(A) the master and prototype, regional prototype, and other preapproved plans of adopting employers are timely amended to meet the requirements of the Internal Revenue Code of 1986 or of any rule or regulation of the Secretary, and

(B) adopting employers receive timely notification of amendments and other actions taken by sponsors with respect to their plans.

PART III—NONDISCRIMINATION PROVISIONS

SEC. 4221. DEFINITION OF HIGHLY COMPENSATED EMPLOYEES.

(a) IN GENERAL.—Paragraph (1) of section 414(q) (defining highly compensated employee) is amended to read as follows:

"(1) IN GENERAL.—The term 'highly compensated employee' means any employee who—

"(A) was a 5-percent owner at any time during the year or the preceding year, or

"(B) had compensation for the preceding year from the employer in excess of $50,000.

The Secretary shall adjust the $50,000 amount under subparagraph (B) at the same time and in the same manner as under section 415(d)."

(b) SPECIAL RULE WHERE NO EMPLOYEES TREATED AS HIGHLY COMPENSATED.—Paragraph (2) of section 414(q) is amended to read as follows:

"(2) SPECIAL RULE IF NO EMPLOYEE DESCRIBED IN PARAGRAPH (1).—If no employee is treated as a highly compensated employee under paragraph (1), the highest paid officer for the year shall be treated as a highly compensated employee."

(c) TREATMENT OF FAMILY MEMBERS.—Paragraph (6) of section 414(q) is hereby repealed.

(d) CONFORMING AMENDMENTS.—

(1) Paragraphs (4), (5), (8), and (12) of section 414(q) are hereby repealed.

(2)(A) Section 414(r) is amended by adding at the end thereof the following new paragraph:

"(9) EXCLUDED EMPLOYEES.—For purposes of this subsection, the following employees shall be excluded:

"(A) Employees who have not completed 6 months of service.

"(B) Employees who normally work less than 17½ hours per week.

"(C) Employees who normally work not more than 6 months during any year.

"(D) Employees who have not attained the age of 21.

"(E) Except to the extent provided in regulations, employees who are included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and the employer.

Except as provided by the Secretary, the employer may elect to apply subparagraph (A), (B), (C), or (D) by substituting a shorter period of service, smaller number of hours or months, or lower age for the period of service, number of hours or months, or age (as the case may be) specified in such subparagraph."

(B) Subparagraph (A) of section 414(r)(2) is amended by striking "subsection (q)(8)" and inserting "paragraph (9)".

(3) Paragraph (17) of section 401(a) is amended by striking the last sentence.

(4) Subsection (l) of section 404 is amended by striking the last sentence.

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1992, except that an employer may elect not to have such amendments apply to years beginning in 1993.

SEC. 4222. MODIFICATION OF ADDITIONAL PARTICIPATION REQUIREMENTS.

(a) GENERAL RULE.—Section 401(a)(26)(A) (relating to additional participation requirements) is amended to read as follows:

"(A) IN GENERAL.—In the case of a trust which is a part of a defined benefit plan, such trust shall not constitute a qualified trust under this subsection unless on each day of the plan year such trust benefits at least the lesser of—

"(i) 50 employees of the employer, or

"(ii) the greater of—

"(I) 40 percent of all employees of the employer, or

"(II) 2 employees (or if there is only 1 employee, such employee)."

(b) SEPARATE LINE OF BUSINESS TEST.—Section 401(a)(26)(G) (relating to separate line of business) is amended by striking "paragraph (7)" and inserting "paragraph (2)(A) or (7)".

(c) EFFECTIVE DATES.—The amendment made by this section shall apply to years beginning after December 31, 1991.

SEC. 4223. NONDISCRIMINATION RULES FOR QUALIFIED CASH OR DEFERRED ARRANGEMENTS AND MATCHING CONTRIBUTIONS.

(a) ALTERNATIVE METHODS OF SATISFYING SECTION 401(k) NONDISCRIMINATION TESTS.—Section 401(k) (relating to cash or deferred arrangements) is amended by adding at the end thereof the following new paragraph:

"(11) ALTERNATIVE METHODS OF MEETING NONDISCRIMINATION REQUIREMENTS.—

"(A) IN GENERAL.—A cash or deferred arrangement shall be treated as meeting the requirements of paragraph (3)(A)(ii) if such arrangement—

"(i) meets the contribution requirements of subparagraph (B) or (C), and

"(ii) meets the notice requirements of subparagraph (D).

"(B) MATCHING CONTRIBUTIONS.—

"(i) IN GENERAL.—The requirements of this subparagraph are met if, under the arrangement, the employer makes matching contributions on behalf of each employee who is not a highly compensated employee in an amount not less than—

"(I) 100 percent of the elective contributions of the employee to the extent such elective contributions do not exceed 3 percent of the employee's compensation, and

"(II) 50 percent of the elective contributions of the employee to the extent that such elective contri-

butions exceed 3 percent but do not exceed 5 percent of the employee's compensation.

"(ii) RATE FOR HIGHLY COMPENSATED EMPLOYEES.—The requirements of this subparagraph are not met if, under the arrangement, the matching contribution with respect to any elective contribution of a highly compensated employee at any level of compensation is greater than that with respect to an employee who is not a highly compensated employee.

"(iii) ALTERNATIVE PLAN DESIGNS.—If the matching contribution with respect to any elective contribution at any specific level of compensation is not equal to the percentage required under clause (i), an arrangement shall not be treated as failing to meet the requirements of clause (i) if—

"(I) the level of an employer's matching contribution does not increase as an employee's elective contributions increase, and

"(II) the aggregate amount of matching contributions with respect to elective contributions not in excess of such level of compensation is at least equal to the amount of matching contributions which would be made if matching contributions were made on the basis of the percentages described in clause (i).

"(C) NONELECTIVE CONTRIBUTIONS.—The requirements of this subparagraph are met if, under the arrangement, the employer is required, without regard to whether the employee makes an elective contribution or employee contribution, to make a contribution to a defined contribution plan on behalf of each employee who is not a highly compensated employee and who is eligible to participate in the arrangement in an amount equal to at least 3 percent of the employee's compensation.

"(D) NOTICE REQUIREMENT.—An arrangement meets the requirements of this paragraph if, under the arrangement, each employee eligible to participate is, within a reasonable period before any year, given written notice of the employee's rights and obligations under the arrangement which—

"(i) is sufficiently accurate and comprehensive to appraise the employee of such rights and obligations, and

"(ii) is written in a manner calculated to be understood by the average employee eligible to participate.

"(E) OTHER REQUIREMENTS.—

"(i) WITHDRAWAL AND VESTING RESTRICTIONS.—An arrangement shall not be treated as meeting the requirements of subparagraph (B) or (C) unless the requirements of subparagraphs (B) and (C) of paragraph (2) are met with respect to employer contributions.

"(ii) SOCIAL SECURITY AND SIMILAR CONTRIBUTIONS NOT TAKEN INTO ACCOUNT.—An arrangement shall not be treated as meeting the requirements of subparagraph (B) or (C) unless such requirements are met without regard to subsection (l), and, for purposes of subsection

(l), employer contributions under subparagraph (B) or (C) shall not be taken into account.

"(F) OTHER PLANS.—An arrangement shall be treated as meeting the requirements under subparagraph (A)(i) if any other plan maintained by the employer meets such requirements with respect to employees eligible under the arrangement."

(b) ALTERNATIVE METHODS OF SATISFYING SECTION 401(m) NONDISCRIMINATION TESTS.—Section 401(m) (relating to nondiscrimination test for matching contributions and employee contributions) is amended by redesignating paragraph (10) as paragraph (11) and by adding after paragraph (9) the following new paragraph:

"(10) ALTERNATIVE METHOD OF SATISFYING TESTS.—

"(A) IN GENERAL.—A defined contribution plan shall be treated as meeting the requirements of paragraph (2) with respect to matching contributions if the plan—

"(i) meets the contribution requirements of subparagraph (B) or (C) of subsection (k)(11),

"(ii) meets the notice requirements of subsection (k)(11)(D), and

"(iii) meets the requirements of subparagraph (B).

"(B) LIMITATION ON MATCHING CONTRIBUTIONS.—The requirements of this subparagraph are met if—

"(i) matching contributions on behalf of any employee may not be made with respect to an employee's contributions or elective deferrals in excess of 6 percent of the employee's compensation,

"(ii) the level of an employer's matching contribution does not increase as an employee's contributions or elective deferrals increase, and

"(iii) the matching contribution with respect to any highly compensated employee at a specific level of compensation is not greater than that with respect to an employee who is not a highly compensated employee."

(c) YEAR FOR COMPUTING NONHIGHLY COMPENSATED EMPLOYEE PERCENTAGE.—

(1) CASH OR DEFERRED ARRANGEMENTS.—Clause (ii) of section 401(k)(3)(A) is amended—

(A) by striking "such year" and inserting "the plan year"; and

(B) by striking "for such plan year" and inserting "the preceding plan year".

(2) MATCHING AND EMPLOYEE CONTRIBUTIONS.—Section 401(m)(2)(A) is amended—

(A) by inserting "for such plan year" after "highly compensated employee", and

(B) by inserting "for the preceding plan year" after "eligible employees" each place it appears in clause (i) and clause (ii).

(d) SPECIAL RULE FOR DETERMINING AVERAGE DEFERRAL PERCENTAGE FOR FIRST PLAN YEAR, ETC.—

(1) Paragraph (3) of section 401(k) is amended by adding at the end thereof the following new subparagraph:

"(E) For purposes of this paragraph, in the case of the first plan year of any plan, the amount taken into account as the average deferral percentage of nonhighly compensated employees for the preceding plan year shall be—

"(i) 3 percent, or

"(ii) if the employer makes an election under this subclause, the average deferral percentage of nonhighly compensated employees determined for such first plan year."

(2) Paragraph (3) of section 401(m) is amended by adding at the end thereof the following: "Rules similar to the rules of subsection (k)(3)(E) shall apply for purposes of this subsection.".

(e) DISTRIBUTION OF EXCESS CONTRIBUTIONS.—

(1) Subparagraph (C) of section 401(k)(8) (relating to arrangement not disqualified if excess contributions distributed) is amended by striking "on the basis of the respective portions of the excess contributions attributable to each of such employees" and inserting "on the basis of the amount of contributions by, or on behalf of, each of such employees".

(2) Subparagraph (C) of section 401(m)(6) (relating to method of distributing excess aggregate contributions) is amended by striking "on the basis of the respective portions of such amounts attributable to each of such employees" and inserting "on the basis of the amount of contributions on behalf of, or by, each such employee".

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1992.

PART IV—MISCELLANEOUS SIMPLIFICATION

SEC. 4231. TREATMENT OF LEASED EMPLOYEES.

(a) GENERAL RULE.—Subparagraph (C) of section 414(n)(2) (defining leased employee) is amended to read as follows:

"(C) such services are performed under significant direction or control by the recipient."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to years beginning after December 31, 1992, but shall not apply to any relationship determined under an Internal Revenue Service ruling issued before the date of the enactment of this Act pursuant to section 414(n)(2)(C) of the Internal Revenue Code of 1986 (as in effect on the day before such date) not to involve a leased employee.

SEC. 4232. TREATMENT OF EMPLOYER REVERSIONS REQUIRED BY CONTRACT TO BE PAID TO THE UNITED STATES.

(a) IN GENERAL.—Subparagraph (B) of section 4980(c)(2) (defining employer reversion) is amended by striking "or" at the end of clause (i), by striking the period at the end of clause (ii) and inserting ", or", and by adding at the end thereof the following new clause:

"(iii) any distribution to the employer to the extent that the distribution is paid within a reasonable period to the United States in satisfaction of a Federal claim for an equitable share of the plan's surplus

assets, as determined pursuant to Federal contracting regulations."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to reversions on or after the date of the enactment of this Act.

SEC. 4233. MODIFICATIONS OF COST-OF-LIVING ADJUSTMENTS.

(a) IN GENERAL.—Section 415(d) (relating to cost-of-living adjustments) is amended to read as follows:

"(d) COST-OF-LIVING ADJUSTMENTS.—

"(1) IN GENERAL.—The Secretary shall adjust annually—

"(A) the $90,000 amount in subsection (b)(1)(A), and

"(B) in the case of a participant who separated from service, the amount taken into account under subsection (b)(1)(B),

for increases in the cost-of-living in accordance with regulations prescribed by the Secretary.

"(2) METHOD.—

"(A) IN GENERAL.—The regulations prescribed under paragraph (1) shall provide for adjustment procedures which are similar to the procedures used to adjust benefit amounts under section 215(i)(2)(A) of the Social Security Act.

"(B) PERIODS FOR ADJUSTMENT OF DOLLAR AMOUNT.—For purposes of paragraph (1)(A)—

"(i) IN GENERAL.—The adjustment with respect to any calendar year shall be based on the increase in the applicable index as of the close of the calendar quarter ending September 30 of the preceding calendar year over such index as of the close of the base period.

"(ii) BASE PERIOD.—For purposes of clause (i), the base period is the calendar quarter beginning October 1, 1986.

"(C) BASE PERIOD FOR SEPARATIONS.—For purposes of paragraph (1)(B), the base period is the last calendar quarter of the calendar year preceding the calendar year in which the participant separated from service.

"(3) ROUNDING.—Any amount determined under paragraph (1) (or by reference to this subsection) shall be rounded to the nearest $1,000, except that the amounts under sections 402(g)(1) and 408(k)(2)(C) shall be rounded to the nearest $100."

(b) EFFECTIVE DATE.—The amendments made by this section apply to adjustments with respect to calendar years beginning after December 31, 1992.

SEC. 4234. PLANS COVERING SELF-EMPLOYED INDIVIDUALS.

(a) AGGREGATION RULES.—Section 401(d) (relating to additional requirements for qualification of trusts and plans benefiting owner-employees) is amended to read as follows:

"(d) CONTRIBUTION LIMIT ON OWNER-EMPLOYEES.—A trust forming part of a pension or profit-sharing plan which provides contributions or benefits for employees some or all of whom are owner-employees shall constitute a qualified trust under this section only if, in addition to meeting the requirements of subsection (a), the plan provides that contributions on behalf of any owner-employee may be

made only with respect to the earned income of such owner-employee which is derived from the trade or business with respect to which such plan is established."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1992.

SEC. 4235. ALTERNATIVE FULL-FUNDING LIMITATION.

(a) IN GENERAL.—Subsection (c) of section 412 (relating to minimum funding standards) is amended by redesignating paragraphs (8) through (11) as paragraphs (9) through (12), respectively, and by adding after paragraph (7) the following new paragraph:

"(8) ALTERNATIVE FULL-FUNDING LIMITATION.—

"(A) GENERAL RULE.—An employer may elect the full-funding limitation under this paragraph with respect to any defined benefit plan of the employer in lieu of the full-funding limitation determined under paragraph (7) if the requirements of subparagraphs (C) and (D) are met.

"(B) ALTERNATIVE FULL-FUNDING LIMITATION.—The full-funding limitation under this paragraph is the full-funding limitation determined under paragraph (7) without regard to subparagraph (A)(i)(I) thereof.

"(C) REQUIREMENTS RELATING TO PLAN ELIGIBILITY.—

"(i) IN GENERAL.—The requirements of this subparagraph are met with respect to a defined benefit plan if—

"(I) as of the 1st day of the election period, the average accrued liability of participants accruing benefits under the plan for the 5 immediately preceding plan years is at least 80 percent of the plan's total accrued liability,

"(II) the plan is not a top-heavy plan (as defined in section 416(g)) for the 1st plan year of the election period or either of the 2 preceding plan years, and

"(III) each defined benefit plan of the employer (and each defined benefit plan of each employer who is a member of any controlled group which includes such employer) meets the requirements of subclauses (I) and (II).

"(ii) FAILURE TO CONTINUE TO MEET REQUIREMENTS.—

"(I) If any plan fails to meet the requirement of clause (i)(I) for any plan year during an election period, the benefits of the election under this paragraph shall be phased out under regulations prescribed by the Secretary.

"(II) If any plan fails to meet the requirement of clause (i)(II) for any plan year during an election period, such plan shall be treated as not meeting the requirements of clause (i) for the remainder of the election period.

If there is a failure described in subclause (I) or (II) with respect to any plan, such plan (and each plan described in clause (i)(III) with respect to such plan) shall *be treated as not meeting the requirements of clause (i) for any of the 10 plan years beginning after the election period.*

"(D) REQUIREMENTS RELATING TO ELECTION.—

"(i) IN GENERAL.—The requirements of this subparagraph are met with respect to an election if—

"(I) FILING DATE.—Notice of such election is filed with the Secretary (in such form and manner and containing such information as the Secretary may provide) by January 1 of any calendar year, and is effective as of the 1st day of the election period beginning on or after January 1 of the following calendar.

"(II) CONSISTENT ELECTION.—Such an election is made for all defined benefit plans maintained by the employer or by any member of a controlled group which includes the employer.

"(ii) TRANSITION PERIOD.—In the case of any election period beginning on and after July 1, 1992, and before January 1, 1994, the requirements of clause (i) shall not apply and the requirements of this subparagraph are met with respect to such election period if—

"(I) FILING DATE.—Notice of election is filed with the Secretary by October 1, 1992.

"(II) INFORMATION.—The notice sets forth the name and tax identification number of the plan sponsor, the names and tax identification numbers of the plans to which the election applies, the limitation under paragraph (7) (determined with and without regard to this paragraph), and a signed certification by an officer of the employer stating that the requirements of this paragraph have been met.

"(iii) REVENUE OFFSET PROCEDURES.—The Secretary shall, by January 1, 1993, notify defined benefit plans that have not made an election under this paragraph for the transition period described in clause (ii) of the adjustment required by subparagraph (H). The revenue offset for the transition period shall apply to plan years beginning on or after July 1, 1992, and before January 1, 1994.

"(iv) EXCESS CONTRIBUTIONS MADE BY NON-ELECTING PLANS.—To the extent a defined benefit plan sponsor makes a contribution to a defined benefit plan with respect to the transition period described in clause (ii) which exceeds the limitation of paragraph (7), as adjusted by the Secretary for the transition period, the sponsor shall offset the excess contribution against allowable contributions to the plan in subsequent quarters in the taxable year of the sponsor. If no subsequent contributions may be made for the taxable year, the trustee of the defined benefit plan shall return the excess contribution to the sponsor in that taxable year or the following taxable year. Notwithstanding any

other provision of this title, no deduction shall be allowed for any contribution made in excess of the limitation of paragraph (7), as adjusted by the Secretary for the transition period, and no penalty shall apply with respect to contributions made in excess of such limitation to the extent such excess contributions are either used to offset subsequent contributions, or returned to the plan sponsor, as provided in this clause.

"(E) TERM OF ELECTION.—Any election made under this paragraph shall apply for the election period.

"(F) OTHER CONSEQUENCES OF ELECTION.—

"(i) NO FUNDING WAIVERS.—In the case of a plan with respect to which an election is made under this paragraph, no waiver may be granted under subsection (d) for any plan year beginning after the date the election was made and ending at the close of the election period with respect thereto.

"(ii) FAILURE TO MAKE SUCCESSIVE ELECTIONS.—If an election is made under this paragraph with respect to any plan and such an election does not apply for each successive plan year of such plan, such plan shall be treated as not meeting the requirements of subparagraph (C) for the period of 10 plan years beginning after the close of the last election period for such plan.

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

"(i) ELECTION PERIOD.—The term 'election period' means the period of 5 consecutive plan years beginning with the 1st plan year for which the election is made.

"(ii) CONTROLLED GROUP.—The term 'controlled group' means all persons who are treated as a single employer under subsection (b), (c), (m), or (o) of section 414.

"(H) PROCEDURES IF ALTERNATIVE FUNDING LIMITATION REDUCES NET FEDERAL REVENUES.—

"(i) IN GENERAL.—At least once with respect to each fiscal year, the Secretary shall estimate whether the application of this paragraph will result in a net reduction in Federal revenues for such fiscal year.

"(ii) ADJUSTMENT OF FULL-FUNDING LIMITATION IF REVENUE SHORTFALL.—If the Secretary estimates that the application of this paragraph will result in a more than insubstantial net reduction in Federal revenues for any fiscal year, the Secretary—

"(I) shall make the adjustment described in clause (iii), and

"(II) to the extent such adjustment is not sufficient to reduce such reduction to an insubstantial amount, shall make the adjustment described in clause (iv).

Such adjustments shall apply only to defined benefit plans with respect to which an election under this paragraph is not in effect.

"(iii) REDUCTION IN LIMITATION BASED ON 150 PERCENT OF CURRENT LIABILITY.—The adjustment described in this clause is an adjustment which substitutes a percentage (not lower than 140 percent) for the percentage described in paragraph (7)(A)(i)(I) determined by reducing the percentage of current liability taken into account with respect to participants who are not accruing benefits under the plan.

"(iv) REDUCTION IN LIMITATION BASED ON ACCRUED LIABILITY.—The adjustment described in this clause is an adjustment which reduces the percentage of accrued liability taken into account under paragraph (7)(A)(i)(II). In no event may the amount of accrued liability taken into account under such paragraph after the adjustment be less than 140 percent of current liability."

(b) ALTERATION OF DISCRETIONARY REGULATORY AUTHORITY.—Subparagraph (D) of section 412(c)(7) is amended by striking "provide—" and all that follows through "(iii) for" and inserting "provide for".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

SEC. 4236. DISTRIBUTIONS UNDER RURAL COOPERATIVE PLANS.

(a) DISTRIBUTIONS AFTER CERTAIN AGE.—Section 401(k)(7) is amended by adding at the end thereof the following new subparagraph:

"(C) SPECIAL RULE FOR CERTAIN DISTRIBUTIONS.—A rural cooperative plan which includes a qualified cash or deferred arrangement shall not be treated as violating the requirements of section 401(a) merely by reason of a distribution to a participant after attainment of age 59½."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after the date of the enactment of this Act.

SEC. 4237. TREATMENT OF GOVERNMENTAL PLANS UNDER SECTION 415.

(a) DEFINITION OF COMPENSATION.—Subsection (k) of section 415 (regarding limitations on benefits and contributions under qualified plans) is amended by adding immediately after paragraph (2) thereof the following new paragraph:

"(3) DEFINITION OF COMPENSATION FOR GOVERNMENTAL PLANS.—For purposes of this section, in the case of a governmental plan (as defined in section 414(d)), the term 'compensation' includes, in addition to the amounts described in subsection (c)(3)—

"(A) any elective deferral (as defined in section 402(g)(3)), and

"(B) any amount which is contributed by the employer at the election of the employee and which is not includible in the gross income of an employee under section 125 or 457."

(b) COMPENSATION LIMIT.—Subsection (b) of section 415 is amended by adding immediately after paragraph (10) the following new paragraph:

"(11) SPECIAL LIMITATION RULE FOR GOVERNMENTAL PLANS.—In the case of a governmental plan (as defined in section 414(d)), subparagraph (B) of paragraph (1) shall not apply."

(c) TREATMENT OF CERTAIN EXCESS BENEFIT PLANS.—

(1) IN GENERAL.—Section 415 is amended by adding at the end thereof the following new subsection:

"(m) TREATMENT OF QUALIFIED GOVERNMENTAL EXCESS BENEFIT ARRANGEMENTS.—

"(1) GOVERNMENTAL PLAN NOT AFFECTED.—In determining whether a governmental plan (as defined in section 414(d)) meets the requirements of this section, benefits provided under a qualified governmental excess benefit arrangement shall not be taken into account. Income accruing to a governmental plan (or to a trust that is maintained solely for the purpose of providing benefits under a qualified governmental excess benefit arrangement) in respect of a qualified governmental excess benefit arrangement shall constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) shall be exempt from tax under section 115.

"(2) TAXATION OF PARTICIPANT.—For purposes of this chapter—

"(A) the taxable year or years for which amounts in respect of a qualified governmental excess benefit arrangement are includible in gross income by a participant, and

"(B) the treatment of such amounts when so includible by the participant,

shall be determined as if such qualified governmental excess benefit arrangement were treated as a plan for the deferral of compensation which is maintained by a corporation not exempt from tax under this chapter and which does not meet the requirements for qualification under section 401.

"(3) QUALIFIED GOVERNMENTAL EXCESS BENEFIT ARRANGEMENT.—For purposes of this subsection, the term 'qualified governmental excess benefit arrangement' means a portion of a governmental plan if—

"(A) such portion is maintained solely for the purpose of providing to participants in the plan that part of the participant's annual benefit otherwise payable under the terms of the plan that exceeds the limitations on benefits imposed by this section,

"(B) under such portion no election is provided at any time to the participant (directly or indirectly) to defer compensation, and

"(C) benefits described in subparagraph (A) are not paid from a trust forming a part of such governmental plan unless such trust is maintained solely for the purpose of providing such benefits."

(2) COORDINATION WITH SECTION 457.—Subsection (e) of section 457 is amended by adding at the end thereof the following new paragraph:

"(15) TREATMENT OF QUALIFIED GOVERNMENTAL EXCESS BENEFIT ARRANGEMENTS.—Subsections (b)(2) and (c)(1) shall not

apply to any qualified governmental excess benefit arrangement (as defined in section 415(m)(3)), and benefits provided under such an arrangement shall not be taken into account in determining whether any other plan is an eligible deferred compensation plan."

(3) CONFORMING AMENDMENT.—Paragraph (2) of section 457(f) is amended by striking the word "and" at the end of subparagraph (C), by striking the period after subparagraph (D) and inserting the words ", and", and by inserting immediately thereafter the following new subparagraph:

"(E) a qualified governmental excess benefit arrangement described in section 415(m)."

(d) EXEMPTION FOR SURVIVOR AND DISABILITY BENEFITS.—Paragraph (2) of section 415(b) is amended by adding at the end thereof the following new subparagraph:

"(I) EXEMPTION FOR SURVIVOR AND DISABILITY BENEFITS PROVIDED UNDER GOVERNMENTAL PLANS.—Subparagraph (B) of paragraph (1), subparagraph (C) of this paragraph, and paragraph (5) shall not apply to—

"(i) income received from a governmental plan (as defined in section 414(d)) as a pension, annuity, or similar allowance as the result of the recipient becoming disabled by reason of personal injuries or sickness, or

"(ii) amounts received from a governmental plan by the beneficiaries, survivors, or the estate of an employee as the result of the death of the employee."

(e) REVOCATION OF GRANDFATHER ELECTION.—Subparagraph (C) of section 415(b)(10) is amended by adding at the end thereof the following new sentence: "An election made pursuant to the preceding sentence to have the provisions of this paragraph applied to the plan may be revoked not later than the last day of the 3rd plan year beginning after the date of enactment with respect to all plan years as to which such election has been applicable and all subsequent plan years; provided that any amount paid by the plan in a taxable year ending after revocation of such election in respect of benefits attributable to a taxable year during which such election was in effect shall be includible in income by the recipient in accordance with the rules of this chapter in the taxable year in which such amount is received (except that such amount shall be treated as received for purposes of the limitations imposed by this section in the earlier taxable year or years to which such amount is attributable)."

(f) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by subsections (a), (b), (c), and (d) shall apply to taxable years beginning on or after the date of the enactment of this Act. The amendments made by subsection (e) shall apply with respect to election revocations adopted after the date of the enactment of this Act.

(2) TREATMENT FOR YEARS BEGINNING BEFORE DATE OF ENACTMENT.—In the case of a governmental plan (as defined in section 414(d) of the Internal Revenue Code of 1986), such plan shall be treated as satisfying the requirements of section 415 of such Code for all taxable years beginning before the date of the enactment of this Act.

SEC. 4238. USE OF EXCESS ASSETS OF BLACK LUNG BENEFIT TRUSTS FOR HEALTH CARE BENEFITS.

(a) GENERAL RULE.—Paragraph (21) of section 501(c) is amended to read as follows:

"(21)(A) A trust or trusts established in writing, created or organized in the United States, and contributed to by any person (except an insurance company) if—

"(i) the purpose of such trust or trusts is exclusively—

"(I) to satisfy, in whole or in part, the liability of such person for, or with respect to, claims for compensation for disability or death due to pneumoconiosis under Black Lung Acts,

"(II) to pay premiums for insurance exclusively covering such liability,

"(III) to pay administrative and other incidental expenses of such trust in connection with the operation of the trust and the processing of claims against such person under Black Lung Acts, and

"(IV) to pay accident or health benefits for retired miners and their spouses and dependents (including administrative and other incidental expenses of such trust in connection therewith) or premiums for insurance exclusively covering such benefits, and

"(ii) no part of the assets of the trust may be used for, or diverted to, any purpose other than—

"(I) the purposes described in clause (i),

"(II) investment (but only to the extent that the trustee determines that a portion of the assets is not currently needed for the purposes described in clause (i)) in qualified investments, or

"(III) payment into the Black Lung Disability Trust Fund established under section 9501, or into the general fund of the United States Treasury (other than in satisfaction of any tax or other civil or criminal liability of the person who established or contributed to the trust).

"(B) No deduction shall be allowed under this chapter for any payment described in subparagraph (A)(i)(IV) from such trust.

"(C) Payments described in subparagraph (A)(i)(IV) may be made from such trust during a taxable year only to the extent that the aggregate amount of such payments during such taxable year does not exceed the lesser of—

"(i) the excess (if any) (as of the close of the preceding taxable year) of—

"(I) the fair market value of the assets of the trust, over

"(II) 110 percent of the present value of the liability described in subparagraph (A)(i)(I) of such person, or

"(ii) the excess (if any) of—

"(I) the sum of a similar excess determined as of the close of the last taxable year ending before the date of the enactment of this subparagraph plus earnings

thereon as of the close of the taxable year preceding the taxable year involved, over

"(II) the aggregate payments described in subparagraph (A)(i)(IV) made from the trust during all taxable years beginning after the date of the enactment of this subparagraph.

The determinations under the preceding sentence shall be made by an independent actuary using actuarial methods and assumptions (not inconsistent with the regulations prescribed under section 192(c)(1)(A)) each of which is reasonable and which are reasonable in the aggregate.

"(D) For purposes of this paragraph—

"(i) The term 'Black Lung Acts' means part C of title IV of the Federal Mine Safety and Health Act of 1977, and any State law providing compensation for disability or death due to pneumoconiosis.

"(ii) The term 'qualified investments' means—

"(I) public debt securities of the United States,

"(II) obligations of a State or local government which are not in default as to principal or interest, and

"(III) time or demand deposits in a bank (as defined in section 581) or an insured credit union (within the meaning of section 101(6) of the Federal Credit Union Act, 12 U.S.C. 1752(6)) located in the United States.

"(iii) The term 'miner' has the same meaning as such term has when used in section 402(d) of the Black Lung Benefits Act (30 U.S.C. 902(d)).

"(iv) The term 'incidental expenses' includes legal, accounting, actuarial, and trustee expenses."

(b) Exception From Tax on Self-Dealing.—Section 4951(f) is amended by striking "clause (i) of section 501(c)(21)(A)" and inserting "subclause (I) or (IV) of section 501(c)(21)(A)(i)".

(c) Technical Amendment.—Paragraph (4) of section 192(c) is amended by striking "clause (ii) of section 501(c)(21)(B)" and inserting "subclause (II) of section 501(c)(21)(A)(ii)".

(d) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 1991.

SEC. 4239. UNIFORM PENALTY PROVISIONS TO APPLY TO CERTAIN PENSION REPORTING REQUIREMENTS.

(a) In General.—

(1) Paragraph (1) of section 6724(d) is amended by striking "and" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", and", and by inserting after subparagraph (B) the following new subparagraph:

"(C) any statement of the amount of payments to another person required to be made to the Secretary under—

"(i) section 408(i) (relating to reports with respect to individual retirement accounts or annuities), or

"(ii) section 6047(d) (relating to reports by employers, plan administrators, etc.)."

(2) Paragraph (2) of section 6724(d) is amended by striking "or" at the end of subparagraph (R), by striking the period at

the end of subparagraph (S) and inserting a comma, and by inserting after subparagraph (S) the following new subparagraphs:

"(T) section 408(i) (relating to reports with respect to individual retirement plans) to any person other than the Secretary with respect to the amount of payments made to such person, or

"(U) section 6047(d) (relating to reports by plan administrators) to any person other than the Secretary with respect to the amount of payments made to such person."

(b) MODIFICATION OF REPORTABLE DESIGNATED DISTRIBUTIONS.—

(1) SECTION 408.—Subsection (i) of section 408 (relating to individual retirement account reports) is amended by inserting "aggregating $10 or more in any calendar year" after "distributions".

(2) SECTION 6047.—Paragraph (1) of section 6047(d) (relating to reports by employers, plan administrators, etc.) is amended by adding at the end thereof the following new sentence: "No return or report may be required under the preceding sentence with respect to distributions to any person during any year unless such distributions aggregate $10 or more."

(c) CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 6047(f) is amended to read as follows:

"(1) For provisions relating to penalties for failures to file returns and reports required under this section, see sections 6652(e), 6721, and 6722."

(2) Subsection (e) of section 6652 is amended by adding at the end thereof the following new sentence: "This subsection shall not apply to any return or statement which is an information return described in section 6724(d)(1)(C)(ii) or a payee statement described in section 6724(d)(2)(U)."

(3) Subsection (a) of section 6693 is amended by adding at the end thereof the following new sentence: "This subsection shall not apply to any report which is an information return described in section 6724(d)(1)(C)(i) or a payee statement described in section 6724(d)(2)(T)."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to returns, reports, and other statements the due date for which (determined without regard to extensions) is after December 31, 1992.

SEC. 4240. CONTRIBUTIONS ON BEHALF OF DISABLED EMPLOYEES.

(a) ALL DISABLED PARTICIPANTS RECEIVING CONTRIBUTIONS.—Section 415(c)(3)(C) is amended by adding at the end thereof the following: "If a defined contribution plan provides for the continuation of contributions on behalf of all participants described in clause (i) for a fixed or determinable period, this subparagraph shall be applied without regard to clauses (ii) and (iii)."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1992.

SEC. 4241. AFFILIATED EMPLOYERS.

(a) IN GENERAL.—For purposes of Treasury Regulations section 1.501(c)(9)-2(a)(1), employers shall be deemed to be affiliated if they satisfy the requirements of subsection (b).

(b) Affiliation.—The requirements of subsection (b) shall be satisfied with respect to employers if—

(1) the employers are in the same line of business,

(2) the employers act jointly to perform tasks that are integral to the activities of each of the employers,

(3) the employers act jointly to such an extent that the joint maintenance of a voluntary employees' beneficiary association is not a major part of the employers' joint activities, and

(4) a substantial number of the employers are exempt from tax under subtitle A of the Internal Revenue Code of 1986.

(c) Effective Date.—The amendments made by this section shall apply to years beginning before, on, or after the date of the enactment of this section.

SEC. 4242. UNIFORM RETIREMENT AGE.

(a) Discrimination Testing.—Paragraph (5) of section 401(a) (relating to special rules relating to nondiscrimination requirements) is amended by adding at the end thereof the following new subparagraph:

"(F) Social security retirement age.—For purposes of testing for discrimination under paragraph (4)—

"(i) the social security retirement age (as defined in section 415(b)(8)) shall be treated as a uniform retirement age, and

"(ii) subsidized early retirement benefits and joint and survivor annuities shall not be treated as being unavailable to employees on the same terms merely because such benefits or annuities are based in whole or in part on an employee's social security retirement age (as so defined)."

(b) Effective Date.—The amendments made by this section shall apply to years beginning after December 31, 1992.

SEC. 4243. SPECIAL RULES FOR PLANS COVERING PILOTS.

(a) General Rule.—

(1) Subparagraph (B) of section 410(b)(3) is amended to read as follows:

"(B) in the case of a plan established or maintained by one or more employers to provide contributions or benefits for air pilots employed by one or more common carriers engaged in interstate or foreign commerce or air pilots employed by carriers transporting mail for or under contract with the United States Government, all employees who are not air pilots."

(2) Paragraph (3) of section 410(b) is amended by striking the last sentence and inserting the following new sentence: "Subparagraph (B) shall not apply in the case of a plan which provides contributions or benefits for employees who are not air pilots or for air pilots whose principal duties are not customarily performed aboard aircraft in flight."

(b) Effective Date.—The amendments made by subsection (a) shall apply to years beginning after December 31, 1992.

SEC. 4244. TREATMENT OF DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.

(a) SPECIAL RULES FOR PLAN DISTRIBUTIONS.—Paragraph (9) of section 457(e) (relating to other definitions and special rules) is amended to read as follows:

"(9) BENEFITS NOT TREATED AS MADE AVAILABLE BY REASON OF CERTAIN ELECTIONS, ETC.—

"(A) TOTAL AMOUNT PAYABLE IS $3,500 OR LESS.—The total amount payable to a participant under the plan shall not be treated as made available merely because the participant may elect to receive such amount (or the plan may distribute such amount without the participant's consent) if—

"(i) such amount does not exceed $3,500, and

"(ii) such amount may be distributed only if—

"(I) no amount has been deferred under the plan with respect to such participant during the 2-year period ending on the date of the distribution, and

"(II) there has been no prior distribution under the plan to such participant to which this subparagraph applied.

A plan shall not be treated as failing to meet the distribution requirements of subsection (d) by reason of a distribution to which this subparagraph applies.

"(B) ELECTION TO DEFER COMMENCEMENT OF DISTRIBUTIONS.—The total amount payable to a participant under the plan shall not be treated as made available merely because the participant may elect to defer commencement of distributions under the plan if—

"(i) such election is made after amounts may be available under the plan in accordance with subsection (d)(1)(A) and before commencement of such distributions, and

"(ii) the participant may make only 1 such election."

(b) COST-OF-LIVING ADJUSTMENT OF MAXIMUM DEFERRAL AMOUNT.—Subsection (e) of section 457 is amended by adding at the end thereof the following new paragraph:

"(14) COST-OF-LIVING ADJUSTMENT OF MAXIMUM DEFERRAL AMOUNT.—The Secretary shall adjust the $7,500 amount specified in subsections (b)(2) and (c)(1) at the same time and in the same manner as under section 415(d) with respect to months after 1991."

(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. 4245. CONTINUATION HEALTH COVERAGE FOR EMPLOYEES OF FAILED FINANCIAL INSTITUTIONS.

(a) ENFORCEMENT OF CONTINUATION OF HEALTH PLAN REQUIREMENTS OF SUCCESSORS OF FAILED DEPOSITORY INSTITUTIONS.—Subsection (f) of section 4980B (relating to continuation of coverage requirements of group health plans) is amended by adding after paragraph (8) the following new paragraph:

"(9) SPECIAL RULES FOR SUCCESSORS OF FAILED DEPOSITORY INSTITUTIONS.—

"(A) In general.—Except as provided in subparagraph (B), any successor of a failed depository institution—

"(i) shall have the same obligation to provide a group health plan meeting the requirements of this subsection with respect to former employees of such institution in the same manner as the failed depository institution would have had but for its failure, and

"(ii) shall be treated as the employer of such former employees for purposes of this section.

"(B) Tax not to apply if FDIC or RTC provide continuation coverage.—Subparagraph (A) shall not apply if the Federal Deposit Insurance Corporation or the Resolution Trust Corporation are, outside of their respective capacities as successors of a failed depository institution, providing a group health plan meeting the requirements of this subsection to former employees of a failed depository institution.

"(C) Successor.—For purposes of this paragraph, an entity is a successor of a failed depository institution during any period if—

"(i) such entity holds substantially all of the assets or liabilities of such institution, and

"(ii)(I) such entity is a bridge bank, or

"(II) such entity acquired such assets or liabilities from the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, or a bridge bank.

"(D) Failed depository institution.—For purposes of this section, the term 'failed depository institution' means any depository institution (as defined in section 3(c) of the Federal Deposit Insurance Act) for which a receiver or conservator has been appointed."

(b) Treatment of Depository Institution Failures as Qualifying Events for Retirees of Such Institutions.—

(1) In general.—Subparagraph (F) of section 4908B(f)(3) is amended—

(A) by striking "A proceeding" and inserting "(i) A proceeding",

(B) by striking the period at the end and inserting ", or", and

(C) by inserting after clause (i) the following new clause:

"(ii) the appointment of a receiver or conservator for a failed depository institution from whose employment the covered employee retired at any time."

(2) Conforming amendment.—Subclause (III) of section 4980B(f)(2)(B)(i) is amended—

(A) by inserting "or failures of depository institutions" after "proceedings" in the heading, and

(B) by inserting "and failures of depository institutions" after "proceedings".

(c) Effective Date.—The amendments made by this section shall apply as if included in section 451 of the Federal Deposit Insurance Corporation Improvement Act of 1991 as of the date of the enactment of such Act.

SEC. 4246. DATE FOR ADOPTION OF PLAN AMENDMENTS.

If any amendment made by this subtitle requires an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after January 1, 1994, if—

(1) during the period after such amendment takes effect and before such first plan year, the plan is operated in accordance with the requirements of such amendment, and

(2) such plan amendment applies retroactively to such period.

Subtitle C—Treatment of Large Partnerships

PART I—GENERAL PROVISIONS

SEC. 4301. SIMPLIFIED FLOW-THROUGH FOR LARGE PARTNERSHIPS.

(a) GENERAL RULE.—Subchapter K (relating to partners and partnerships) is amended by adding at the end thereof the following new part:

"PART IV—SPECIAL RULES FOR LARGE PARTNERSHIPS

"Sec. 771. Application of subchapter to large partnerships.
"Sec. 772. Simplified flow-through.
"Sec. 773. Computations at partnership level.
"Sec. 774. Other modifications.
"Sec. 775. Large partnership defined.
"Sec. 776. Special rules for partnerships holding oil and gas properties.
"Sec. 777. Regulations.

"SEC. 771. APPLICATION OF SUBCHAPTER TO LARGE PARTNERSHIPS.

"The preceding provisions of this subchapter to the extent inconsistent with the provisions of this part shall not apply to a large partnership and its partners.

"SEC. 772. SIMPLIFIED FLOW-THROUGH.

"(a) GENERAL RULE.—In determining the income tax of a partner of a large partnership, such partner shall take into account separately such partner's distributive share of the partnership's—

"(1) taxable income or loss from passive loss limitation activities,

"(2) taxable income or loss from other activities,

"(3) net capital gain (or net capital loss)—

"(A) to the extent allocable to passive loss limitation activities, and

"(B) to the extent allocable to other activities,

"(4) tax-exempt interest,

"(5) applicable net AMT adjustment separately computed for—

"(A) passive loss limitation activities, and

"(B) other activities,

"(6) general credits,

"(7) low-income housing credit determined under section 42,

"(8) rehabilitation credit determined under section 47,

"(9) foreign income taxes, and

"(10) the credit allowable under section 29.

"(b) SEPARATE COMPUTATIONS.—In determining the amounts required under subsection (a) to be separately taken into account by any partner, this section and section 773 shall be applied separately with respect to such partner by taking into account such partner's distributive share of the items of income, gain, loss, deduction, or credit of the partnership.

"(c) TREATMENT AT PARTNER LEVEL.—

"(1) IN GENERAL.—Except as provided in this subsection, rules similar to the rules of section 702(b) shall apply to any partner's distributive share of the amounts referred to in subsection (a).

"(2) INCOME OR LOSS FROM PASSIVE LOSS LIMITATION ACTIVITIES.—For purposes of this chapter, any partner's distributive share of any income or loss described in subsection (a)(1) shall be treated as an item of income or loss (as the case may be) from the conduct of a trade or business which is a single passive activity (as defined in section 469). A similar rule shall apply to a partner's distributive share of amounts referred to in paragraphs (3)(A) and (5)(A) of subsection (a).

"(3) INCOME OR LOSS FROM OTHER ACTIVITIES.—

"(A) IN GENERAL.—For purposes of this chapter, any partner's distributive share of any income or loss described in subsection (a)(2) shall be treated as an item of income or expense (as the case may be) with respect to property held for investment.

"(B) DEDUCTIONS FOR LOSS NOT SUBJECT TO SECTION 67.—The deduction under section 212 for any loss described in subparagraph (A) shall not be treated as a miscellaneous itemized deduction for purposes of section 67.

"(4) TREATMENT OF NET CAPITAL GAIN OR LOSS.—For purposes of this chapter, any partner's distributive share of any gain or loss described in subsection (a)(3) shall be treated as a long-term capital gain or loss, as the case may be.

"(5) MINIMUM TAX TREATMENT.—In determining the alternative minimum taxable income of any partner, such partner's distributive share of any applicable net AMT adjustment shall be taken into account in lieu of making the separate adjustments provided in sections 56, 57, and 58 with respect to the items of the partnership. Except as provided in regulations, the applicable net AMT adjustment shall be treated, for purposes of section 53, as an adjustment or item of tax preference not specified in section 53(d)(1)(B)(ii).

"(6) GENERAL CREDITS.—A partner's distributive share of the amount referred to in paragraph (6) of subsection (a) shall be taken into account as a current year business credit.

"(d) OPERATING RULES.—For purposes of this section—

"(1) PASSIVE LOSS LIMITATION ACTIVITY.—The term 'passive loss limitation activity' means—

"(A) any activity which involves the conduct of a trade or business, and

"(B) any rental activity.

For purposes of the preceding sentence, the term 'trade or business' includes any activity treated as a trade or business under paragraph (5) or (6) of section 469(c).

"(2) TAX-EXEMPT INTEREST.—The term 'tax-exempt interest' means interest excludable from gross income under section 103.

"(3) APPLICABLE NET AMT ADJUSTMENT.—

"(A) IN GENERAL.—The applicable net AMT adjustment is—

"(i) with respect to taxpayers other than corporations, the net adjustment determined by using the adjustments applicable to individuals, and

"(ii) with respect to corporations, the net adjustment determined by using the adjustments applicable to corporations.

"(B) NET ADJUSTMENT.—The term 'net adjustment' means the net adjustment in the items attributable to passive loss activities or other activities (as the case may be) which would result if such items were determined with the adjustments of sections 56, 57, and 58.

"(4) TREATMENT OF CAPITAL GAINS AND LOSSES.—

"(A) EXCLUSION FOR CERTAIN PURPOSES.—In determining the amounts referred to in paragraphs (1) and (2) of subsection (a), any net capital gain or net capital loss (as the case may be) shall be excluded.

"(B) ALLOCATION RULES.—The net capital gain shall be treated—

"(i) as allocable to passive loss limitation activities to the extent the net capital gain does not exceed the net capital gain determined by only taking into account gains and losses from sales and exchanges of property used in connection with such activities, and

"(ii) as allocable to other activities to the extent such gain exceeds the amount allocated under clause (i).

A similar rule shall apply for purposes of allocating any net capital loss.

"(C) NET CAPITAL LOSS.—The term 'net capital loss' means the excess of the losses from sales or exchanges of capital assets over the gains from sales or exchange of capital assets.

"(5) GENERAL CREDITS.—The term 'general credits' means any credit other than the low-income housing credit, the rehabilitation credit, the foreign tax credit, and the credit allowable under section 29.

"(6) FOREIGN INCOME TAXES.—The term 'foreign income taxes' means taxes described in section 901 which are paid or accrued to foreign countries and to possessions of the United States.

"(e) SPECIAL RULE FOR UNRELATED BUSINESS TAX.—In the case of a partner which is an organization subject to tax under section 511, such partner's distributive share of any items shall be taken into account separately to the extent necessary to comply with the provisions of section 512(c)(1).

"(f) SPECIAL RULES FOR APPLYING PASSIVE LOSS LIMITATIONS.—If any person holds an interest in a large partnership other than as a limited partner—

"(1) paragraph (2) of subsection (c) shall not apply to such partner, and

"(2) such partner's distributive share of the partnership items allocable to passive loss limitation activities shall be taken into account separately to the extent necessary to comply with the provisions of section 469.

The preceding sentence shall not apply to any items allocable to an interest held as a limited partner.

"SEC. 773. COMPUTATIONS AT PARTNERSHIP LEVEL.

"(a) GENERAL RULE.—

"(1) TAXABLE INCOME.—The taxable income of a large partnership shall be computed in the same manner as in the case of an individual except that—

"(A) the items described in section 772(a) shall be separately stated, and

"(B) the modifications of subsection (b) shall apply.

"(2) ELECTIONS.—All elections affecting the computation of the taxable income of a large partnership or the computation of any credit of a large partnership shall be made by the partnership; except that the election under section 901 shall be made by each partner separately.

"(3) LIMITATIONS, ETC.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), all limitations and other provisions affecting the computation of the taxable income of a large partnership or the computation of any credit of a large partnership shall be applied at the partnership level (and not at the partner level).

"(B) CERTAIN LIMITATIONS APPLIED AT PARTNER LEVEL.—The following provisions shall be applied at the partner level (and not at the partnership level):

"(i) Section 68 (relating to overall limitation on itemized deductions).

"(ii) Sections 49 and 465 (relating to at risk limitations).

"(iii) Section 469 (relating to limitation on passive activity losses and credits).

"(iv) Any other provision specified in regulations.

"(4) COORDINATION WITH OTHER PROVISIONS.—Paragraphs (2) and (3) shall apply notwithstanding any other provision of this chapter other than this part.

"(b) MODIFICATIONS TO DETERMINATION OF TAXABLE INCOME.—In determining the taxable income of a large partnership—

"(1) CERTAIN DEDUCTIONS NOT ALLOWED.—The following deductions shall not be allowed:

"(A) The deduction for personal exemptions provided in section 151.

"(B) The net operating loss deduction provided in section 172.

"(C) The additional itemized deductions for individuals provided in part VII of subchapter B (other than section 212 thereof).

"(2) CHARITABLE DEDUCTIONS.—In determining the amount allowable under section 170, the limitation of section 170(b)(2) shall apply.

"(3) COORDINATION WITH SECTION 67.—In lieu of applying section 67, 70 percent of the amount of the miscellaneous itemized deductions shall be disallowed.

"(c) SPECIAL RULES FOR INCOME FROM DISCHARGE OF INDEBTEDNESS.—If a large partnership has income from the discharge of any indebtedness—

"(1) such income shall be excluded in determining the amounts referred to in section 772(a), and

"(2) in determining the income tax of any partner of such partnership—

"(A) such income shall be treated as an item required to be separately taken into account under section 772(a), and

"(B) the provisions of section 108 shall be applied without regard to this part.

"SEC. 774. OTHER MODIFICATIONS.

"(a) TREATMENT OF CERTAIN OPTIONAL ADJUSTMENTS, ETC.—In the case of a large partnership—

"(1) computations under section 773 shall be made without regard to any adjustment under section 743(b) or 108(b), but

"(2) a partner's distributive share of any amount referred to in section 772(a) shall be appropriately adjusted to take into account any adjustment under section 743(b) or 108(b) with respect to such partner.

"(b) DEFERRED SALE TREATMENT OF CONTRIBUTED PROPERTY.—

"(1) TREATMENT OF PARTNERSHIP.—In the case of any contribution of property to which this subsection applies—

"(A) the basis of such property to the partnership shall be its fair market value as of the time of such contribution, and

"(B) section 704(c) shall not apply to such property.

"(2) TREATMENT OF CONTRIBUTING PARTNER.—

"(A) IN GENERAL.—In the case of any partner who makes a contribution of property to which this subsection applies—

"(i) such partner shall recognize the precontribution gain or loss from such property as provided in this paragraph, and

"(ii) appropriate adjustments to the basis of such partner's interest in the partnership shall be made for the amounts recognized under this paragraph.

"(B) CHARACTER.—The character of any gain or loss recognized under this paragraph shall be determined by reference to the character which would have resulted if the property had been sold to the partnership at the time of the contributions; except that any gain or loss recognized under subparagraph (C)(i) shall be treated as ordinary income or loss, as the case may be.

"(C) TRANSACTIONS AT PARTNERSHIP LEVEL.—

"(i) DEPRECIATION, ETC.—If any partnership deduction for depreciation, depletion, or amortization is increased by reason of an increase in the basis of any property under paragraph (1), the contributing partner shall recognize so much of the precontribution gain

with respect to such property as does not exceed the increase in such deduction. If there is a precontribution loss, a similar rule shall apply to any decrease in such a deduction.

"(ii) DISPOSITIONS.—

"(I) IN GENERAL.—Except as otherwise provided in this clause, any precontribution gain or loss with respect to any property (to the extent not previously taken into account under this paragraph) shall be recognized by the contributing partner if the partnership makes any disposition of the property.

"(II) DISTRIBUTIONS TO CONTRIBUTING PARTNER.—No gain or loss shall be recognized under subclause (I) by reason of any distribution of the contributed property to the contributing partner (and subparagraph (D)(ii) shall not apply to any such distribution). In any such case, no adjustment shall be made under section 734 on account of such distribution and the adjusted basis of such property in the hands of the contributing partner shall be its adjusted basis immediately before the contribution properly adjusted for gain or loss previously recognized under this paragraph.

"(iii) YEAR FOR WHICH AMOUNT TAKEN INTO ACCOUNT.—Any amount recognized under this subparagraph shall be taken into account for the partner's taxable year in which or with which ends the partnership taxable year of the deduction or disposition.

"(D) TRANSACTIONS AT PARTNER LEVEL.—

"(i) IN GENERAL.—If the contributing partner makes a disposition of any portion of his interest in the partnership, a corresponding portion of any precontribution gain or loss which was not previously taken into account under this paragraph shall be recognized for the partner's taxable year in which the disposition occurs. The preceding sentence shall not apply to a disposition at death.

"(ii) TREATMENT OF CERTAIN DISTRIBUTIONS.—If—

"(I) the amount of cash and the fair market value of property distributed to a partner, exceeds

"(II) the adjusted basis of such partner's interest in the partnership immediately before the distribution (determined without regard to any adjustment under subparagraph (A)(ii) resulting from such distribution),

the contributing partner shall recognize so much of any precontribution gain as does not exceed such excess.

"(iii) SPECIAL RULE.—Except as provided in clause (ii)(II), any basis adjustment under subparagraph (A)(ii) resulting from any gain or loss recognized under this subparagraph shall be treated as occurring immediately before the disposition or distribution involved.

"(E) SECTION 267 AND 707(b) PRINCIPLES TO APPLY.—No loss shall be recognized under subparagraph (C)(ii) or (D) by reason of any disposition (directly or indirectly) to a person related (within the meaning of section 267(b) or 707(b)(1)) to the contributing partner.

"(F) TREATMENT OF CERTAIN NONTAXABLE EXCHANGES.—

"(i) SECTION 1031 AND 1033 TRANSACTIONS.—If the disposition referred to in subclause (I) of subparagraph (C)(ii) is an exchange described in section 1031 or a compulsory or involuntary conversion within the meaning of section 1033—

"(I) the amount of gain or loss recognized by the contributing partner under such subclause (I) shall not exceed the gain or loss recognized by the partnership on the disposition, and

"(II) the replacement property shall be treated as the contributed property for purposes of this paragraph.

For purposes of the preceding sentence, the term 'replacement property' means the property the basis of which is determined under section 1031(d) or 1033(b), whichever is applicable.

"(ii) CONTRIBUTIONS TO CONTROLLED PARTNERSHIP.—If the disposition referred to in subclause (I) of subparagraph (C)(ii) is a contribution of the property to another partnership which is a controlled partnership—

"(I) the rules of subclause (I) of clause (i) shall apply, and

"(II) the partnership shall be treated as continuing to hold the contributed property so long as the other partnership continues to be a controlled partnership and continues to hold such property.

For purposes of the preceding sentence, the term 'controlled partnership' means any partnership in which the partnership making the disposition owns more than 50 percent of the capital interest or profits interest.

"(3) PRECONTRIBUTION GAIN OR LOSS.—For purposes of this subsection—

"(A) PRECONTRIBUTION GAIN.—The term 'precontribution gain' means the excess (if any) of—

"(i) the fair market value of the contributed property as of the time of the contribution, over

"(ii) the adjusted basis of such property immediately before such contribution.

"(B) PRECONTRIBUTION LOSS.—The term 'precontribution loss' means the excess (if any) of the amount referred to in clause (ii) of subparagraph (A) over the amount referred to in clause (i) of subparagraph (A).

"(4) CONTRIBUTIONS TO WHICH SUBSECTION APPLIES.—This subsection shall apply to any contribution of property (other than cash) which is made by any partner to a partnership if—

"(A) as of the time of such contribution, such partnership is a large partnership, or

"(B) such contribution is to a partnership reasonably expected to become a large partnership.

This subsection shall not apply to any contribution made before the date of the enactment of this part.

"(c) Credit Recapture Determined at Partnership Level.—

"(1) In general.—In the case of a large partnership—

"(A) any credit recapture shall be taken into account by the partnership, and

"(B) the amount of such recapture shall be determined as if the credit with respect to which the recapture is made had been fully utilized to reduce tax.

"(2) Method of taking recapture into account.—A large partnership shall take into account a credit recapture by reducing the amount of the appropriate current year credit to the extent thereof, and if such recapture exceeds the amount of such current year credit, the partnership shall be liable to pay such excess.

"(3) Dispositions not to trigger recapture.—No credit recapture shall be required by reason of any transfer of an interest in a large partnership.

"(4) Credit recapture.—For purposes of this subsection, the term 'credit recapture' means any increase in tax under section 42(j) or 50(a).

"(d) Partnership Not Terminated by Reason of Change in Ownership.—Subparagraph (B) of section 708(b)(1) shall not apply to a large partnership.

"(e) Partnership Entitled to Certain Credits.—The following shall be allowed to a large partnership and shall not be taken into account by the partners of such partnership:

"(1) The credit provided by section 34.

"(2) Any credit or refund under section 852(b)(3)(D).

"(f) Treatment of REMIC Residuals.—For purposes of applying section 860E(e)(6) to any large partnership—

"(1) all interests in such partnership shall be treated as held by disqualified organizations,

"(2) in lieu of applying subparagraph (C) of section 860E(e)(6), the amount subject to tax under section 860E(e)(6) shall be excluded from the gross income of such partnership, and

"(3) subparagraph (D) of section 860E(e)(6) shall not apply.

"(g) Special Rules for Applying Certain Installment Sale Rules.—In the case of a large partnership—

"(1) the provisions of sections 453(l)(3) and 453A shall be applied at the partnership level, and

"(2) in determining the amount of interest payable under such sections, such partnership shall be treated as subject to tax under this chapter at the highest rate of tax in effect under section 1 or 11.

"SEC. 775. LARGE PARTNERSHIP.

"(a) General Rule.—For purposes of this part—

"(1) In general.—Except as otherwise provided in this section or section 776, the term 'large partnership' means, with re-

spect to any partnership taxable year, any partnership if the number of persons who were partners in such partnership in such taxable year or any preceding partnership taxable year beginning after December 31, 1992, equaled or exceeded 250. To the extent provided in regulations, a partnership shall cease to be treated as a large partnership for any partnership taxable year if in such taxable year fewer than 100 persons were partners in such partnership.

"(2) ELECTION FOR PARTNERSHIPS WITH AT LEAST 100 PARTNERS.—If a partnership makes an election under this paragraph, paragraph (1) shall be applied by substituting '100' for '250'. Such an election shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

"(b) SPECIAL RULES FOR CERTAIN SERVICE PARTNERSHIPS.—

"(1) CERTAIN PARTNERS NOT COUNTED.—For purposes of this section, the term 'partner' does not include any individual performing substantial services in connection with the activities of the partnership and holding an interest in such partnership, or an individual who formerly performed substantial services in connection with such activities and who held an interest in such partnership at the time the individual performed such services.

"(2) EXCLUSION.—For purposes of this part, the term 'large partnership' does not include any partnership if substantially all the partners of such partnership—

"(A) are individuals performing substantial services in connection with the activities of such partnership or are personal service corporations (as defined in section 269A(b)) the owner-employees (as defined in section 269A(b)) of which perform such substantial services,

"(B) are retired partners who had performed such substantial services, or

"(C) are spouses of partners who are performing (or had previously performed) such substantial services.

"(3) SPECIAL RULE FOR LOWER TIER PARTNERSHIPS.—For purposes of this subsection, the activities of a partnership shall include the activities of any other partnership in which the partnership owns directly an interest in the capital and profits of at least 80 percent.

"(c) EXCLUSION OF COMMODITY POOLS.—For purposes of this part, the term 'large partnership' does not include any partnership the principal activity of which is the buying and selling of commodities (not described in section 1221(1)), or options, futures, or forwards with respect to such commodities.

"(d) SECRETARY MAY RELY ON TREATMENT ON RETURN.—If, on the partnership return of any partnership, such partnership is treated as a large partnership, such treatment shall be binding on such partnership and all partners of such partnership but not on the Secretary.

"SEC. 776. SPECIAL RULES FOR PARTNERSHIPS HOLDING OIL AND GAS PROPERTIES.

"(a) EXCEPTION FOR PARTNERSHIPS HOLDING SIGNIFICANT OIL AND GAS PROPERTIES.—

"(1) IN GENERAL.—For purposes of this part, the term 'large partnership' shall not include any partnership if the average percentage of assets (by value) held by such partnership during the taxable year which are oil or gas properties is at least 25 percent. For purposes of the preceding sentence, any interest held by a partnership in another partnership shall be disregarded, except that the partnership shall be treated as holding its proportionate share of the assets of such other partnership.

"(2) ELECTION TO WAIVE EXCEPTION.—Any partnership may elect to have paragraph (1) not apply. Such an election shall apply to the partnership taxable year for which made and all subsequent partnership taxable years unless revoked with the consent of the Secretary.

"(b) SPECIAL RULES WHERE PART APPLIES.—

"(1) COMPUTATION OF PERCENTAGE DEPLETION.—In the case of a large partnership, except as provided in paragraph (2)—

"(A) the allowance for depletion under section 611 with respect to any partnership oil or gas property shall be computed at the partnership level without regard to any provision of section 613A requiring such allowance to be computed separately by each partner,

"(B) such allowance shall be determined without regard to the provisions of section 613A(c) limiting the amount of production for which percentage depletion is allowable and without respect to paragraph (1) of section 613A(d), and

"(C) paragraph (3) of section 705(a) shall not apply.

"(2) TREATMENT OF CERTAIN PARTNERS.—

"(A) IN GENERAL.—In the case of a disqualified person, the treatment under this chapter of such person's distributive share of any item of income, gain, loss, deduction, or credit attributable to any partnership oil or gas property shall be determined without regard to this part. Such person's distributive share of any such items shall be excluded for purposes of making determinations under sections 772 and 773.

"(B) DISQUALIFIED PERSON.—For purposes of subparagraph (A), the term 'disqualified person' means, with respect to any partnership taxable year—

"(i) any person referred to in paragraph (2) or (4) of section 613A(d) for such person's taxable year in which such partnership taxable year ends, and

"(ii) any other person if such person's average daily production of domestic crude oil and natural gas for such person's taxable year in which such partnership taxable year ends exceeds 500 barrels.

"(C) AVERAGE DAILY PRODUCTION.—For purposes of subparagraph (B), a person's average daily production of domestic crude oil and natural gas for any taxable year shall be computed as provided in section 613A(c)(2)—

"(i) by taking into account all production of domestic crude oil and natural gas (including such person's proportionate share of any production of a partnership),

"(ii) by treating 6,000 cubic feet of natural gas as a barrel of crude oil, and

"(iii) by treating as 1 person all persons treated as 1 taxpayer under section 613A(c)(8) or among whom allocations are required under such section.

"SEC. 777. REGULATIONS.

"The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this part."

(b) CLERICAL AMENDMENT.—The table of parts for subchapter K of chapter 1 is amended by adding at the end thereof the following new item:

"Part IV. Special rules for large partnerships."

SEC. 4302. SIMPLIFIED AUDIT PROCEDURES FOR LARGE PARTNERSHIPS.

(a) GENERAL RULE.—Chapter 63 is amended by adding at the end thereof the following new subchapter:

"SUBCHAPTER D—TREATMENT OF LARGE PARTNERSHIPS

"Part I. Treatment of partnership items and adjustments.
"Part II. Partnership level adjustments.
"Part III. Definitions and special rules.

"PART I—TREATMENT OF PARTNERSHIP ITEMS AND ADJUSTMENTS

"Sec. 6240. Application of subchapter.
"Sec. 6241. Partner's return must be consistent with partnership return.
"Sec. 6242. Procedures for taking partnership adjustments into account.

"SEC. 6240. APPLICATION OF SUBCHAPTER.

"(a) GENERAL RULE.—This subchapter shall only apply to large partnerships and partners in such partnerships.

"(b) COORDINATION WITH OTHER PARTNERSHIP AUDIT PROCEDURES.—

"(1) IN GENERAL.—Subchapter C of this chapter shall not apply to any large partnership other than in its capacity as a partner in another partnership which is not a large partnership.

"(2) TREATMENT WHERE PARTNER IN OTHER PARTNERSHIP.—If a large partnership is a partner in another partnership which is not a large partnership—

"(A) subchapter C of this chapter shall apply to items of such large partnership which are partnership items with respect to such other partnership, but

"(B) any adjustment under such subchapter C shall be taken into account in the manner provided by section 6242.

"SEC. 6241. PARTNER'S RETURN MUST BE CONSISTENT WITH PARTNERSHIP RETURN.

"(a) GENERAL RULE.—A partner of any large partnership shall, on the partner's return, treat each partnership item attributable to such partnership in a manner which is consistent with the treatment of such partnership item on the partnership return.

"(b) UNDERPAYMENT DUE TO INCONSISTENT TREATMENT ASSESSED AS MATH ERROR.—Any underpayment of tax by a partner by reason of failing to comply with the requirements of subsection (a) shall be assessed and collected in the same manner as if such underpayment were on account of a mathematical or clerical error appearing on the partner's return. Paragraph (2) of section 6213(b) shall not apply to any assessment of an underpayment referred to in the preceding sentence.

"(c) ADJUSTMENTS NOT TO AFFECT PRIOR YEAR OF PARTNERS.—

"(1) IN GENERAL.—Except as provided in paragraph (2), subsections (a) and (b) shall apply without regard to any adjustment to the partnership item under part II.

"(2) CERTAIN CHANGES IN DISTRIBUTIVE SHARE TAKEN INTO ACCOUNT BY PARTNER.—

"(A) IN GENERAL.—To the extent that any adjustment under part II involves a change under section 704 in a partner's distributive share of the amount of any partnership item shown on the partnership return, such adjustment shall be taken into account in applying this title to such partner for the partner's taxable year for which such item was required to be taken into account.

"(B) COORDINATION WITH DEFICIENCY PROCEDURES.—

"(i) IN GENERAL.—Subchapter B shall not apply to the assessment or collection of any underpayment of tax attributable to an adjustment referred to in subparagraph (A).

"(ii) ADJUSTMENT NOT PRECLUDED.—Notwithstanding any other law or rule of law, nothing in subchapter B (or in any proceeding under subchapter B) shall preclude the assessment or collection of any underpayment of tax (or the allowance of any credit or refund of any overpayment of tax) attributable to an adjustment referred to in subparagraph (A) and such assessment or collection or allowance (or any notice thereof) shall not preclude any notice, proceeding, or determination under subchapter B.

"(C) PERIOD OF LIMITATIONS.—The period for—

"(i) assessing any underpayment of tax, or

"(ii) filing a claim for credit or refund of any overpayment of tax,

attributable to an adjustment referred to in subparagraph (A) shall not expire before the close of the period prescribed by section 6248 for making adjustments with respect to the partnership taxable year involved.

"(D) TIERED STRUCTURES.—If the partner referred to in subparagraph (A) is another partnership or an S corporation, the rules of this paragraph shall also apply to persons holding interests in such partnership or S corporation (as

the case may be); except that, if such partner is a large partnership, the adjustment referred to in subparagraph (A) shall be taken into account in the manner provided by section 6242.

"(d) Addition to Tax for Failure To Comply With Section.—

"For addition to tax in case of partner's disregard of requirements of this section, see part II of subchapter A of chapter 68.

"SEC. 6242. PROCEDURES FOR TAKING PARTNERSHIP ADJUSTMENTS INTO ACCOUNT.

"(a) Adjustments Flow Through to Partners for Year in Which Adjustment Takes Effect.—

"(1) In general.—If any partnership adjustment with respect to any partnership item takes effect (within the meaning of subsection (d)(2)) during any partnership taxable year and if an election under paragraph (2) does not apply to such adjustment, such adjustment shall be taken into account in determining the amount of such item for the partnership taxable year in which such adjustment takes effect. In applying this title to any person who is (directly or indirectly) a partner in such partnership during such partnership taxable year, such adjustment shall be treated as an item actually arising during such taxable year.

"(2) Partnership liable in certain cases.—If—

"(A) a partnership elects under this paragraph to not take an adjustment into account under paragraph (1),

"(B) a partnership does not make such an election but in filing its return for any partnership taxable year fails to take fully into account any partnership adjustment as required under paragraph (1), or

"(C) any partnership adjustment involves a reduction in a credit which exceeds the amount of such credit determined for the partnership taxable year in which the adjustment takes effect,

the partnership shall pay to the Secretary an amount determined by applying the rules of subsection (b)(4) to the adjustments not so taken into account and any excess referred to in subparagraph (C).

"(3) Offsetting adjustments taken into account.—If a partnership adjustment requires another adjustment in a taxable year after the adjusted year and before the partnership taxable year in which such partnership adjustment takes effect, such other adjustment shall be taken into account under this subsection for the partnership taxable year in which such partnership adjustment takes effect.

"(4) Coordination with part II.—Amounts taken into account under this subsection for any partnership taxable year shall continue to be treated as adjustments for the adjusted year for purposes of determining whether such amounts may be readjusted under part II.

"(b) Partnership Liable for Interest and Penalties.—

"(1) In general.—If a partnership adjustment takes effect during any partnership taxable year and such adjustment results in an imputed underpayment for the adjusted year, the partnership—

"(A) shall pay to the Secretary interest computed under paragraph (2), and

"(B) shall be liable for any penalty, addition to tax, or additional amount as provided in paragraph (3).

"(2) DETERMINATION OF AMOUNT OF INTEREST.—The interest computed under this paragraph with respect to any partnership adjustment is the interest which would be determined under chapter 67—

"(A) on the imputed underpayment determined under paragraph (4) with respect to such adjustment, or

"(B) for the period beginning on the day after the return due date for the adjusted year and ending on the return due date for the partnership taxable year in which such adjustment takes effect (or, if earlier, in the case of any adjustment to which subsection (a)(2) applies, the date on which the payment under subsection (a)(2) is made).

Proper adjustments in the amount determined under the preceding sentence shall be made for adjustments required for partnership taxable years after the adjusted year and before the year in which the partnership adjustment takes effect by reason of such partnership adjustment.

"(3) PENALTIES.—A partnership shall be liable for any penalty, addition to tax, or additional amount for which it would have been liable if such partnership had been an individual subject to tax under chapter 1 for the adjusted year and the imputed underpayment determined under paragraph (4) were an actual underpayment (or understatement) for such year.

"(4) IMPUTED UNDERPAYMENT.—For purposes of this subsection, the imputed underpayment determined under this paragraph with respect to any partnership adjustment is the underpayment (if any) which would result—

"(A) by netting all adjustments to items of income, gain, loss, or deduction and—

"(i) if such netting results in a net increase in income, by treating such net increase as an underpayment equal to the amount of such net increase multiplied by the highest rate of tax in effect under section 1 or 11 for the adjusted year, or

"(ii) if such netting results in a net decrease in income, by treating such net decrease as an overpayment equal to such net decrease multiplied by such highest rate, and

"(B) by taking adjustments to credits into account as increases or decreases (whichever is appropriate) in the amount of tax.

For purposes of the preceding sentence, any net decrease in a loss shall be treated as an increase in income and a similar rule shall apply to a net increase in a loss.

"(c) ADMINISTRATIVE PROVISIONS.—

"(1) IN GENERAL.—Any payment required by subsection (a)(2) or (b)(1)(A)—

"(A) shall be assessed and collected in the same manner as if it were a tax imposed by subtitle C, and

"(B) shall be paid on or before the return due date for the partnership taxable year in which the partnership adjustment takes effect.

"(2) INTEREST.—For purposes of determining interest, any payment required by subsection (a)(2) or (b)(1)(A) shall be treated as an underpayment of tax.

"(3) PENALTIES.—

"(A) IN GENERAL.—In the case of any failure by any partnership to pay on the date prescribed therefor any amount required by subsection (a)(2) or (b)(1)(A), there is hereby imposed on such partnership a penalty of 10 percent of the underpayment. For purposes of the preceding sentence, the term 'underpayment' means the excess of any payment required under this section over the amount (if any) paid on or before the date prescribed therefor.

"(B) ACCURACY-RELATED AND FRAUD PENALTIES MADE APPLICABLE.—For purposes of part II of subchapter A of chapter 68, any payment required by subsection (a)(2) shall be treated as an underpayment of tax.

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

"(1) PARTNERSHIP ADJUSTMENT.—The term 'partnership adjustment' means any adjustment in the amount of any partnership item of a large partnership.

"(2) WHEN ADJUSTMENT TAKES EFFECT.—A partnership adjustment takes effect—

"(A) in the case of an adjustment pursuant to the decision of a court in a proceeding brought under part II, when such decision becomes final,

"(B) in the case of an adjustment pursuant to any administrative adjustment request under section 6251, when such adjustment is allowed by the Secretary, or

"(C) in any other case, when such adjustment is made.

"(3) ADJUSTED YEAR.—The term 'adjusted year' means the partnership taxable year to which the item being adjusted relates.

"(4) RETURN DUE DATE.—The term 'return due date' means, with respect to any taxable year, the date prescribed for filing the partnership return for such taxable year (determined without regard to extensions).

"(5) ADJUSTMENTS INVOLVING CHANGES IN CHARACTER.—Under regulations, appropriate adjustments in the application of this section shall be made for purposes of taking into account partnership adjustments which involve a change in the character of any item of income, gain, loss, or deduction.

"(e) PAYMENTS NONDEDUCTIBLE.—No deduction shall be allowed under subtitle A for any payment required to be made by a large partnership under this section.

"PART II—PARTNERSHIP LEVEL ADJUSTMENTS

"Subpart A. Adjustments by Secretary.
"Subpart B. Claims for adjustments by partnership.

"Subpart A—Adjustments by Secretary

"Sec. 6245. Secretarial authority.
"Sec. 6246. Restrictions on partnership adjustments.
"Sec. 6247. Judicial review of partnership adjustment.
"Sec. 6248. Period of limitations for making adjustments.

"SEC. 6245. SECRETARIAL AUTHORITY.

"(a) GENERAL RULE.—The Secretary is authorized and directed to make adjustments at the partnership level in any partnership item to the extent necessary to have such item be treated in the manner required.

"(b) NOTICE OF PARTNERSHIP ADJUSTMENT.—

"(1) IN GENERAL.—If the Secretary determines that a partnership adjustment is required, the Secretary is authorized to send notice of such adjustment to the partnership by certified mail or registered mail. Such notice shall be sufficient if mailed to the partnership at its last known address even if the partnership has terminated its existence.

"(2) FURTHER NOTICES RESTRICTED.—If the Secretary mails a notice of a partnership adjustment to any partnership for any partnership taxable year and the partnership files a petition under section 6247 with respect to such notice, in the absence of a showing of fraud, malfeasance, or misrepresentation of a material fact, the Secretary shall not mail another such notice to such partnership with respect to such taxable year.

"(3) AUTHORITY TO RESCIND NOTICE WITH PARTNERSHIP CONSENT.—The Secretary may, with the consent of the partnership, rescind any notice of a partnership adjustment mailed to such partnership. Any notice so rescinded shall not be treated as a notice of a partnership adjustment, for purposes of this section, section 6246, and section 6247, and the taxpayer shall have no right to bring a proceeding under section 6247 with respect to such notice. Nothing in this subsection shall affect any suspension of the running of any period of limitations during any period during which the rescinded notice was outstanding.

"SEC. 6246. RESTRICTIONS ON PARTNERSHIP ADJUSTMENTS.

"(a) GENERAL RULE.—Except as otherwise provided in this chapter, no adjustment to any partnership item may be made (and no levy or proceeding in any court for the collection of any amount resulting from such adjustment may be made, begun or prosecuted) before—

"(1) the close of the 90th day after the day on which a notice of a partnership adjustment was mailed to the partnership, and

"(2) if a petition is filed under section 6247 with respect to such notice, the decision of the court has become final.

"(b) PREMATURE ACTION MAY BE ENJOINED.—Notwithstanding section 7421(a), any action which violates subsection (a) may be enjoined in the proper court, including the Tax Court. The Tax Court shall have no jurisdiction to enjoin any action under this subsection unless a timely petition has been filed under section 6247 and then only in respect of the adjustments that are the subject of such petition.

"(c) EXCEPTIONS TO RESTRICTIONS ON ADJUSTMENTS.—

"(1) ADJUSTMENTS ARISING OUT OF MATH OR CLERICAL ERRORS.—

"(A) IN GENERAL.—If the partnership is notified that, on account of a mathematical or clerical error appearing on the partnership return, an adjustment to a partnership item is required, rules similar to the rules of paragraphs (1) and (2) of section 6213(b) shall apply to such adjustment.

"(B) SPECIAL RULE.—If a large partnership is a partner in another large partnership, any adjustment on account of such partnership's failure to comply with the requirements of section 6241(a) with respect to its interest in such other partnership shall be treated as an adjustment referred to in subparagraph (A), except that paragraph (2) of section 6213(b) shall not apply to such adjustment.

"(2) PARTNERSHIP MAY WAIVE RESTRICTIONS.—The partnership shall at any time (whether or not a notice of partnership adjustment has been issued) have the right, by a signed notice in writing filed with the Secretary, to waive the restrictions provided in subsection (a) on the making of any partnership adjustment.

"(d) LIMIT WHERE NO PROCEEDING BEGUN.—If no proceeding under section 6247 is begun with respect to any notice of a partnership adjustment during the 90-day period described in subsection (a), the amount for which the partnership is liable under section 6242 (and any increase in any partner's liability for tax under chapter 1 by reason of any adjustment under section 6242(a)) shall not exceed the amount determined in accordance with such notice.

"SEC. 6247. JUDICIAL REVIEW OF PARTNERSHIP ADJUSTMENT.

"(a) GENERAL RULE.—Within 90 days after the date on which a notice of a partnership adjustment is mailed to the partnership with respect to any partnership taxable year, the partnership may file a petition for a readjustment of the partnership items for such taxable year with—

"(1) the Tax Court,

"(2) the district court of the United States for the district in which the partnership's principal place of business is located, or

"(3) the Claims Court.

"(b) JURISDICTIONAL REQUIREMENT FOR BRINGING ACTION IN DISTRICT COURT OR CLAIMS COURT.—

"(1) IN GENERAL.—A readjustment petition under this section may be filed in a district court of the United States or the Claims Court only if the partnership filing the petition deposits with the Secretary, on or before the date the petition is filed, the amount for which the partnership would be liable under section 6242(b) (as of the date of the filing of the petition) if the partnership items were adjusted as provided by the notice of partnership adjustment. The court may by order provide that the jurisdictional requirements of this paragraph are satisfied where there has been a good faith attempt to satisfy such requirement and any shortfall of the amount required to be deposited is timely corrected.

"(2) Interest payable.—Any amount deposited under paragraph (1), while deposited, shall not be treated as a payment of tax for purposes of this title (other than chapter 67).

"(c) Scope of Judicial Review.—A court with which a petition is filed in accordance with this section shall have jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the notice of partnership adjustment relates and the proper allocation of such items among the partners (and the applicability of any penalty, addition to tax, or additional amount for which the partnership may be liable under section 6242(b)).

"(d) Determination of Court Reviewable.—Any determination by a court under this section shall have the force and effect of a decision of the Tax Court or a final judgment or decree of the district court or the Claims Court, as the case may be, and shall be reviewable as such. The date of any such determination shall be treated as being the date of the court's order entering the decision.

"(e) Effect of Decision Dismissing Action.—If an action brought under this section is dismissed other than by reason of a rescission under section 6245(b)(3), the decision of the court dismissing the action shall be considered as its decision that the notice of partnership adjustment is correct, and an appropriate order shall be entered in the records of the court.

"SEC. 6248. PERIOD OF LIMITATIONS FOR MAKING ADJUSTMENTS.

"(a) General Rule.—Except as otherwise provided in this section, no adjustment under this subpart to any partnership item for any partnership taxable year may be made after the date which is 3 years after the later of—

"(1) the date on which the partnership return for such taxable year was filed, or

"(2) the last day for filing such return for such year (determined without regard to extensions).

"(b) Extension by Agreement.—The period described in subsection (a) (including an extension period under this subsection) may be extended by an agreement entered into by the Secretary and the partnership before the expiration of such period.

"(c) Special Rule in Case of Fraud, Etc.—

"(1) False return.—In the case of a false or fraudulent partnership return with intent to evade tax, the adjustment may be made at any time.

"(2) Substantial omission of income.—If any partnership omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in its return, subsection (a) shall be applied by substituting '6 years' for '3 years'.

"(3) No return.—In the case of a failure by a partnership to file a return for any taxable year, the adjustment may be made at any time.

"(4) Return filed by secretary.—For purposes of this section, a return executed by the Secretary under subsection (b) of section 6020 on behalf of the partnership shall not be treated as a return of the partnership.

"(d) Suspension When Secretary Mails Notice of Adjustment.—If notice of a partnership adjustment with respect to any

taxable year is mailed to the partnership, the running of the period specified in subsection (a) (as modified by the other provisions of this section) shall be suspended—

"(1) for the period during which an action may be brought under section 6247 (and, if a petition is filed under section 6247 with respect to such notice, until the decision of the court becomes final), and

"(2) for 1 year thereafter.

"Subpart B—Claims for Adjustments by Partnership

"Sec. 6251. Administrative adjustment requests.
"Sec. 6252. Judicial review where administrative adjustment request is not allowed in full.

"SEC. 6251. ADMINISTRATIVE ADJUSTMENT REQUESTS.

"(a) GENERAL RULE.—A partnership may file a request for an administrative adjustment of partnership items for any partnership taxable year at any time which is—

"(1) within 3 years after the later of—

"(A) the date on which the partnership return for such year is filed, or

"(B) the last day for filing the partnership return for such year (determined without regard to extensions), and

"(2) before the mailing to the partnership of a notice of a partnership adjustment with respect to such taxable year.

"(b) SECRETARIAL ACTION.—If a partnership files an administrative adjustment request under subsection (a), the Secretary may allow any part of the requested adjustments.

"(c) SPECIAL RULE IN CASE OF EXTENSION UNDER SECTION 6248.—If the period described in section 6248(a) is extended pursuant to an agreement under section 6248(b), the period prescribed by subsection (a)(1) shall not expire before the date 6 months after the expiration of the extension under section 6248(b).

"SEC. 6252. JUDICIAL REVIEW WHERE ADMINISTRATIVE ADJUSTMENT REQUEST IS NOT ALLOWED IN FULL.

"(a) IN GENERAL.—If any part of an administrative adjustment request filed under section 6251 is not allowed by the Secretary, the partnership may file a petition for an adjustment with respect to the partnership items to which such part of the request relates with—

"(1) the Tax Court,

"(2) the district court of the United States for the district in which the principal place of business of the partnership is located, or

"(3) the Claims Court.

"(b) PERIOD FOR FILING PETITION.—A petition may be filed under subsection (a) with respect to partnership items for a partnership taxable year only—

"(1) after the expiration of 6 months from the date of filing of the request under section 6251, and

"(2) before the date which is 2 years after the date of such request.

The 2-year period set forth in paragraph (2) shall be extended for such period as may be agreed upon in writing by the partnership and the Secretary.

"(c) COORDINATION WITH SUBPART A.—

"(1) NOTICE OF PARTNERSHIP ADJUSTMENT BEFORE FILING OF PETITION.—No petition may be filed under this section after the Secretary mails to the partnership a notice of a partnership adjustment for the partnership taxable year to which the request under section 6251 relates.

"(2) NOTICE OF PARTNERSHIP ADJUSTMENT AFTER FILING BUT BEFORE HEARING OF PETITION.—If the Secretary mails to the partnership a notice of a partnership adjustment for the partnership taxable year to which the request under section 6251 relates after the filing of a petition under this subsection but before the hearing of such petition, such petition shall be treated as an action brought under section 6247 with respect to such notice, except that subsection (b) of section 6247 shall not apply.

"(3) NOTICE MUST BE BEFORE EXPIRATION OF STATUTE OF LIMITATIONS.—A notice of a partnership adjustment for the partnership taxable year shall be taken into account under paragraphs (1) and (2) only if such notice is mailed before the expiration of the period prescribed by section 6248 for making adjustments to partnership items for such taxable year.

"(d) SCOPE OF JUDICIAL REVIEW.—Except in the case described in paragraph (2) of subsection (c), a court with which a petition is filed in accordance with this section shall have jurisdiction to determine only those partnership items to which the part of the request under section 6251 not allowed by the Secretary relates and those items with respect to which the Secretary asserts adjustments as offsets to the adjustments requested by the partnership.

"(e) DETERMINATION OF COURT REVIEWABLE.—Any determination by a court under this subsection shall have the force and effect of a decision of the Tax Court or a final judgment or decree of the district court or the Claims Court, as the case may be, and shall be reviewable as such. The date of any such determination shall be treated as being the date of the court's order entering the decision.

"PART III—DEFINITIONS AND SPECIAL RULES.

"Sec. 6255. Definitions and special rules.

"SEC. 6255. DEFINITIONS AND SPECIAL RULES.

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

"(1) LARGE PARTNERSHIP.—The term 'large partnership' has the meaning given to such term by section 775 without regard to section 776(a).

"(2) PARTNERSHIP ITEM.—The term 'partnership item' has the meaning given to such term by section 6231(a)(3).

"(b) PARTNERS BOUND BY ACTIONS OF PARTNERSHIP, ETC.—

"(1) DESIGNATION OF PARTNER.—Each large partnership shall designate (in the manner prescribed by the Secretary) a partner (or other person) who shall have the sole authority to act on behalf of such partnership under this subchapter. In any case

in which such a designation is not in effect, the Secretary may select any partner as the partner with such authority.

"(2) BINDING EFFECT.—A large partnership and all partners of such partnership shall be bound—

"(A) by actions taken under this subchapter by the partnership, and

"(B) by any decision in a proceeding brought under this subchapter.

"(c) PARTNERSHIPS HAVING PRINCIPAL PLACE OF BUSINESS OUTSIDE THE UNITED STATES.—For purposes of sections 6247 and 6252, a principal place of business located outside the United States shall be treated as located in the District of Columbia.

"(d) TREATMENT WHERE PARTNERSHIP CEASES TO EXIST.—If a partnership ceases to exist before a partnership adjustment under this subchapter takes effect, such adjustment shall be taken into account by the former partners of such partnership under regulations prescribed by the Secretary.

"(e) DATE DECISION BECOMES FINAL.—For purposes of this subchapter, the principles of section 7481(a) shall be applied in determining the date on which a decision of a district court or the Claims Court becomes final.

"(f) PARTNERSHIPS IN CASES UNDER TITLE 11 OF THE UNITED STATES CODE.—The running of any period of limitations provided in this subchapter on making a partnership adjustment (or provided by section 6501 or 6502 on the assessment or collection of any amount required to be paid under section 6242) shall, in a case under title 11 of the United States Code, be suspended during the period during which the Secretary is prohibited by reason of such case from making the adjustment (or assessment or collection) and—

"(1) for adjustment or assessment, 60 days thereafter, and

"(2) for collection, 6 months thereafter.

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

"(1) to prevent abuse through manipulation of the provisions of this subchapter, and

"(2) providing that this subchapter shall not apply to any case described in section 6231(c)(1) (or the regulations prescribed thereunder) where the application of this subchapter to such a case would interfere with the effective and efficient enforcement of this title.

In any case to which this subchapter does not apply by reason of paragraph (2), rules similar to the rules of sections 6229(f) and 6255(f) shall apply."

(b) CLERICAL AMENDMENT.—The table of subchapters for chapter 63 is amended by adding at the end thereof the following new item:

"SUBCHAPTER D. Treatment of large partnerships."

SEC. 4303. DUE DATE FOR FURNISHING INFORMATION TO PARTNERS OF LARGE PARTNERSHIPS.

(a) GENERAL RULE.—Subsection (b) of section 6031 (relating to copies to partners) is amended by adding at the end thereof the following new sentence: "In the case of a large partnership (as defined in sections 775 and 776(a)), such information shall be furnished on

or before the first March 15 following the close of such taxable year."

(b) TREATMENT AS INFORMATION RETURN.—Section 6724 is amended by adding at the end thereof the following new subsection:

"(e) SPECIAL RULE FOR CERTAIN PARTNERSHIP RETURNS.—If any partnership return under section 6031(a) is required under section 6011(e) to be filed on magnetic media or in other machine-readable form, for purposes of this part, each schedule required to be included with such return with respect to each partner shall be treated as a separate information return."

SEC. 4304. RETURNS MAY BE REQUIRED ON MAGNETIC MEDIA.

Paragraph (2) of section 6011(e) (relating to returns on magnetic media) is amended by adding at the end thereof the following new sentence: "The preceding sentence shall not apply in the case of the partnership return of a large partnership (as defined in sections 775 and 776(a)) or any other partnership with 250 or more partners."

SEC. 4305. EFFECTIVE DATE.

(a) GENERAL RULE.—Except as provided in subsection (b), the amendments made by this part shall apply to partnership taxable years ending on or after December 31, 1992.

(b) SPECIAL RULE FOR SECTION 4304.—In the case of a partnership which is not a large partnership (as defined in sections 775 and 776(a) of the Internal Revenue Code of 1986, as added by this part), the amendment made by section 4304 shall only apply to partnership taxable years ending on or after December 31, 1998.

PART II—PROVISIONS RELATED TO TEFRA PARTNERSHIP PROCEEDINGS

SEC. 4311. TREATMENT OF PARTNERSHIP ITEMS IN DEFICIENCY PROCEEDINGS.

(a) IN GENERAL.—Subchapter C of chapter 63 is amended by adding at the end thereof the following new section:

"SEC. 6234. DECLARATORY JUDGMENT RELATING TO TREATMENT OF ITEMS OTHER THAN PARTNERSHIP ITEMS WITH RESPECT TO AN OVERSHELTERED RETURN.

"(a) GENERAL RULE.—If—

"(1) a taxpayer files an oversheltered return for a taxable year,

"(2) the Secretary makes a determination with respect to the treatment of items (other than partnership items) of such taxpayer for such taxable year, and

"(3) the adjustments resulting from such determination do not give rise to a deficiency (as defined in section 6211) but would give rise to a deficiency if there were no net loss from partnership items,

the Secretary is authorized to send a notice of adjustment reflecting such determination to the taxpayer by certified or registered mail.

"(b) OVERSHELTERED RETURN.—For purposes of this section, the term 'oversheltered return' means an income tax return which—

"(1) shows no taxable income for the taxable year, and

"(2) shows a net loss from partnership items.

"(c) JUDICIAL REVIEW IN THE TAX COURT.—Within 90 days, or 150 days if the notice is addressed to a person outside the United States, after the day on which the notice of adjustment authorized in subsection (a) is mailed to the taxpayer, the taxpayer may file a petition with the Tax Court for redetermination of the adjustments. Upon the filing of such a petition, the Tax Court shall have jurisdiction to make a declaration with respect to all items (other than partnership items and affected items which require partner level determinations as described in section 6230(a)(2)(A)(i)) for the taxable year to which the notice of adjustment relates, in accordance with the principles of section 6214(a). Any such declaration shall have the force and effect of a decision of the Tax Court and shall be reviewable as such.

"(d) FAILURE TO FILE PETITION.—

"(1) IN GENERAL.—Except as provided in paragraph (2), if the taxpayer does not file a petition with the Tax Court within the time prescribed in subsection (c), the determination of the Secretary set forth in the notice of adjustment that was mailed to the taxpayer shall be deemed to be correct.

"(2) EXCEPTION.—Paragraph (1) shall not apply after the date that the taxpayer—

"(A) files a petition with the Tax Court within the time prescribed in subsection (c) with respect to a subsequent notice of adjustment relating to the same taxable year, or

"(B) files a claim for refund of an overpayment of tax under section 6511 for the taxable year involved.

If a claim for refund is filed by the taxpayer, then solely for purposes of determining (for the taxable year involved) the amount of any computational adjustment in connection with a partnership proceeding under this subchapter (other than under this section) or the amount of any deficiency attributable to affected items in a proceeding under section 6230(a)(2), the items that are the subject of the notice of adjustment shall be presumed to have been correctly reported on the taxpayer's return during the pendency of the refund claim (and, if within the time prescribed by section 6532 the taxpayer commences a civil action for refund under section 7422, until the decision in the refund action becomes final).

"(e) LIMITATIONS PERIOD.—

"(1) IN GENERAL.—Any notice to a taxpayer under subsection (a) shall be mailed before the expiration of the period prescribed by section 6501 (relating to the period of limitations on assessment).

"(2) SUSPENSION WHEN SECRETARY MAILS NOTICE OF ADJUSTMENT.—If the Secretary mails a notice of adjustment to the taxpayer for a taxable year, the period of limitations on the making of assessments shall be suspended for the period during which the Secretary is prohibited from making the assessment (and, in any event, if a proceeding in respect of the notice of adjustment is placed on the docket of the Tax Court, until the decision of the Tax Court becomes final), and for 60 days thereafter.

"(3) RESTRICTIONS ON ASSESSMENT.—Except as otherwise provided in section 6851, 6852, or 6861, no assessment of a deficiency with respect to any tax imposed by subtitle A attributable to any item (other than a partnership item or any item affected by a partnership item) shall be made—

"(A) until the expiration of the applicable 90-day or 150-day period set forth in subsection (c) for filing a petition with the Tax Court, or

"(B) if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final.

"(f) FURTHER NOTICES OF ADJUSTMENT RESTRICTED.—If the Secretary mails a notice of adjustment to the taxpayer for a taxable year and the taxpayer files a petition with the Tax Court within the time prescribed in subsection (c), the Secretary may not mail another such notice to the taxpayer with respect to the same taxable year in the absence of a showing of fraud, malfeasance, or misrepresentation of a material fact.

"(g) COORDINATION WITH OTHER PROCEEDINGS UNDER THIS SUBCHAPTER.—

"(1) IN GENERAL.—The treatment of any item that has been determined pursuant to subsection (c) or (d) shall be taken into account in determining the amount of any computational adjustment that is made in connection with a partnership proceeding under this subchapter (other than under this section), or the amount of any deficiency attributable to affected items in a proceeding under section 6230(a)(2), for the taxable year involved. Notwithstanding any other law or rule of law pertaining to the period of limitations on the making of assessments, for purposes of the preceding sentence, any adjustment made in accordance with this section shall be taken into account regardless of whether any assessment has been made with respect to such adjustment.

"(2) SPECIAL RULE IN CASE OF COMPUTATIONAL ADJUSTMENT.—In the case of a computational adjustment that is made in connection with a partnership proceeding under this subchapter (other than under this section), the provisions of paragraph (1) shall apply only if the computational adjustment is made within the period prescribed by section 6229 for assessing any tax under subtitle A which is attributable to any partnership item or affected item for the taxable year involved.

"(3) CONVERSION TO DEFICIENCY PROCEEDING.—If—

"(A) after the notice referred to in subsection (a) is mailed to a taxpayer for a taxable year but before the expiration of the period for filing a petition with the Tax Court under subsection (c) (or, if a petition is filed with the Tax Court, before the Tax Court makes a declaration for that taxable year), the treatment of any partnership item for the taxable year is finally determined, or any such item ceases to be a partnership item pursuant to section 6231(b), and

"(B) as a result of that final determination or cessation, a deficiency can be determined with respect to the items that are the subject of the notice of adjustment,

the notice of adjustment shall be treated as a notice of deficiency under section 6212 and any petition filed in respect of the notice shall be treated as an action brought under section 6213.

"(4) FINALLY DETERMINED.—For purposes of this subsection, the treatment of partnership items shall be treated as finally determined if—

"(A) the Secretary enters into a settlement agreement (within the meaning of section 6224) with the taxpayer regarding such items,

"(B) a notice of final partnership administrative adjustment has been issued and—

"(i) no petition has been filed under section 6226 and the time for doing so has expired, or

"(ii) a petition has been filed under section 6226 and the decision of the court has become final, or

"(C) the period within which any tax attributable to such items may be assessed against the taxpayer has expired.

"(h) SPECIAL RULES IF SECRETARY INCORRECTLY DETERMINES APPLICABLE PROCEDURE.—

"(1) SPECIAL RULE IF SECRETARY ERRONEOUSLY MAILS NOTICE OF ADJUSTMENT.—If the Secretary erroneously determines that subchapter B does not apply to a taxable year of a taxpayer and consistent with that determination timely mails a notice of adjustment to the taxpayer pursuant to subsection (a) of this section, the notice of adjustment shall be treated as a notice of deficiency under section 6212 and any petition that is filed in respect of the notice shall be treated as an action brought under section 6213.

"(2) SPECIAL RULE IF SECRETARY ERRONEOUSLY MAILS NOTICE OF DEFICIENCY.—If the Secretary erroneously determines that subchapter B applies to a taxable year of a taxpayer and consistent with that determination timely mails a notice of deficiency to the taxpayer pursuant to section 6212, the notice of deficiency shall be treated as a notice of adjustment under subsection (a) and any petition that is filed in respect of the notice shall be treated as an action brought under subsection (c)."

(b) TREATMENT OF PARTNERSHIP ITEMS IN DEFICIENCY PROCEEDINGS.—Section 6211 (defining deficiency) is amended by adding at the end thereof the following new subsection:

"(c) COORDINATION WITH SUBCHAPTER C.—In determining the amount of any deficiency for purposes of this subchapter, adjustments to partnership items shall be made only as provided in subchapter C."

(c) CLERICAL AMENDMENT.—The table of sections for subchapter C of chapter 63 is amended by adding at the end thereof the following new item:

"Sec. 6234. Declaratory judgment relating to treatment of items other than partnership items with respect to an oversheltered return.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to partnership taxable years ending after the date of the enactment of this Act.

SEC. 4312. PARTNERSHIP RETURN TO BE DETERMINATIVE OF AUDIT PROCEDURES TO BE FOLLOWED.

(a) IN GENERAL.—Section 6231 (relating to definitions and special rules) is amended by adding at the end thereof the following new subsection:

"(g) PARTNERSHIP RETURN TO BE DETERMINATIVE OF WHETHER SUBCHAPTER APPLIES.—

"(1) DETERMINATION THAT SUBCHAPTER APPLIES.—If, on the basis of a partnership return for a taxable year, the Secretary reasonably determines that this subchapter applies to such partnership for such year but such determination is erroneous, then the provisions of this subchapter are hereby extended to such partnership (and its items) for such taxable year and to partners of such partnership.

"(2) DETERMINATION THAT SUBCHAPTER DOES NOT APPLY.—If, on the basis of a partnership return for a taxable year, the Secretary reasonably determines that this subchapter does not apply to such partnership for such year but such determination is erroneous, then the provisions of this subchapter shall not apply to such partnership (and its items) for such taxable year or to partners of such partnership."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to partnership taxable years ending after the date of the enactment of this Act.

SEC. 4313. PROVISIONS RELATING TO STATUTE OF LIMITATIONS.

(a) SUSPENSION OF STATUTE WHERE UNTIMELY PETITION FILED.—Paragraph (1) of section 6229(d) (relating to suspension where Secretary makes administrative adjustment) is amended by striking all that follows "section 6226" and inserting the following: "(and, if a petition is filed under section 6226 with respect to such administrative adjustment, until the decision of the court becomes final), and."

(b) SUSPENSION OF STATUTE DURING BANKRUPTCY PROCEEDING.—Section 6229 is amended by adding at the end thereof the following new subsection:

"(h) SUSPENSION DURING PENDENCY OF BANKRUPTCY PROCEEDING.—If a petition is filed naming a partner as a debtor in a bankruptcy proceeding under title 11 of the United States Code, the running of the period of limitations provided in this section with respect to such partner shall be suspended—

"(1) for the period during which the Secretary is prohibited by reason of such bankruptcy proceeding from making an assessment, and

"(2) for 60 days thereafter."

(c) TAX MATTERS PARTNER IN BANKRUPTCY.—Section 6229(b) is amended by redesignating paragraph (2) as paragraph (3) and by inserting after paragraph (1) the following new paragraph:

"(2) SPECIAL RULE WITH RESPECT TO DEBTORS IN TITLE 11 CASES.—Notwithstanding any other law or rule of law, if an agreement is entered into under paragraph (1)(B) and the agreement is signed by a person who would be the tax matters partner but for the fact that, at the time that the agreement is executed, the person is a debtor in a bankruptcy proceeding under title 11 of the United States Code, such agreement shall be

binding on all partners in the partnership unless the Secretary has been notified of the bankruptcy proceeding in accordance with regulations prescribed by the Secretary."

(d) EFFECTIVE DATES.—

(1) SUBSECTIONS (a) AND (b).—The amendments made by subsections (a) and (b) shall apply to partnership taxable years with respect to which the period under section 6229 of the Internal Revenue Code of 1986 for assessing tax has not expired on or before the date of the enactment of this Act.

(2) SUBSECTION (c).—The amendment made by subsection (c) shall apply to agreements entered into after the date of the enactment of this Act.

SEC. 4314. EXPANSION OF SMALL PARTNERSHIP EXCEPTION.

(a) IN GENERAL.—Clause (i) of section 6231(a)(1)(B) (relating to exception for small partnerships) is amended to read as follows:

"(i) IN GENERAL.—The term 'partnership' shall not include any partnership having 10 or fewer partners each of whom is an individual (other than a nonresident alien), a C corporation, or an estate of a deceased partner. For purposes of the preceding sentence, a husband and wife (and their estates) shall be treated as 1 partner."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to partnership taxable years ending after the date of the enactment of this Act.

SEC. 4315. EXCLUSION OF PARTIAL SETTLEMENTS FROM 1 YEAR LIMITATION ON ASSESSMENT.

(a) IN GENERAL.—Subsection (f) of section 6229 (relating to items becoming nonpartnership items) is amended—

(1) by striking "(f) ITEMS BECOMING NONPARTNERSHIP ITEMS.—If " and inserting the following:

"(f) SPECIAL RULES.—

"(1) ITEMS BECOMING NONPARTNERSHIP ITEMS.—If ",

(2) by moving the text of such subsection 2 ems to the right, and

(3) by adding at the end thereof the following new paragraph:

"(2) SPECIAL RULE FOR PARTIAL SETTLEMENT AGREEMENTS.—If a partner enters into a settlement agreement with the Secretary with respect to the treatment of some of the partnership items in dispute for a partnership taxable year but other partnership items for such year remain in dispute, the period of limitations for assessing any tax attributable to the settled items shall be determined as if such agreement had not been entered into."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to partnership taxable years ending after the date of the enactment of this Act.

SEC. 4316. EXTENSION OF TIME FOR FILING A REQUEST FOR ADMINISTRATIVE ADJUSTMENT.

(a) IN GENERAL.—Section 6227 (relating to administrative adjustment requests) is amended by redesignating subsections (b) and (c) as subsections (c) and (d), respectively, and by inserting after subsection (a) the following new subsection:

"(b) Special Rule in Case of Extension of Period of Limitations Under Section 6229.—The period prescribed by subsection (a)(1) for filing of a request for an administrative adjustment shall be extended—

"(1) for the period within which an assessment may be made pursuant to an agreement (or any extension thereof) under section 6229(b), and

"(2) for 6 months thereafter."

(b) Effective Date.—The amendment made by this section shall take effect as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

SEC. 4317. AVAILABILITY OF INNOCENT SPOUSE RELIEF IN CONTEXT OF PARTNERSHIP PROCEEDINGS.

(a) In General.—Subsection (a) of section 6230 is amended by adding at the end thereof the following new paragraph:

"(3) Special rule in case of assertion by partner's spouse of innocent spouse relief.—

"(A) Notwithstanding section 6404(b), if the spouse of a partner asserts that section 6013(e) applies with respect to a liability that is attributable to any adjustment to a partnership item, then such spouse may file with the Secretary within 60 days after the notice and demand (or notice of computational adjustment) is mailed to the spouse a request for abatement of the assessment specified in such notice. Upon receipt of such request, the Secretary shall abate the assessment. Any reassessment of the tax with respect to which an abatement is made under this subparagraph shall be subject to the deficiency procedures prescribed by subchapter B. The period for making any such reassessment shall not expire before the expiration of 60 days after the date of such abatement.

"(B) If the spouse files a petition with the Tax Court pursuant to section 6213 with respect to the request for abatement described in subparagraph (A), the Tax Court shall only have jurisdiction pursuant to this section to determine whether the requirements of section 6013(e) have been satisfied. For purposes of such determination, the treatment of partnership items under the settlement, the final partnership administrative adjustment, or the decision of the court (whichever is appropriate) that gave rise to the liability in question shall be conclusive.

"(C) Rules similar to the rules contained in subparagraphs (B) and (C) of paragraph (2) shall apply for purposes of this paragraph."

(b) Claims for Refund.—Subsection (c) of section 6230 is amended by adding at the end thereof the following new paragraph:

"(5) Rules for seeking innocent spouse relief.—

"(A) In general.—The spouse of a partner may file a claim for refund on the ground that the Secretary failed to relieve the spouse under section 6013(e) from a liability that is attributable to an adjustment to a partnership item.

"(B) Time for filing claim.—Any claim under subparagraph (A) shall be filed within 6 months after the day on

which the Secretary mails to the spouse the notice and demand (or notice of computational adjustment) referred to in subsection (a)(3)(A).

"(C) SUIT IF CLAIM NOT ALLOWED.—If the claim under subparagraph (B) is not allowed, the spouse may bring suit with respect to the claim within the period specified in paragraph (3).

"(D) PRIOR DETERMINATIONS ARE BINDING.—For purposes of any claim or suit under this paragraph, the treatment of partnership items under the settlement, the final partnership administrative adjustment, or the decision of the court (whichever is appropriate) that gave rise to the liability in question shall be conclusive."

(c) TECHNICAL AMENDMENTS.—

(1) Paragraph (1) of section 6230(a) is amended by striking "paragraph (2)" and inserting "paragraph (2) or (3)".

(2) Subsection (a) of section 6503 is amended by striking "section 6230(a)(2)(A)" and inserting "paragraph (2)(A) or (3) of section 6230(a)".

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

SEC. 4318. DETERMINATION OF PENALTIES AT PARTNERSHIP LEVEL.

(a) IN GENERAL.—Section 6221 (relating to tax treatment determined at partnership level) is amended by striking "item" and inserting "item (and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item)".

(b) CONFORMING AMENDMENTS.—

(1) Subsection (f) of section 6226 is amended—

(A) by striking "relates and" and inserting "relates,", and

(B) by inserting before the period ", and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item".

(2) Clause (i) of section 6230(a)(2)(A) is amended to read as follows:

"(i) affected items which require partner level determinations (other than penalties, additions to tax, and additional amounts that relate to adjustments to partnership items), or".

(3)(A) Subparagraph (A) of section 6230(a)(3), as added by section 3317, is amended by inserting "(including any liability for any penalty, addition to tax, or additional amount relating to such adjustment)" after "partnership item".

(B) Subparagraph (B) of such section is amended by inserting "(and the applicability of any penalties, additions to tax, or additional amounts)" after "partnership items".

(C) Subparagraph (A) of section 6230(c)(5), as added by section 3317, is amended by inserting before the period "(including any liability for any penalties, additions to tax, or additional amounts relating to such adjustment)".

(D) Subparagraph (D) of section 6230(c)(5), as added by section 3317, is amended by inserting "(and the applicability of any penalties, additions to tax, or additional amounts)" after "partnership items".

(4) Paragraph (1) of section 6230(c) is amended by striking "or" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", or", and by adding at the end thereof the following new subparagraph:

"(C) the Secretary erroneously imposed any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item."

(5) So much of subparagraph (A) of section 6230(c)(2) as precedes "shall be filed" is amended to read as follows:

"(A) Under paragraph (1) (A) or (C).—Any claim under subparagraph (A) or (C) of paragraph (1)".

(6) Paragraph (4) of section 6230(c) is amended by adding at the end thereof the following: "In addition, the determination under the final partnership administrative adjustment or under the decision of the court (whichever is appropriate) concerning the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item shall also be conclusive.

Notwithstanding the preceding sentence, the partner shall be allowed to assert any partner level defenses that may apply or to challenge the amount of the computational adjustment."

(c) Effective Date.—The amendments made by this section shall apply to partnership taxable years ending after the date of the enactment of this Act.

SEC. 4319. PROVISIONS RELATING TO COURT JURISDICTION, ETC.

(a) Tax Court Jurisdiction To Enjoin Premature Assessments of Deficiencies Attributable to Partnership Items.—Subsection (b) of section 6225 is amended by striking "the proper court." and inserting "the proper court, including the Tax Court. The Tax Court shall have no jurisdiction to enjoin any action or proceeding under this subsection unless a timely petition for a readjustment of the partnership items for the taxable year has been filed and then only in respect of the adjustments that are the subject of such petition."

(b) Jurisdiction To Consider Statute of Limitations With Respect to Partners.—Paragraph (1) of section 6226(d) is amended by adding at the end thereof the following new sentence:

"Notwithstanding subparagraph (B), any person treated under subsection (c) as a party to an action shall be permitted to participate in such action (or file a readjustment petition under subsection (b) or paragraph (2) of this subsection) solely for the purpose of asserting that the period of limitations for assessing any tax attributable to partnership items has expired with respect to such person, and the court having jurisdiction of such action shall have jurisdiction to consider such assertion."

(c) Tax Court Jurisdiction To Determine Overpayments Attributable to Affected Items.—

(1) Paragraph (6) of section 6230(d) is amended by striking "(or an affected item)".

(2) Paragraph (3) of section 6512(b) is amended by adding at the end thereof the following new sentence:

"In the case of a credit or refund relating to an affected item (within the meaning of section 6229), the preceding sentence shall be applied by substituting the periods under sections 6229 and 6230(d) for the periods under section 6511(b)(2), (c), and (d)."

(d) VENUE ON APPEAL.—

(1) Paragraph (1) of section 7482(b) is amended by striking "or" at the end of subparagraph (D), by striking the period at the end of subparagraph (E) and inserting ", or", and by inserting after subparagraph (E) the following new subparagraph:

"(F) in the case of a petition under section 6234(c)—

"(i) the legal residence of the petitioner if the petitioner is not a corporation, and

"(ii) the place or office applicable under subparagraph (B) if the petitioner is a corporation."

(2) The last sentence of section 7482(b) is amended by striking "or 6228(a)" and inserting ", 6228(a), or 6234(c)".

(e) OTHER PROVISIONS.—

(1) Subsection (c) of section 7459 is amended by striking "or section 6228(a)" and inserting ", 6228(a), or 6234(c)".

(2) Subsection (o) of section 6501 is amended by adding at the end thereof the following new paragraph:

"(3) For declaratory judgment relating to treatment of items other than partnership items with respect to an oversheltered return, see section 6234."

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to partnership taxable years ending after the date of the enactment of this Act.

SEC. 4320. TREATMENT OF PREMATURE PETITIONS FILED BY NOTICE PARTNERS OR 5-PERCENT GROUPS.

(a) IN GENERAL.—Subsection (b) of section 6226 (relating to judicial review of final partnership administrative adjustments) is amended by redesignating paragraph (5) as paragraph (6) and by inserting after paragraph (4) the following new paragraph:

"(5) TREATMENT OF PREMATURE PETITIONS.—If—

"(A) a petition for a readjustment of partnership items for the taxable year involved is filed by a notice partner (or a 5-percent group) during the 90-day period described in subsection (a), and

"(B) no action is brought under paragraph (1) during the 60-day period described therein with respect to such taxable year which is not dismissed,

such petition shall be treated for purposes of paragraph (1) as filed on the last day of such 60-day period."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to petitions filed after the date of the enactment of this Act.

SEC. 4321. BONDS IN CASE OF APPEALS FROM TEFRA PROCEEDING.

(a) IN GENERAL.—Subsection (b) of section 7485 (relating to bonds to stay assessment of collection) is amended—

(1) by inserting "penalties," after "any interest,", and

(2) by striking "aggregate of such deficiencies" and inserting "aggregate liability of the parties to the action".

(b) Effective Date.—The amendment made by this section shall take effect as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

SEC. 4322. SUSPENSION OF INTEREST WHERE DELAY IN COMPUTATIONAL ADJUSTMENT RESULTING FROM TEFRA SETTLEMENTS.

(a) In General.—Subsection (c) of section 6601 (relating to interest on underpayment, nonpayment, or extension of time for payment, of tax) is amended by adding at the end thereof the following new sentence: "In the case of a settlement under section 6224(c) which results in the conversion of partnership items to nonpartnership items pursuant to section 6231(b)(1)(C), the preceding sentence shall apply to a computational adjustment resulting from such settlement in the same manner as if such adjustment were a deficiency and such settlement were a waiver referred to in the preceding sentence."

(b) Effective Date.—The amendment made by this section shall apply to settlements entered into after the date of the enactment of this Act.

Subtitle D—Foreign Provisions

PART I—SIMPLIFICATION OF TREATMENT OF PASSIVE FOREIGN CORPORATIONS

SEC. 4401. REPEAL OF FOREIGN PERSONAL HOLDING COMPANY RULES AND FOREIGN INVESTMENT COMPANY RULES.

(a) General Rule.—The following provisions are hereby repealed:

(1) Part III of subchapter G of chapter 1 (relating to foreign personal holding companies).

(2) Section 1246 (relating to gain on foreign investment company stock).

(3) Section 1247 (relating to election by foreign investment companies to distribute income currently).

(b) Exemption of Foreign Corporations From Accumulated Earnings Tax and Personal Holding Company Rules.—

(1) Accumulated earnings tax.—Subsection (b) of section 532 (relating to exceptions) is amended—

(A) by striking paragraph (2) and inserting the following: "(2) a foreign corporation, or",

(B) by striking ", or" at the end of paragraph (3) and inserting a period, and

(C) by striking paragraph (4).

(2) Personal holding company rules.—Subsection (c) of section 542 (relating to exceptions) is amended—

(A) by striking paragraph (5) and inserting the following: "(5) a foreign corporation,",

(B) by striking paragraphs (7) and (10) and by redesignating paragraphs (8) and (9) as paragraphs (7) and (8), respectively,

(C) by inserting "and" at the end of paragraph (7) (as so redesignated), and

(D) by striking "; and" at the end of paragraph (8) (as so redesignated) and inserting a period.

(c) TREATMENT OF CERTAIN SERVICE CONTRACTS UNDER SUBPART F.—

(1) Paragraph (1) of section 954(c) (defining foreign personal holding company income) is amended by adding at the end thereof the following new subparagraph:

"(F) PERSONAL SERVICE CONTRACTS.—

"(i) Amounts received under a contract under which the corporation is to furnish personal services, if some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract.

"(ii) Amounts received from the sale or other disposition of such contract.

This subparagraph shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services. For purposes of the preceding sentence, the attribution rules of section 544 shall apply, determined as if any reference to section 543(a)(7) were a reference to this subparagraph."

(2) Clause (iii) of section 904(d)(2)(A) is amended by striking "and" at the end of subclause (III), by striking the period at the end of subclause (IV) and inserting ", and", and by adding at the end thereof the following new subclause:

"(V) any income described in section 954(c)(1)(F) (relating to personal service contracts)."

SEC. 4402. REPLACEMENT FOR PASSIVE FOREIGN INVESTMENT COMPANY RULES.

(a) GENERAL RULE.—Part VI of subchapter P of chapter 1 (relating to treatment of certain passive foreign investment companies) is amended to read as follows:

"PART VI—TREATMENT OF PASSIVE FOREIGN CORPORATIONS

"Subpart A. Current taxation rules.
"Subpart B. Interest on holdings to which subpart A does not apply.
"Subpart C. General provisions.

"Subpart A—Current Taxation Rules

"Sec. 1291. Stock in certain passive foreign corporations marked to market.
"Sec. 1292. Inclusion of income of certain passive foreign corporations.

"SEC. 1291. STOCK IN CERTAIN PASSIVE FOREIGN CORPORATIONS MARKED TO MARKET.

"(a) GENERAL RULE.—In the case of marketable stock in a passive foreign corporation which is owned (or treated under subsection (g) as owned) by a United States person at the close of any taxable year of such person—

"(1) If the fair market value of such stock as of the close of such taxable year exceeds its adjusted basis, such United States person shall include in gross income for such taxable year an amount equal to the amount of such excess.

"(2) If the adjusted basis of such stock exceeds the fair market value of such stock as of the close of such taxable year, such United States person shall be allowed a deduction for such taxable year equal to the lesser of—

"(A) the amount of such excess, or

"(B) the unreversed inclusions with respect to such stock.

"(b) BASIS ADJUSTMENTS.—

"(1) IN GENERAL.—The adjusted basis of stock in a passive foreign corporation—

"(A) shall be increased by the amount included in the gross income of the United States person under subsection (a)(1) with respect to such stock, and

"(B) shall be decreased by the amount allowed as a deduction to the United States person under subsection (a)(2) with respect to such stock.

"(2) SPECIAL RULE FOR STOCK CONSTRUCTIVELY OWNED.—In the case of stock in a passive foreign corporation which the United States person is treated as owning under subsection (g)—

"(A) the adjustments under paragraph (1) shall apply to such stock in the hands of the person actually holding such stock but only for purposes of determining the subsequent treatment under this chapter of the United States person with respect to such stock, and

"(B) similar adjustments shall be made to the adjusted basis of the property by reason of which the United States person is treated as owning such stock.

"(c) CHARACTER AND SOURCE RULES.—

"(1) ORDINARY TREATMENT.—

"(A) GAIN.—Any amount included in gross income under subsection (a)(1), and any gain on the sale or other disposition of marketable stock in a passive foreign corporation, shall be treated as ordinary income.

"(B) LOSS.—Any—

"(i) amount allowed as a deduction under subsection (a)(2), and

"(ii) loss on the sale or other disposition of marketable stock in a passive foreign corporation to the extent that the amount of such loss does not exceed the unreversed inclusions with respect to such stock,

shall be treated as an ordinary loss. The amount so treated shall be treated as a deduction allowable in computing adjusted gross income.

"(2) SOURCE.—The source of any amount included in gross income under subsection (a)(1) (or allowed as a deduction under

subsection (a)(2)) shall be determined in the same manner as if such amount were gain or loss (as the case may be) from the sale of stock in the passive foreign corporation.

"(d) UNREVERSED INCLUSIONS.—For purposes of this section, the term 'unreversed inclusions' means, with respect to any stock in a passive foreign corporation, the excess (if any) of—

"(1) the amount included in gross income of the taxpayer under subsection (a)(1) with respect to such stock for prior taxable years, over

"(2) the amount allowed as a deduction under subsection (a)(2) with respect to such stock for prior taxable years.

The amount referred to in paragraph (1) shall include any amount which would have been included in gross income under subsection (a)(1) with respect to such stock for any prior taxable year but for section 1293.

"(e) COORDINATION WITH SECTION 1292.—This section shall not apply with respect to any stock in a passive foreign corporation—

"(1) which is U.S. controlled,

"(2) which is a qualified electing fund with respect to the United States person for the taxable year, or

"(3) in which the United States person is a 25-percent shareholder.

"(f) TREATMENT OF CONTROLLED FOREIGN CORPORATIONS WHICH ARE SHAREHOLDERS IN PASSIVE FOREIGN CORPORATIONS.—In the case of a foreign corporation which is a controlled foreign corporation (or is treated as a controlled foreign corporation under section 1292) and which owns (or is treated under subsection (g) as owning) stock in a passive foreign corporation—

"(1) this section (other than subsection (c)(2) thereof) shall apply to such foreign corporation in the same manner as if such corporation were a United States person, and

"(2) for purposes of subpart F of part III of subchapter N—

"(A) any amount included in gross income under subsection (a)(1) shall be treated as foreign personal holding company income described in section 954(c)(1)(A), and

"(B) any amount allowed as a deduction under subsection (a)(2) shall be treated as a deduction allocable to foreign personal holding company income so described.

"(g) STOCK OWNED THROUGH CERTAIN FOREIGN ENTITIES.—Except as provided in regulations—

"(1) IN GENERAL.—For purposes of this section, stock owned, directly or indirectly, by or for a foreign partnership or foreign trust or foreign estate shall be considered as being owned proportionately by its partners or beneficiaries. Stock considered to be owned by a person by reason of the application of the preceding sentence shall, for purposes of applying such sentence, be treated as actually owned by such person.

"(2) TREATMENT OF CERTAIN DISPOSITIONS.—In any case in which a United States person is treated as owning stock in a passive foreign corporation by reason of paragraph (1)—

"(A) any disposition by the United States person or by any other person which results in the United States person being treated as no longer owning such stock, and

"(B) any disposition by the person owning such stock,

shall be treated as a disposition by the United States person of the stock in the passive foreign corporation.

"(h) COORDINATION WITH SECTION 851(b).—For purposes of paragraphs (2) and (3) of section 851(b), any amount included in gross income under subsection (a) shall be treated as a dividend.

"(i) TRANSITION RULES.—

"(1) INDIVIDUALS BECOMING SUBJECT TO U.S. TAX.—If any individual becomes a United States person in a taxable year beginning after December 31, 1992, solely for purposes of this section, the adjusted basis (before adjustments under subsection (b)) of any marketable stock in a passive foreign corporation owned (or treated as owned under subsection (g)) by such individual on the first day of such taxable year shall be treated as being the greater of its fair market value on such first day or its adjusted basis on such first day.

"(2) MARKETABLE STOCK HELD BEFORE EFFECTIVE DATE.—

"(A) IN GENERAL.—If any marketable stock in a passive foreign corporation is owned (or treated under subsection (g) as owned) by a United States person on the first day of such person's first taxable year, beginning after December 31, 1992—

"(i) paragraph (2) of section 1294(a) shall apply to such stock as if it became marketable during such first taxable year; except that—

"(I) section 1293 shall not apply to the amount included in gross income under subsection (a) to the extent such amount is attributable to increases in fair market value during such first taxable year, and

"(II) the taxpayer's holding period shall be treated as having ended on the last day of the preceding taxable year for purposes of allocating amounts under section 1293(a)(1)(A), and

"(ii) such person may elect to extend the time for the payment of the applicable section 1293 deferred tax as provided in subparagraph (B).

"(B) ELECTION TO EXTEND TIME FOR PAYMENT.—

"(i) IN GENERAL.—At the election of the taxpayer, the time for the payment of the applicable section 1293 deferred tax shall be extended to the extent and subject to the limitations provided in this subparagraph.

"(ii) TERMINATION OF EXTENSION.—

"(I) DISTRIBUTIONS.—If any distribution is received with respect to any stock to which an extension under clause (i) relates and such distribution would be an excess distribution within the meaning of section 1293 if such section applied to such stock, then the extension under clause (i) for the appropriate portion (as determined under regulations) of the applicable section 1293 deferred tax shall expire on the last day prescribed by law (determined without regard to extensions) for filing the return of tax for the taxable year in which the distribution is received.

"(II) REVERSAL OF INCLUSION.—If an amount is allowable as a deduction under subsection (a)(2) with respect to any stock to which an extension under clause (i) relates and the amount so allowable is allocable to the amount which gave rise to the applicable section 1293 deferred tax, then the extension under clause (i) for the appropriate portion (as determined under regulations) of the applicable section 1293 deferred tax shall expire on the last day prescribed by law (determined without regard to extensions) for filing the return of the tax for the taxable year for which such deduction is allowed.

"(III) DISPOSITIONS, ETC.—If stock in a passive foreign corporation is disposed of during the taxable year, all extensions under clause (i) for payment of the applicable section 1293 deferred tax attributable to such stock which have not expired before the date of such disposition shall expire on the last date prescribed by law (determined without regard to extensions) for filing the return of tax for the taxable year in which such disposition occurs. To the extent provided in regulations, the preceding sentence shall not apply in the case of a disposition in a transaction with respect to which gain or loss is not recognized (in whole or in part), and the person acquiring such stock in such transaction shall succeed to the treatment under this section of the person making such disposition.

"(iii) OTHER RULES.—

"(I) ELECTION.—The election under clause (i) shall be made not later than the time prescribed by law (including extensions) for filing the return of tax imposed by this chapter for the first taxable year referred to in subparagraph (A).

"(II) TREATMENT OF LOANS TO SHAREHOLDER.—For purposes of this subparagraph, any loan by a passive foreign corporation (directly or indirectly) to a shareholder of such corporation shall be treated as a distribution to such shareholder.

"(C) CROSS REFERENCE.—

"For provisions providing for interest for the period of the extension under this paragraph, see section 6601.

"(D) APPLICABLE SECTION 1293 DEFERRED TAX.—For purposes of this paragraph, the term 'applicable section 1293 deferred tax' means the deferred tax amount determined under section 1293 with respect to the amount which, but for section 1293, would have been included in gross income for the first taxable year referred to in subparagraph (A). Such term also includes the tax imposed by this chapter for such first taxable year to the extent attributable to the amounts allocated under section 1293(a)(1)(A) to a period described in section 1293(a)(1)(B)(ii).

"(3) SPECIAL RULES FOR REGULATED INVESTMENT COMPANIES.—

"(A) IN GENERAL.—If any marketable stock in a passive foreign corporation is owned (or treated under subsection (g) as owned) by a regulated investment company on the first day of such company's first taxable year beginning after December 31, 1992—

"(i) section 1293 shall not apply to such stock with respect to any distribution or disposition during, or amount included in gross income under this section for, such first taxable year, but

"(ii) such company's tax under this chapter for such first taxable year shall be increased by the aggregate amount of interest which would have been determined under section 1293(c)(3) if section 1293 were applied without regard to this subparagraph.

"(B) DISALLOWANCE OF DEDUCTION.—No deduction shall be allowed to any regulated investment company for the increase in tax under subparagraph (A)(ii).

"SEC. 1292. CURRENT INCLUSION OF INCOME OF CERTAIN PASSIVE FOREIGN CORPORATIONS.

"(a) PASSIVE FOREIGN CORPORATIONS WHICH ARE U.S. CONTROLLED.—

"(1) TREATMENT UNDER SUBPART F.—

"(A) IN GENERAL.—If a passive foreign corporation is United States controlled, then for purposes of subpart F of part III of subchapter N—

"(i) such corporation, if not otherwise a controlled foreign corporation, shall be treated as a controlled foreign corporation,

"(ii) the term 'United States shareholder' means, with respect to such corporation, any United States person who owns (within the meaning of section 958(a)) any stock in such corporation,

"(iii) the entire gross income of such corporation shall, after being reduced under the principles of paragraph (5) of section 954(b), be treated as foreign base company income, and

"(iv) sections 970 and 971 shall not apply.

Except as provided in regulations, the preceding sentence shall also apply for purposes of section 904(d).

"(B) SPECIAL RULES.—If any taxpayer is treated as being a United States shareholder in a controlled foreign corporation solely by reason of this section—

"(i) section 954(b)(4) (relating to exception for certain income subject to high foreign taxes) shall not apply for purposes of determining the amount included in the gross income of such taxpayer under section 951 by reason of being so treated with respect to such corporation, and

"(ii) the amount so included in the gross income of such taxpayer under section 951 with respect to such corporation shall be treated as long-term capital gain

to the extent attributable to the net capital gain of such corporation.

"(2) U.S. CONTROLLED.—For purposes of this subpart, a passive foreign corporation is United States controlled if—

"(A) such corporation is a controlled foreign corporation determined without regard to this subsection, or

"(B) at any time during the taxable year more than 50 percent of—

"(i) the total combined voting power of all classes of stock of such corporation entitled to vote, or

"(ii) the total value of the stock of such corporation,

is owned directly or indirectly by 5 or fewer United States persons.

"(3) CONSTRUCTIVE OWNERSHIP RULES FOR PURPOSES OF PARAGRAPH (2)(B).—For purposes of paragraph (2)(B), the attribution rules provided in section 544 shall apply, determined as if any reference to a personal holding company were a reference to a corporation described in paragraph (2)(B) (and any reference to the stock ownership requirement provided in section 542(a)(2) were a reference to the requirement of paragraph (2)(B)); except that—

"(A) subsection (a)(4) of such section shall be applied by substituting 'Paragraphs (1), (2), and (3)' for 'Paragraphs (2) and (3)',

"(B) stock owned by a nonresident alien individual shall not be considered by reason of attribution through family membership as owned by a citizen or resident alien individual who is not the spouse of the nonresident alien individual and who does not otherwise own stock in the foreign corporation (determined after the application of such attribution rules other than attribution through family membership), and

"(C) stock of a corporation owned by any foreign person shall not be considered by reason of attribution through partners as owned by a citizen or resident of the United States who does not otherwise own stock in the foreign corporation (determined after the application of such attribution rules and subparagraph (A), other than attribution through partners).

"(b) TAXPAYERS ELECTING CURRENT INCLUSION AND 25-PERCENT SHAREHOLDERS.—

"(1) IN GENERAL.—If a passive foreign corporation which is not United States controlled is a qualified electing fund with respect to any taxpayer or the taxpayer is a 25-percent shareholder in such corporation, then for purposes of subpart F of part III of subchapter N—

"(A) such passive foreign corporation shall be treated as a controlled foreign corporation with respect to such taxpayer,

"(B) such taxpayer shall be treated as a United States shareholder in such corporation, and

"(C) the modifications of clauses (iii) and (iv) of subsection (a)(1)(A) and of subparagraph (B) of subsection (a)(1)

shall apply in determining the amount included under such subpart F in the gross income of such taxpayer (and the character of the amount so included).

For purposes of section 904(d), any amount included in the gross income of the taxpayer under the preceding sentence shall be treated as a dividend from a foreign corporation which is not a controlled foreign corporation.

"(2) QUALIFIED ELECTING FUND.—For purposes of this subpart, the term 'qualified electing fund' means any passive foreign corporation if—

"(A) an election by the taxpayer under paragraph (3) applies to such corporation for the taxable year of the taxpayer, and

"(B) such corporation complies with such requirements as the Secretary may prescribe for purposes of carrying out the purposes of this subpart.

"(3) ELECTION.—

"(A) IN GENERAL.—A taxpayer may make an election under this paragraph with respect to any passive foreign corporation for any taxable year of the taxpayer. Such an election, once made with respect to any corporation, shall apply to all subsequent taxable years of the taxpayer with respect to such corporation unless revoked by the taxpayer with the consent of the Secretary.

"(B) WHEN MADE.—An election under this subsection may be made for any taxable year of the taxpayer at any time on or before the due date (determined with regard to extensions) for filing the return of the tax imposed by this chapter for such taxable year. To the extent provided in regulations, such an election may be made later than as required in the preceding sentence where the taxpayer fails to make a timely election because the taxpayer reasonably believes that the corporation was not a passive foreign corporation.

"(4) 25-PERCENT SHAREHOLDER.—For purposes of this subpart, the term '25-percent shareholder' means, with respect to any passive foreign corporation, any United States person who owns (within the meaning of section 958(a)), or is considered as owning by applying the rules of section 958(b), 25 percent or more (by vote or value) of the stock of such corporation.

"SUBPART B—INTEREST ON HOLDINGS TO WHICH SUBPART A DOES NOT APPLY

"Sec. 1293. Interest on tax deferral.
"Sec. 1294. Definitions and special rules.

"SEC. 1293. INTEREST ON TAX DEFERRAL.

"(a) TREATMENT OF DISTRIBUTIONS AND STOCK DISPOSITIONS.—

"(1) DISTRIBUTIONS.—If a United States person receives an excess distribution in respect of stock to which this section applies, then—

"(A) the amount of the excess distribution shall be allocated ratably to each day in the taxpayer's holding period for the stock,

"(B) with respect to such excess distribution, the taxpayer's gross income for the current year shall include (as ordinary income) only the amounts allocated under subparagraph (A) to—

"(i) the current year, or

"(ii) any period in the taxpayer's holding period before the first day of the first taxable year of the corporation which begins after December 31, 1986, and for which it was a passive foreign corporation, and

"(C) the tax imposed by this chapter for the current year shall be increased by the deferred tax amount (determined under subsection (c)).

"(2) DISPOSITIONS.—If the taxpayer disposes of stock to which this section applies, then the rules of paragraph (1) shall apply to any gain recognized on such disposition in the same manner as if such gain were an excess distribution.

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

"(A) HOLDING PERIOD.—The taxpayer's holding period shall be determined under section 1223; except that—

"(i) for purposes of applying this section to an excess distribution, such holding period shall be treated as ending on the date of such distribution, and

"(ii) if section 1291 applied to such stock with respect to the taxpayer for any prior taxable year, such holding period shall be treated as beginning on the first day of the first taxable year beginning after the last taxable year for which section 1291 so applied.

"(B) CURRENT YEAR.—The term 'current year' means the taxable year in which the excess distribution or disposition occurs.

"(b) EXCESS DISTRIBUTION.—

"(1) IN GENERAL.—For purposes of this section, the term 'excess distribution' means any distribution in respect of stock received during any taxable year to the extent such distribution does not exceed its ratable portion of the total excess distribution (if any) for such taxable year.

"(2) TOTAL EXCESS DISTRIBUTION.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'total excess distribution' means the excess (if any) of—

"(i) the amount of the distributions in respect of the stock received by the taxpayer during the taxable year, over

"(ii) 125 percent of the average amount received in respect of such stock by the taxpayer during the 3 preceding taxable years (or, if shorter, the portion of the taxpayer's holding period before the taxable year).

For purposes of clause (ii), any excess distribution received during such 3-year period shall be taken into account only to the extent it was included in gross income under subsection (a)(1)(B).

"(B) NO EXCESS FOR FIRST YEAR.—The total excess distributions with respect to any stock shall be zero for the tax-

able year in which the taxpayer's holding period in such stock begins.

"(3) ADJUSTMENTS.—Under regulations prescribed by the Secretary—

"(A) determinations under this subsection shall be made on a share-by-share basis, except that shares with the same holding period may be aggregated,

"(B) proper adjustments shall be made for stock splits and stock dividends,

"(C) if the taxpayer does not hold the stock during the entire taxable year, distributions received during such year shall be annualized,

"(D) if the taxpayer's holding period includes periods during which the stock was held by another person, distributions received by such other person shall be taken into account as if received by the taxpayer,

"(E) if the distributions are received in a foreign currency, determinations under this subsection shall be made in such currency and the amount of any excess distribution determined in such currency shall be translated into dollars,

"(F) proper adjustment shall be made for amounts not includible in gross income by reason of section 959(a) or for which a deduction is allowable under section 245(c), and

"(G) if a charitable deduction was allowable under section 642(c) to a trust for any distribution of its income, proper adjustments shall be made for the deduction so allowable to the extent allocable to distributions or gain in respect of stock in a passive foreign corporation.

For purposes of subparagraph (F), any amount not includible in gross income by reason of section 551(d) (as in effect on January 1, 1992) or 1293(c) (as so in effect) shall be treated as an amount not includible in gross income by reason of section 959(a).

"(c) DEFERRED TAX AMOUNT.—For purposes of this section—

"(1) IN GENERAL.—The term 'deferred tax amount' means, with respect to any distribution or disposition to which subsection (a) applies, an amount equal to the sum of—

"(A) the aggregate increases in taxes described in paragraph (2), plus

"(B) the aggregate amount of interest (determined in the manner provided under paragraph (3)) on such increases in tax.

Any increase in the tax imposed by this chapter for the current year under subsection (a) to the extent attributable to the amount referred to in subparagraph (B) shall be treated as interest paid under section 6601 on the due date for the current year.

"(2) AGGREGATE INCREASES IN TAXES.—For purposes of paragraph (1)(A), the aggregate increases in taxes shall be determined by multiplying each amount allocated under subsection (a)(1)(A) to any taxable year (other than the current year) by the highest rate of tax in effect for such taxable year under section 1 or 11, whichever applies.

"(3) COMPUTATION OF INTEREST.—

"(A) In general.—The amount of interest referred to in paragraph (1)(B) on any increase determined under paragraph (2) for any taxable year shall be determined for the period—

"(i) beginning on the due date for such taxable year, and

"(ii) ending on the due date for the taxable year with or within which the distribution or disposition occurs,

by using the rates and method applicable under section 6621 for underpayments of tax for such period.

"(B) Due date.—For purposes of this subsection, the term 'due date' means the date prescribed by law (determined without regard to extensions) for filing the return of the tax imposed by this chapter for the taxable year.

"(C) Special rule.—For purposes of determining the amount of interest referred to in paragraph (1)(B), the amount of any increase in tax determined under paragraph (2) shall be determined without regard to any reduction under section 1294(d) for a tax described in paragraph (2)(A)(ii) thereof.

"SEC. 1294. DEFINITIONS AND SPECIAL RULES.

"(a) Stock to Which Section 1293 Applies.—

"(1) In general.—Except as otherwise provided in this paragraph, section 1293 shall apply to any stock in a passive foreign corporation unless—

"(A) such stock is marketable stock as of the time of the distribution or disposition involved, or

"(B)(i) with respect to each of such corporation's taxable years which begin after December 31, 1992, and include any portion of the taxpayer's holding period in such stock—

"(I) such corporation was U.S. controlled (within the meaning of section 1292(a)(2)), or

"(II) such corporation was treated as a controlled foreign corporation under section 1292(b) with respect to the taxpayer, and

"(ii) with respect to each of such corporation's taxable years which begin after December 31, 1986, and before January 1, 1993, and include any portion of the taxpayer's holding period in such stock, such corporation was treated as a qualified electing fund under this part (as in effect on January 1, 1992) with respect to the taxpayer.

"(2) Treatment where stock becomes marketable.—If any stock in a passive foreign corporation becomes marketable stock after the beginning of the taxpayer's holding period in such stock, section 1293 shall apply to—

"(A) any distributions with respect to, or disposition of, such stock in the taxable year of the taxpayer in which it becomes so marketable, and

"(B) any amount which, but for section 1293, would have been included in gross income under section 1291(a) with respect to such stock for such taxable year in the same manner as if such amount were gain on the disposition of such stock.

"(3) ELECTION TO RECOGNIZE GAIN WHERE COMPANY BECOMES SUBJECT TO CURRENT INCLUSIONS.—

"(A) IN GENERAL.—If—

"(i) a passive foreign corporation first meets the requirements of clause (i) of paragraph (1)(B) with respect to the taxpayer for a taxable year of such taxpayer which begins after December 31, 1992,

"(ii) the taxpayer holds stock in such company on the first day of such taxable year, and

"(iii) the taxpayer establishes to the satisfaction of the Secretary the fair market value of such stock on such first day,

the taxpayer may elect to recognize gain as if he sold such stock on such first day for such fair market value.

"(B) ADDITIONAL ELECTION FOR SHAREHOLDER OF CONTROLLED FOREIGN CORPORATIONS.—

"(i) IN GENERAL.—If—

"(I) a passive foreign corporation first meets the requirements of subclause (I) of paragraph (1)(B)(i) with respect to the taxpayer for a taxable year of such taxpayer which begins after December 31, 1992,

"(II) the taxpayer holds stock in such corporation on the first day of such taxable year, and

"(III) such corporation is a controlled foreign corporation without regard to this part,

the taxpayer may elect to be treated as receiving a dividend on such first day in an amount equal to the portion of the post-1986 earnings and profits of such corporation attributable (under regulations prescribed by the Secretary) to the stock in such corporation held by the taxpayer on such first day. The amount treated as a dividend under the preceding sentence shall be treated as an excess distribution and shall be allocated under section 1293(a)(1)(A) only two days during periods taken into account in determining the post-1986 earnings and profits so attributable.

"(ii) POST-1986 EARNINGS AND PROFITS.—For purposes of clause (i), the term 'post-1986 earnings and profits' means earnings and profits which were accumulated in taxable years of the corporation beginning after December 31, 1986, and during the period or periods the stock was held by the taxpayer while the corporation was a passive foreign corporation.

"(iii) COORDINATION WITH SECTION 1959(e).—For purposes of section 959(e), any amount treated as a dividend under this subparagraph shall be treated as included in gross income under section 1248(a).

"(C) ADJUSTMENTS.—In the case of any stock to which subparagraph (A) or (B) applies—

"(i) the adjusted basis of such stock shall be increased by the gain recognized under subparagraph (A) or the amount treated as a dividend under subparagraph (B), as the case may be, and

"(ii) the taxpayer's holding period in such stock shall be treated as beginning on the first day referred to in such subparagraph.

"(b) RULES RELATING TO STOCK ACQUIRED FROM A DECEDENT.—

"(1) BASIS.—In the case of stock of a passive foreign corporation acquired by bequest, devise, or inheritance (or by the decedent's estate), notwithstanding section 1014, the basis of such stock in the hands of the person so acquiring it shall be the adjusted basis of such stock in the hands of the decedent immediately before his death (or, if lesser, the basis which would have been determined under section 1014 without regard to this paragraph).

"(2) DEDUCTION FOR ESTATE TAX.—If stock in a passive foreign corporation is acquired from a decedent, the taxpayer shall, under regulations prescribed by the Secretary, be allowed (for the taxable year of the sale or exchange) a deduction from gross income equal to that portion of the decedent's estate tax deemed paid which is attributable to the excess of (A) the value at which such stock was taken into account for purposes of determining the value of the decedent's gross estate, over (B) the basis determined under paragraph (1).

"(3) EXCEPTIONS.—This subsection shall not apply to any stock in a passive foreign corporation if—

"(A) section 1293 would not have applied to a disposition of such stock by the decedent immediately before his death, or

"(B) the decedent was a nonresident alien at all times during his holding period in such stock.

"(c) RECOGNITION OF GAIN.—Except as otherwise provided in regulations, in the case of any transfer of stock in a passive foreign company to which section 1293 applies, where (but for this subsection) there is not full recognition of gain, the excess (if any) of—

"(1) the fair market value of such stock, over

"(2) its adjusted basis,

shall be treated as gain from the sale or exchange of such stock and shall be recognized notwithstanding any provision of law. Proper adjustment shall be made to the basis of property for gain recognized under the preceding sentence.

"(d) COORDINATION WITH FOREIGN TAX CREDIT RULES.—

"(1) IN GENERAL.—If there are creditable foreign taxes with respect to any distribution in respect of stock in a passive foreign corporation—

"(A) the amount of such distribution shall be determined for purposes of section 1293 with regard to section 78,

"(B) the excess distribution taxes shall be allocated ratably to each day in the taxpayer's holding period for the stock, and

"(C) to the extent—

"(i) that such excess distribution taxes are allocated to a taxable year referred to in section 1293(a)(1)(B), such taxes shall be taken into account under section 901 for the current year, and

"(ii) that such excess distribution taxes are allocated to any other taxable year, such taxes shall reduce (sub-

ject to the principles of section 904 and not below zero) the increase in tax determined under section 1293(c)(2) for such taxable year by reason of such distribution (but such taxes shall not be taken into account under section 901).

"(2) DEFINITIONS.—For purposes of this subsection—

"(A) CREDITABLE FOREIGN TAXES.—The term 'creditable foreign taxes' means, with respect to any distribution—

"(i) any foreign taxes deemed paid under section 902 with respect to such distribution, and

"(ii) any withholding tax imposed with respect to such distribution,

but only if the taxpayer chooses the benefits of section 901 and such taxes are creditable under section 901 (determined without regard to paragraph (1)(C)(ii)).

"(B) EXCESS DISTRIBUTION TAXES.—The term 'excess distribution taxes' means, with respect to any distribution, the portion of the creditable foreign taxes with respect to such distribution which is attributable (on a pro rata basis) to the portion of such distribution which is an excess distribution.

"(C) SECTION 1248 GAIN.—The rules of this subsection also shall apply in the case of any gain which but for this section would be includible in gross income as a dividend under section 1248.

"(e) ATTRIBUTION OF OWNERSHIP.—For purposes of this subpart—

"(1) ATTRIBUTION TO UNITED STATES PERSONS.—This subsection—

"(A) shall apply to the extent that the effect is to treat stock of a passive foreign corporation as owned by a United States person, and

"(B) except as provided in paragraph (3) or in regulations, shall not apply to treat stock owned (or treated as owned under this subsection) by a United States person as owned by any other person.

"(2) CORPORATIONS.—

"(A) IN GENERAL.—If 50 percent or more in value of the stock of a corporation (other than an S corporation) is owned, directly or indirectly, by or for any person, such person shall be considered as owning the stock owned directly or indirectly by or for such corporation in that proportion which the value of the stock which such person so owns bears to the value of all stock in the corporation.

"(B) 50-PERCENT LIMITATION NOT TO APPLY IN CERTAIN CASES.—For purposes of determining whether a shareholder of a passive foreign corporation (or whether a United States shareholder of a controlled foreign corporation which is not a passive foreign corporation) is treated as owning stock owned directly or indirectly by or for such corporation, subparagraph (A) shall be applied without regard to the 50-percent limitation contained therein.

"(C) FAMILY AND PARTNER ATTRIBUTION FOR 50-PERCENT LIMITATION.—For purposes of determining whether the 50-percent limitation of subparagraph (A) is met, the construc-

tive ownership rules of section 544(a)(2) shall apply in addition to the other rules of this subsection.

"(3) PARTNERSHIPS, ETC.—Except as provided in regulations, stock owned, directly or indirectly, by or for a partnership, S corporation, estate, or trust shall be considered as being owned proportionately by its partners, shareholders, or beneficiaries (as the case may be).

"(4) OPTIONS.—To the extent provided in regulations, if any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

"(5) SUCCESSIVE APPLICATION.—Stock considered to be owned by a person by reason of the application of paragraph (2), (3), or (4) shall, for purposes of applying such paragraphs, be considered as actually owned by such person.

"(f) OTHER SPECIAL RULES.—For purposes of this subpart—

"(1) TIME FOR DETERMINATION.—Stock held by a taxpayer shall be treated as stock in a passive foreign corporation if, at any time during the holding period of the taxpayer with respect to such stock, such corporation (or any predecessor) was a passive foreign corporation. The preceding sentence shall not apply if the taxpayer elects to recognize gain (as of the last day of the last taxable year for which the company was a passive foreign corporation) under rules similar to the rules of subsection (a)(3)(A).

"(2) APPLICATION OF SUBPART WHERE STOCK HELD BY OTHER ENTITY.—Under regulations—

"(A) IN GENERAL.—In any case in which a United States person is treated as owning stock in a passive foreign corporation by reason of subsection (e)—

"(i) any transaction which results in the United States person being treated as no longer owning such stock,

"(ii) any disposition of such stock by the person owning such stock, and

"(iii) any distribution of property in respect of such stock to the person holding such stock,

shall be treated as a disposition by, or distribution to, the United States person with respect to the stock in the passive foreign corporation.

"(B) AMOUNT TREATED IN SAME MANNER AS PREVIOUSLY TAXED INCOME.—Rules similar to the rules of section 959(b) shall apply to any amount described in subparagraph (A) in respect of stock which the taxpayer is treated as owning under subsection (e).

"(C) COORDINATION WITH SECTION 951.—If, but for this subparagraph, an amount would be taken into account under section 1293 by reason of subparagraph (A) and such amount would also be included in the gross income of the taxpayer under section 951, such amount shall only be taken into account under section 1293.

"(3) DISPOSITIONS.—Except as provided in regulations, if a taxpayer uses any stock in a passive foreign corporation as security for a loan, the taxpayer shall be treated as having disposed of such stock.

"SUBPART C—GENERAL PROVISIONS

"Sec. 1296. Passive foreign corporation.
"Sec. 1297. Special rules.

"SEC. 1296. PASSIVE FOREIGN CORPORATION.

"(a) IN GENERAL.—For purposes of this part, except as otherwise provided in this subpart, the term 'passive foreign corporation' means any foreign corporation if—

"(1) 60 percent or more of the gross income of such corporation for the taxable year is passive income,

"(2) the average percentage of assets (by value) held by such corporation during the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent, or

"(3) such corporation is registered under the Investment Company Act of 1940, as amended (15 U.S.C. 80a-1 to 80b-2), either as a management company or as a unit investment trust.

A foreign corporation may elect to have the determination under paragraph (2) based on the adjusted bases of its assets in lieu of their value. Such an election, once made, may be revoked only with the consent of the Secretary.

"(b) PASSIVE INCOME.—For purposes of this section—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, the term 'passive income' means any income which is of a kind which would be foreign personal holding company income as defined in section 954(c) without regard to paragraph (3) thereof.

"(2) EXCEPTIONS.—Except as provided in regulations, the term 'passive income' does not include any income—

"(A) derived in the active conduct of a banking business by an institution licensed to do business as a bank in the United States (or, to the extent provided in regulations, by any other corporation),

"(B) derived in the active conduct of an insurance business by a corporation which is predominantly engaged in an insurance business and which would be subject to tax under subchapter L if it were a domestic corporation,

"(C) which is interest, a dividend, or a rent or royalty, which is received or accrued from a related person (within the meaning of section 954(d)(3)) to the extent such amount is properly allocable (under regulations prescribed by the Secretary) to income of such related person which is not passive income, or

"(D) any foreign trade income of a FSC.

For purposes of subparagraph (C), the term 'related person' has the meaning given such term by section 954(d)(3) determined by substituting 'foreign corporation' for 'controlled foreign corporation' each place it appears in section 954(d)(3).

"(3) TREATMENT OF INCOME FROM CERTAIN ASSETS.—To the extent that any asset is properly treated as not held for the production of passive income for purposes of subsection (a)(2), all income from such asset shall be treated as income which is not passive income.

"(c) LOOK-THROUGH IN CASE OF 25-PERCENT OWNED CORPORATION.—If a foreign corporation owns (directly or indirectly) at least 25 percent (by value) of the stock of another corporation, for purposes of determining whether such foreign corporation is a passive foreign corporation, such foreign corporation shall be treated as if it—

"(1) held its proportionate share of the assets of such other corporation, and

"(2) received directly its proportionate share of the income of such other corporation.

"SEC. 1297. SPECIAL RULES.

"(a) UNITED STATES PERSON.—For purposes of this part, the term 'United States person' has the meaning given to such term by section 7701(a)(30).

"(b) CONTROLLED FOREIGN CORPORATION.—For purposes of this part, the term 'controlled foreign corporation' has the meaning given such term by section 957(a).

"(c) MARKETABLE STOCK.—For purposes of this part—

"(1) IN GENERAL.—The term 'marketable stock' means—

"(A) any stock which is regularly traded on—

"(i) a national securities exchange which is registered with the Securities and Exchange Commission or the national market system established pursuant to section 11A of the Securities and Exchange Act of 1934, or

"(ii) any exchange or other market which the Secretary determines has rules adequate to carry out the purposes of this part, and

"(B) to the extent provided in regulations, stock in any foreign corporation which is comparable to a regulated investment company and which offers for sale or has outstanding any stock of which it is the issuer and which is redeemable at its net asset value.

"(2) SPECIAL RULE FOR REGULATED INVESTMENT COMPANIES.—In the case of any regulated investment company which is offering for sale or has outstanding any stock of which it is the issuer and which is redeemable at its net asset value, all stock in a passive foreign corporation which it owns (or is treated under section 1291(g) as owning) shall be treated as marketable stock for purposes of this part. Except as provided in regulations, a similar rule shall apply in the case of any other regulated investment company.

"(d) OTHER SPECIAL RULES.—For purposes of this part—

"(1) CERTAIN CORPORATIONS NOT TREATED AS PASSIVE.—A corporation shall not be treated as a passive foreign corporation for the 1st taxable year such corporation has gross income (hereinafter in this paragraph referred to as the 'start-up year') if—

"(A) no predecessor of such corporation was a passive foreign corporation,

"(B) it is established to the satisfaction of the Secretary that such corporation will not be a passive foreign corporation for either of the 1st 2 taxable years following the start-up year, and

"(C) such corporation is not a passive foreign corporation for either of the 1st 2 taxable years following the start-up year.

"(2) CERTAIN CORPORATIONS CHANGING BUSINESSES.—A corporation shall not be treated as a passive foreign corporation for any taxable year if—

"(A) neither such corporation (nor any predecessor) was a passive foreign corporation for any prior taxable year,

"(B) it is established to the satisfaction of the Secretary that—

"(i) substantially all of the passive income of the corporation for the taxable year is attributable to proceeds from the disposition of 1 or more active trades or businesses, and

"(ii) such corporation will not be a passive foreign corporation for either of the 1st 2 taxable years following the taxable year, and

"(C) such corporation is not a passive foreign corporation for either of such 2 taxable years.

For purposes of section 1296(c), any passive income referred to in subparagraph (B)(i) shall be treated as income which is not passive income and any assets which produce income so described shall be treated as assets producing income other than passive income.

"(3) TREATMENT OF CERTAIN FOREIGN CORPORATIONS OWNING STOCK IN 25-PERCENT OWNED DOMESTIC CORPORATION.—

"(A) IN GENERAL.—If a foreign corporation owns at least 25 percent (by value) of the stock of a domestic corporation, for purposes of determining whether such foreign corporation is a passive foreign corporation, any qualified stock held by such domestic corporation shall be treated as an asset which does not produce passive income (and is not held for the production of passive income) and any amount included in gross income with respect to such stock shall not be treated as passive income.

"(B) QUALIFIED STOCK.—For purposes of subparagraph (A), the term 'qualified stock' means any stock in a C corporation which is a domestic corporation and which is not a regulated investment company or real estate investment trust.

"(4) TREATMENT OF CORPORATION WHICH WAS A PFIC.—A corporation shall be treated as a passive foreign corporation for any taxable year beginning before January 1, 1993, if and only if such corporation was a passive foreign investment company under this part as in effect for such taxable year.

"(5) SEPARATE INTERESTS TREATED AS SEPARATE CORPORATIONS.—Under regulations prescribed by the Secretary, where necessary to carry out the purposes of this part, separate classes of stock (or other interests) in a corporation shall be treated as interests in separate corporations.

"(e) TREATMENT OF CERTAIN LEASED PROPERTY.—For purposes of section 1296(a)(2)—

"(1) IN GENERAL.—Any tangible personal property with respect to which the foreign corporation is the lessee under a lease with a term of at least 12 months shall be treated as an asset actually held by such corporation.

"(2) DETERMINATION OF VALUE.—

"(A) IN GENERAL.—The value of any asset to which paragraph (1) applies shall be the lesser of—

"(i) the fair market value of such property, or

"(ii) the unamortized portion (as determined under regulations prescribed by the Secretary) of the present value of the payments under the lease for the use of such property.

"(B) PRESENT VALUE.—For purposes of subparagraph (A), the present value of payments described in subparagraph (A)(ii) shall be determined in the manner provided in regulations prescribed by the Secretary—

"(i) as of the beginning of the lease term, and

"(ii) except as provided in such regulations, by using a discount rate equal to the applicable Federal rate determined under section 1274(d)—

"(I) by substituting the lease term for the term of the debt instrument, and

"(II) without regard to paragraph (2) or (3) thereof.

"(3) EXCEPTIONS.—This subsection shall not apply in any case where—

"(A) the lessor is a related person (as defined in the last sentence of section 1296(b)(2)) with respect to the foreign corporation, or

"(B) a principal purpose of leasing the property was to avoid the provisions of this part.

"(f) ELECTION BY CERTAIN PASSIVE FOREIGN CORPORATIONS TO BE TREATED AS A DOMESTIC CORPORATION.—

"(1) IN GENERAL.—For purposes of this title, if—

"(A) a passive foreign corporation would qualify as a regulated investment company under part I of subchapter M if such passive foreign corporation were a domestic corporation,

"(B) such passive foreign corporation meets such requirements as the Secretary shall prescribe to ensure that the taxes imposed by this title on such passive foreign corporation are paid, and

"(C) such passive foreign corporation makes an election to have this paragraph apply and waives all benefits which are granted by the United States under any treaty and to which such corporation would otherwise be entitled by reason of being a resident of another country,

such corporation shall be treated as a domestic corporation.

"(2) CERTAIN RULES MADE APPLICABLE.—Rules similar to the rules of paragraphs (2), (3), (4)(A), and (5) of section 953(d) shall apply with respect to any corporation making an election under paragraph (1).

"(g) Special Rules for Certain Taxpayers.—

"(1) Tax-exempt organizations.—In the case of any organization exempt from tax under section 501—

"(A) this part shall apply to any stock in a passive foreign corporation owned (or treated as owned under section 1294(e)) by such organization only to the extent that a dividend on such stock would be taken into account in determining the unrelated business taxable income of such organization, and

"(B) to the extent that this part applies to any such stock, this part shall be applied in the same manner as if such organization were not exempt from tax under section 501(a).

"(2) Treatment of stock held by pooled income fund.—If stock in a passive foreign corporation is owned (or treated as owned under section 1294(e)) by a pooled income fund (as defined in section 642(c)(5)) and no portion of any gain from a disposition of such stock may be allocated to income under the terms of the governing instrument of such fund—

"(A) section 1293 shall not apply to any gain on a disposition of such stock by such fund if (without regard to section 1293) a deduction would be allowable with respect to such gain under section 642(c)(3),

"(B) subpart A shall not apply with respect to such stock, and

"(C) in determining whether section 1293 applies to any distribution in respect of such stock, such stock shall be treated as failing to qualify for the exceptions under section 1294(a)(1).

"(h) Information From Shareholders.—Every United States person who owns stock in any passive foreign corporation shall furnish with respect to such corporation such information as the Secretary may prescribe.

"(i) Regulations.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this part, including regulations—

"(1) providing that gross income shall be determined without regard to section 1293 for such purposes as may be specified in such regulations, and

"(2) to prevent avoidance of the provisions of this part through changes in citizenship or residence status."

(b) Installment Sales Treatment Not Available.—Paragraph (2) of section 453(k) is amended by striking "or" at the end of subparagraph (A), by inserting "or" at the end of subparagraph (B), and by adding at the end thereof the following new subparagraph:

"(C) stock in a passive foreign corporation (as defined in section 1296) if section 1293 applies to such sale,".

(c) Treatment of Mark-to-Market Gain Under Section 4982.—

(1) Subsection (e) of section 4982 is amended by adding at the end thereof the following new paragraph:

"(6) Treatment of gain recognized under section 1291.—For purposes of determining a regulated investment company's ordinary income—

"(A) notwithstanding paragraph (1)(C), section 1291 shall be applied as if such company's taxable year ended on October 31, and

"(B) any ordinary gain or loss from an actual disposition of stock in a passive foreign corporation during the portion of the calendar year after October 31 shall be taken into account in determining such company's ordinary income for the following calendar year.

In the case of a company making an election under paragraph (4), the preceding sentence shall be applied by substituting the last day of the company's taxable year for October 31."

(2) Subsection (b) of section 852 is amended by adding at the end thereof the following new paragraph:

"(10) SPECIAL RULE FOR CERTAIN LOSSES ON STOCK IN PASSIVE FOREIGN CORPORATIONS.—To the extent provided in regulations, the taxable income of a regulated investment company (other than a company to which an election under section 4982(e)(4) applies) shall be computed without regard to any net reduction in the value of any stock of a passive foreign corporation to which section 1291 applies occurring after October 31 of the taxable year, and any such reduction shall be treated as occurring on the first day of the following taxable year."

(3) Subsection (c) of section 852 is amended by inserting after "October 31 of such year" the following: ", without regard to any net reduction in the value of any stock of a passive foreign corporation to which section 1291 applies occurring after October 31 of such year,".

(d) TREATMENT OF CERTAIN PREVIOUSLY TAXED AMOUNTS.—Subsection (e) of section 959 is amended—

(1) by adding at the end thereof the following new sentence: "A similar rule shall apply in the case of amounts included in gross income under section 1293 (as in effect on January 1, 1992).", and

(2) by striking "AMOUNTS PREVIOUSLY TAXED UNDER SECTION 1248" in the subsection heading and inserting "CERTAIN PREVIOUSLY TAXED AMOUNTS".

SEC. 4403. TECHNICAL AND CONFORMING AMENDMENTS.

(a) GENERAL RULE.—

(1) Paragraph (2) of section 171(c) is amended—

(A) by striking ", or by a foreign personal holding company, as defined in section 552", and

(B) by striking ", or a foreign personal holding company".

(2) Section 312 is amended by striking subsection (j).

(3) Subsection (m) of section 312 is amended by striking ", a foreign investment company (within the meaning of section 1246(b)), or a foreign personal holding company (within the meaning of section 552)" and inserting "or a passive foreign corporation (as defined in section 1296)".

(4) Subsection (e) of section 443 is amended by striking paragraph (3) and by redesignating paragraphs (4) and (5) as paragraphs (3) and (4), respectively.

(5) Clause (ii) of section 465(c)(7)(B) is amended to read as follows:

"(ii) a passive foreign corporation with respect to which the stock ownership requirements of section 1292(a)(2)(B) are met, or".

(6) Subsection (b) of section 535 is amended by striking paragraph (9).

(7) Subsection (d) of section 535 is hereby repealed.

(8) Paragraph (1) of section 543(b) is amended by inserting "and" at the end of subparagraph (A), by striking ", and" at the end of subparagraph (B) and inserting a period, and by striking subparagraph (C).

(9) Paragraph (1) of section 562(b) is amended by striking "or a foreign personal holding company described in section 552".

(10) Section 563 is amended—

(A) by striking subsection (c),

(B) by redesignating subsection (d) as subsection (c), and

(C) by striking "subsection (a), (b), or (c)" in subsection (c) (as so redesignated) and inserting "subsection (a) or (b)".

(11) Paragraph (2) of section 751(d) is amended by striking "subsection (a) of section 1246 (relating to gain on foreign investment company stock)" and inserting "section 1291 (relating to stock in certain passive foreign corporations marked to market)".

(12) Subsection (b) of section 851 is amended by striking the sentence following paragraph (4)(B) which contains a reference to section 1293(a).

(13) Clause (ii) of section 864(b)(2)(A) is amended by striking "(other than" and all that follows down through "holding company)" and inserting "(other than a corporation which would be a personal holding company but for section 542(c)(5) and which is not United States controlled (as defined in section 1292(a)(2))".

(14) Subsection (d) of section 904 is amended by striking paragraphs (2)(A)(ii), (2)(E)(iii), and (3)(I).

(15)(A) Subparagraph (A) of section 904(g)(1) is amended to read as follows:

"(A) Any amount included in gross income under section 951(a) (relating to amounts included in gross income of United States shareholders)."

(B) The paragraph heading of paragraph (2) of section 904(g) is amended by striking "AND FOREIGN PERSONAL HOLDING OR PASSIVE FOREIGN INVESTMENT COMPANY".

(16) Section 951 is amended by striking subsections (c), (d), and (f), and by redesignating subsection (e) as subsection (c).

(17) Paragraph (1) of section 986(c) is amended by striking "or 1293(c)".

(18) Paragraph (3) of section 989(b) is amended by striking ", 551(a), or 1293(a)".

(19) Paragraph (5) of section 1014(b) is hereby repealed.

(20) Subsection (a) of section 1016 is amended by striking paragraph (13) and by redesignating the following paragraphs accordingly.

(21) Paragraph (3) of section 1212(a) is amended—

(A) by striking subparagraph (A),

(B) by redesignating subparagraphs (B) and (C) as subparagraphs (A) and (B), respectively, and

(C) by amending subparagraph (D) to read as follows:

"(C) for which it is a passive foreign corporation."

(22) Section 1223 is amended by striking paragraph (10) and by redesignating the following paragraphs accordingly.

(23) Subsection (d) of section 1248 is amended by striking paragraphs (5) and (7).

(24)(A) Subsection (a) of section 6035 is amended by striking "foreign personal holding company (as defined in section 552)" and inserting "passive foreign corporation with respect to which the stock ownership requirements of section 1292(a)(2)(B) are met".

(B) The section heading for section 6035 is amended by striking "FOREIGN PERSONAL HOLDING COMPANIES" and inserting "CLOSELY HELD PASSIVE FOREIGN CORPORATIONS",.

(C) The table of sections for subpart A of part III of subchapter A of chapter 61 is amended by striking "foreign personal holding companies" in the item relating to section 6035 and inserting "closely-held passive foreign corporations".

(25) Subparagraph (D) of section 6103(e)(1) is amended by striking clause (iv) and redesignating clauses (v) and (vi) as clauses (iv) and (v), respectively.

(26) Subparagraph (B) of section 6501(e)(1) is amended to read as follows:

"(B) CONSTRUCTIVE DIVIDENDS.—If the taxpayer omits from gross income an amount properly includible therein under section 951(a), the tax may be assessed, or a proceeding in court for the collection of such tax may be done without assessing, at any time within 6 years after the return was filed."

(27) Section 4947 and section 4948(c)(4) are each amended by striking "556(b)(2)," each place it appears.

(b) CLERICAL AMENDMENTS.—

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

(2) The table of sections for part IV of subchapter P of chapter 1 is amended by striking the items relating to sections 1246 and 1247.

(3) The table of parts for subchapter P of chapter 1 is amended by striking the item relating to part VI and inserting the following:

"Part VI. Treatment of passive foreign corporations."

SEC. 4404. EFFECTIVE DATE.

(a) GENERAL RULE.—Except as otherwise provided in this section, the amendments made by this part shall apply to—

(1) taxable years of United States persons beginning after December 31, 1992, and

(2) taxable years of foreign corporations ending with or within such taxable years of United States persons.

(b) DENIAL OF INSTALLMENT SALES TREATMENT.—The amendment made by section 3402(b) shall apply to dispositions after December 31, 1992.

(c) BASIS RULE.—The amendments made by this part shall not affect the determination of the basis of any stock acquired from a decedent in a taxable year beginning before January 1, 1993.

PART II—TREATMENT OF CONTROLLED FOREIGN CORPORATIONS

SEC. 4411. GAIN ON CERTAIN STOCK SALES BY CONTROLLED FOREIGN CORPORATIONS TREATED AS DIVIDENDS.

(a) GENERAL RULE.—Section 964 (relating to miscellaneous provisions) is amended by adding at the end thereof the following new subsection:

"(f) GAIN ON CERTAIN STOCK SALES BY CONTROLLED FOREIGN CORPORATIONS TREATED AS DIVIDENDS.—

"(1) IN GENERAL.—If a controlled foreign corporation sells or exchanges stock in any other foreign corporation, gain recognized on such sale or exchange shall be included in the gross income of such controlled foreign corporation as a dividend to the same extent that it would have been so included under section 1248(a) if such controlled foreign corporation were a United States person. For purposes of determining the amount which would have been so includible, the determination of whether such other foreign corporation was a controlled foreign corporation shall be made without regard to the preceding sentence.

"(2) SAME COUNTRY EXCEPTION NOT APPLICABLE.—Clause (i) of section 954(c)(3)(A) shall not apply to any amount treated as a dividend by reason of paragraph (1).

"(3) CLARIFICATION OF DEEMED SALES.—For purposes of this subsection, a controlled foreign corporation shall be treated as having sold or exchanged any stock if, under any provision of this subtitle, such controlled foreign corporation is treated as having gain from the sale or exchange of such stock.".

(b) AMENDMENT OF SECTION 904(d).—Clause (i) of section 904(d)(2)(E) is amended by striking "and except as provided in regulations, the taxpayer was a United States shareholder in such corporation".

(c) EFFECTIVE DATES.—

(1) The amendment made by subsection (a) shall apply to gain recognized on transactions occurring after the date of the enactment of this Act.

(2) The amendment made by subsection (b) shall apply to distributions after the date of the enactment of this Act.

SEC. 4412. AUTHORITY TO PRESCRIBE SIMPLIFIED METHOD FOR APPLYING SECTION 960(b)(2).

(a) GENERAL RULE.—Paragraph (2) of section 960(b) is amended by adding at the end thereof the following new sentence: "The Secretary may prescribe regulations requiring the use of simplified methods set forth in such regulations for determining the amount of the increase referred to in the preceding sentence."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

SEC. 4413. MISCELLANEOUS MODIFICATIONS TO SUBPART F.

(a) SECTION 1248 GAIN TAKEN INTO ACCOUNT IN DETERMINING PRO RATA SHARE.—

(1) IN GENERAL.—Paragraph (2) of section 951(a) (defining pro rata share of subpart F income) is amended by adding at the end thereof the following new sentence: "For purposes of subparagraph (B), any gain included in the gross income of any person as a dividend under section 1248 shall be treated as a distribution received by such person with respect to the stock involved."

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to dispositions after the date of the enactment of this Act.

(b) BASIS ADJUSTMENTS IN STOCK HELD BY FOREIGN CORPORATION.—

(1) IN GENERAL.—Section 961 (relating to adjustments to basis of stock in controlled foreign corporations and of other property) is amended by adding at the end thereof the following new subsection:

"(c) BASIS ADJUSTMENTS IN STOCK HELD BY FOREIGN CORPORATION.—Under regulations prescribed by the Secretary, if a United States shareholder is treated under section 958(a)(2) as owning any stock in a controlled foreign corporation which is actually owned by another controlled foreign corporation, adjustments similar to the adjustments provided by subsections (a) and (b) shall be made to the basis of such stock in the hands of such other controlled foreign corporation, but only for the purposes of determining the amount included under section 951 in the gross income of such United States shareholder (or any other United States shareholder who acquires from any person any portion of the interest of such United States shareholder by reason of which such shareholder was treated as owning such stock, but only to the extent of such portion, and subject to such proof of identity of such interest as the Secretary may prescribe by regulations)."

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply for purposes of determining inclusions for taxable years of United States shareholders beginning after December 31, 1992.

(c) DETERMINATION OF PREVIOUSLY TAXED INCOME IN SECTION 304 DISTRIBUTIONS, ETC.—

(1) IN GENERAL.—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:

"(f) ADJUSTMENTS FOR CERTAIN TRANSACTIONS.—If by reason of—

"(1) a transaction to which section 304 applies,

"(2) the structure of a United States shareholder's holdings in controlled foreign corporations, or

"(3) other circumstances,

there would be a multiple inclusion of any item in income (or an inclusion or exclusion without an appropriate basis adjustment) by reason of this subpart, the Secretary may prescribe regulations providing such modifications in the application of this subpart as may be necessary to eliminate such multiple inclusion or provide such basis adjustment, as the case may be."

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall take effect on the date of the enactment of this Act.

(d) CLARIFICATION OF TREATMENT OF BRANCH TAX EXEMPTIONS OR REDUCTIONS.—

(1) IN GENERAL.—Subsection (b) of section 952 is amended by adding at the end thereof the following new sentence: "For purposes of this subsection, any exemption (or reduction) with respect to the tax imposed by section 884 shall not be taken into account."

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to taxable years beginning after December 31, 1986.

SEC. 4414. INDIRECT FOREIGN TAX CREDIT ALLOWED FOR CERTAIN LOWER TIER COMPANIES.

(a) SECTION 902 CREDIT.—

(1) IN GENERAL.—Subsection (b) of section 902 (relating to deemed taxes increased in case of certain 2nd and 3rd tier foreign corporations) is amended to read as follows:

"(b) DEEMED TAXES INCREASED IN CASE OF CERTAIN LOWER TIER CORPORATIONS.—

"(1) IN GENERAL.—If—

"(A) any foreign corporation is a member of a qualified group, and

"(B) such foreign corporation owns 10 percent or more of the voting stock of another member of such group from which it receives dividends in any taxable year,

such foreign corporation shall be deemed to have paid the same proportion of such other member's post-1986 foreign income taxes as would be determined under subsection (a) if such foreign corporation were a domestic corporation.

"(2) QUALIFIED GROUP.—For purposes of paragraph (1), the term 'qualified group' means—

"(A) the foreign corporation described in subsection (a), and

"(B) any other foreign ccrporation if—

"(i) the domestic corporation owns at least 5 percent of the voting stock of such other foreign corporation indirectly through a chain of foreign corporations connected through stock ownership of at least 10 percent of their voting stock,

"(ii) the foreign corporation described in subsection (a) is the first tier corporation in such chain, and

"(iii) such other corporation is not below the sixth tier in such chain,

The term 'qualified group' shall not include any foreign corporation below the third tier in the chain referred to in clause (i) unless such foreign corporation is a controlled foreign corporation (as defined in section 957) and the domestic corporation is a United States shareholder (as defined in section 951(b)) in such foreign corporation. Paragraph (1) shall apply to those taxes paid by a member of the qualified group below the third tier only with respect to periods during which it was a controlled foreign corporation."

(2) CONFORMING AMENDMENTS.—

(A) Subparagraph (B) of section 902(c)(3) is amended by adding "or" at the end of clause (i) and by striking clauses (ii) and (iii) and inserting the following new clause:

"(ii) the requirements of subsection (b)(2) are met with respect to such foreign corporation."

(B) Subparagraph (B) of section 902(c)(4) is amended by striking "3rd foreign corporation" and inserting "sixth tier foreign corporation".

(C) The heading for paragraph (3) of section 902(c) is amended by striking "WHERE DOMESTIC CORPORATION ACQUIRES 10 PERCENT OF FOREIGN CORPORATION" and inserting "WHERE FOREIGN CORPORATION FIRST QUALIFIES".

(D) Paragraph (3) of section 902(c) is amended by striking "ownership" each place it appears.

(b) SECTION 960 CREDIT.—Paragraph (1) of section 960(a) (relating to special rules for foreign tax credits) is amended to read as follows:

"(1) DEEMED PAID CREDIT.—For purposes of subpart A of this part, if there is included under section 951(a) in the gross income of a domestic corporation any amount attributable to earnings and profits of a foreign corporation which is a member of a qualified group (as defined in section 902(b)) with respect to the domestic corporation, then, except to the extent provided in regulations, section 902 shall be applied as if the amount so included were a dividend paid by such foreign corporation (determined by applying section 902(c) in accordance with section 904(d)(3)(B))."

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxes of foreign corporations for taxable years of such corporations beginning after the date of enactment of this Act.

(2) SPECIAL RULE.—In the case of any chain of foreign corporations described in clauses (i) and (ii) of section 902(b)(2)(B) of the Internal Revenue Code of 1986 (as amended by this section), no liquidation, reorganization, or similar transaction in a taxable year beginning after the date of the enactment of this Act shall have the effect of permitting taxes to be taken into account under section 902 of the Internal Revenue Code of 1986 which could not have been taken into account under such section but for such transaction.

PART III—OTHER PROVISIONS

SEC. 4421. EXCHANGE RATE USED IN TRANSLATING FOREIGN TAXES.

(a) ACCRUED TAXES TRANSLATED BY USING AVERAGE RATE FOR YEAR TO WHICH TAXES RELATE.—

(1) IN GENERAL.—Subsection (a) of section 986 (relating to translation of foreign taxes) is amended to read as follows:

"(a) FOREIGN INCOME TAXES.—

"(1) TRANSLATION OF ACCRUED TAXES.—

"(A) IN GENERAL.—For purposes of determining the amount of the foreign tax credit, in the case of a taxpayer who takes foreign income taxes into account when accrued,

the amount of any foreign income taxes (and any adjustment thereto) shall be translated into dollars by using the average exchange rate for the taxable year to which such taxes relate.

"(B) EXCEPTION FOR TAXES NOT PAID WITHIN FOLLOWING 2 YEARS.—

"(i) Subparagraph (A) shall not apply to any foreign income taxes paid after the date 2 years after the close of the taxable year to which such taxes relate.

"(ii) Subparagraph (A) shall not apply to taxes paid before the beginning of the taxable year to which such taxes relate.

"(C) EXCEPTION FOR INFLATIONARY CURRENCIES.—To the extent provided in regulations, subparagraph (A) shall not apply to any foreign income taxes the liability for which is denominated in any currency determined to be an inflationary currency under such regulations.

"(D) CROSS REFERENCE.—

"For adjustments where tax is not paid within 2 years, see section 905(c).

"(2) TRANSLATION OF TAXES TO WHICH PARAGRAPH (1) DOES NOT APPLY.—For purposes of determining the amount of the foreign tax credit, in the case of any foreign income taxes to which subparagraph (A) of paragraph (1) does not apply—

"(A) such taxes shall be translated into dollars using the exchange rates as of the time such taxes were paid to the foreign country or possession of the United States, and

"(B) any adjustment to the amount of such taxes shall be translated into dollars using—

"(i) except as provided in clause (ii), the exchange rate as of the time when such adjustment is paid to the foreign country or possession, or

"(ii) in the case of any refund or credit of foreign income taxes, using the exchange rate as of the time of the original payment of such foreign income taxes.

"(3) FOREIGN INCOME TAXES.—For purposes of this subsection, the term 'foreign income taxes' means any income, war profits, or excess profits taxes paid or accrued to any foreign country or to any possession of the United States."

(2) ADJUSTMENT WHEN NOT PAID WITHIN 2 YEARS AFTER YEAR TO WHICH TAXES RELATE.—Subsection (c) of section 905 is amended to read as follows:

"(c) ADJUSTMENTS TO ACCRUED TAXES.—

"(1) IN GENERAL.—If—

"(A) accrued taxes when paid differ from the amounts claimed as credits by the taxpayer,

"(B) accrued taxes are not paid before the date 2 years after the close of the taxable year to which such taxes relate, or

"(C) any tax paid is refunded in whole or in part,

the taxpayer shall notify the Secretary, who shall redetermine the amount of the tax for the year or years affected.

"(2) SPECIAL RULE FOR TAXES NOT PAID WITHIN 2 YEARS.—In making the redetermination under paragraph (1), no credit

shall be allowed for accrued taxes not paid before the date referred to in subparagraph (B) of paragraph (1). Any such taxes if subsequently paid shall be taken into account for the taxable year in which paid and no redetermination under this section shall be made on account of such payment.

"(3) ADJUSTMENTS.—The amount of tax due on any redetermination under paragraph (1) (if any) shall be paid by the taxpayer on notice and demand by the Secretary, and the amount of tax overpaid (if any) shall be credited or refunded to the taxpayer in accordance with subchapter B of chapter 66 (section 6511 et seq.).

"(4) BOND REQUIREMENTS.—In the case of any tax accrued but not paid, the Secretary, as a condition precedent to the allowance of the credit provided in this subpart, may require the taxpayer to give a bond, with sureties satisfactory to and approved by the Secretary, in such sum as the Secretary may require, conditioned on the payment by the taxpayer of any amount of tax found due on any such redetermination. Any such bond shall contain such further conditions as the Secretary may require.

"(5) OTHER SPECIAL RULES.—In any redetermination under paragraph (1) by the Secretary of the amount of tax due from the taxpayer for the year or years affected by a refund, the amount of the taxes refunded for which credit has been allowed under this section shall be reduced by the amount of any tax described in section 901 imposed by the foreign country or possession of the United States with respect to such refund; but no credit under this subpart, or deduction under section 164, shall be allowed for any taxable year with respect to any such tax imposed on the refund. No interest shall be assessed or collected on any amount of tax due on any redetermination by the Secretary, resulting from a refund to the taxpayer, for any period before the receipt of such refund, except to the extent interest was paid by the foreign country or possession of the United States on such refund for such period."

(b) AUTHORITY TO USE AVERAGE RATES.—

(1) IN GENERAL.—Subsection (a) of section 986 (relating to foreign taxes) is amended by adding at the end thereof the following new paragraph:

"(3) AUTHORITY TO PERMIT USE OF AVERAGE RATES.—To the extent prescribed in regulations, the average exchange rate for the period (specified in such regulations) during which the taxes or adjustment is paid may be used instead of the exchange rate as of the time of such payment."

(2) DETERMINATION OF AVERAGE RATES.—Subsection (c) of section 989 is amended by striking "and" at the end of paragraph (4), by striking the period at the end of paragraph (5) and inserting ", and", and by adding at the end thereof the following new paragraph:

"(6) setting forth procedures for determining the average exchange rate for any period."

(3) CONFORMING AMENDMENTS.—Subsection (b) of section 989 is amended by striking "weighted" each place it appears.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxes paid or accrued in taxable years beginning after December 31, 1991.

SEC. 4422. ELECTION TO USE SIMPLIFIED SECTION 904 LIMITATION FOR ALTERNATIVE MINIMUM TAX.

(a) GENERAL RULE.—Subsection (a) of section 59 (relating to alternative minimum tax foreign tax credit) is amended by adding at the end thereof the following new paragraph:

"(3) ELECTION TO USE SIMPLIFIED SECTION 904 LIMITATION.—

"(A) IN GENERAL.—In determining the alternative minimum tax foreign tax credit for any taxable year to which an election under this paragraph applies—

"(i) subparagraph (B) of paragraph (1) shall not apply, and

"(ii) the limitation of section 904 shall be based on the proportion which—

"(I) the taxpayer's taxable income (as determined for purposes of the regular tax) from sources without the United States (but not in excess of the taxpayer's entire alternative minimum taxable income), bears to

"(II) the taxpayer's entire alternative minimum taxable income for the taxable year.

"(B) ELECTION.—

"(i) IN GENERAL.—An election under this paragraph may be made only for the taxpayer's first taxable year which begins after December 31, 1992, and for which the taxpayer claims an alternative minimum foreign tax credit.

"(ii) ELECTION REVOCABLE ONLY WITH CONSENT.—An election under this paragraph, once made, shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1992.

SEC. 4423. MODIFICATION OF SECTION 1491.

(a) GENERAL RULE.—So much of chapter 5 (relating to tax on transfers to avoid income tax) as precedes section 1492 is amended to read as follows:

"CHAPTER 5—TREATMENT OF TRANSFERS TO AVOID INCOME TAX

"Sec. 1491. Recognition of gain.
"Sec. 1492. Exceptions.

"SEC. 1491. RECOGNITION OF GAIN.

"In the case of any transfer of property by a United States person to a foreign corporation as paid-in surplus or as a contribution to capital, to a foreign estate or trust, or to a foreign partnership, for purposes of this subtitle, such transfer shall be treated as a sale or exchange for an amount equal to the fair market value of the prop-

erty transferred, and the transferor shall recognize as gain the excess of—

"(1) the fair market value of the property so transferred, over

"(2) the adjusted basis (for purposes of determining gain) of such property in the hands of the transferor."

(b) CONFORMING AMENDMENTS.—

(1) Section 1057 is hereby repealed.

(2) Section 1492 is amended to read as follows:

"SEC. 1492. EXCEPTIONS.

"The provisions of section 1491 shall not apply—

"(1) If the transferee is an organization exempt from income tax under part I of subchapter F of chapter 1 (other than an organization described in section 401(a)),

"(2) To a transfer described in section 367, or

"(3) To any other transfer, to the extent provided in regulations in accordance with principles similar to the principles of section 367 or otherwise consistent with the purpose of section 1491."

(3) Section 1494 is hereby repealed.

(4) The table of sections for part IV of subchapter O of chapter 1 is amended by striking the item relating to section 1057.

(5) The table of chapters for subtitle A is amended by striking "Tax on" in the item relating to chapter 5 and inserting "Treatment of".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to transfers after the date of the enactment of this Act.

SEC. 4424. MODIFICATION OF SECTION 367(b).

(a) GENERAL RULE.—Paragraph (1) of section 367(b) is amended to read as follows:

"(1) IN GENERAL.—In the case of any transaction described in section 332, 351, 354, 355, 356, or 361 in which the status of a foreign corporation as a corporation is a general condition for nonrecognition by 1 or more of the parties to the transaction, income shall be required to be recognized to the extent provided in regulations prescribed by the Secretary which are necessary or appropriate to prevent the avoidance of Federal income taxes. This subsection shall not apply to a transaction in which the foreign corporation is not treated as a corporation under subsection (a)(1)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to transfers after December 31, 1993.

Subtitle E—Treatment of Intangibles

SEC. 4501. AMORTIZATION OF GOODWILL AND CERTAIN OTHER INTANGIBLES.

(a) GENERAL RULE.—Part VI of subchapter B of chapter 1 (relating to itemized deductions for individuals and corporations) is amended by adding at the end thereof the following new section:

"SEC. 197. AMORTIZATION OF GOODWILL AND CERTAIN OTHER INTANGIBLES.

"(a) GENERAL RULE.—A taxpayer shall be entitled to an amortization deduction with respect to any amortizable section 197 intangible. The amount of such deduction shall be determined by amortizing the adjusted basis (for purposes of determining gain) of such intangible ratably over the 14-year period beginning with the month in which such intangible was acquired.

"(b) NO OTHER DEPRECIATION OR AMORTIZATION DEDUCTION ALLOWABLE.—Except as provided in subsection (a), no depreciation or amortization deduction shall be allowable with respect to any amortizable section 197 intangible.

"(c) AMORTIZABLE SECTION 197 INTANGIBLE.—For purposes of this section—

"(1) IN GENERAL.—Except as otherwise provided in this section, the term 'amortizable section 197 intangible' means any section 197 intangible—

"(A) which is acquired by the taxpayer after the date of the enactment of this section, and

"(B) which is held in connection with the conduct of a trade or business or an activity described in section 212.

"(2) EXCLUSION OF SELF-CREATED INTANGIBLES, ETC.—The term 'amortizable section 197 intangible' shall not include any section 197 intangible—

"(A) which is not described in subparagraph (D), (E), or (F) of subsection (d)(1), and

"(B) which is created by the taxpayer.

This paragraph shall not apply if the intangible is created in connection with a transaction (or series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof.

"(3) ANTI-CHURNING RULES.—

"For exclusion of intangibles acquired in certain transactions, see subsection (f)(9).

"(d) SECTION 197 INTANGIBLE.—For purposes of this section—

"(1) IN GENERAL.—Except as otherwise provided in this section, the term 'section 197 intangible' means—

"(A) goodwill,

"(B) going concern value,

"(C) any of the following intangible items:

"(i) workforce in place including its composition and terms and conditions (contractual or otherwise) of its employment,

"(ii) business books and records, operating systems, or any other information base (including lists or other information with respect to current or prospective customers),

"(iii) any patent, copyright, formula, process, design, pattern, knowhow, format, or other similar item,

"(iv) any customer-based intangible,

"(v) any supplier-based intangible, and

"(vi) any other similar item,

"(D) any license, permit, or other right granted by a governmental unit or an agency or instrumentality thereof,

"(E) any covenant not to compete (or other arrangement to the extent such arrangement has substantially the same effect as a covenant not to compete) entered into in connection with an acquisition (directly or indirectly) of an interest in a trade or business or substantial portion thereof, and

"(F) any franchise, trademark, or trade name.

"(2) CUSTOMER-BASED INTANGIBLE.—

"(A) IN GENERAL.—The term 'customer-based intangible' means—

"(i) composition of market,

"(ii) market share, and

"(iii) any other value resulting from future provision of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with customers.

"(B) SPECIAL RULE FOR FINANCIAL INSTITUTIONS.—In the case of a financial institution, the term 'customer-based intangible' includes deposit base and similar items.

"(3) SUPPLIER-BASED INTANGIBLE.—The term 'supplier-based intangible' means any value resulting from future acquisitions of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with suppliers of goods or services to be used or sold by the taxpayer.

"(e) EXCEPTIONS.—For purposes of this section, the term 'section 197 intangible' shall not include any of the following:

"(1) FINANCIAL INTERESTS.—Any interest—

"(A) in a corporation, partnership, trust, or estate, or

"(B) under an existing futures contract, foreign currency contract, notional principal contract, interest rate swap, or other similar financial contract.

"(2) LAND.—Any interest in land.

"(3) COMPUTER SOFTWARE.—Any—

"(A) computer software which is readily available for purchase by the general public, is subject to a nonexclusive license, and has not been substantially modified, and

"(B) other computer software which is not acquired in a transaction (or series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof.

For purposes of the preceding sentence, the term 'computer software' means any program designed to cause a computer to perform a desired function; except that such term shall not include any data base or similar item.

"(4) CERTAIN INTERESTS OR RIGHTS ACQUIRED SEPARATELY.—Any of the following not acquired in a transaction (or series of related transactions) referred to in paragraph (3)(B):

"(A) Any interest in a film, sound recording, video tape, book, or similar property.

"(B) Any right to receive tangible property or services under a contract or granted by a governmental unit or agency or instrumentality thereof.

"(C) Any interest in a patent or copyright.

"(5) INTERESTS UNDER LEASES AND DEBT INSTRUMENTS.—Any interest under—

"(A) an existing lease of tangible property, or

"(B) except as provided in subsection (d)(2)(B), any existing indebtedness.

"(6) TREATMENT OF SPORTS FRANCHISES.—A franchise to engage in professional football, basketball, baseball, or other professional sport, and any item acquired in connection with such a franchise.

"(f) SPECIAL RULES.—

"(1) TREATMENT OF CERTAIN DISPOSITIONS, ETC.—If there is a disposition of any amortizable section 197 intangible acquired in a transaction or series of related transactions (or any such intangible becomes worthless) and one or more other amortizable section 197 intangibles acquired in such transaction or series of related transactions are retained—

"(A) no loss shall be recognized by reason of such disposition (or such worthlessness), and

"(B) appropriate adjustments to the adjusted bases of such retained intangibles shall be made for any loss not recognized under subparagraph (A).

All persons treated as a single taxpayer under section 41(f) shall be so treated for purposes of the preceding sentence.

"(2) TREATMENT OF CERTAIN TRANSFERS.—

"(A) IN GENERAL.—In the case of any section 197 intangible transferred in a transaction described in subparagraph (B), the transferee shall be treated as the transferor for purposes of applying this section with respect to so much of the adjusted basis in the hands of the transferee as does not exceed the adjusted basis in the hands of the transferor.

"(B) TRANSACTIONS COVERED.—The transactions described in this subparagraph are—

"(i) any transaction described in section 332, 351, 361, 721, 731, 1031, or 1033, and

"(ii) any transaction between members of the same affiliated group during any taxable year for which a consolidated return is made by such group.

"(3) TREATMENT OF AMOUNTS PAID PURSUANT TO COVENANTS NOT TO COMPETE, ETC.—Any amount paid or incurred pursuant to a covenant or arrangement referred to in subsection (d)(1)(E) shall be treated as an amount chargeable to capital account.

"(4) TREATMENT OF FRANCHISES, ETC.—

"(A) FRANCHISE.—The term 'franchise' has the meaning given to such term by section 1253(b)(1).

"(B) TREATMENT OF RENEWALS.—Any renewal of a franchise, trademark, or trade name (or of a license, a permit, or other right referred to in subsection (d)(1)(D)) shall be treated as an acquisition. The preceding sentence shall only apply with respect to costs incurred in connection with such renewal.

"(C) CERTAIN AMOUNTS NOT TAKEN INTO ACCOUNT.—Any amount to which section 1253(d)(1) applies shall not be taken into account under this section.

"(5) TREATMENT OF CERTAIN REINSURANCE TRANSACTIONS.—In the case of any amortizable section 197 intangible resulting from an assumption reinsurance transaction, the amount taken into account as the adjusted basis of such intangible under this section shall be the excess of—

"(A) the amount paid or incurred by the acquirer under the assumption reinsurance transaction, over

"(B) the amount required to be capitalized under section 848 in connection with such transaction.

Subsection (b) shall not apply to any amount required to be capitalized under section 848.

"(6) TREATMENT OF CERTAIN SUBLEASES.—For purposes of this section, a sublease shall be treated in the same manner as a lease of the underlying property involved.

"(7) TREATMENT AS DEPRECIABLE.—For purposes of this chapter, any amortizable section 197 intangible shall be treated as property which is of a character subject to the allowance for depreciation provided in section 167.

"(8) TREATMENT OF CERTAIN INCREMENTS IN VALUE.—This section shall not apply to any increment in value if, without regard to this section, such increment is properly taken into account in determining the cost of property which is not a section 197 intangible.

"(9) ANTI-CHURNING RULES.—For purposes of this section—

"(A) IN GENERAL.—The term 'amortizable section 197 intangible' shall not include any section 197 intangible which is described in subparagraph (A) or (B) of subsection (d)(1) (or for which depreciation or amortization would not have been allowable but for this section) and which is acquired by the taxpayer after the date of the enactment of this section, if—

"(i) the intangible was held or used at any time on or after July 25, 1991, and on or before such date of enactment by the taxpayer or a related person,

"(ii) the intangible was acquired from a person who held such intangible at any time on or after July 25, 1991, and on or before such date of enactment, and, as part of the transaction, the user of such intangible does not change, or

"(iii) the taxpayer grants the right to use such intangible to a person (or a person related to such person) who held or used such intangible at any time on or after July 25, 1991, and on or before such date of enactment.

For purposes of this subparagraph, the determination of whether the user of property changes as part of a transaction shall be determined in accordance with regulations prescribed by the Secretary.

"(B) RELATED PERSON DEFINED.—For purposes of this paragraph—

"(i) RELATED PERSON.—A person (hereinafter in this paragraph referred to as the 'related person') is related to any person if—

"(I) the related person bears a relationship to such person specified in section 267(b) or section 707(b)(1), or

"(II) the related person and such person are engaged in trades or businesses under common control (within the meaning of subparagraphs (A) and (B) of section 41(f)(1)).

For purposes of subclause (I), in applying section 267(b) or 707(b)(1), '20 percent' shall be substituted for '50 percent'.

"(ii) TIME FOR MAKING DETERMINATION.—A person shall be treated as related to another person if such relationship exists immediately before or immediately after the acquisition of the intangible involved.

"(C) ACQUISITIONS BY REASON OF DEATH.—Subparagraph (A) shall not apply to the acquisition of any property by the taxpayer if the basis of the property in the hands of the taxpayer is determined under section 1014(a).

"(D) SPECIAL RULE FOR PARTNERSHIPS.—With respect to any increase in the basis of partnership property under section 732, 734, or 743, determinations under this paragraph shall be made at the partner level and each partner shall be treated as having owned and used such partner's proportionate share of the partnership assets.

"(E) ANTI-ABUSE RULES.—The term 'amortizable section 197 intangible' does not include any section 197 intangible acquired in a transaction, one of the principal purposes of which is to avoid the requirement of subsection (c)(1) that the intangible be acquired after the date of the enactment of this section or to avoid the provisions of subparagraph (A).

"(g) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this section, including such regulations as may be appropriate to prevent avoidance of the purposes of this section through related persons or otherwise."

(b) MODIFICATIONS TO DEPRECIATION RULES.—

(1) TREATMENT OF CERTAIN PROPERTY EXCLUDED FROM SECTION 197.—Section 167 (relating to depreciation deduction) is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection:

"(f) TREATMENT OF CERTAIN PROPERTY EXCLUDED FROM SECTION 197.—

"(1) COMPUTER SOFTWARE.—

"(A) IN GENERAL.—If a depreciation deduction is allowable under subsection (a) with respect to any computer software, such deduction shall be computed by using the straight line method and a useful life of 36 months.

"(B) COMPUTER SOFTWARE.—For purposes of this section, the term 'computer software' has the meaning given to such term by the last sentence of section 197(e)(3); except that such term shall not include any such software which is an amortizable section 197 intangible.

"(2) CERTAIN INTERESTS OR RIGHTS ACQUIRED SEPARATELY.—If a depreciation deduction is allowable under subsection (a) with

respect to any property described in subparagraph (B) or (C) of section 197(e)(4), such deduction shall be computed in accordance with regulations prescribed by the Secretary."

(2) ALLOCATION OF BASIS IN CASE OF LEASED PROPERTY.—Subsection (c) of section 167 is amended to read as follows:

"(c) BASIS FOR DEPRECIATION.—

"(1) IN GENERAL.—The basis on which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 1011, for the purpose of determining the gain on the sale or other disposition of such property.

"(2) SPECIAL RULE FOR PROPERTY SUBJECT TO LEASE.—If any property is acquired subject to a lease—

"(A) no portion of the adjusted basis shall be allocated to the leasehold interest, and

"(B) the entire adjusted basis shall be taken into account in determining the depreciation deduction (if any) with respect to the property subject to the lease."

(c) AMENDMENTS TO SECTION 1253.—Subsection (d) of section 1253 is amended by striking paragraphs (2), (3), (4), and (5) and inserting the following:

"(2) OTHER PAYMENTS.—Any amount paid or incurred on account of a transfer, sale, or other disposition of a franchise, trademark, or trade name to which paragraph (1) does not apply shall be treated as an amount chargeable to capital account.

"(3) RENEWALS, ETC.—For purposes of determining the term of a transfer agreement under this section, there shall be taken into account all renewal options (and any other period for which the parties reasonably expect the agreement to be renewed)."

(d) AMENDMENT TO SECTION 848.—Subsection (g) of section 848 is amended by striking "this section" and inserting "this section or section 197".

(e) AMENDMENTS TO SECTION 1060.—

(1) Paragraph (1) of section 1060(b) is amended by striking "goodwill or going concern value" and inserting "section 197 intangibles".

(2) Paragraph (1) of section 1060(d) is amended by striking "goodwill or going concern value (or similar items)" and inserting "section 197 intangibles".

(f) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Subsection (g) of section 167 (as redesignated by subsection (b)) is amended to read as follows:

"(g) CROSS REFERENCE.—

"(1) For additional rule applicable to depreciation of improvements in the case of mines, oil and gas wells, other natural deposits, and timber, see section 611.

"(2) For amortization of goodwill and certain other intangibles, see section 197."

(2) Subsection (f) of section 642 is amended by striking "section 169" and inserting "sections 169 and 197".

(3) Subsection (a) of section 1016 is amended by striking paragraph (19) and by redesignating the following paragraphs accordingly.

(4) Subparagraph (C) of section 1245(a)(2) is amended by striking "193, or 1253(d) (2) or (3)" and inserting "or 193".

(5) Paragraph (3) of section 1245(a) is amended by striking "section 185 or 1253(d) (2) or (3)".

(6) The table of sections for part VI of subchapter B of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 197. Amortization of goodwill and certain other intangibles."

(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 acquired after the date of the enactment of this Act.

(2) ELECTION TO HAVE AMENDMENTS APPLY TO PROPERTY ACQUIRED AFTER JULY 25, 1991.—

(A) IN GENERAL.—If an election under this paragraph applies to the taxpayer—

(i) the amendments made by this section shall apply to property acquired by the taxpayer after July 25, 1991,

(ii) subsection (c)(1)(A) of section 197 of the Internal Revenue Code of 1986 (as added by this section) (and so much of subsection (f)(9)(A) of such section 197 as precedes clause (i) thereof) shall be applied with respect to the taxpayer by treating July 25, 1991, as the date of the enactment of such section, and

(iii) in applying subsection (f)(9) of such section, with respect to any property acquired by the taxpayer on or before the date of the enactment of this Act, only holding or use on July 25, 1991, shall be taken into account.

(B) ELECTION.—An 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. Such an election by any taxpayer, once made—

(i) may be revoked only with the consent of the Secretary, and

(ii) shall apply to the taxpayer making such election and any other taxpayer under common control with the taxpayer (within the meaning of subparagraphs (A) and (B) of section 41(f)(1) of such Code) at any time after November 22, 1991, and on or before the date on which such election is made.

(3) ELECTION TO HAVE AMENDMENTS APPLY TO PROPERTY ACQUIRED IN ALL OPEN YEARS.—

(A) IN GENERAL.—If an election under this paragraph applies to the taxpayer—

(i) the amendments made by this section shall apply to property acquired by the taxpayer after the date referred to in subparagraph (B),

(ii) subsection (c)(1)(A) of section 197 of the Internal Revenue Code of 1986 (as added by this section) shall be applied with respect to the taxpayer by treating the date referred to in subparagraph (B) as the date of the enactment of such section,

(iii) subsection (f)(9) of such section 197 shall not apply with respect to any property acquired by the taxpayer on or before July 25, 1991, and

(iv) in applying subsection (f)(9) of such section 197 with respect to property acquired by the taxpayer after July 25, 1991, and on or before the date of the enactment of this Act, the modifications to such subsection contained in clauses (ii) and (iii) of paragraph (2)(A) shall apply.

(B) DATE.—For purposes of subparagraph (A), the date referred to in this subparagraph is the first day of the first taxable year in a series of consecutive taxable years all of which are open years. For purposes of the preceding sentence, a taxable year is an open year if the period prescribed by section 6501 of the Internal Revenue Code of 1986 for the assessment of any tax for such taxable year had not expired before July 25, 1991 (determined without regard to subparagraph (C)(iii)).

(C) EFFECT OF ELECTION.—

(i) 17-YEAR AMORTIZATION PERIOD.—If an election under this paragraph applies to the taxpayer, section 197(a) of the Internal Revenue Code of 1986 shall be applied with respect to all property to which the amendments made by this section apply and which are acquired by the taxpayer on or before the date of the enactment of this Act by substituting "17-year period" for "14-year period".

(ii) NO INTEREST ALLOWED ON REFUNDS.—No interest shall be payable on any refund of tax resulting from the provisions of this paragraph.

(iii) EXTENSION OF STATUTE.—If the assessment of any deficiency of tax attributable to an election under this paragraph is barred on the date of the enactment of this Act or at any time within the 2-year period beginning on the date on which such election is made by any law or rule of law, such deficiency may, nevertheless, be assessed if such assessment is made within such 2-year period. If credit or refund of any tax attributable to an election under this paragraph is barred on the date of the enactment of this Act or at any time within the 2-year period beginning on the date on which such election is made by any law or rule of law, such credit or refund may, nevertheless, be allowed or made if claim therefore is made within such 2-year period.

(D) ELECTION.—An 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. Such an election by any taxpayer, once made—

(i) may be revoked only with the consent of the Secretary, and

(ii) shall apply to the taxpayer making such election and any other taxpayer under common control with the taxpayer (within the meaning of subparagraphs (A) and (B) of section 41(f)(1) of such Code) at any time after November 22, 1991, and on or before the date on which such election is made.

(E) SPECIAL RULE FOR CERTAIN ACQUISITIONS IN CLOSED YEARS.—If—

(i) an election under this paragraph applies to the taxpayer,

(ii) there was an agreement between the taxpayer and the Internal Revenue Service with respect to the amortization of any intangibles which were acquired by the taxpayer before the date referred to in subparagraph (B), and

(iii) as of February 14, 1992, there was an active dispute between the taxpayer and the Internal Revenue Service by reason of the Internal Revenue Service taking a position inconsistent with such agreement,

the amortization of such intangibles in open years shall be made in accordance with the agreement referred to in clause (ii).

(4) ELECTIVE BINDING CONTRACT EXCEPTION.—

(A) IN GENERAL.—The amendments made by this section shall not apply to any acquisition of property by the taxpayer if—

(i) such acquisition is pursuant to a written binding contract in effect on February 14, 1992, and at all times thereafter before such acquisition,

(ii) an election under paragraph (2) or (3) does not apply to the taxpayer, and

(iii) the taxpayer makes an election under this paragraph with respect to such contract.

(B) ELECTION.—An election under this paragraph shall be made at such time and in such manner as the Secretary of the Treasury or his delegate shall prescribe. Such an election, once made—

(i) may be revoked only with the consent of the Secretary, and

(ii) shall apply to all property acquired pursuant to the contract with respect to which such election was made.

SEC. 4502. TREATMENT OF CERTAIN PAYMENTS TO RETIRED OR DECEASED PARTNER.

(a) SECTION 736(b) NOT TO APPLY IN CERTAIN CASES.—Subsection (b) of section 736 (relating to payments for interest in partnership) is amended by adding at the end thereof the following new paragraph:

"(3) LIMITATION ON APPLICATION OF PARAGRAPH (2).—Paragraph (2) shall apply only if—

"(A) capital is not a material income-producing factor for the partnership, and

"(B) the retiring or deceased partner was a general partner in the partnership."

(b) LIMITATION ON DEFINITION OF UNREALIZED RECEIVABLES.—

(1) IN GENERAL.—Subsection (c) of section 751 (defining unrealized receivables) is amended—

(A) by striking "sections 731, 736, and 741" each place they appear and inserting ", sections 731 and 741 (but not for purposes of section 736)", and

(B) by striking "section 731, 736, or 741" each place it appears and inserting "section 731 or 741".

(2) TECHNICAL AMENDMENTS.—

(A) Subsection (e) of section 751 is amended by striking "sections 731, 736, and 741" and inserting "sections 731 and 741".

(B) Section 736 is amended by striking subsection (c).

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply in the case of partners retiring or dying after February 14, 1992.

(2) BINDING CONTRACT EXCEPTION.—The amendments made by this section shall not apply to any partner retiring after February 14, 1992, if a written contract to purchase such partner's interest in the partnership was binding on February 14, 1992, and at all times thereafter before such purchase.

Subtitle F—Other Income Tax Provisions

PART I—PROVISIONS RELATING TO SUBCHAPTER S CORPORATIONS

SEC. 4601. DETERMINATION OF WHETHER CORPORATION HAS 1 CLASS OF STOCK.

(a) GENERAL RULE.—Paragraph (4) of section 1361(c) is amended to read as follows:

"(4) DETERMINATION OF WHETHER CORPORATION HAS 1 CLASS OF STOCK.—For purposes of subsection (b)(1)(D), a corporation shall be treated as having 1 class of stock if all outstanding shares of stock of the corporation confer identical rights to distributions and liquidation proceeds. The preceding sentence shall apply whether or not there are differences in voting rights among such shares."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1982.

SEC. 4602. AUTHORITY TO VALIDATE CERTAIN INVALID ELECTIONS.

(a) GENERAL RULE.—Subsection (f) of section 1362 (relating to inadvertent terminations) is amended to read as follows:

"(f) INADVERTENT INVALID ELECTIONS OR TERMINATIONS.—If—

"(1) an election under subsection (a) by any corporation—

"(A) was not effective for the taxable year for which made (determined without regard to subsection (b)(2)) by reason of a failure to meet the requirements of section 1361(b) or to obtain shareholder consents, or

"(B) was terminated under paragraph (2) or (3) of subsection (d),

"(2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent,

"(3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken—

"(A) so that the corporation is a small business corporation, or

"(B) to acquire the required shareholder consents, and

"(4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period,

then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary."

(b) LATE ELECTIONS.—Subsection (b) of section 1362 is amended by adding at the end thereof the following new paragraph:

"(5) AUTHORITY TO TREAT LATE ELECTIONS AS TIMELY.—If—

"(A) an election under subsection (a) is made for any taxable year (determined without regard to paragraph (3)) after the date prescribed by this subsection for making such election for such taxable year, and

"(B) the Secretary determines that there was reasonable cause for the failure to timely make such election,

the Secretary may treat such election as timely made for such taxable year (and paragraph (3) shall not apply)."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to elections for taxable years beginning after December 31, 1982.

SEC. 4603. TREATMENT OF DISTRIBUTIONS DURING LOSS YEARS.

(a) ADJUSTMENTS FOR DISTRIBUTIONS TAKEN INTO ACCOUNT BEFORE LOSSES.—

(1) Subparagraph (A) of section 1366(d)(1) is amended by striking "paragraph (1)" and inserting "paragraphs (1) and (2)(A)".

(2) Subsection (d) of section 1368 is amended by adding at the end thereof the following new sentence:

"In the case of any distribution made during any taxable year, the adjusted basis of the stock shall be determined with regard to the adjustments provided in paragraph (1) of section 1367(a) for the taxable year."

(b) ACCUMULATED ADJUSTMENTS ACCOUNT.—Paragraph (1) of section 1368(e) (relating to accumulated adjustments account) is amended by adding at the end thereof the following new subparagraph:

"(C) NET LOSS FOR YEAR DISREGARDED.—

"(i) IN GENERAL.—In applying this section to distributions made during any taxable year, the amount in the accumulated adjustments account as of the close of

such taxable year shall be determined without regard to any net negative adjustment for such taxable year.

"(ii) Net negative adjustment.—For purposes of clause (i), the term 'net negative adjustment' means, with respect to any taxable year, the excess (if any) of—

"(I) the reductions in the account for the taxable year (other than for distributions), over

"(II) the increases in such account for such taxable year."

(c) Conforming Amendments.—Subparagraph (A) of section 1368(e)(1) is amended—

(1) by striking "as provided in subparagraph (B)" and inserting "as otherwise provided in this paragraph", and

(2) by striking "section 1367(b)(2)(A)" and inserting "section 1367(a)(2)".

(d) Effective Date.—The amendments made by this section shall apply to distributions in taxable years beginning after December 31, 1991.

SEC. 4604. OTHER MODIFICATIONS.

(a) Treatment of S Corporations Under Subchapter C.—Subsection (a) of section 1371 (relating to application of subchapter C rules) is amended to read as follows:

"(a) Application of Subchapter C Rules.—Except as otherwise provided in this title, and except to the extent inconsistent with this subchapter, subchapter C shall apply to an S corporation and its shareholders."

(b) S Corporations Permitted To Hold Subsidiaries.—

(1) In general.—Paragraph (2) of section 1361(b) (defining ineligible corporation) is amended by striking subparagraph (A) and by redesignating subparagraphs (B), (C), (D), and (E) as subparagraphs (A), (B), (C), and (D), respectively.

(2) Conforming amendments.—

(A) Subsection (c) of section 1361 is amended by striking paragraph (6).

(B) Subsection (b) of section 1504 (defining includible corporation) is amended by adding at the end thereof the following new paragraph:

"(8) An S corporation."

(c) Elimination of Pre-1983 Earnings and Profits.—

(1) In general.—If—

(A) a corporation was an electing small business corporation under subchapter S of chapter 1 of the Internal Revenue Code of 1986 for any taxable year beginning before January 1, 1983, and

(B) such corporation is an S corporation under subchapter S of chapter 1 of such Code for its first taxable year beginning after December 31, 1991,

the amount of such corporation's accumulated earnings and profits (as of the beginning of such first taxable year) shall be reduced by an amount equal to the portion (if any) of such accumulated earnings and profits which were accumulated in any taxable year beginning before January 1, 1983, for which such *corporation was an electing small business corporation under such subchapter S.*

(2) CONFORMING AMENDMENTS.—

(A) Paragraph (3) of section 1362(d) is amended—

(i) by striking "subchapter C" in the paragraph heading and inserting "accumulated",

(ii) by striking "subchapter C" in subparagraph (A)(i)(I) and inserting "accumulated", and

(iii) by striking subparagraph (B) and redesignating the following subparagraphs accordingly.

(B)(i) Subsection (a) of section 1375 is amended by striking "subchapter C" in paragraph (1) and inserting "accumulated".

(ii) Paragraph (3) of section 1375(b) is amended to read as follows:

"(3) PASSIVE INVESTMENT INCOME, ETC.—The terms 'passive investment income' and 'gross receipts' have the same respective meanings as when used in paragraph (3) of section 1362(d)."

(iii) The section heading for section 1375 is amended by striking "SUBCHAPTER C" and inserting "ACCUMULATED".

(iv) The table of sections for part III of subchapter S of chapter 1 is amended by striking "subchapter C" in the item relating to section 1375 and inserting "accumulated".

(C) Clause (i) of section 1042(c)(4)(A) is amended by striking "section 1362(d)(3)(D)" and inserting "section 1362(d)(3)(C)".

(d) ADJUSTMENTS TO BASIS OF INHERITED S STOCK TO REFLECT CERTAIN ITEMS OF INCOME.—Subsection (b) of section 1367 (relating to adjustments to basis of stock of shareholders, etc.) is amended by adding at the end thereof the following new paragraph:

"(4) ADJUSTMENTS IN CASE OF INHERITED STOCK.—

"(A) IN GENERAL.—If any person acquires stock in an S corporation by reason of the death of a decedent or by bequest, devise, or inheritance, section 691 shall be applied with respect to any item of income of the S corporation in the same manner as if the decedent had held directly his pro rata share of such item.

"(B) ADJUSTMENTS TO BASIS.—The basis determined under section 1014 of any stock in an S corporation shall be reduced by the portion of the value of the stock which is attributable to items constituting income in respect of the decedent."

(e) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 1991.

(2) SUBSECTION (d).—The amendment made by subsection (d) shall apply in the case of decedents dying after the date of the enactment of this Act.

PART II—ACCOUNTING PROVISIONS

SEC. 4611. MODIFICATIONS TO LOOK-BACK METHOD FOR LONG-TERM CONTRACTS.

(a) LOOK-BACK METHOD NOT TO APPLY IN CERTAIN CASES.—Subsection (b) of section 460 (relating to percentage of completion method) is amended by adding at the end thereof the following new paragraph:

"(6) ELECTION TO HAVE LOOK-BACK METHOD NOT APPLY IN DE MINIMIS CASES.—

"(A) AMOUNTS TAKEN INTO ACCOUNT AFTER COMPLETION OF CONTRACT.—Paragraph (1)(B) shall not apply with respect to any taxable year (beginning after the taxable year in which the contract is completed) if—

"(i) the cumulative taxable income (or loss) under the contract as of the close of such taxable year, is within

"(ii) 10 percent of the cumulative look-back taxable income (or loss) under the contract as of the close of the most recent taxable year to which paragraph (1)(B) applied (or would have applied but for subparagraph (B)).

"(B) DE MINIMIS DISCREPANCIES.—Paragraph (1)(B) shall not apply in any case to which it would otherwise apply if—

"(i) the cumulative taxable income (or loss) under the contract as of the close of each prior contract year, is within

"(ii) 10 percent of the cumulative look-back income (or loss) under the contract as of the close of such prior contract year.

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

"(i) CONTRACT YEAR.—The term 'contract year' means any taxable year for which income is taken into account under the contract.

"(ii) LOOK-BACK INCOME OR LOSS.—The look-back income (or loss) is the amount which would be the taxable income (or loss) under the contract if the allocation method set forth in paragraph (2)(A) were used in determining taxable income.

"(iii) DISCOUNTING NOT APPLICABLE.—The amounts taken into account after the completion of the contract shall be determined without regard to any discounting under the second sentence of paragraph (2).

"(D) CONTRACTS TO WHICH PARAGRAPH APPLIES.—This paragraph shall only apply if the taxpayer makes an election under this subparagraph. Unless revoked with the consent of the Secretary, such an election shall apply to all long-term contracts completed during the taxable year for which such election is made or during any subsequent taxable year."

(b) MODIFICATION OF INTEREST RATE.—

(1) IN GENERAL.—Subparagraph (C) of section 460(b)(2) is amended by striking "the overpayment rate established by sec-

tion 6621" and inserting "the adjusted overpayment rate (as defined in paragraph (7))".

(2) ADJUSTED OVERPAYMENT RATE.—Subsection (b) of section 460 is amended by adding at the end thereof the following new paragraph:

"(7) ADJUSTED OVERPAYMENT RATE.—

"(A) IN GENERAL.—The adjusted overpayment rate for any interest accrual period is the overpayment rate in effect under section 6621 for the calendar quarter in which such interest accrual period begins.

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

"(i) beginning on the day after the return due date for any taxable year of the taxpayer, and

"(ii) ending on the return due date for the following taxable year.

For purposes of the preceding sentence, the term 'return due date' means the date prescribed for filing the return of the tax imposed by this chapter (determined without regard to extensions)."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to contracts completed in taxable years ending after the date of the enactment of this Act.

SEC. 4612. SIMPLIFIED METHOD FOR CAPITALIZING CERTAIN INDIRECT COSTS.

(a) GENERAL RULE.—Subsection (i) of section 263A (relating to regulations) is amended by striking "and" at the end of paragraph (1), by striking the period at the end of paragraph (2) and inserting ", and", and by adding at the end thereof the following:

"(3) regulations providing that allocations of costs of any administrative, service, or support function or department may be made on the basis of the base period percentage of the current costs of such function or department.

For purposes of paragraph (3), the term 'base period percentage' means, with respect to any function or department, the percentage of the costs of such function or department during a base period specified in regulations which were allocable to property to which this section applies."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after the date of the enactment of this Act.

PART III—PROVISIONS RELATING TO REGULATED INVESTMENT COMPANIES

SEC. 4621. REPEAL OF 30-PERCENT GROSS INCOME LIMITATION.

(a) GENERAL RULE.—Subsection (b) of section 851 (relating to limitations) is amended by striking paragraph (3), by adding "and" at the end of paragraph (2), and by redesignating paragraph (4) as paragraph (3).

(b) TECHNICAL AMENDMENTS.—

(1) The material following paragraph (3) of section 851 (as redesignated by subsection (a)) is amended—

(A) by striking out "paragraphs (2) and (3)" and inserting "paragraph (2)", and

(B) by striking out the last sentence thereof.

(2) Subsection (c) of section 851 is amended by striking "subsection (b)(4)" each place it appears (including the heading) and inserting "subsection (b)(3)".

(3) Subsection (d) of section 851 is amended by striking "subsections (b)(4)" and inserting "subsections (b)(3)".

(4) Paragraph (1) of section 851(e) is amended by striking "subsection (b)(4)" and inserting "subsection (b)(3)".

(5) Paragraph (4) of section 851(e) is amended by striking "subsections (b)(4)" and inserting "subsections (b)(3)"

(6) Section 851 is amended by striking subsection (g) and redesignating subsection (h) as subsection (g).

(7) Subsection (g) of section 851 (as redesignated by paragraph (6)) is amended by striking paragraph (3).

(8) Section 817(h)(2) is amended—

(A) by striking "851(b)(4)" in subparagraph (A) and inserting "851(b)(3)", and

(B) by striking "851(b)(4)(A)(i)" in subparagraph (B) and inserting "851(b)(3)(A)(i)".

(9) Section 1092(f)(2) is amended by striking "Except for purposes of section 851(b)(3), the" and inserting "The".

(c) Effective Date.—The amendments made by this section shall apply to taxable years ending after the date of the enactment of this Act.

SEC. 4622. BASIS RULES FOR SHARES IN OPEN-END REGULATED INVESTMENT COMPANIES.

(a) Additional Reporting Requirement.—Section 6045 (relating to returns of brokers) is amended by adding at the end thereof the following new subsection:

"(f) Additional Information Required With Respect to Open-End Regulated Investment Companies.—

"(1) In general.—If any person is required under subsection (a) to make a return regarding the gross proceeds from any disposition of stock in an open-end regulated investment company, such return shall include for each such disposition—

"(A) the basis of the stock disposed of (determined by reference to the average basis of all of the stock in the account from which the disposition was made immediately before the disposition), and

"(B) the portion of such gross proceeds attributable to stock held for more than 2 years and the portion not so attributable.

Determinations under subparagraph (B) shall be made on a first-in, first-out, basis and determinations of basis and holding period shall be made in such manner as the Secretary may prescribe.

"(2) Open-end regulated investment company.—For purposes of this subsection, the term 'open-end regulated investment company' means any regulated investment company which

is offering for sale or has outstanding any redeemable security (as defined in section 2(a)(32) of the Investment Company Act of 1940) of which it is the issuer.

"(3) INFORMATION TRANSFERS.—To the extent provided in regulations, there shall be such exchanges of information between brokers as such regulations may require for purposes of enabling brokers to meet the requirements of this subsection.

"(4) APPLICATION OF SUBSECTION.—This subsection shall not apply with respect to stock in any account—

"(A) which was established before January 1, 1994, or

"(B) which includes any stock not acquired by purchase."

(b) BASIS FOR INCOME TAX PURPOSES.—Section 1012 of such Code is amended—

(1) by striking "The basis" and inserting "(a) GENERAL RULE.—The basis", and

(2) by adding at the end thereof the following new subsection:

"(b) SPECIAL RULES FOR STOCK IN OPEN-END REGULATED INVESTMENT COMPANIES.—

"(1) IN GENERAL.—In the case of any disposition of stock from a covered account—

"(A) the basis of such stock shall be determined by reference to the average basis of all of the stock in such account immediately before such disposition, and

"(B) the determination of which stock in such account is so disposed of shall be made on a first-in, first-out, basis.

"(2) COVERED ACCOUNT.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'covered account' means any account of stock in an open-end regulated investment company if section 6045(f) applies to such account.

"(B) ELECTION OUT.—The term 'covered account' shall not include any account if, on the taxpayer's return for his first taxable year in which a disposition from such account occurs, the taxpayer elects to have this subsection not apply to such account."

(c) TECHNICAL AMENDMENT.—Section 6724 of such Code is amended by adding at the end thereof the following new subsection:

"(e) SPECIAL RULE FOR CERTAIN REPORTS WITH RESPECT TO STOCK IN OPEN END REGULATED INVESTMENT COMPANIES.—For purposes of sections 6721(e)(2)(B) and 6722(c)(1)(B), the amount required to be reported under section 6045 shall be determined without regard to subsection (f) thereof."

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to returns and statements required for calendar year 1994 and subsequent calendar years.

(2) SUBSECTION (b).—The amendments made by subsection (b) shall apply to dispositions on or after December 31, 1993.

SEC. 4623. NONRECOGNITION TREATMENT FOR CERTAIN TRANSFERS BY COMMON TRUST FUNDS TO REGULATED INVESTMENT COMPANIES.

(a) GENERAL RULE.—Section 584 (relating to common trust funds) is amended by redesignating subsection (h) as subsection (i) and by inserting after subsection (g) the following new subsection:

"(h) NONRECOGNITION TREATMENT FOR CERTAIN TRANSFERS TO REGULATED INVESTMENT COMPANIES.—

"(1) IN GENERAL.—If—

"(A) a common trust fund transfers substantially all of its assets to a regulated investment company in exchange solely for stock in such company, and

"(B) such stock is distributed by such common trust fund to participants in such common trust fund in exchange for their interests in such common trust fund,

no gain or loss shall be recognized by such common trust fund by reason of such transfer or distribution, and no gain or loss shall be recognized by any participant in such common trust fund by reason of such exchange.

"(2) BASIS RULES.—

"(A) REGULATED INVESTMENT COMPANY.—The basis of any asset received by a regulated investment company in a transfer referred to in paragraph (1)(A) shall be the same as it would be in the hands of the common trust fund.

"(B) PARTICIPANTS.—The basis of any stock in a regulated investment company which is received in an exchange referred to in paragraph (1)(B) shall be the same as that of the property exchanged.

"(3) COMMON TRUST FUND MUST MEET DIVERSIFICATION RULES.—This subsection shall not apply to any common trust fund which would not meet the requirements of section 368(a)(2)(F)(ii) if it were a corporation."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to transfers after the date of the enactment of this Act.

PART IV—TAX-EXEMPT BOND PROVISIONS

SEC. 4631. REPEAL OF $100,000 LIMITATION ON UNSPENT PROCEEDS UNDER 1-YEAR EXCEPTION FROM REBATE.

Subclause (I) of section 148(f)(4)(B)(ii) (relating to additional period for certain bonds) is amended by striking "the lesser of 5 percent of the proceeds of the issue or $100,000" and inserting "5 percent of the proceeds of the issue".

SEC. 4632. EXCEPTION FROM REBATE FOR EARNINGS ON BONA FIDE DEBT SERVICE FUND UNDER CONSTRUCTION BOND RULES.

Subparagraph (C) of section 148(f)(4) is amended by adding at the end thereof the following new clause:

"(xvii) TREATMENT OF BONA FIDE DEBT SERVICE FUNDS.—If the spending requirements of clause (ii) are met with respect to the available construction proceeds of a construction issue, then paragraph (2) shall not apply to earnings on a bona fide debt service fund for such issue."

SEC. 4633. AUTOMATIC EXTENSION OF INITIAL TEMPORARY PERIOD FOR CONSTRUCTION ISSUES.

Subsection (c) of section 148 (relating to temporary period exception) is amended by adding at the end thereof the following new paragraph:

"(3) EXTENSION OF INITIAL TEMPORARY PERIOD FOR CONSTRUCTION ISSUES.—If—

"(A) at least 85 percent of the available construction proceeds (as defined in subsection (f)(4)(C)) of a construction issue (as defined in such subsection) are spent as of the close of the initial temporary period (determined without regard to this paragraph), and

"(B) the issuer reasonably expects (as of the close of such period) that the remaining available construction proceeds of such issue will be spent within 1 year after the close of such period,

then such initial temporary period shall be extended 1 year."

SEC. 4634. AGGREGATION OF ISSUES RULES NOT TO APPLY TO TAX OR REVENUE ANTICIPATION BONDS.

Section 150 (relating to definitions and special rules) is amended by adding at the end thereof the following new subsection:

"(f) TAX OR REVENUE ANTICIPATION BONDS TREATED AS SEPARATE ISSUES.—For purposes of this part, if—

"(1) all of the bonds which are part of an issue are qualified 501(c)(3) bonds or bonds which are not private activity bonds, and

"(2) any portion of such issue consists of tax or revenue anticipation bonds which are reasonably expected to meet the requirements of section 148(f)(4)(B)(iii),

then such portion shall, subject to appropriate allocations specified in regulations prescribed by the Secretary, be treated as a separate issue."

SEC. 4635. EXPANDED EXCEPTION FROM REBATE FOR ISSUERS ISSUING $10,000,000 OR LESS OF BONDS.

Subparagraph (D) of section 148(f) (relating to exception for governmental units issuing $5,000,000 or less of bonds) is amended by striking "$5,000,000" each place it appears (including the heading) and inserting "$10,000,000".

SEC. 4636. REPEAL OF DEBT SERVICE-BASED LIMITATION ON INVESTMENT IN CERTAIN NONPURPOSE INVESTMENTS.

Subsection (d) of section 148 (relating to special rules for reasonably required reserve or replacement fund) is amended by striking paragraph (3).

SEC. 4637. ALLOCATION OF INTEREST EXPENSE OF FINANCIAL INSTITUTIONS TO TAX-EXEMPT INTEREST.

Subparagraphs (C) and (D) of section 265(b)(3) (relating to exception for certain tax-exempt obligations) are each amended by striking "$10,000,000" each place it appears and inserting "$20,000,000".

SEC. 4638. REPEAL OF EXPIRED PROVISIONS.

(a) Paragraph (2) of section 148(c) is amended by striking subparagraph (B) and by redesignating subparagraphs (C), (D), and (E) as subparagraph (B), (C), and (D), respectively.

(b) Paragraph (4) of section 148(f) is amended by striking subparagraph (E).

SEC. 4639. CLARIFICATION OF INVESTMENT-TYPE PROPERTY.

Subparagraph (D) of section 148(b)(2) is amended to read as follows:

"(D) any investment-type property, or".

SEC. 4640. EFFECTIVE DATES.

(a) IN GENERAL.—Except as otherwise provided in this section, the amendments made by this subtitle shall apply to bonds issued after the date of the enactment of this Act.

(b) CALENDAR YEAR RULES.—The amendments made by sections 4635 and 4637 shall apply to bonds issued in calendar years beginning after the date of the enactment of this Act.

(c) INVESTMENT-TYPE PROPERTY.—The amendment made by section 4640 shall take effect as if included in the amendments made by section 1301 of the Tax Reform Act of 1986.

PART V—ELECTION OF ALTERNATIVE TAXABLE YEARS

SEC. 4641. ELECTION OF TAXABLE YEAR OTHER THAN REQUIRED TAXABLE YEAR.

(a) LIMITATIONS ON TAXABLE YEARS WHICH MAY BE ELECTED.—Subsection (b) of section 444 (relating to limitations on taxable years which may be elected) is amended to read as follows:

"(b) TAXABLE YEAR MUST BE SAME AS REPORTING PERIOD.—If an entity has annual reports or statements—

"(1) which ascertain income, profit, or loss of the entity, and

"(2) which are—

"(A) provided to shareholders, partners, or other proprietors, or

"(B) used for credit purposes,

the entity may make an election under subsection (a) only if the taxable year elected covers the same period as such reports or statements."

(b) PERIOD OF ELECTION.—Section 444(d)(2) (relating to period of election) is amended to read as follows:

"(2) PERIOD OF ELECTION.—

"(A) IN GENERAL.—An election under subsection (a) shall remain in effect until the partnership, S corporation, or personal service corporation terminates the election and adopts the required taxable year.

"(B) CHANGE NOT TREATED AS TERMINATION.—For purposes of subparagraph (A), a change from a taxable year which is not a required taxable year to another such taxable year shall not be treated as a termination."

(c) EXCEPTION FOR TRUSTS.—Section 444(d)(3) (relating to tiered structures) is amended by adding at the end thereof the following new subparagraph:

"(C) EXCEPTION FOR CERTAIN STRUCTURES THAT INCLUDE TRUSTS.—An entity shall not be considered to be part of a tiered structure to which subparagraph (A) applies solely because a trust owning an interest in such entity is a trust all of the beneficiaries of which use a calendar year for their taxable year."

(d) REGULATIONS.—Subsection (g) of section 444 (relating to regulations) is amended to read as follows:

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

"(1) to prevent the avoidance of the provisions of this section through a change in entity or form of an entity,

"(2) to prevent the carryback to any preceding taxable year of a net operating loss (or similar item) arising in any short taxable year created pursuant to an election or termination of an election under this section, and

"(3) to provide for the termination of an election under subsection (a) if an entity does not continue to meet the requirements of subsection (b)."

SEC. 4642. REQUIRED PAYMENTS FOR ENTITIES ELECTING NOT TO HAVE REQUIRED TAXABLE YEAR.

(a) Additional Required Payment.—

(1) In general.—Section 7519(b) (defining required payment) is amended to read as follows:

"(b) Required Payment.—For purposes of this section—

"(1) In general.—The term 'required payment' means, with respect to any applicable election year of a partnership or S corporation, an amount equal to the excess (if any) of—

"(A) the adjusted highest section 1 rate, multiplied by the net base year income of the entity, over

"(B) the net required payment balance.

For purposes of paragraph (1)(A), the term 'adjusted highest section 1 rate' means the highest rate of tax in effect under section 1 as of the close of the first required taxable year ending within such year, plus 2 percentage points.

"(2) Additional payment for new applicable election years.—

"(A) In general.—In the case of a new applicable election year, the required payment shall include, in addition to any amount determined under paragraph (1), the amount determined under subparagraph (C).

"(B) New applicable election year.—For purposes of this section, the term 'new applicable election year' means any applicable election year—

"(i) with respect to which the preceding taxable year was not an applicable election year, or

"(ii) which covers a different period than the preceding taxable year by reason of a change described in section 444(d)(2)(B).

If any year described in the preceding sentence is a short taxable year which does not include the last day of the required taxable year, the new applicable election year shall be the taxable year following the short taxable year.

"(C) Additional amount.—For purposes of subparagraph (A), the amount determined under this subparagraph shall be—

"(i) in the case of a year described in subparagraph (B)(i), 75 percent of the required payment for the year, and

"(ii) in the case of a year described in subparagraph (B)(ii), 75 percent of the excess (if any) of—

"(I) the required payment for the year, over

"(II) the required payment for the year which would have been computed if the change described in subparagraph (B)(ii) had not occurred.

"(D) REQUIRED PAYMENT.—For purposes of this paragraph, the term 'required payment' means the payment required by this section (determined without regard to this paragraph)."

(2) DUE DATE.—Paragraph (2) of section 7519(f) (defining due date) is amended to read as follows:

"(2) DUE DATE.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the amount of any required payment for any applicable election year shall be paid on or before May 15 of the calendar year following the calendar year in which the applicable election year begins.

"(B) SPECIAL RULE WHERE NEW APPLICABLE ELECTION YEAR ADOPTED.—In the case of a new applicable election year, the portion of any required payment determined under subsection (b)(2) shall be paid on or before September 15 of the calendar year in which the applicable election year begins."

(3) PENALTIES.—

(A) IN GENERAL.—Section 7519(f)(4) (relating to penalties) is amended by adding at the end thereof the following new subparagraph:

"(D) FAILURE TO PAY ADDITIONAL AMOUNT.—In the case of any failure by any entity to pay on the date prescribed therefore the portion of any required payment described in subsection (b)(2) for any applicable election year—

"(i) subparagraph (A) shall not apply, but

"(ii) the entity shall, for purposes of this title, be treated as having terminated the election under section 444 for such year and changed to the required taxable year."

(B) CONFORMING AMENDMENT.—Section 7519(f)(4)(A) is amended by striking "In" and inserting "Except as provided in subparagraph (D), in".

(4) REFUNDS.—Section 7519(c)(2)(A) (relating to refund of payments) is amended to read as follows:

"(A) an election under section 444 is not in effect for any year but was in effect for the preceding year, or".

(5) CONFORMING AMENDMENTS.—

(A) Paragraph (1) of section 7519(c) is amended—

(i) by striking "subsection (b)(2)" and inserting "subsection (b)(1)(B)", and

(ii) by striking "subsection (b)(1)" and inserting "subsection (b)(1)(A)".

(B) Subsection (d) of section 7519 is amended by striking paragraph (4) and redesignating paragraph (5) as paragraph (4).

(b) OTHER DEFINITIONS AND SPECIAL RULES.—

(1) Refund.—Paragraph (3) of section 7519(c) (relating to date on which refund payable) is amended in the matter preceding subparagraph (A) by striking "on the later of" and inserting "by the later of".

(2) Deferral ratio.—The last sentence of paragraph (1) of section 7519(d) is amended to read as follows: "Except as provided in regulations, the term 'deferral ratio' means the ratio which the number of months in the deferral period of the applicable election year bears to the number of months in the applicable election year."

(3) Net income.—Paragraph (2) of section 7519(d) is amended by adding at the end the following new subparagraph:

"(D) Excess applicable payments for base year.—In the case of any new applicable election year, the net income for the base year shall be increased by the excess (if any) of—

"(i) the applicable payments taken into account in determining net income for the base year, over

"(ii) 120 percent of the average amount of applicable payments made during the first 3 taxable years preceding the base year."

(4) Deferral period.—Paragraph (1) of section 7519(e) (defining deferral period) is amended to read as follows:

"(1) Deferral period.—Except as provided in regulations, the term 'deferral period' means, with respect to any taxable year of the entity, the months between—

"(A) the beginning of such year, and

"(B) the close of the first required taxable year (as defined in section 444(e)) ending within such year."

(5) Base year.—

(A) In general.—Paragraph (2)(A) of section 7519(e) (defining base year) is amended to read as follows:

"(A) Base year.—The term 'base year' means, with respect to any applicable election year, the first taxable year of 12 months (or 52–53 weeks) of the partnership or S corporation preceding such applicable election year."

(B) Conforming amendment.—Paragraph (2) of subsection (g) of section 7519 is amended to read as follows:

"(2) there is no base year described in subsection (e)(2)(A) or no preceding taxable year described in section 280H(c)(1)(A)(i)."

(c) Interest.—Section 7519(f)(3) (relating to interest) is amended to read as follows:

"(3) Interest.—For purposes of determining interest, any payment required by this section shall be treated as a tax, except that interest shall be allowed with respect to any refund of a payment under this section only for the period from the latest date specified in subsection (c)(3) for such refund to the actual date of payment of such refund."

SEC. 4643. LIMITATION ON CERTAIN AMOUNTS PAID TO EMPLOYEE-OWNERS OF PERSONAL SERVICE CORPORATIONS.

(a) Carryover of Nondeductible Amounts.—Subsection (b) of section 280H (relating to carryover of nondeductible amounts) is amended to read as follows:

"(b) CARRYOVER OF NONDEDUCTIBLE AMOUNTS.—Any amount not allowed as a deduction for a taxable year pursuant to subsection (a) shall be allowed as a deduction in the succeeding taxable year."

(b) MINIMUM DISTRIBUTION REQUIREMENT.—Paragraph (1) of section 280H(c) is amended to read as follows:

"(1) IN GENERAL.—A personal service corporation meets the minimum distribution requirements of this subsection if the applicable amounts paid during the deferral period of the taxable year equal or exceed the lesser of—

"(A) 110 percent of the product of—

"(i) the applicable amounts paid during the first preceding taxable year of 12 months (or 52–53 weeks), divided by 12, and

"(ii) the number of months in the deferral period of the taxable year, or

"(B) 110 percent of the amount equal to the applicable percentage of the adjusted taxable income for the deferral period of the taxable year."

(c) DISALLOWANCE OF NOL CARRYBACKS.—Subsection (e) of section 280H (relating to disallowance of net operating loss carrybacks) is amended by striking "to (or from)" and inserting "from".

(d) CONFORMING AMENDMENT.—Subparagraph (A) of section 280H(f)(3) (relating to deferral period) is amended by striking "section 444(b)(4)" and inserting "section 7519(e)(1)."

SEC. 4644. EFFECTIVE DATE.

The amendments made by this part shall apply to taxable years beginning after December 31, 1991.

PART VI—COOPERATIVES

SEC. 4651. TREATMENT OF CERTAIN LOAN REQUIREMENTS.

(a) IN GENERAL.—Subparagraph (C) of section 501(c)(12) is amended by striking "or" at the end of clause (i), by striking the period at the end of clause (ii) and inserting ", or", and by adding at the end the following new clause:

"(i) from the prepayment of any loan under section 2387 of the Food, Agriculture, Conservation, and Trade Act of 1990 (as in effect on January 1, 1992)."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning before, on, or after the date of the enactment of this Act.

SEC. 4652. COOPERATIVE SERVICE ORGANIZATIONS FOR CERTAIN FOUNDATIONS.

(a) IN GENERAL.—Section 501 (relating to exemption from tax on corporations, certain trusts, etc.), is amended by redesignating subsection (n) as subsection (o) and by inserting after subsection (m) the following new subsection:

"(n) COOPERATIVE SERVICE ORGANIZATIONS FOR CERTAIN FOUNDATIONS.—

"(1) IN GENERAL.—For purposes of this title, if an organization—

"(A) is organized and operated solely for purposes referred to in subsection (f)(1),

"(B) is comprised solely of members which are exempt from taxation under subsection (a) and are—

"(i) private foundations, or

"(ii) community foundations as to which section 170(b)(1)(A)(vi) applies,

"(C) has at least 20 members,

"(D) does not at any time after the second taxable year beginning after the date of its organization, or, if later, the date of the enactment of this subsection, have a member which holds more than 10 percent (by value) of the interests in the organization,

"(E) is not controlled by any one member and does not have a member which controls another member of the organization, and

"(F) permits members of the organization to require the dismissal of any of the organization's investment advisors, following reasonable notice, upon a vote of the members holding a majority of interest in the account managed by such advisor,

then such organization shall be treated as an organization organized and operated exclusively for charitable purposes.

"(2) TREATMENT OF INCOME OF MEMBERS.—If any member of an organization described in paragraph (1) is a private foundation (other than an exempt operating foundation, as defined in section 4940(d)), such private foundation's allocable share of the capital gain net income and gross investment income of the organization for any taxable year of the organization shall be treated, for purposes of section 4940, as capital gain net income and gross investment income of such private foundation (whether or not distributed to such foundation) for the taxable year of such private foundation with or within which the taxable year of the organization described in paragraph (1) ends.

"(3) APPLICABLE EXCISE TAXES.—Subchapter A of chapter 42 (other than sections 4940 and 4942) shall apply to any organization described in paragraph (1)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years ending after the date of the enactment of this Act.

SEC. 4653. TREATMENT OF CERTAIN AMOUNTS RECEIVED BY A COOPERATIVE TELEPHONE COMPANY.

(a) NONMEMBER INCOME.—

(1) IN GENERAL.—Paragraph (12) of section 501(c) (relating to list of exempt organizations) is amended by adding at the end thereof the following new subparagraph:

"(E) In the case of a mutual or cooperative telephone company (hereafter in this subparagraph referred to as the 'cooperative'), 50 percent of the income received or accrued directly or indirectly from a nonmember telephone company for the performance of communication services by the cooperative shall be treated for purposes of subparagraph (A) as collected from members of the cooperative for the sole purpose of meeting the losses and expenses of the cooperative."

(2) CERTAIN BILLING AND COLLECTION SERVICE FEES NOT TAKEN INTO ACCOUNT.—Subparagraph (B) of section 501(c)(12) is amended by striking "or" at the end of clause (iii), by striking the period at the end of clause (iv) and inserting ", or", and by adding at the end thereof the following new clause:

"(v) from billing and collection services performed for a nonmember telephone company.".

(3) CONFORMING AMENDMENT.—Clause (i) of section 501(c)(12)(B) is amended by inserting before the comma ", other than income described in subparagraph (E)".

(4) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years beginning before, on, or after the date of the enactment of this Act.

(5) NO INFERENCE AS TO UNRELATED BUSINESS INCOME TREATMENT OF BILLING AND COLLECTION SERVICE FEES.—Nothing in the amendments made by this subsection shall be construed to indicate the proper treatment of billing and collection service fees under part III of subchapter F of chapter 1 of the Internal Revenue Code of 1986 (relating to taxation of business income of certain exempt organizations).

(b) TREATMENT OF CERTAIN INVESTMENT INCOME OF MUTUAL OR COOPERATIVE TELEPHONE COMPANIES.—

(1) IN GENERAL.—Paragraph (12) of section 501(c) (relating to list of exempt organizations) is amended by adding at the end thereof the following new subparagraph:

"(F) In the case of a mutual or cooperative telephone company, subparagraph (A) shall be applied without taking into account reserve income (as defined in section 512(d)(2)) if such income, when added to other income not collected from members for the sole purpose of meeting losses and expenses, does not exceed 35 percent of the company's total income."

(2) PORTION OF INVESTMENT INCOME SUBJECT TO UNRELATED BUSINESS INCOME TAX.—Section 512 is amended by adding at the end thereof the following new subsection:

"(d) INVESTMENT INCOME OF CERTAIN MUTUAL OR COOPERATIVE TELEPHONE COMPANIES.—

"(1) IN GENERAL.—In determining the unrelated business taxable income of a mutual or cooperative telephone company described in section 501(c)(12)—

"(A) there shall be included, as an item of gross income derived from an unrelated trade or business, reserve income to the extent such reserve income, when added to other income not collected from members for the sole purpose of meeting losses and expenses, exceeds 15 percent of the company's total income, and

"(B) there shall be allowed all deductions directly connected with the portion of the reserve income which is so included.

"(2) RESERVE INCOME.—For purposes of paragraph (1), the term 'reserve income' means income—

"(A) which would (but for this subsection) be excluded under subsection (b), and

"(B) which is derived from assets set aside for the repair or replacement of telephone system facilities of such company."

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 4654. TAX TREATMENT OF COOPERATIVE HOUSING CORPORATIONS.

(a) SECTION 277 NOT TO APPLY TO COOPERATIVE HOUSING CORPORATIONS.—Section 277(b) (relating to exceptions) is amended by striking "or" at the end of paragraph (3), by striking the period at the end of paragraph (4) and inserting a comma and "or", and by adding at the end thereof the following new paragraph:

"(5) which for the taxable year is a cooperative housing corporation described in section 216(b)(1)."

(b) APPLICATION OF RULES RELATING TO TAX TREATMENT OF COOPERATIVES.—

(1) PATRONAGE EARNINGS MAY BE OFFSET ONLY BY PATRONAGE LOSSES.—Section 1388(a) is amended by adding at the end the following new sentence: "In no event shall any patronage losses of a cooperative housing corporation described in section 216(b)(1) be used to offset earnings which are not patronage earnings."

(2) PATRONAGE EARNINGS AND LOSSES OF COOPERATIVE HOUSING CORPORATIONS.—Section 1388 is amended by adding at the end the following new subsection:

"(k) PATRONAGE EARNINGS OR LOSSES DEFINED.—For purposes of this section—

"(1) IN GENERAL.—The terms 'patronage earnings' and 'patronage losses' mean earnings and losses, respectively, which are derived from business done with or for patrons of the organization.

"(2) SPECIAL RULES FOR COOPERATIVE HOUSING CORPORATION.—In the case of a cooperative housing corporation, the following earnings shall be treated as patronage earnings:

"(A) Interest on reasonable reserves established in connection with the corporation, including reserves required by a governmental agency or lender.

"(B) Income from laundry and parking facilities located on property owned or leased by the cooperative to the extent attributable to use of the facilities by tenant-stockholders and their guests.

"(C) In the case of a limited equity cooperative housing corporation, rental income from other than tenant-stockholders to the extent attributable to any project operated by the corporation.

"(3) DEFINITIONS.—For purposes of paragraph (2)—

"(A) COOPERATIVE HOUSING CORPORATION.—The term 'cooperative housing corporation' has the meaning given such term by section 216(b)(1).

"(B) LIMITED EQUITY COOPERATIVE HOUSING CORPORATION.—The term 'limited equity cooperative housing corporation' means a cooperative housing corporation with re-

spect to which the requirements of clause (i) of section 143(k)(9)(D) are met at all times during the taxable year.

"(C) TENANT-STOCKHOLDER.—The term 'tenant-stockholder' has the meaning given such term by section 216(b)(2)."

(3) CONFORMING AMENDMENT.—Section 1388(j) is amended by striking paragraph (4).

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

(2) NO INFERENCE.—Nothing in the provisions of this section shall be construed as a change in the treatment of income derived by any cooperative housing corporation, or any corporation operating on a cooperative basis under section 1381 of the Internal Revenue Code of 1986, and the treatment of such income for any year to which the amendments made by this section does not apply shall be made as if this section had not been enacted.

PART VII—EMPLOYMENT

SEC. 4661. CREDIT FOR PORTION OF EMPLOYER SOCIAL SECURITY TAXES PAID WITH RESPECT TO EMPLOYEE CASH TIPS.

(a) IN GENERAL.—Subpart D of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1986 (relating to business related credits) is amended by adding at the end the following new section:

"SEC. 45. CREDIT FOR PORTION OF EMPLOYER SOCIAL SECURITY TAXES PAID WITH RESPECT TO EMPLOYEE CASH TIPS.

"(a) GENERAL RULE.—For purposes of section 38, the employer social security credit determined under this section for the taxable year is an amount equal to the excess employer social security tax paid or incurred by the taxpayer during the taxable year.

"(b) EXCESS EMPLOYER SOCIAL SECURITY TAX.—For purposes of this section, the term 'excess employer social security tax' means any tax paid by an employer under section 3111 with respect to tips received by an employee during any month, to the extent such tips—

"(1) are deemed to have been paid by the employer to the employee pursuant to section 3121(q), and

"(2) exceed the amount by which the wages (excluding tips) paid by the employer to the employee during such month are less than the total amount which would be payable (with respect to such employment) at the minimum wage rate applicable to such individual under section 6(a)(1) of the Fair Labor Standards Act of 1938 (determined without regard to section 3(m) of such Act).

"(c) DENIAL OF DOUBLE BENEFIT.—No deduction shall be allowed under this chapter for any amount taken into account in determining the credit under this section."

(b) CREDIT TO BE PART OF GENERAL BUSINESS CREDIT.—

(1) IN GENERAL.—Subsection (b) of section 38 of such Code (relating to current year business credit) is amended by striking "plus" at the end of paragraph (6), by striking the period at the

end of paragraph (7) and inserting ", plus", and by adding at the end the following new paragraph:

"(8) the employer social security credit determined under section 45(a)."

(2) LIMITATION ON CARRYBACKS.—Subsection (d) of section 39 of such Code (relating to transitional rules) is amended—

(A) by redesignating the paragraph added by section 11511(b)(2) of the Revenue Reconciliation Act of 1990 as paragraph (1),

(B) by redesignating the paragraph added by section 11611(b)(2) of such Act as paragraph (2), and

(C) by adding at the end the following new paragraph:

"(3) NO CARRYBACK OF SECTION 45 CREDIT BEFORE ENACTMENT.—No portion of the unused business credit for any taxable year which is attributable to the employer social security credit determined under section 45 may be carried back to a taxable year ending before the date of the enactment of section 45."

(c) CLERICAL AMENDMENT.—The table of sections for subpart D of part IV of subchapter A of chapter 1 of such Code is amended by adding at the end the following new item:

"Sec. 45. Employer social security credit."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to tips received (and wages paid) after the date of the enactment of this Act.

SEC. 4662. CLARIFICATION OF EMPLOYMENT TAX STATUS OF CERTAIN FISHERMEN.

(a) AMENDMENTS OF INTERNAL REVENUE CODE OF 1986.—

(1) DETERMINATION OF SIZE OF CREW.—Subsection (b) of section 3121 (defining employment) is amended by adding at the end thereof the following new sentence:

"For purposes of paragraph (20), the operating crew of a boat shall be treated as normally made up of fewer than 10 individuals if the average size of the operating crew on trips made during the preceding 4 calendar quarters consisted of fewer than 10 individuals."

(2) CERTAIN CASH REMUNERATION PERMITTED.—Subparagraph (A) of section 3121(b)(20) is amended to read as follows:

"(A) such individual does not receive any cash remuneration other than as provided in subparagraph (B) and other than cash remuneration—

"(i) which does not exceed $100 per trip;

"(ii) which is contingent on a minimum catch; and

"(iii) which is paid solely for additional duties (such as mate, engineer, or cook) for which additional cash remuneration is traditional in the industry,".

(b) AMENDMENT OF SOCIAL SECURITY ACT.—

(1) DETERMINATION OF SIZE OF CREW.—Subsection (a) of section 210 of the Social Security Act is amended by adding at the end thereof the following new sentence:

"For purposes of paragraph (20), the operating crew of a boat shall be treated as normally made up of fewer than 10 individuals if the average size of the operating crew on trips made during the preceding 4 calendar quarters consisted of fewer than 10 individuals."

(2) CERTAIN CASH REMUNERATION PERMITTED.—Subparagraph (A) of section 210(a)(20) of such Act is amended to read as follows:

"(A) such individual does not receive any additional compensation other than as provided in subparagraph (B) and other than cash remuneration—

"(i) which does not exceed $100 per trip;

"(ii) which is contingent on a minimum catch; and

"(iii) which is paid solely for additional duties (such as mate, engineer, or cook) for which additional cash remuneration is traditional in the industry,".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to remuneration paid after December 31, 1992.

(2) SPECIAL RULE.—The amendments made by this section shall also apply to remuneration paid after December 31, 1984, and before January 1, 1993, unless the payor treated such remuneration (when paid) as being subject to tax under chapter 21 of the Internal Revenue Code of 1986.

PART VIII—OTHER PROVISIONS

SEC. 4671. CLOSING OF PARTNERSHIP TAXABLE YEAR WITH RESPECT TO DECEASED PARTNER.

(a) GENERAL RULE.—Subparagraph (A) of section 706(c)(2) (relating to disposition of entire interest) is amended to read as follows:

"(A) DISPOSITION OF ENTIRE INTEREST.—The taxable year of a partnership shall close with respect to a partner whose entire interest in the partnership terminates (whether by reason of death, liquidation, or otherwise)."

(b) CLERICAL AMENDMENT.—The paragraph heading for paragraph (2) of section 706(c) is amended to read as follows:

"(2) TREATMENT OF DISPOSITIONS.—".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to partnership taxable years beginning after December 31, 1991.

SEC. 4672. REPEAL OF SPECIAL TREATMENT OF OWNERSHIP CHANGES IN DETERMINING ADJUSTED CURRENT EARNINGS.

(a) GENERAL RULE.—Paragraph (4) of section 56(g) (relating to adjustments) is amended by striking subparagraph (G) and by redesignating the following subparagraph as paragraph (G).

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to ownership changes after December 31, 1991.

SEC. 4673. REPEAL OF INVESTMENT RESTRICTIONS APPLICABLE TO NUCLEAR DECOMMISSIONING FUNDS.

(a) IN GENERAL.—Subparagraph (C) of section 468A(e)(4) (relating to special rules for nuclear decommissioning funds) is amended by striking "described in section 501(c)(21)(B)(ii)".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1991.

SEC. 4674. MODIFICATION OF CREDIT FOR PRODUCING FUEL FROM A NONCONVENTIONAL SOURCE.

(a) IN GENERAL.—Subparagraph (A) of section 29(c)(2) (relating to gas from geopressured brine, etc.) is amended by adding at the end the following new sentence: "If the Federal Energy Regulatory Commission ceases to make the determinations described in the preceding sentence, the Secretary shall make such determinations in accordance with section 503 of such Act."

(b) CONFORMING AMENDMENT.—Section 29(c)(2)(A) is amended by inserting "(as in effect before its repeal by the Natural Gas Wellhead Decontrol Act of 1989)" after "Natural Gas Policy Act of 1978".

Subtitle G—Estate And Gift Tax Provisions

SEC. 4701. CLARIFICATION OF WAIVER OF CERTAIN RIGHTS OF RECOVERY.

(a) AMENDMENT TO SECTION 2207A.—Paragraph (2) of section 2207A(a) (relating to right of recovery in the case of certain marital deduction property) is amended to read as follows:

> *"(2) DECEDENT MAY OTHERWISE DIRECT.—Paragraph (1) shall not apply with respect to any property to the extent that the decedent in his will (or a revocable trust) specifically indicates an intent to waive any right of recovery under this subchapter with respect to such property."*

(b) AMENDMENT TO SECTION 2207B.—Paragraph (2) of section 2207B(a) (relating to right of recovery where decedent retained interest) is amended to read as follows:

> *"(2) DECEDENT MAY OTHERWISE DIRECT.—Paragraph (1) shall not apply with respect to any property to the extent that the decedent in his will (or a revocable trust) specifically indicates an intent to waive any right of recovery under this subchapter with respect to such property."*

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to the estates of decedents dying after the date of the enactment of this Act.

SEC. 4702. ADJUSTMENTS FOR GIFTS WITHIN 3 YEARS OF DECEDENT'S DEATH.

(a) GENERAL RULE.—Section 2035 is amended to read as follows:

"SEC. 2035. ADJUSTMENTS FOR CERTAIN GIFTS MADE WITHIN 3 YEARS OF DECEDENT'S DEATH.

"(a) INCLUSION OF CERTAIN PROPERTY IN GROSS ESTATE.—If—

> *"(1) the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and*
>
> *"(2) the value of such property (or an interest therein) would have been included in the decedent's gross estate under section 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of his death,*

the value of the gross estate shall include the value of any property (or interest therein) which would have been so included.

"(b) INCLUSION OF GIFT TAX ON GIFTS MADE DURING 3 YEARS BEFORE DECEDENT'S DEATH.—The amount of the gross estate (determined without regard to this subsection) shall be increased by the amount of any tax paid under chapter 12 by the decedent or his estate on any gift made by the decedent or his spouse during the 3-year period ending on the date of the decedent's death.

"(c) OTHER RULES RELATING TO TRANSFERS WITHIN 3 YEARS OF DEATH.—

"(1) IN GENERAL.—For purposes of—

"(A) section 303(b) (relating to distributions in redemption of stock to pay death taxes),

"(B) section 2032A (relating to special valuation of certain farms, etc., real property), and

"(C) subchapter C of chapter 64 (relating to lien for taxes),

the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, during the 3-year period ending on the date of the decedent's death.

"(2) COORDINATION WITH SECTION 6166.—An estate shall be treated as meeting the 35 percent of adjusted gross estate requirement of section 6166(a)(1) only if the estate meets such requirement both with and without the application of paragraph (1).

"(3) SMALL TRANSFERS.—Paragraph (1) shall not apply to any transfer (other than a transfer with respect to a life insurance policy) made during a calendar year to any donee if the decedent was not required by section 6019 (other than by reason of section 6019(a)(2)) to file any gift tax return for such year with respect to transfers to such donee.

"(d) EXCEPTION.—Subsection (a) shall not apply to any bona fide sale for an adequate and full consideration in money or money's worth.

"(e) TREATMENT OF CERTAIN REVOCABLE TRUSTS.—For purposes of this section and section 2038, any transfer from any portion of a trust with respect to which the decedent was the grantor during any period when the decedent held the power to revest in the decedent title to such portion shall be treated as a transfer made directly by the decedent."

(b) CLERICAL AMENDMENT.—The table of sections for part III of subchapter A of chapter 11 is amended by striking "gifts" in the item relating to section 2035 and inserting "certain gifts".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to the estates of decedents dying after the date of the enactment of this Act.

SEC. 4703. CLARIFICATION OF QUALIFIED TERMINABLE INTEREST RULES.

(a) GENERAL RULE.—

(1) ESTATE TAX.—Subparagraph (B) of section 2056(b)(7) (defining qualified terminable interest property) is amended by adding at the end thereof the following new clause:

"(v)(i) TREATMENT OF CERTAIN INCOME DISTRIBUTIONS.—An income interest shall not fail to qualify as a qualified income interest for life solely because

income for the period after the last distribution date and on or before the date of the surviving spouse's death is not required to be distributed to the surviving spouse or to the estate of the surviving spouse."

(2) Gift tax.—Paragraph (3) of section 2523(f) is amended by striking "and (iv)" and inserting ", (iv), and (vi)".

(b) Clarification of Subsequent Inclusions.—Section 2044 is amended by adding at the end thereof the following new subsection:

"(d) Clarification of Inclusion of Certain Income.—The amount included in the gross estate under subsection (a) shall include the amount of any income from the property to which this section applies for the period after the last distribution date and on or before the date of the decedent's death if such income is not otherwise included in the decedent's gross estate."

(c) Effective Date.—

(1) In general.—The amendments made by this section shall apply with respect to the estates of decedents dying, and gifts made, after the date of the enactment of this Act.

(2) Application of section 2044 to transfers before date of enactment.—In the case of the estate of any decedent dying after the date of the enactment of this Act, if there was a transfer of property on or before such date—

(A) such property shall not be included in the gross estate of the decedent under section 2044 of the Internal Revenue Code of 1986 if no prior marital deduction was allowed with respect to such a transfer of such property to the decedent, but

(B) such property shall be so included if such a deduction was allowed.

SEC. 4704. TREATMENT OF PORTIONS OF PROPERTY UNDER MARITAL DEDUCTION.

(a) Estate Tax.—Subsection (b) of section 2056 (relating to limitation in case of life estate or other terminable interest) is amended by adding at the end thereof the following new paragraph:

"(10) Specific portion.—For purposes of paragraphs (5), (6), and (7)(B)(iv), the term 'specific portion' only includes a portion determined on a fractional or percentage basis."

(b) Gift Tax.—

(1) Subsection (e) of section 2523 is amended by adding at the end thereof the following new sentence: "For purposes of this subsection, the term 'specific portion' only includes a portion determined on a fractional or percentage basis."

(2) Paragraph (3) of section 2523(f) is amended by inserting before the period at the end thereof the following: "and the rules of section 2056(b)(10) shall apply".

(c) Effective Dates.—

(1) Subsection (a).—

(A) In general.—Except as provided in subparagraph (B), the amendment made by subsection (a) shall apply to the estates of decedents dying after the date of the enactment of this Act.

(B) Exception.—The amendment made by subsection (a) shall not apply to any interest in property which passes (or

has passed) to the surviving spouse of the decedent pursuant to a will (or revocable trust) in existence on the date of the enactment of this Act if—

(i) the decedent dies on or before the date 3 years after such date of enactment, or

(ii) the decedent was, on such date of enactment, under a mental disability to change the disposition of his property and did not regain his competence to dispose of such property before the date of his death.

The preceding sentence shall not apply if such will (or revocable trust) is amended at any time after such date of enactment in any respect which will increase the amount of the interest which so passes or alters the terms of the transfer by which the interest so passes.

(2) SUBSECTION (b).—The amendments made by subsection (b) shall apply to gifts made after the date of the enactment of this Act.

SEC. 4705. TRANSITIONAL RULE UNDER SECTION 2056A.

(a) GENERAL RULE.—In the case of any trust created under an instrument executed before the date of the enactment of the Revenue Reconciliation Act of 1990, such trust shall be treated as meeting the requirements of paragraph (1) of section 2056A(a) of the Internal Revenue Code of 1986 if the trust instrument requires that all trustees of the trust be individual citizens of the United States or domestic corporations.

(b) EFFECTIVE DATE.—The provisions of subsection (a) shall take effect as if included in the provisions of section 11702(g) of the Revenue Reconciliation Act of 1990.

SEC. 4706. OPPORTUNITY TO CORRECT CERTAIN FAILURES UNDER SECTION 2032A.

(a) GENERAL RULE.—Paragraph (3) of section 2032A(d) (relating to modification of election and agreement to be permitted) is amended to read as follows:

"(3) MODIFICATION OF ELECTION AND AGREEMENT TO BE PERMITTED.—The Secretary shall prescribe procedures which provide that in any case in which the executor makes an election under paragraph (1) (and submits the agreement referred to in paragraph (2)) within the time prescribed therefor, but—

"(A) the notice of election, as filed, does not contain all required information, or

"(B) signatures of 1 or more persons required to enter into the agreement described in paragraph (2) are not 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 signatures."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to the estates of decedents dying after the date of the enactment of this Act.

Subtitle H—Excise Tax Simplification

PART I—FUEL TAX PROVISIONS

SEC. 4801. REPEAL OF CERTAIN RETAIL AND USE TAXES.

(a) IN GENERAL.—Section 4041 is amended to read as follows:

"SEC. 4041. SPECIAL MOTOR FUELS AND NONCOMMERCIAL AVIATION GASOLINE.

"(a) SPECIAL MOTOR FUELS.—

"(1) IN GENERAL.—There is hereby imposed a tax on benzol, benzene, naphtha, liquefied petroleum gas, casing head and natural gasoline, or any other liquid—

"(A) sold by any person to an owner, lessee, or other operator of a motor vehicle or a motorboat for use as a fuel in such motor vehicle or motorboat, or

"(B) used by any person as a fuel in a motor vehicle or motorboat unless there was a taxable sale of such liquid under subparagraph (A).

"(2) RATE OF TAX.—The rate of the tax imposed by this subsection shall be the aggregate rate of tax in effect under section 4081 at the time of such sale or use.

"(3) CERTAIN FUELS EXEMPT FROM TAX.—The tax imposed by this subsection shall not apply to gasoline (as defined in section 4082), diesel fuel (as defined in section 4092), kerosene, gas oil, or fuel oil.

"(4) REDUCED RATES OF TAX ON CERTAIN FUELS.—

"(A) QUALIFIED METHANOL AND ETHANOL FUEL.—

"(i) IN GENERAL.—In the case of any qualified methanol or ethanol fuel—

"(I) the Highway Trust Fund financing rate applicable under paragraph (2) shall be 5.4 cents per gallon less than the otherwise applicable rate (6 cents per gallon less in the case of a mixture none of the alcohol in which consists of ethanol), and

"(II) the Leaking Underground Storage Tank Trust Fund financing rate applicable under paragraph (2) shall be 0.05 cent per gallon.

"(ii) QUALIFIED METHANOL OR ETHANOL FUEL.—The term 'qualified methanol or ethanol fuel' means any liquid at least 85 percent of which consists of methanol, ethanol, or other alcohol produced from a substance other than petroleum or natural gas.

"(iii) TERMINATION.—Clause (i) shall not apply to any sale or use after September 30, 2000.

"(B) NATURAL GAS-DERIVED METHANOL OR ETHANOL FUEL.—

"(i) IN GENERAL.—In the case of natural gas-derived methanol or ethanol fuel—

"(I) the Highway Trust Fund financing rate applicable under paragraph (2) shall be 5.75 cents per gallon, and

"(II) the deficit reduction rate applicable under paragraph (2) shall be 1.25 cents per gallon.

"(ii) NATURAL GAS-DERIVED METHANOL OR ETHANOL FUEL.—The term 'natural-gas derived methanol or ethanol fuel' means any liquid at least 85 percent of which consists of methanol, ethanol, or other alcohol produced from natural gas.

"(C) OTHER FUELS CONTAINING ALCOHOL.—

"(i) IN GENERAL.—Under regulations prescribed by the Secretary, in the case of any liquid at least 10 percent of which consists of alcohol (as defined in section 4081(c)(3)), the Highway Trust Fund financing rate applicable under paragraph (2) shall be the comparable rate under section 4081.

"(ii) LATER SEPARATION.—If any person separates the liquid fuel from a mixture of the liquid fuel and alcohol to which clause (i) applies, such separation shall be treated as a sale of the liquid fuel. Any tax imposed on such sale shall be reduced by the amount (if any) of the tax imposed on the sale of such mixture.

"(iii) TERMINATION.—Clause (i) shall not apply to any sale or use after September 30, 2000.

"(D) LIQUEFIED PETROLEUM GAS.—The rate of tax applicable under paragraph (2) to liquefied petroleum gas shall be determined without regard to the Leaking Underground Storage Tank Trust Fund financing rate under section 4081.

"(5) EXEMPTION FOR OFF-HIGHWAY BUSINESS USE.—No tax shall be imposed by paragraph (1) on liquids sold for use or used in an off-highway business use (within the meaning of section 6420(f)).

"(b) NONCOMMERCIAL AVIATION GASOLINE.—

"(1) IN GENERAL.—There is hereby imposed a tax on gasoline—

"(A) sold by any person to an owner, lessee, or other operator of an aircraft for use as a fuel in such aircraft in noncommercial aviation, or

"(B) used by any person as a fuel in an aircraft in noncommercial aviation unless there was a taxable sale of such gasoline under subparagraph (A).

The tax imposed by this paragraph shall be in addition to any tax imposed by section 4081.

"(2) RATE OF TAX.—The rate of the tax imposed by paragraph (1) on any gasoline is the excess of 15 cents a gallon over the sum of the Highway Trust Fund financing rate plus the deficit reduction rate at which tax was imposed on such gasoline under section 4081.

"(3) NONCOMMERCIAL AVIATION.—For purposes of this subsection, the term 'noncommercial aviation' means any use of an aircraft other than use in a business of transporting persons or property for compensation or hire by air. Such term includes any use of an aircraft, in a business described in the preceding sentence, which is properly allocable to any transportation exempt from the taxes imposed by sections 4261 and 4271 by reason of section 4281 or 4282.

"(4) EXEMPTION FOR FUELS CONTAINING ALCOHOL.—No tax shall be imposed by this subsection on any liquid at least 10 percent of which consists of alcohol (as defined in section 4081(c)(3)).

"(5) EXEMPTION FOR CERTAIN HELICOPTER USES.—No tax shall be imposed by this subsection on gasoline sold for use or used in a helicopter for purposes of providing transportation with respect to which the requirements of subsection (e) or (f) of section 4261 are met.

"(6) REGISTRATION.—Except as provided in regulations prescribed by the Secretary, if any gasoline is sold by any person for use as a fuel in an aircraft, it shall be presumed for purposes of this subsection that a tax imposed by this subsection applies to the sale of such gasoline unless the purchaser is registered in such manner (and furnished such information in respect of the use of the gasoline) as the Secretary shall by regulations provide.

"(7) GASOLINE.—For purposes of this subsection, the term 'gasoline' has the meaning given such term by section 4082.

"(8) TERMINATION.—Paragraph (1) shall not apply to any sale or use after December 31, 1995.

"(c) EXEMPTION FOR FARM USE.—

"(1) IN GENERAL.—Under regulations prescribed by the Secretary, no tax shall be imposed under this section on any liquid sold for use or used on a farm for farming purposes (determined in accordance with paragraphs (1), (2), and (3) of section 6420(e)).

"(2) TERMINATION.—Except with respect to so much of the tax imposed by subsection (a) as is determined by reference to the Leaking Underground Storage Tank Trust Fund financing rate under section 4081, paragraph (1) shall not apply after September 30, 1999.

"(d) EXEMPTIONS FOR STATE AND LOCAL GOVERNMENTS, SCHOOLS, EXPORTATION, AND SUPPLIES FOR VESSELS AND AIRCRAFT.—

"(1) IN GENERAL.—Under regulations prescribed by the Secretary, no tax shall be imposed under this section on any liquid sold for use, or used, in an exempt use described in paragraph (4), (5), (6), or (7) of section 6420(b).

"(2) TERMINATION.—Except with respect to so much of the tax imposed by subsection (a) as is determined by reference to the Leaking Underground Storage Tank Trust Fund financing rate under section 4081, after September 30, 1999, paragraph (1) shall not apply to exempt uses described in paragraph (4) and (5) of section 6420(b).

"(e) EXEMPTION FOR USE BY CERTAIN AIRCRAFT MUSEUMS.—Under regulations prescribed by the Secretary, no tax shall be imposed under this section on any liquid sold for use or used in an exempt use described in section 6420(b)(11)."

(b) CERTAIN ADDITIONAL PURCHASERS OF FUEL TREATED AS PRODUCERS.—

(1) IN GENERAL.—Subparagraph (C) of section 4092(b)(1) is amended to read as follows:

"(C) REDUCED-TAX PURCHASERS TREATED AS PRODUCERS.—Any person to whom any fuel is sold in a sale on which the

amount of tax otherwise required to be paid under section 4091 is reduced under section 4093 shall be treated as the producer of such fuel. The amount of tax imposed by section 4091 on any sale of such fuel by such person shall be reduced by the amount of tax imposed under section 4091 (and not credited or refunded) on any prior sale of such fuel."

(2) CONFORMING AMENDMENT.—Subsection (b) of section 4093 is amended by inserting "(as defined in section 4092(b) without regard to paragraph (1)(C) thereof)" after "producer".

SEC. 4802. REVISION OF FUEL TAX CREDIT AND REFUND PROCEDURES.

(a) REFUNDS TO CERTAIN SELLERS OF DIESEL FUEL AND AVIATION FUEL.—

(1) IN GENERAL.—Paragraph (2) of section 6416(b) is amended by striking "4091 or 4121" and inserting "4121 or 4091; except that this paragraph shall apply to a person selling diesel fuel or aviation fuel for a use described in the first sentence if such person meets such requirements as the Secretary may by regulations prescribe".

(2) LIMITATIONS ON AMOUNT OF TAX ONLY HIGHWAY TRUST FUND FINANCING RATE TO BE REFUNDABLE.—Paragraph (2) of section 6416(b) is amended by adding at the end thereof the following new sentence: "This paragraph shall not apply to the taxes imposed by sections 4081 and 4091 with respect to any use to the same extent that section 6420(a) does not apply to such use by reason of paragraph (1) or (2) of section 6420(c)."

(b) CONSOLIDATION OF REFUND PROVISIONS; REPEAL OF CONSENT REQUIREMENT FOR REFUND OF FUEL TAXES TO CROPDUSTERS, ETC.—Section 6420 (relating to gasoline used on farms) is amended to read as follows:

"SEC. 6420. CERTAIN TAXES ON FUELS USED FOR EXEMPT PURPOSES.

"(a) IN GENERAL.—Except as otherwise provided in this section, if any fuel on which tax was imposed under section 4041, 4081, or 4091 is used in an exempt use, the Secretary shall pay (without interest) to the ultimate purchaser of such fuel the amount equal to the aggregate tax imposed on such fuel under such sections.

"(b) EXEMPT USES.—For purposes of this section, the term 'exempt use' means—

"(1) in the case of diesel fuel, use other than as a fuel in a diesel-powered highway vehicle or a diesel-powered boat,

"(2) in the case of aviation fuel, use other than as a fuel in an aircraft,

"(3) in the case of gasoline or aviation fuel, use in an aircraft other than in noncommercial aviation (as defined in section 4041(b)),

"(4) use by any State, any political subdivision of a State, or the District of Columbia,

"(5) use by a nonprofit educational organization (as defined in section 4221(d)(5)),

"(6) export,

"(7) use as supplies for vessels or aircraft (within the meaning of section 4221(d)(3)),

"(8) use on a farm for farming purposes (within the meaning of subsection (e)),

"(9) use in an off-highway business use (within the meaning of subsection (f)),

"(10) use in qualified bus transportation (within the meaning of subsection (g)),

"(11) use by an aircraft museum (within the meaning of subsection (h)),

"(12) use in a nonpurpose use (within the meaning of subsection (i)),

"(13) use in a helicopter for purposes of providing transportation with respect to which the requirements of subsection (e) or (f) of section 4261 are met, and

"(14) use in producing a mixture of a fuel if at least 10 percent of such mixture consists of alcohol (as defined in section 4081(c)(3)) and if such mixture is sold or used in the trade or business of the person producing such mixture.

Paragraph (14) shall not apply with respect to any mixture sold or used after September 30, 2000.

"(c) LIMITATIONS ON AMOUNT OF PAYMENT.—

"(1) NO REFUND OF LEAKING UNDERGROUND STORAGE TANK TRUST FUND TAXES IN CERTAIN CASES.—Subsection (a) shall not apply to so much of the taxes imposed by sections 4081 and 4091 as are attributable to a Leaking Underground Storage Tank Trust Fund financing rate in the case of—

"(A) fuel used in a train, and

"(B) fuel used in any aircraft (except as supplies for vessels or aircraft within the meaning of section 4221(d)(3)).

"(2) NO REFUND OF DEFICIT REDUCTION TAX ON DIESEL FUEL USED IN TRAINS.—Subsection (a) shall not apply to so much of the tax imposed by section 4091 as is attributable to a deficit reduction rate in the case of diesel fuel used in a diesel-powered train.

"(3) NO REFUND OF PORTION OF TAX ON DIESEL FUEL USED IN CERTAIN BUSES.—

"(A) IN GENERAL.—Except as provided in subparagraphs (B) and (C), the rate of tax taken into account under subsection (a) with respect to diesel fuel used in qualified bus transportation (within the meaning of subsection (g)(1)) shall be 3.1 cents per gallon less than the aggregate rate of tax imposed on such fuel by section 4091.

"(B) EXCEPTION FOR SCHOOL BUS TRANSPORTATION.—Subparagraph (A) shall not apply to fuel used in an automobile bus while engaged in transportation described in subsection (g)(1)(B).

"(C) EXCEPTION FOR CERTAIN INTRACITY TRANSPORTATION.—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.

"(D) 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 with (or is receiving more than a nominal subsidy from) any State or local government (as defined in section 4221(d)) to furnish such transportation.

"(4) ALCOHOL FUELS.—

"(A) IN GENERAL.—In the case of a fuel used as described in subsection (b)(14) and on which tax was imposed at regular tax rate, the rate of tax taken into account under subsection (a) with respect to the fuel so used shall equal the excess of the regular tax rate over the incentive tax rate.

"(B) REGULAR TAX RATE.—The term 'regular tax rate' means—

"(i) in the case of gasoline, the aggregate rate of tax imposed by section 4081 determined without regard to subsection (c) thereof,

"(ii) in the case of diesel fuel, the aggregate rate of tax imposed by section 4091 on such fuel determined without regard to subsection (c) thereof, and

"(iii) in the case of aviation fuel, the aggregate rate of tax imposed by section 4091 on such fuel determined without regard to subsection (d) thereof.

"(C) INCENTIVE TAX RATE.—The term 'incentive tax rate' means—

"(i) in the case of gasoline, the aggregate rate of tax imposed by section 4081 with respect to fuel described in subsection (c)(1) thereof,

"(ii) in the case of diesel fuel, the aggregate rate of tax imposed by section 4091 with respect to fuel described in subsection (c)(1)(B) thereof, and

"(iii) in the case of aviation fuel, the aggregate rate of tax imposed by section 4091 with respect to fuel described in subsection (d)(1)(B) thereof.

"(5) GASOHOL USED IN NONCOMMERCIAL AVIATION.—If—

"(A) tax is imposed by section 4081 at the rate determined under subsection (c) thereof on gasohol (as defined in such subsection), and

"(B) such gasohol is used as a fuel in any aircraft in noncommercial aviation (as defined in section 4041(b)),

the payment under subsection (a) shall be equal to 1.4 cents (2 cents in the case of gasohol none of the alcohol in which consists of ethanol) per gallon of gasohol so used.

"(d) TIME FOR FILING CLAIMS; PERIOD COVERED.—

"(1) GENERAL RULE.—Except as provided in paragraphs (2) and (3), not more than one claim may be filed under this section by any person with respect to fuel used (or a qualified diesel powered highway vehicle purchased) during his taxable year; and no claim shall be allowed under this paragraph with respect to fuel used (or a qualified diesel powered highway vehicle purchased) during any taxable year unless filed by the purchaser not later than the time prescribed by law for filing a claim for credit or refund of overpayment of income tax for

such taxable year. For purposes of this subsection, a person's taxable year shall be his taxable year for purposes of subtitle A.

"(2) EXCEPTIONS.—

"(A) IN GENERAL.—If as of the close of any quarter of a person's taxable year, $750 or more is payable under this section to such person with respect to fuel used (or a qualified diesel powered highway vehicle purchased) during such quarter or any prior quarter of such taxable year (and for which no other claim has been filed), a claim may be filed under this section with respect to fuel so used (or qualified diesel powered highway vehicles so purchased).

"(B) TIME FOR FILING CLAIM.—No claim filed under this paragraph shall be allowed unless filed during the first quarter following the last quarter included in the claim.

"(3) SPECIAL RULE FOR GASOHOL CREDIT.—

"(A) IN GENERAL.—A claim may be filed for gasoline used to produce gasohol (as defined in section 4081(c)(1)) for any period—

"(i) for which $200 or more is payable by reason of subsection (b)(14), and

"(ii) which is not less than 1 week.

"(B) PAYMENT OF CLAIM.—Notwithstanding subsection (a), if the Secretary has not paid a claim filed pursuant to subparagraph (A) within 20 days of the date of the filing of such claim, the claim shall be paid with interest from such date determined by using the overpayment rate and method under section 6621.

"(e) USE ON A FARM FOR FARMING.—For purposes of subsection (b)(8)—

"(1) IN GENERAL.—Fuel shall be treated as used on a farm for farming purposes only if used—

"(A) in carrying on a trade or business,

"(B) on a farm situated in the United States, and

"(C) for farming purposes.

"(2) FARM.—The term 'farm' includes stock, dairy, poultry, fruit, fur-bearing animal, and truck farms, plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities, and orchards.

"(3) FARMING PURPOSES.—Fuel shall be treated as used for farming purposes only if used—

"(A) by the owner, tenant, or operator of a farm, in connection with cultivating the soil, or in connection with raising or harvesting any agricultural or horticultural commodity, including the raising, shearing, feeding, caring for, training, and management of livestock, bees, poultry, and fur-bearing animals and wildlife, on a farm of which he is the owner, tenant, or operator;

"(B) by the owner, tenant, or operator of a farm, in handling, drying, packing, grading, or storing any agricultural or horticultural commodity in its unmanufactured state; but only if such owner, tenant, or operator produced more than one-half of the commodity which he so treated during the period with respect to which claim is filed;

"(C) by the owner, tenant, or operator of a farm, in connection with—

"(i) the planting, cultivating, caring for, or cutting of trees, or

"(ii) the preparation (other than milling) of trees for market, incidental to farming operations; or

"(D) by the owner, tenant, or operator of a farm, in connection with the operation, management, conservation, improvement, or maintenance of such farm and its tools and equipment.

"(4) CERTAIN FARMING USE OTHER THAN BY OWNER, ETC.—In applying paragraph (3)(A) to a use on a farm for any purpose described in paragraph (3)(A) by any person other than the owner, tenant, or operator of such farm—

"(A) the owner, tenant, or operator of such farm shall be treated as the user and ultimate purchaser of the fuel, except that

"(B) if the person so using the fuel is an aerial or other applicator of fertilizers or other substances and is the ultimate purchaser of the fuel, then subparagraph (A) of this paragraph shall not apply and the aerial or other applicator shall be treated as having used such fuel on a farm for farming purposes.

"(f) OFF-HIGHWAY BUSINESS USE.—For purposes of subsection (b)(9)—

"(1) IN GENERAL.—The term 'off-highway business use' means any use by a person in a trade or business of such person or in an activity of such person described in section 212 (relating to production of income) otherwise than as a fuel in a highway vehicle—

"(A) which (at the time of such use) is registered, or is required to be registered, for highway use under the laws of any State or foreign country, or

"(B) which, in the case of a highway vehicle owned by the United States, is used on the highway.

"(2) USES IN MOTORBOATS.—The term 'off-highway business use' does not include any use in a motorboat; except that such term shall include any use in—

"(A) a vessel employed in the fisheries or in the whaling business, and

"(B) in the case of diesel fuel, a boat in the active conduct of—

"(i) a trade or business of commercial fishing or transporting persons or property for compensation or hire, or

"(ii) any other trade or business unless the boat is used predominantly in any activity which is of a type generally considered to constitute entertainment, amusement or recreation.

"(g) QUALIFIED BUS TRANSPORTATION.—For purposes of subsection (b)(10)—

"(1) IN GENERAL.—Fuel is used in qualified bus transportation if it is used in an automobile bus while engaged in—

"(A) furnishing (for compensation) passenger land transportation available to the general public, or

"(B) the transportation of students and employees of schools (as defined in the last sentence of section 4221(d)(7)(C)).

"(2) LIMITATION IN THE CASE OF NONSCHEDULED INTERCITY OR LOCAL BUSES.—Paragraph (1)(A) shall not apply in respect of fuel used in any automobile bus while engaged in furnishing transportation which is not along regular routes unless the seating capacity of such bus is at least 20 adults (not including the driver).

"(h) USE BY AN AIRCRAFT MUSEUM.—For purposes of subsection (b)(11)—

"(1) IN GENERAL.—Fuel is used by an aircraft museum if it is used in an aircraft or vehicle owned by such museum and used exclusively for purposes set forth in paragraph (2)(C).

"(2) AIRCRAFT MUSEUM.—For purposes of this subsection, the term 'aircraft museum' means an organization—

"(A) described in section 501(c)(3) which is exempt from income tax under section 501(a),

"(B) operated as a museum under charter by a State or the District of Columbia, and

"(C) operated exclusively for the procurement, care, and exhibition of aircraft of the type used for combat or transport in World War II.

"(i) USE IN A NONPURPOSE USE.—For purposes of subsection (b)(12), fuel is used in a nonpurpose use if—

"(1) tax was imposed by section 4041 on the sale thereof and the purchaser—

"(A) uses such fuel other than for the use for which it is sold, or

"(B) resells such fuel, or

"(2) tax was imposed by section 4081 on any gasoline blend stock or product commonly used as an additive in gasoline and the purchaser establishes that the ultimate use of such blend stock or product is not to produce gasoline.

"(j) 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 (d), the Secretary shall pay (without interest) to the original purchaser of any qualified diesel-powered highway vehicle an amount 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.—This subsection shall only apply to qualified diesel-powered highway vehicles originally purchased after January 1, 1985, and before January 1, 1995.

"(6) 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.

"(k) INCOME TAX CREDIT IN LIEU OF PAYMENT; OTHER SPECIAL RULES.—

"(1) INCOME TAX CREDIT IN LIEU OF PAYMENT.—

"(A) PERSONS NOT SUBJECT TO INCOME TAX.—Payment shall be made under this section only to—

"(i) the United States or an agency or instrumentality thereof, a State, a political subdivision of a State, or any agency or instrumentality of one or more States or political subdivisions, or

"(ii) an organization exempt from tax under section 501(a) (other than an organization required to make a return of the tax imposed under subtitle A for its taxable year).

"(B) EXCEPTION.—Subparagraph (A) shall not apply to a payment of a claim filed under paragraph (2) or (3) of subsection (d).

"(C) ALLOWANCE OF CREDIT AGAINST INCOME TAX.—

"For allowances of credit against the income tax imposed by subtitle A for fuel used by the purchaser in an exempt use, see section 34.

"(2) APPLICABLE LAWS.—

"(A) IN GENERAL.—All provisions of law, including penalties, applicable in respect of the tax with respect to which a payment is claimed under this section shall, insofar as applicable and not inconsistent with this section, apply in respect of such payment to the same extent as if such payment constituted a refund of overpayments of such tax.

"(B) EXAMINATION OF BOOKS AND WITNESSES.—For the purpose of ascertaining the correctness of any claim made

under this section, or the correctness of any payment made in respect of any such claim, the Secretary shall have the authority granted by paragraphs (1), (2), and (3) of section 7602(a) (relating to examination of books and witnesses) as if the claimant were the person liable for tax.

"(3) COORDINATION WITH SECTION 6416, ETC.—No amount shall be payable under this section to any person with respect to any fuel if the Secretary determines that the amount of tax for which such payment is sought was not included in the price paid by such person for such fuel. The amount which would (but for this sentence) be payable under this section with respect to any fuel shall be reduced by any other amount which the Secretary determines is payable under this section, or is refundable under any other provision of this title, to any person with respect to such fuel.

"(4) REGULATIONS.—The Secretary may by regulations prescribe the conditions, not inconsistent with the provisions of this section, under which payments may be made under this section.

"(l) FUELS—For purposes of this section, the terms 'gasoline', 'diesel fuel', and 'aviation fuel' have the respective meanings given such terms by sections 4082 and 4092.

"(m) TERMINATION.—Except as otherwise provided in this section, this section shall not apply to any liquid purchased after September 30, 1999. The preceding sentence shall not apply to taxes attributable to any Leaking Underground Storage Tank Trust Fund financing rate."

SEC. 4803. AUTHORITY TO PROVIDE EXCEPTIONS FROM INFORMATION REPORTING WITH RESPECT TO DIESEL FUEL AND AVIATION FUEL.

(a) RETURNS BY PRODUCERS AND IMPORTERS.—Subparagraph (A) of section 4093(c)(4) (relating to returns by producers and importers) is amended by striking "Each producer" and inserting "Except as provided by the Secretary by regulations, each producer".

(b) RETURNS BY PURCHASERS.—Subparagraph (C) of section 4093(c)(4) (relating to returns by purchasers) is amended by striking "Each person" and inserting "Except as provided by the Secretary by regulations, each person".

SEC. 4804. TECHNICAL AND CONFORMING AMENDMENTS.

(1) Sections 6421 and 6427 are hereby repealed.

(2) Section 34 is amended to read as follows:

"SEC. 34. EXCISE TAXES ON FUEL USED FOR EXEMPT PURPOSES.

"There shall be allowed as a credit against the tax imposed by this subtitle for the taxable year an amount equal to the excess of—

"(1) the aggregate amount payable to the taxpayer under section 6420 (determined without regard to section 6420(k)(1)) with respect to—

"(A) exempt uses (as defined in section 6420(b)) during such taxable year, and

"(B) qualified diesel-powered highway vehicles purchased during such taxable year, over

"(2) the portion of such amount for which a claim payable under section 6420(d) is timely filed."

(3) Subsection (c) of section 40 is amended by striking "subsection (b)(2), (k), or (m)" and inserting "subsection (a)(4) or (b)(4)"

(4) Paragraph (2) of section 451(e) is amended by striking "section 6420(c)(3)" and inserting "section 6420(e)(3)".

(5) Clause (i) of section 1274(c)(3)(A) is amended by striking "section 6420(c)(2)" and inserting "section 6420(e)(2)".

(6) Sections 874(a) and 1366(f)(1) are each amended by striking "gasoline and special" and inserting "taxable".

(7) Paragraph (2) of section 882(c) is amended by striking "gasoline" and inserting "taxable fuels".

(8) Subsection (b) of section 4042 is amended by striking paragraph (3) and by redesignating paragraph (4) as paragraph (3).

(9) Subsection (b) of section 4082 is amended by striking "special fuels referred to in section 4041" and inserting "special motor fuels referred to in section 4041(a)".

(10) Section 4083 is amended to read as follows:

"SEC. 4083. CROSS REFERENCE.

"For provision allowing a credit or refund for gasoline used for exempt purposes, see section 6420."

(11) Subsections (c)(2) and (d)(2) of section 4091 are each amended by striking "section 6427(f)(1)" and inserting "section 6420(b)(14)".

(12) Paragraph (1) of section 4093(c) is amended by striking "by the purchaser" and all that follows and inserting "by the purchaser in an exempt use (as defined in section 6420(b) other than paragraph (14) thereof)."

(13) Subparagraph (C) of section 4093(c)(2) is amended by striking "section 6427(b)(2)(A)" and inserting "section 6420(c)(3)(A)".

(14) Clause (i) of section 4093(c)(4)(C) is amended to read as follows:

"(i) whether such use was an exempt use (as defined in section 6420(b)) and the amount of fuel so used,".

(15) Section 4093 is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) USE BY PRODUCER OR IMPORTER.—If any producer or importer uses any taxable fuel, then such producer or importer shall be liable for tax under section 4091 in the same manner as if such fuel were sold by him for such use."

(16) Subsection (f) of section 4093, as redesignated by paragraph (15), is amended to read as follows:

"(e) CROSS REFERENCE.—

"For provision allowing a credit or refund for fuel used for exempt purposes, see section 6420."

(17) Section 6206 is amended to read as follows:

"SEC. 6206. SPECIAL RULES APPLICABLE TO EXCESSIVE FUEL TAX REFUND CLAIMS.

"Any portion of a payment made under section 6420 which constitutes an excessive amount (as defined in section 6675(b)), and any civil penalty provided by section 6675, may be assessed and collected as if—

"(1) it were a tax imposed by the section to which the claim relates, and

"(2) the person making the claim were liable for such tax.

The period for assessing any such portion, and for assessing any such penalty, shall be 3 years from the last day prescribed for filing the claim under section 6420."

(18) Subparagraph (A) of section 6416(a)(2) is amended by striking "(relating to tax on special fuels)" and inserting "(relating to special motor fuels and noncommercial aviation gasoline)".

(19) Paragraph (2) of section 6416(b) is amended—

(A) in the matter preceding subparagraph (A) by striking "subsection (a) or (d) of section 4041" and inserting "section 4041(a)", and

(B) in subparagraph (F) by striking "special fuels referred to in section 4041" and inserting "special motor fuels referred to in section 4041(a)".

(20) Paragraph (9) of section 6504 is amended to read as follows:

"(9) Assessments to recover excessive amounts paid under section 6420 (relating to certain taxes on fuels used for exempt purposes) and assessments of civil penalties under section 6675 for excessive claims under section 6420, see section 6206."

(21) Subsection (h) of section 6511 is amended by striking paragraphs (5) and (6), by redesignating paragraph (7) as paragraph (6), and by inserting after paragraph (4) the following new paragraph:

"(5) For limitations in the case of payments under section 6420 (relating to certain taxes on fuels used for exempt purposes), see section 6420(d)."

(22) Subsection (c) of section 6612 is amended by striking "6420 (relating to payments in the case of gasoline used on the farm for farming purposes) and 6421 (relating to payments in the case of gasoline used for certain nonhighway purposes or by local transit systems)" and inserting "and 6420 (relating to certain taxes on fuels used for exempt purposes)".

(23) Subsection (a) of section 6675 is amended by striking "section 6420 (relating to gasoline used on farms), 6421 (relating to gasoline used for certain nonhighway purposes or by local transit systems), or 6427 (relating to fuels not used for taxable purposes)" and inserting "section 6420 (relating to certain taxes on fuels used for exempt purposes)".

(24) Paragraph (1) of section 6675(b) is amended by striking ", 6421, or 6427, as the case may be,".

(25) Section 7210 is amended by striking "sections 6420(e)(2), 6421(g)(2), 6427(j)(2)" and inserting "sections 6420(k)(3)(B)".

(26) Section 7603, subsections (b) and (c)(2) of section 7604, section 7605, and 7610(c) are each amended by striking "section 6420(e)(2), 6421(g)(2), 6427(j)(2)," each place it appears and inserting "section 6420(k)(2)(B)".

(27) Sections 7605 and 7609(c)(1) are each amended by striking "section 6420(e)(2), 6421(g)(2), or 6427(j)(2)" and inserting "section 6420(k)(2)(B)".

(28) Paragraph (1) of section 9502(b) is amended by striking "subsections (c) and (e) of section 4041 (taxes on aviation fuel)" and inserting "section 4041(b) (relating to taxes on noncommercial aviation gasoline)".

(29) Paragraph (2) of section 9502(d) is amended by striking "fuel used in aircraft" and all that follows and inserting "fuel used in aircraft, under section 6420 (relating to certain taxes on fuels used for exempt purposes)."

(30) Paragraph (1) of section 9502(e) is amended by striking "4041(c)(1) and".

(31) Subparagraph (A) of section 9503(b)(1) is amended to read as follows:

> *"(A) section 4041 (relating to special motor fuels and noncommercial aviation gasoline),".*

(32) Paragraph (4) of section 9503(b) is amended to read as follows:

"(4) CERTAIN ADDITIONAL TAXES NOT TRANSFERRED TO HIGHWAY TRUST FUND.—For purposes of paragraphs (1) and (2), the taxes imposed by sections 4041, 4081, and 4091 shall be taken into account only to the extent attributable to the Highway Trust Fund financing rates under such sections."

(33)(A) Clause (i) of section 9503(c)(2)(A) is amended to read as follows:

> *"(i) the amounts paid before July 1, 1996, under section 6420 (relating to certain taxes on fuels used for exempt purposes) on the basis of claims filed for periods ending before October 1, 1995, and".*

(B) For purposes of section 9503(c)(2)(A)(i) of the Internal Revenue Code of 1986, the reference to section 6420 shall be treated as including a reference to sections 6420, 6421, and 6427 of such Code as in effect before the enactment of this Act.

(34) Clause (ii) of section 9503(c)(2)(A) is amended by striking "gasoline, special fuels, and lubricating oil" each place it appears and inserting "taxable fuels".

(35) Subparagraph (D) of section 9503(c)(4) is amended by striking "section 4041(a)(2)" and inserting "section 4041(a)".

(36) Subparagraph (A) of section 9503(e)(5) is amended by striking "section 6427(g)" and inserting "section 6420(j)".

(37) Paragraph (1) of section 9508(b) is amended to read as follows:

"(1) taxes received in the Treasury under section 4041 (relating to special motor fuels and noncommercial aviation gasoline) to the extent attributable to the Leaking Underground Storage Tank Trust Fund financing rates applicable under such section,".

(38) Subparagraph (A) of section 9508(c)(2) is amended by striking "equivalent to—" and all that follows and inserting the following: "equivalent to—

> *"(i) amounts paid under section 6420 (relating to certain taxes on fuels used for exempt purposes), and*
>
> *"(ii) credits allowed under section 34,*

with respect to so much of the taxes imposed by sections 4041, 4081, and 4091 as are attributable to the Leaking Un-

derground Storage Tank Trust Fund financing rates applicable under such sections."

(39) The table of sections for subpart C of part IV of subchapter A of chapter 1 is amended by striking the item relating to section 34 and inserting the following:

"Sec. 34. Excise taxes on fuels used for exempt purposes."

(40) The table of sections for subchapter B of chapter 31 is amended by striking the item relating to section 4041 and inserting the following:

"Sec. 4041. Special motor fuels and noncommercial aviation gasoline."

(41) The table of sections for subpart A of part III of subchapter A of chapter 32 is amended by striking the item relating to section 4083 and inserting the following:

"Sec. 4083. Cross reference."

(42) The table of sections for subchapter B of chapter 65 is amended by striking the items relating to sections 6421 and 6427 and by striking the item relating to section 6420 and inserting the following new item:

"Sec. 6420. Certain taxes on fuels used for exempt purposes."

(43) The table of sections for subchapter A of chapter 63 is amended by striking the item relating to section 6206 and inserting the following new item:

"Sec. 6206. Special rules applicable to excessive fuel tax refund claims."

SEC. 4805. EFFECTIVE DATE.

The amendments made by this part shall take effect on January 1, 1993.

PART II—PROVISIONS RELATED TO DISTILLED SPIRITS, WINES, AND BEER

SEC. 4811. CREDIT OR REFUND FOR IMPORTED BOTTLED DISTILLED SPIRITS RETURNED TO DISTILLED SPIRITS PLANT.

(a) In General.—Paragraph (1) of section 5008(c) (relating to distilled spirits returned to bonded premises) is amended by striking "withdrawn from bonded premises on payment or determination of tax" and inserting "on which tax has been determined or paid".

(b) Effective Date.—The amendment made by subsection (a) shall take effect on the 180th day after the date of the enactment of this Act.

SEC. 4812. AUTHORITY TO CANCEL OR CREDIT EXPORT BONDS WITHOUT SUBMISSION OF RECORDS.

(a) In General.—Subsection (c) of section 5175 (relating to export bonds) is amended by striking "on the submission of" and all that follows and inserting "if there is such proof of exportation as the Secretary may by regulations require."

(b) Effective Date.—The amendment made by subsection (a) shall take effect on the 180th day after the date of the enactment of this Act.

SEC. 4813. REPEAL OF REQUIRED MAINTENANCE OF RECORDS ON PREMISES OF DISTILLED SPIRITS PLANT.

(a) IN GENERAL.—Subsection (c) of section 5207 (relating to records and reports) is amended by striking "shall be kept on the premises where the operations covered by the record are carried on and".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the 180th day after the date of the enactment of this Act.

SEC. 4814. FERMENTED MATERIAL FROM ANY BREWERY MAY BE RECEIVED AT A DISTILLED SPIRITS PLANT.

(a) IN GENERAL.—Paragraph (2) of section 5222(b) (relating to production, receipt, removal, and use of distilling materials) is amended to read as follows:

"(2) beer conveyed without payment of tax from brewery premises, beer which has been lawfully removed from brewery premises upon determination of tax, or".

(b) CLARIFICATION OF AUTHORITY TO PERMIT REMOVAL OF BEER WITHOUT PAYMENT OF TAX FOR USE AS DISTILLING MATERIAL.—Section 5053 (relating to exemptions) is amended by redesignating subsection (f) as subsection (i) and by inserting after subsection (e) the following new subsection:

"(f) REMOVAL FOR USE AS DISTILLING MATERIAL.—Subject to such regulations as the Secretary may prescribe, beer may be removed from a brewery without payment of tax to any distilled spirits plant for use as distilling material."

(c) CLARIFICATION OF REFUND AND CREDIT OF TAX.—Section 5056 (relating to refund and credit of tax, or relief from liability) is amended—

(1) by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) BEER RECEIVED AT A DISTILLED SPIRITS PLANT.—Any tax paid by any brewer on beer produced in the United States may be refunded or credited to the brewer, without interest, or if the tax has not been paid, the brewer may be relieved of liability therefor, under regulations as the Secretary may prescribe, if such beer is received on the bonded premises of a distilled spirits plant pursuant to the provisions of section 5222(b)(2), for use in the production of distilled spirits.", and

(2) by striking "or rendering unmerchantable" in subsection (d) (as so redesignated) and inserting "rendering unmerchantable, or receipt on the bonded premises of a distilled spirits plant".

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect on the 180th day after the date of the enactment of this Act.

SEC. 4815. REPEAL OF REQUIREMENT FOR WHOLESALE DEALERS IN LIQUORS TO POST SIGN.

(a) IN GENERAL.—Section 5115 (relating to sign required on premises) is hereby repealed.

(b) CONFORMING AMENDMENTS.—

(1) Subsection (a) section 5681 is amended by striking ", and every wholesale dealer in liquors," and by striking "section 5115(a) or".

(2) Subsection (c) of section 5681 is amended—

(A) by striking "or wholesale liquor establishment, on which no sign required by section 5115(a) or" and inserting "on which no sign required by", and

(B) by striking "or wholesale liquor establishment, or who" and inserting "or who".

(3) The table of sections for subpart D of part II of subchapter A of chapter 51 is amended by striking the item relating to section 5115.

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

SEC. 4816. REFUND OF TAX TO WINE RETURNED TO BOND NOT LIMITED TO UNMERCHANTABLE WINE.

(a) IN GENERAL.—Subsection (a) of section 5044 (relating to refund of tax on unmerchantable wine) is amended by striking "as unmerchantable".

(b) CONFORMING AMENDMENTS.—

(1) Section 5361 is amended by striking "unmerchantable".

(2) The section heading for section 5044 is amended by striking "UNMERCHANTABLE".

(3) The item relating to section 5044 in the table of sections for subpart C of part I of subchapter A of chapter 51 is amended by striking "unmerchantable".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the 180th day after the date of the enactment of this Act.

SEC. 4817. USE OF ADDITIONAL AMELIORATING MATERIAL IN CERTAIN WINES.

(a) IN GENERAL.—Subparagraph (D) of section 5384(b)(2) (relating to ameliorated fruit and berry wines) is amended by striking "loganberries, currants, or gooseberries," and inserting "any fruit or berry with a natural fixed acid of 20 parts per thousand or more (before any correction of such fruit or berry)".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on the 180th day after the date of the enactment of this Act.

SEC. 4818. DOMESTICALLY-PRODUCED BEER MAY BE WITHDRAWN FREE OF TAX FOR USE OF FOREIGN EMBASSIES, LEGATIONS, ETC.

(a) IN GENERAL.—Section 5053 (relating to exemptions) is amended by inserting after subsection (f) the following new subsection:

"(g) REMOVALS FOR USE OF FOREIGN EMBASSIES, LEGATIONS, ETC.—

"(1) IN GENERAL.—Subject to such regulations as the Secretary may prescribe—

"(A) beer may be withdrawn from the brewery without payment of tax for transfer to any customs bonded warehouse for entry pending withdrawal therefrom as provided in subparagraph (B), and

"(B) beer entered into any customs bonded warehouse under subparagraph (A) may be withdrawn for consumption in the United States by, and for the official and family use of, such foreign governments, organizations, and

individuals as are entitled to withdraw imported beer from such warehouses free of tax.

Beer transferred to any customs bonded warehouse under subparagraph (A) shall be entered, stored, and accounted for in such warehouse under such regulations and bonds as the Secretary may prescribe, and may be withdrawn therefrom by such governments, organizations, and individuals free of tax under the same conditions and procedures as imported beer.

"(2) OTHER RULES TO APPLY.—Rules similar to the rules of paragraphs (2) and (3) of section 5362(e) of such section shall apply for purposes of this subsection."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the 180th day after the date of the enactment of this Act.

SEC. 4819. BEER MAY BE WITHDRAWN FREE OF TAX FOR DESTRUCTION.

(a) IN GENERAL.—Section 5053 is amended by inserting after subsection (g) the following new subsection:

"(h) REMOVALS FOR DESTRUCTION.—Subject to such regulations as the Secretary may prescribe, beer may be removed from the brewery without payment of tax for destruction."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the 180th day after the date of the enactment of this Act.

SEC. 4820. AUTHORITY TO ALLOW DRAWBACK ON EXPORTED BEER WITHOUT SUBMISSION OF RECORDS.

(a) IN GENERAL.—The first sentence of section 5055 (relating to drawback of tax on beer) is amended by striking "found to have been paid" and all that follows and inserting "paid on such beer if there is such proof of exportation as the Secretary may by regulations require."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the 180th day after the date of the enactment of this Act.

SEC. 4821. TRANSFER TO BREWERY OF BEER IMPORTED IN BULK WITHOUT PAYMENT OF TAX.

(a) IN GENERAL.—Part II of subchapter G of chapter 51 is amended by adding at the end thereof the following new section:

"SEC. 5418. BEER IMPORTED IN BULK.

"Beer imported or brought into the United States in bulk containers may, under such regulations as the Secretary may prescribe, be withdrawn from customs custody and transferred in such bulk containers to the premises of a brewery without payment of the internal revenue tax imposed on such beer. The proprietor of a brewery to which such beer is transferred shall become liable for the tax on the beer withdrawn from customs custody under this section upon release of the beer from customs custody, and the importer, or the person bringing such beer into the United States, shall thereupon be relieved of the liability for such tax."

(b) CLERICAL AMENDMENT.—The table of sections for such part II is amended by adding at the end thereof the following new item:

"Sec. 5418. Beer imported in bulk."

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the 180th day after the date of the enactment of this Act.

PART III—OTHER EXCISE TAX PROVISIONS

SEC. 4831. AUTHORITY TO GRANT EXEMPTIONS FROM REGISTRATION REQUIREMENTS.

(a) IN GENERAL.—The first sentence of section 4222 (relating to registration) is amended to read as follows: "Except as provided in subsection (b), section 4221 shall not apply with respect to the sale of any article by or to any person who is required by the Secretary to be registered under this section and who is not so registered."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to sales after the 180th day after the date of the enactment of this Act.

SEC. 4832. REPEAL OF EXPIRED PROVISIONS.

(a) PIGGY-BACK TRAILERS.—Section 4051 is amended by striking subsection (d) and by redesignating subsection (e) as subsection (d).

(b) DEEP SEABED MINING.—

(1) Subchapter F of chapter 36 (relating to tax on removal of hard mineral resources from deep seabed) is hereby repealed.

(2) The table of subchapters for chapter 36 is amended by striking the item relating to subchapter F.

Subtitle I—Administrative Provisions

PART I—GENERAL PROVISIONS

SEC. 4901. SIMPLIFICATION OF DEPOSIT REQUIREMENTS FOR SOCIAL SECURITY, RAILROAD RETIREMENT, AND WITHHELD INCOME TAXES.

(a) IN GENERAL.—Subsection (g) of section 6302 (relating to deposits of social security taxes and withheld income taxes) is amended to read as follows:

"(g) DEPOSITS OF SOCIAL SECURITY, RAILROAD RETIREMENT, AND WITHHELD INCOME TAXES.—

"(1) GENERAL RULE.—Except as otherwise provided in this subsection—

"(A) employment taxes attributable to payments on Wednesday, Thursday, or Friday of any week shall be deposited on or before the following Tuesday, and

"(B) employment taxes attributable to payments on Saturday, Sunday, Monday, or Tuesday of any week shall be deposited on or before the following Friday.

"(2) SMALL DEPOSITORS.—

"(A) IN GENERAL.—If any person is a small depositor for any calendar quarter, such person shall make deposits of employment taxes attributable to payments during any month in such quarter on or before the 15th day of the following month.

"(B) SMALL DEPOSITOR.—For purposes of this subsection, a person is a small depositor for any calendar quarter if,

for each calendar quarter in the base period, the amount of employment taxes attributable to payments made by such person during such calendar quarter was $12,000 or less. For purposes of the preceding sentence, the base period for any calendar quarter is the 4 calendar quarters ending with the second preceding calendar quarter.

"(C) CESSATION AS SMALL DEPOSITOR.—A person shall cease to be treated as a small depositor for a calendar quarter after any day on which such person is required to make a deposit under paragraph (3).

"(3) LARGE DEPOSITORS.—Notwithstanding paragraphs (1) and (2), if, on any day, any person has $100,000 or more of employment taxes for deposit, such taxes shall be deposited on or before the next day.

"(4) SAFE HARBOR.—

"(A) IN GENERAL.—A person shall be treated as depositing the required amount of employment taxes in any deposit if the shortfall does not exceed the greater of—

"(i) $100, or

"(ii) 2 percent of the amount of employment taxes required to be deposited in such deposit (determined without regard to this paragraph).

Such shortfall shall be deposited as required by the Secretary by regulations.

"(B) SHORTFALL.—For purposes of this paragraph, the term 'shortfall' means, with respect to any deposit, the excess of the amount of employment taxes required to be deposited in such deposit (determined without regard to this paragraph) over the amount (if any) thereof deposited on or before the last date prescribed therefor.

"(5) DEPOSIT REQUIRED ONLY ON BANKING DAYS.—If taxes are required to be deposited under this subsection on any day which is not a banking day, such taxes shall be treated as timely deposited if deposited on the first banking day thereafter.

"(6) EMPLOYMENT TAXES.—For purposes of this subsection, the term 'employment taxes' means the taxes imposed by chapters 21, 22, and 24.

"(7) SUBSECTION TO APPLY ONLY TO REQUIRED DEPOSITS.—This subsection shall not apply to employment taxes which are not required to be deposited under the regulations prescribed by the Secretary under this section.

"(8) REGULATIONS.—The Secretary may prescribe regulations—

"(A) specifying employment tax deposit requirements for persons who fail to comply with the requirements of this subsection,

"(B) specifying circumstances under which a person shall be treated as a small depositor for purposes of this subsection notwithstanding that such person is not described in paragraph (2)(B),

"(C) specifying modifications to the provisions of this subsection for end-of-quarter periods, and

"(D) establishing deposit requirements for taxes imposed by section 3406 which apply in lieu of the requirements of this subsection."

(b) CONFORMING AMENDMENT.—Section 226 of the Railroad Retirement Solvency Act of 1983 is hereby repealed.

(c) EFFECTIVE DATE.—The amendment made by this section shall apply to amounts attributable to payments made after December 31, 1992.

SEC. 4902. SIMPLIFICATION OF EMPLOYMENT TAXES ON DOMESTIC SERVICES.

(a) THRESHOLD REQUIREMENT FOR SOCIAL SECURITY TAXES.—

(1) Subparagraph (B) of section 3121(a)(7) (defining wages) is amended to read as follows:

"(B) cash remuneration paid by an employer in any calendar year to an employee for domestic service in a private home of the employer, if the cash remuneration paid in such year by the employer to the employee for such service is less than $300. As used in this subparagraph, the term 'domestic service in a private home of the employer' does not include service described in subsection (g)(5);"

(2) Subparagraph (B) of section 209(a)(6) of the Social Security Act is amended to read as follows:

"(B) Cash remuneration paid by an employer in any calendar year to an employee for domestic service in a private home of the employer, if the cash remuneration paid in such year by the employer to the employee for such service is less than $300. As used in this subparagraph, the term 'domestic service in a private home of the employer' does not include service described in section 210(f)(5)."

(3) The second sentence of section 3102(a) is amended—

(A) by striking "calendar quarter" each place it appears and inserting "calendar year", and

(B) by striking "$50" and inserting "$300".

(b) COORDINATION OF COLLECTION OF DOMESTIC SERVICE EMPLOYMENT WITH COLLECTION OF INCOME TAXES.—

(1) IN GENERAL.—Chapter 25 (relating to general provisions relating to employment taxes) is amended by adding at the end thereof the following new section:

"SEC. 3510. COORDINATION OF COLLECTION OF DOMESTIC SERVICE EMPLOYMENT TAXES WITH COLLECTION OF INCOME TAXES.

"(a) GENERAL RULE.—Except as otherwise provided in this section—

"(1) returns with respect to domestic service employment taxes shall be made on a calendar year basis,

"(2) any such return for any calendar year shall be filed on or before the due date (including extensions) of the income tax return for the employer's taxable year which begins in such calendar year, and

"(3) no requirement to make deposits (or to pay installments under section 6157) shall apply with respect to such taxes.

"(b) DOMESTIC SERVICE EMPLOYMENT TAXES SUBJECT TO ESTIMATED TAX PROVISIONS.—

"(1) IN GENERAL.—Solely for purposes of section 6654, domestic service employment taxes imposed with respect to any calendar year shall be treated as a tax imposed by chapter 2 for the taxable year of the employer which begins in such calendar year.

"(2) ANNUALIZATION.—Under regulations prescribed by the Secretary, appropriate adjustments shall be made in the application of section 6654(d)(2) in respect of the amount treated as tax under paragraph (1).

"(3) TRANSITIONAL RULE.—For purposes of applying section 6654 to a taxable year beginning in 1993, the amount referred to in clause (ii) of section 6654(d)(1)(B) shall be increased by 90 percent of the amount treated as tax under paragraph (1) for such taxable year.

"(c) DOMESTIC SERVICE EMPLOYMENT TAXES.—For purposes of this section, the term 'domestic service employment taxes' means—

"(1) any taxes imposed by chapter 21 or 23 on remuneration paid for domestic service in a private home of the employer, and

"(2) any amount withheld from such remuneration pursuant to an agreement under section 3402(p).

For purposes of this subsection, the term 'domestic service in a private home of the employer' does not include service described in section 3121(g)(5).

"(d) EXCEPTION WHERE EMPLOYER LIABLE FOR OTHER EMPLOYMENT TAXES.—To the extent provided in regulations prescribed by the Secretary, this section shall not apply to any employer for any calendar year if such employer is liable for any tax under this subtitle with respect to remuneration for services other than domestic service in a private home of the employer.

"(e) AUTHORITY TO ENTER INTO AGREEMENTS TO COLLECT STATE UNEMPLOYMENT TAXES.—

"(1) IN GENERAL.—The Secretary is hereby authorized to enter into an agreement with any State to collect, as the agent of such State, such State's unemployment taxes imposed on remuneration paid for domestic service in a private home of the employer. Any taxes to be collected by the Secretary pursuant to such an agreement shall be treated as domestic service employment taxes for purposes of this section.

"(2) TRANSFERS TO STATE ACCOUNT.—Any amount collected under an agreement referred to in paragraph (1) shall be transferred by the Secretary to the account of the State in the Unemployment Trust Fund.

"(3) SUBTITLE F MADE APPLICABLE.—For purposes of subtitle F, any amount required to be collected under an agreement under paragraph (1) shall be treated as a tax imposed by chapter 23.

"(4) STATE.—For purposes of this subsection, the term 'State' has the meaning given such term by section 3306(j)(1)."

(2) CLERICAL AMENDMENT.—The table of sections for chapter 25 is amended by adding at the end thereof the following:

"Sec. 3510. Coordination of collection of domestic service employment taxes with collection of income taxes."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to remuneration paid in calendar years after 1992.

SEC. 4903. CERTAIN NOTICES DISREGARDED UNDER PROVISION INCREASING INTEREST RATE ON LARGE CORPORATE UNDERPAYMENTS.

(a) GENERAL RULE.—Subparagraph (B) of section 6621(c)(2) (defining applicable date) is amended by adding at the end thereof the following new clause:

> *"(iii) EXCEPTION FOR LETTERS OR NOTICES INVOLVING SMALL AMOUNTS.—For purposes of this paragraph, any letter or notice shall be disregarded if the amount of the deficiency or proposed deficiency (or the assessment or proposed assessment) set forth in such letter or notice is not greater than $100,000 (determined by not taking into account any interest, penalties, or additions to tax)."*

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply for purposes of determining interest for periods after December 31, 1990.

SEC. 4904. USE OF REPRODUCTIONS OF RETURNS STORED IN DIGITAL IMAGE FORMAT.

(a) IN GENERAL.—Paragraph (2) of section 6103(p) (relating to procedure and recordkeeping) is amended by adding at the end thereof the following new subparagraph:

> *"(D) REPRODUCTION FROM DIGITAL IMAGES.—For purposes of this paragraph, the term 'reproduction' includes a reproduction from digital images."*

(b) STUDY.—The Comptroller General of the United States shall conduct a study of available digital image technology for the purpose of determining the extent to which reproductions of documents stored using that technology accurately reflect the data on the original document and the appropriate period for retaining the original document. Not later than 1 year after the date of the enactment of this Act, a report on the results of such study shall be submitted to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate.

SEC. 4905. REPEAL OF AUTHORITY TO DISCLOSE WHETHER PROSPECTIVE JUROR HAS BEEN AUDITED.

(a) IN GENERAL.—Subsection (h) of section 6103 (relating to disclosure to certain Federal officers and employees for purposes of tax administration, etc.) is amended by striking paragraph (5) and by redesignating paragraph (6) as paragraph (5).

(b) CONFORMING AMENDMENT.—Paragraph (4) of section 6103(p) is amended by striking "(h)(6)" each place it appears and inserting "(h)(5)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to judicial proceedings pending on, or commenced after, the date of the enactment of this Act.

SEC. 4906. REPEAL OF SPECIAL AUDIT PROVISIONS FOR SUBCHAPTER S ITEMS.

(a) GENERAL RULE.—Subchapter D of chapter 63 (relating to tax treatment of subchapter S items) is hereby repealed.

(b) CONSISTENT TREATMENT REQUIRED.—Section 6037 (relating to return of S corporation) is amended by adding at the end thereof the following new subsection:

"(c) SHAREHOLDER'S RETURN MUST BE CONSISTENT WITH CORPORATE RETURN OR SECRETARY NOTIFIED OF INCONSISTENCY.—

"(1) IN GENERAL.—A shareholder of an S corporation shall, on such shareholder's return, treat a subchapter S item in a manner which is consistent with the treatment of such item on the corporate return.

"(2) NOTIFICATION OF INCONSISTENT TREATMENT.—

"(A) IN GENERAL.—In the case of any subchapter S item, if—

"(i)(I) the corporation has filed a return but the shareholder's treatment on his return is (or may be) inconsistent with the treatment of the item on the corporate return, or

"(II) the corporation has not filed a return, and

"(ii) the shareholder files with the Secretary a statement identifying the inconsistency,

paragraph (1) shall not apply to such item.

"(B) SHAREHOLDER RECEIVING INCORRECT INFORMATION.—A shareholder shall be treated as having complied with clause (ii) of subparagraph (A) with respect to a subchapter S item if the shareholder—

"(i) demonstrates to the satisfaction of the Secretary that the treatment of the subchapter S item on the shareholder's return is consistent with the treatment of the item on the schedule furnished to the shareholder by the corporation, and

"(ii) elects to have this paragraph apply with respect to that item.

"(3) EFFECT OF FAILURE TO NOTIFY.—In any case—

"(A) described in subparagraph (A)(i)(I) of paragraph (2), and

"(B) in which the shareholder does not comply with subparagraph (A)(ii) of paragraph (2),

any adjustment required to make the treatment of the items by such shareholder consistent with the treatment of the items on the corporate return shall be treated as arising out of mathematical or clerical errors and assessed according to section 6213(b)(1). Paragraph (2) of section 6213(b) shall not apply to any assessment referred to in the preceding sentence.

"(4) SUBCHAPTER S ITEM.—For purposes of this subsection, the term 'subchapter S item' means any item of an S corporation to the extent that regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the corporation level than at the shareholder level.

"(5) ADDITION TO TAX FOR FAILURE TO COMPLY WITH SECTION.—

"For addition to tax in the case of a shareholder's negligence in connection with, or disregard of, the requirements of this section, see part II of subchapter A of chapter 68."

(c) CONFORMING AMENDMENTS.—

(1) Section 1366 is amended by striking subsection (g).

(2) Subsection (b) of section 6233 is amended to read as follows:

"(b) SIMILAR RULES IN CERTAIN CASES.—If a partnership return is filed for any taxable year but it is determined that there is no entity for such taxable year, to the extent provided in regulations, rules similar to the rules of subsection (a) shall apply."

(3) The table of subchapters for chapter 63 is amended by striking the item relating to subchapter D.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 4907. CLARIFICATION OF STATUTE OF LIMITATIONS.

(a) IN GENERAL.—Subsection (a) of section 6501 (relating to limitations on assessment and collection) is amended by adding at the end thereof the following new sentence: "For purposes of this chapter, the term 'return' means the return required to be filed by the taxpayer (and does not include a return of any person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

PART II—TAX COURT PROCEDURES

SEC. 4911. OVERPAYMENT DETERMINATIONS OF TAX COURT.

(a) APPEAL OF ORDER.—Paragraph (2) of section 6512(b) (relating to jurisdiction to enforce) is amended by adding at the end the following new sentence: "An order of the Tax Court disposing of a motion under this paragraph shall be reviewable in the same manner as a decision of the Tax Court, but only with respect to the matters determined in such order."

(b) DENIAL OF JURISDICTION REGARDING CERTAIN CREDITS AND REDUCTIONS.—Subsection (b) of section 6512 (relating to overpayment determined by Tax Court) is amended by adding at the end the following new paragraph:

"(4) DENIAL OF JURISDICTION REGARDING CERTAIN CREDITS AND REDUCTIONS.—The Tax Court shall have no jurisdiction under this subsection to restrain or review any credit or reduction made by the Secretary under section 6402."

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

SEC. 4912. AWARDING OF ADMINISTRATIVE COSTS.

(a) RIGHT TO APPEAL TAX COURT DECISION.—Subsection (f) of section 7430 (relating to right of appeal) is amended by adding at the end the following new paragraph:

"(3) APPEAL OF TAX COURT DECISION.—An order of the Tax Court disposing of a petition under paragraph (2) shall be reviewable in the same manner as a decision of the Tax Court, but only with respect to the matters determined in such order."

(b) PERIOD FOR APPLYING TO IRS FOR COSTS.—Subsection (b) of section 7430 (relating to limitations) is amended by adding at the end the following new paragraph:

"(5) PERIOD FOR APPLYING TO IRS FOR ADMINISTRATIVE COSTS.—An award may be made under subsection (a) for reasonable administrative costs only if the prevailing party files an application for such costs before the 91st day after the date on which the party was determined to be the prevailing party under subsection (c)(4)(B)."

(c) PERIOD FOR PETITIONING OF TAX COURT FOR REVIEW OF DENIAL OF COSTS.—Paragraph (2) of section 7430(f) (relating to right of appeal) is amended—

(1) by striking "appeal to" and inserting "the filing of a petition for review with", and

(2) by adding at the end the following new sentence: "If the Secretary sends by certified or registered mail a notice of such decision to the petitioner, no proceeding in the Tax Court may be initiated under this paragraph unless such petition is filed before the 91st day after the date of such mailing."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to civil actions or proceedings commenced after the date of the enactment of this Act.

SEC. 4913. REDETERMINATION OF INTEREST PURSUANT TO MOTION.

(a) IN GENERAL.—Paragraph (3) of section 7481(c) (relating to jurisdiction over interest determinations) is amended by striking "petition" and inserting "motion".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on the date of the enactment of this Act.

SEC. 4914. APPLICATION OF NET WORTH REQUIREMENT FOR AWARDS OF LITIGATION COSTS.

(a) IN GENERAL.—Paragraph (4) of section 7430(c) (defining prevailing party) is amended by adding at the end thereof the following new subparagraph:

"(C) SPECIAL RULES FOR APPLYING NET WORTH REQUIREMENT.—In applying the requirements of section 2412(d)(2)(B) of title 28, United States Code, for purposes of subparagraph (A)(iii) of this paragraph—

"(i) the net worth limitation in clause (i) of such section shall apply to—

"(I) an estate but shall be determined as of the date of the decedent's death, and

"(II) a trust but shall be determined as of the last day of the taxable year involved in the proceeding, and

"(ii) individuals filing a joint return shall be treated as 1 individual for purposes of clause (i) of such section, except in the case of a spouse relieved of liability under section 6013(e)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to proceedings commenced after the date of the enactment of this Act.

PART III—AUTHORITY FOR CERTAIN COOPERATIVE AGREEMENTS

SEC. 4921. COOPERATIVE AGREEMENTS WITH STATE TAX AUTHORITIES.

(a) General Rule.—Chapter 77 (relating to miscellaneous provisions) is amended by adding at the end thereof the following new section:

"SEC. 7524. COOPERATIVE AGREEMENTS WITH STATE TAX AUTHORITIES.

"(a) Authorization of Agreements.—The Secretary is hereby authorized to enter into cooperative agreements with State tax authorities for purposes of enhancing joint tax administration. Such agreements may provide for—

"(1) joint filing of Federal and State income tax returns,

"(2) single processing of such returns,

"(3) joint collection of taxes (other than Federal income taxes), and

"(4) such other provisions as may enhance joint tax administration.

"(b) Services on Reimbursable Basis.—Any agreement under subsection (a) may require reimbursement for services provided by either party to the agreement.

"(c) Availability of Funds.—Any funds appropriated for purposes of the administration of this title shall be available for purposes of carrying out the Secretary's responsibility under an agreement entered into under subsection (a). Any reimbursement received pursuant to such an agreement shall be credited to the amount so appropriated.

"(d) State Tax Authority.—For purposes of this section, the term 'State tax authority' means agency, body, or commission referred to in section 6103(d)(1)."

(b) Clerical Amendment.—The table of sections for chapter 77 is amended by adding at the end thereof the following new item:

"Sec. 7524. Cooperative agreements with State tax authorities."

TITLE V—TAXPAYER BILL OF RIGHTS 2

SEC. 5000. SHORT TITLE.

This title may be cited as the "Taxpayer Bill of Rights 2".

Subtitle A—Taxpayer Advocate

SEC. 5001. ESTABLISHMENT OF POSITION OF TAXPAYER ADVOCATE WITHIN INTERNAL REVENUE SERVICE.

(a) General Rule.—Section 7802 (relating to Commissioner of Internal Revenue; Assistant Commissioner (Employee Plans and Exempt Organizations)) is amended by adding at the end thereof the following new subsection:

"(d) Office of Taxpayer Advocate.—

"(1) In general.—There is established in the Internal Revenue Service an office to be known as the 'Office of the Taxpayer Advocate'. Such office, including all problem resolution officers,

shall be under the supervision and direction of an official to be known as the 'Taxpayer Advocate' who shall be appointed by the President by and with the advice and consent of the Senate, and who shall report directly to the Commissioner of Internal Revenue. The Taxpayer Advocate shall be entitled to compensation at the same rate as the Chief Counsel for the Internal Revenue Service.

"(2) FUNCTIONS OF OFFICE.—

"(A) IN GENERAL.—It shall be the function of the Office of Taxpayer Advocate to—

"(i) assist taxpayers in resolving problems with the Internal Revenue Service,

"(ii) identify areas in which taxpayers have problems in dealings with the Internal Revenue Service,

"(iii) to the extent possible, propose changes in the administrative practices of the Internal Revenue Service to mitigate problems identified under clause (ii), and

"(iv) identify potential legislative changes which may be appropriate to mitigate such problems.

"(B) ANNUAL REPORTS.—

"(i) OBJECTIVES.—Not later than October 31 of each calendar year after 1991, the Taxpayer Advocate shall report to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate on the objectives of the Taxpayer Advocate for the following calendar year. Any such report shall contain full and substantive analysis, in addition to statistical information.

"(ii) ACTIVITIES.—Not later than December 31 of each calendar year after 1991, the Taxpayer Advocate shall report to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate on the activities of the Taxpayer Advocate during the fiscal year ending during such calendar year. Any such report shall contain full and substantive analysis, in addition to statistical information, and shall—

"(I) identify the initiatives the Taxpayer Advocate has taken on improving taxpayer services and Internal Revenue Service responsiveness,

"(II) contain recommendations received from individuals with the authority to issue taxpayer assistance orders under section 7811,

"(III) contain a summary of at least 20 of the most serious problems encountered by taxpayers, including a description of the nature of such problems,

"(IV) contain an inventory of the items described in subclauses (I), (II), and (III) for which action has been taken and the result of such action,

"(V) contain an inventory of the items described in subclauses (I), (II), and (III) for which action re-

mains to be completed and the period during which each item has remained on such inventory,

"(VI) contain an inventory of the items described in subclauses (II) and (III) for which no action has been taken, the period during which each item has remained on such inventory, the reasons for the inaction, and identify any Internal Revenue Service official who is responsible for such inaction,

"(VII) identify any Taxpayer Assistance Order which was not honored by the Internal Revenue Service in a timely manner, as specified under section 7811(b),

"(VIII) contain recommendations for such administrative and legislative action as may be appropriate to resolve problems encountered by taxpayers, and

"(IX) include such other information as the Taxpayer Advocate may deem advisable.

"(3) RESPONSIBILITIES OF COMMISSIONER OF INTERNAL REVENUE SERVICE.—The Commissioner of Internal Revenue shall establish procedures requiring a formal response to all recommendations submitted to the Commissioner by the Taxpayer Advocate."

(b) CONFORMING AMENDMENTS.—

(1) Section 7811 (relating to taxpayer assistance orders) is amended—

(A) by striking "the Office of Ombudsman" in subsection (a) and inserting "the Office of the Taxpayer Advocate", and

(B) by striking "Ombudsman" each place it appears (including in the headings of subsections (e) and (f)) and inserting "Taxpayer Advocate".

(2) The heading for section 7802 is amended to read as follows:

"SEC. 7802. COMMISSIONER OF INTERNAL REVENUE; ASSISTANT COMMISSIONERS; TAXPAYER ADVOCATE."

(3) The table of sections for subchapter A of chapter 80 of subtitle F is amended by striking the item relating to section 7802 and inserting the following new item:

"Sec. 7802. Commissioner of Internal Revenue; Assistant Commissioners; Taxpayer Advocate."

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

SEC. 5002. EXPANSION OF AUTHORITY TO ISSUE TAXPAYER ASSISTANCE ORDERS.

(a) TERMS OF ORDERS.—Subsection (b) of section 7811 (relating to terms of taxpayer assistance orders) is amended—

(1) by inserting "within a specified time period" after "the Secretary", and

(2) by striking "cease any action" and inserting "cease any action, take any action".

(b) LIMITATION ON AUTHORITY TO MODIFY OR RESCIND.—Section 7811(c) (relating to authority to modify or rescind) is amended to read as follows:

"(c) AUTHORITY TO MODIFY OR RESCIND.—Any Taxpayer Assistance Order issued by the Taxpayer Advocate under this section may be modified or rescinded only by the Taxpayer Advocate, the Commissioner, or any superior of either."

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

Subtitle B—Modifications to Installment Agreement Provisions

SEC. 5101. NOTIFICATION OF REASONS FOR TERMINATION OR DENIAL OF INSTALLMENT AGREEMENTS.

(a) TERMINATIONS.—Subsection (b) of section 6159 (relating to extent to which agreements remain in effect) is amended by adding at the end thereof the following new paragraph:

"(5) NOTICE REQUIREMENTS.—The Secretary may not take any action under paragraph (2), (3), or (4) unless—

"(A) a notice of such action is provided to the taxpayer not later than the day 30 days before the date of such action, and

"(B) such notice includes an explanation why the Secretary intends to take such action.

The preceding sentence shall not apply in any case in which the Secretary believes that collection of any tax to which an agreement under this section relates is in jeopardy."

(b) DENIALS.—Section 6159 (relating to agreements for payment of tax liability in installments) is amended by adding at the end thereof the following new subsection:

"(c) NOTICE REQUIREMENTS FOR DENIALS.—The Secretary may not deny any request for an installment agreement under this section unless—

"(1) a notice of the proposed denial is provided to the taxpayer not later than the day 30 days before the date of such denial, and

"(2) such notice includes an explanation why the Secretary intends to deny such request.

The preceding sentence shall not apply in any case in which the Secretary believes that collection of any tax to which a request for an agreement under this section relates is in jeopardy."

(c) CONFORMING AMENDMENT.—Paragraph (3) of section 6159(b) is amended to read as follows:

"(3) SUBSEQUENT CHANGE IN FINANCIAL CONDITIONS.—If the Secretary makes a determination that the financial condition of a taxpayer with whom the Secretary has entered into an agreement under subsection (a) has significantly changed, the Secretary may alter, modify, or terminate such agreement."

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date 6 months after the date of the enactment of this Act.

SEC. 5102. ADMINISTRATIVE REVIEW OF DENIAL OF REQUEST FOR, OR TERMINATION OF, INSTALLMENT AGREEMENT.

(a) GENERAL RULE.—Section 6159 (relating to agreements for payment of tax liability in installments), as amended by section 5101, is amended by adding at the end thereof the following new subsection:

"(d) ADMINISTRATIVE REVIEW.—The Secretary shall establish procedures for an independent administrative review of denials of requests for, or terminations of, installment agreements under this section."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

SEC. 5103. RUNNING OF FAILURE TO PAY PENALTY SUSPENDED DURING PERIOD INSTALLMENT AGREEMENT IN EFFECT.

(a) GENERAL RULE.—Section 6651 (relating to penalty for failure to file tax return or to pay tax) is amended by adding at the end thereof the following new subsection:

"(g) TREATMENT OF INSTALLMENT AGREEMENTS UNDER SECTION 6159.—If an agreement is entered into under section 6159 for the payment of any tax in installments, the period during which such agreement is in effect shall be disregarded in determining the amount of any addition under paragraph (2) or (3) of subsection (a) with respect to such tax."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to installment agreements entered into after the date of the enactment of this Act.

Subtitle C—Interest

SEC. 5201. EXPANSION OF AUTHORITY TO ABATE INTEREST.

(a) GENERAL RULE.—Paragraph (1) of section 6404(e) (relating to abatement of interest in certain cases) is amended by striking "ministerial act" each place it appears and inserting "ministerial or managerial act".

(b) CLERICAL AMENDMENT.—The subsection heading for subsection (e) of section 6404 is amended by striking "Assessments" and inserting "Abatement".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to interest accruing with respect to deficiencies or payments for taxable years beginning after the date of the enactment of this Act.

SEC. 5202. EXTENSION OF INTEREST-FREE PERIOD FOR PAYMENT OF TAX AFTER NOTICE AND DEMAND.

(a) GENERAL RULE.—Paragraph (3) of section 6601(e) (relating to payments made within 10 days after notice and demand) is amended to read as follows:

> *"(3) PAYMENTS MADE WITHIN SPECIFIED PERIOD AFTER NOTICE AND DEMAND.—If notice and demand is made for payment of any amount and if such amount is paid within 21 days (10 days if the amount for which such notice and demand is made equals or exceeds $100,000) after the date of such notice and demand, interest under this section on the amount so paid shall not be imposed for the period after the date of such notice and demand."*

(b) Effective Date.—The amendment made by subsection (a) shall apply in the case of any notice and demand given after the date 6 months after the date of the enactment of this Act.

Subtitle D—Joint Returns

SEC. 5301. DISCLOSURE OF COLLECTION ACTIVITIES.

(a) General Rule.—Subsection (e) of section 6103 (relating to disclosure to persons having material interest) is amended by adding at the end thereof the following new paragraph:

"(8) Disclosure of collection activities with respect to joint return.—If any deficiency of tax with respect to a joint return is assessed and the individuals filing such return are no longer married or no longer reside in the same household, upon request in writing of either of such individuals, the Secretary may disclose in writing to the individual making the request whether the Secretary has attempted to collect such deficiency from such other individual, the general nature of such collection activities, and the amount collected."

(b) Effective Date.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

SEC. 5302. JOINT RETURN MAY BE MADE AFTER SEPARATE RETURNS WITHOUT FULL PAYMENT OF TAX.

(a) General Rule.—Paragraph (2) of section 6013(b) (relating to limitations on filing of joint return after filing separate returns) is amended by striking subparagraph (A) and redesignating the following subparagraphs accordingly.

(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 E—Collection Activities

SEC. 5401. MODIFICATIONS TO LIEN AND LEVY PROVISIONS.

(a) Withdrawal of Certain Notices.—Section 6323 (relating to validity and priority against certain persons) is amended by adding at the end thereof the following new subsection:

"(j) Withdrawal of Notice in Certain Circumstances.—

"(1) In general.—The Secretary may withdraw a notice of a lien filed under this section and this chapter shall be applied as if the withdrawn notice had not been filed, if the Secretary determines that—

"(A) the filing of such notice was premature or otherwise not in accordance with administrative procedures of the Secretary,

"(B) the taxpayer has entered into an agreement under section 6159 to satisfy the tax liability for which the lien was imposed by means of installment payments, unless such agreement provides otherwise,

"(C) the withdrawal of such notice will facilitate the collection of the tax liability, or

"(D) with the consent of the taxpayer or the Taxpayer Advocate, the withdrawal of such notice would be in the best interests of the taxpayer and the United States.

Any such withdrawal shall be made by filing notice thereof at the same office as the withdrawn notice.

"(2) NOTICE TO CREDIT AGENCIES, ETC.—Upon written request by the taxpayer with respect to whom a notice of a lien was withdrawn under paragraph (1), the Secretary shall promptly make reasonable efforts to notify credit reporting agencies, and financial institutions specified in such request, of the withdrawal of such notice. Any such request shall be in such form as the Secretary may prescribe."

(b) RETURN OF LEVIED PROPERTY IN CERTAIN CASES.—Section 6343 (relating to authority to release levy and return property) is amended by adding at the end thereof the following new subsection:

"(d) RETURN OF PROPERTY IN CERTAIN CASES.—If—

"(1) any property has been levied upon, and

"(2) the Secretary determines that—

"(A) the levy on such property was premature or otherwise not in accordance with administrative procedures of the Secretary,

"(B) the taxpayer has entered into an agreement under section 6159 to satisfy the tax liability for which the levy was imposed by means of installment payments, unless such agreement provides otherwise,

"(C) the return of such property will facilitate the collection of the tax liability, or

"(D) with the consent of the taxpayer or the Taxpayer Advocate, the return of such property would be in the best interests of the taxpayer and the United States,

the provisions of subsection (b) shall apply in the same manner as if such property had been wrongly levied upon, except that no interest shall be allowed under subsection (c)."

(c) MODIFICATIONS IN CERTAIN LEVY EXEMPTION AMOUNTS.—

(1) FUEL, ETC.—Paragraph (2) of section 6334(a) (relating to fuel, provisions, furniture, and personal effects exempt from levy) is amended—

(A) by striking "If the taxpayer is the head of a family, so" and inserting "So", and

(B) by striking "$1,650 ($1,500 in the case of levies issued during 1989)" and inserting "$1,700".

(2) BOOKS, ETC.—Paragraph (3) of section 6334(a) (relating to books and tools of a trade, business, or profession exempt from levy) is amended by striking "$1,100 ($1,050 in the case of levies issued during 1989)" and inserting "$1,200".

(3) INDEXED FOR INFLATION.—Section 6334 (relating to property exempt from levy) is amended by adding at the end thereof the following new subsection:

"(f) INFLATION ADJUSTMENTS.—

"(1) IN GENERAL.—In the case of any calendar year beginning after 1993, each dollar amount referred to in paragraphs (2) and (3) of subsection (a) shall be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year, by substituting 'calendar year 1992' for 'calendar year 1991' in subparagraph (B) thereof.

"(2) ROUNDING.—If any dollar amount after being increased under paragraph (1) is not a multiple of $10, such dollar amount shall be rounded to the nearest multiple of $10 (or, if such dollar amount is a multiple of $5, such dollar amount shall be increased to the next higher multiple of $10)."

(d) EFFECTIVE DATES.—

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

(2) EXEMPT AMOUNTS.—The amendments made by subsection (c) shall take effect with respect to levies issued after December 31, 1992.

SEC. 5402. OFFERS-IN-COMPROMISE.

(a) GENERAL RULE.—Subsection (a) of section 7122 (relating to compromises) is amended by adding at the end thereof the following new sentence: "The Secretary may make such a compromise in any case where the Secretary determines that such compromise would be in the best interests of the United States.".

(b) REVIEW REQUIREMENTS.—Subsection (b) of section 7122 (relating to records) is amended by striking "$500." and inserting "$50,000. However, such compromise shall be subject to continuing quality review by the Secretary.".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

SEC. 5403. NOTIFICATION OF EXAMINATION.

(a) IN GENERAL.—Section 7605 (relating to restrictions on examination of taxpayer) is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) NOTIFICATION REQUIREMENT.—No examination described in subsection (a) shall be made unless the Secretary notifies the taxpayer in writing by mail to an address determined under section 6212(b) that the taxpayer is under examination and provides the taxpayer with an explanation of the process as described in section 7521(b)(1). The preceding sentence shall not apply in the case of any examination if the Secretary determines that—

"(1) such examination is in connection with a criminal investigation or is with respect to a tax the collection of which is in jeopardy, or

"(2) the application of the preceding sentence would be inconsistent with national security needs or would interfere with the effective conduct of a confidential law enforcement or foreign counterintelligence activity."

(b) CONFORMING AMENDMENT.—Paragraph (1) of section 7521(b) (relating to safeguards) is amended by striking "or at".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

SEC. 5404. INCREASE IN LIMIT ON RECOVERY OF CIVIL DAMAGES FOR UNAUTHORIZED COLLECTION ACTIONS.

(a) GENERAL RULE.—Subsection (b) of section 7433 (relating to damages) is amended by striking "$100,000" and inserting "$1,000,000".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to actions by officers or employees of the Internal Revenue Service after the date of the enactment of this Act.

SEC. 5405. SAFEGUARDS RELATING TO DESIGNATED SUMMONS.

(a) STANDARD OF REVIEW.—Subparagraph (A) of section 6503(k)(2) (defining designated summons) is amended by redesignating clauses (i) and (ii) as clauses (ii) and (iii), respectively, and by inserting before clause (ii) (as so redesignated) the following new clause:

> *"(i) the issuance of such summons is preceded by a review of such issuance by the regional counsel of the Office of Chief Counsel for the region in which the examination of the corporation is being conducted,".*

(b) NOTICE REQUIREMENTS FOR ISSUANCE.—Section 6503(k) is amended by adding at the end thereof the following new paragraph:

> *"(4) NOTICE REQUIREMENTS.—With respect to any summons referred to in paragraph (1)(A) issued to any person other than the corporation, the Secretary shall promptly notify the corporation, in writing, that such summons has been issued with respect to such corporation's return of tax."*

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to summons issued after the date of the enactment of this Act.

Subtitle F—Information Returns

SEC. 5501. PHONE NUMBER OF PERSON PROVIDING PAYEE STATEMENTS REQUIRED TO BE SHOWN ON SUCH STATEMENT.

(a) GENERAL RULE.—The following provisions are each amended by striking "name and address" and inserting "name, address, and phone number of the information contact":

(1) Section 6041(d)(1).
(2) Section 6041A(e)(1).
(3) Section 6042(c)(1).
(4) Section 6044(e)(1).
(5) Section 6045(b)(1).
(6) Section 6049(c)(1)(A).
(7) Section 6050B(b)(1).
(8) Section 6050H(d)(1).
(9) Section 6050I(e)(1).
(10) Section 6050J(e).
(11) Section 6050K(b)(1).
(12) Section 6050N(b)(1).

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to statements required to be furnished after December 31, 1992 (determined without regard to any extension).

SEC. 5502. CIVIL DAMAGES FOR FRAUDULENT FILING OF INFORMATION RETURNS.

(a) GENERAL RULE.—Subchapter B of chapter 76 (relating to proceedings by taxpayers and third parties) is amended by redesignat-

ing section 7434 as section 7435 and by inserting after section 7433 the following new section:

"SEC. 7434. CIVIL DAMAGES FOR FRAUDULENT FILING OF INFORMATION RETURNS.

"(a) IN GENERAL.—If any person willfully files a false or fraudulent information return with respect to payments purported to be made to any other person, such other person may bring a civil action for damages against the person so filing such return.

"(b) DAMAGES.—In any action brought under subsection (a), upon a finding of liability on the part of the defendant, the defendant shall be liable to the plaintiff in an amount equal to the greater of $5,000 or the sum of—

"(1) any actual damages sustained by the plaintiff as a proximate result of the filing of the false or fraudulent information return (including any costs attributable to resolving deficiencies asserted as a result of such filing), and

"(2) the costs of the action.

"(c) PERIOD FOR BRINGING ACTION.—Notwithstanding any other provision of law, an action to enforce the liability created under this section may be brought without regard to the amount in controversy and may be brought only within 6 years after the filing of the false or fraudulent information return.

"(d) INFORMATION RETURN.—For purposes of this section, the term 'information return' means any statement described in section 6724(d)(1)(A)."

(b) CLERICAL AMENDMENT.—The table of sections for subchapter B of chapter 76 is amended by striking the item relating to section 7434 and inserting the following:

"Sec. 7434. Civil damages for fraudulent filing of information returns.

"Sec. 7435. Cross references."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to false or fraudulent information returns filed after the date of the enactment of this Act.

SEC. 5503. REQUIREMENT TO VERIFY ACCURACY OF INFORMATION RETURNS.

(a) GENERAL RULE.—Section 6201 (relating to assessment authority) is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) REQUIRED REASONABLE VERIFICATION OF INFORMATION RETURNS.—In any court proceeding, if a taxpayer asserts a reasonable dispute with respect to any item of income reported on an information return filed with the Secretary under chapter 61 by a third party and the taxpayer has fully cooperated with the Secretary, the Secretary, in presenting evidence of the deficiency based on such information return, shall present reasonable evidence of such deficiency in addition to such information return."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

Subtitle G—Modifications to Penalty for Failure To Collect and Pay Over Tax

SEC. 5601. PRELIMINARY NOTICE REQUIREMENT.

(a) IN GENERAL.—Section 6672 (relating to failure to collect and pay over tax, or attempt to evade or defeat tax) is amended by redesignating subsection (b) as subsection (c) and by inserting after subsection (a) the following new subsection:

"(b) PRELIMINARY NOTICE REQUIREMENT.—

"(1) IN GENERAL.—No penalty shall be imposed under subsection (a) unless the Secretary notifies the taxpayer in writing by mail to an address as determined under section 6212(b) that the taxpayer shall be subject to an assessment of such penalty.

"(2) TIMING OF NOTICE.—The mailing of the notice described in paragraph (1) shall precede any notice and demand of any penalty under subsection (a) by at least 60 days.

"(3) STATUTE OF LIMITATIONS.—If a notice described in paragraph (1) with respect to any penalty is mailed before the expiration of the period provided by section 6501 for the assessment of such penalty (determined without regard to this paragraph), the period provided by such section for the assessment of such penalty shall not expire before the date 60 days after the date on which such notice was mailed.

"(4) EXCEPTION FOR JEOPARDY.—This subsection shall not apply if the Secretary finds that the collection of the penalty is in jeopardy."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply in the case of failures after the date of the enactment of this Act.

SEC. 5602. NO PENALTY IF PROMPT NOTIFICATION OF THE SECRETARY.

(a) IN GENERAL.—Section 6672 (relating to failure to collect and pay over tax, or attempt to evade or defeat tax) is amended by adding at the end thereof the following new subsection:

"(d) PENALTY NOT APPLICABLE WHERE PROMPT NOTIFICATION OF FAILURE.—

"(1) IN GENERAL.—A person shall not be liable for any penalty under subsection (a) by reason of any failure referred to in subsection (a) if—

"(A) such person is not a significant owner, or highly compensated employee, of the trade or business with respect to which such failure occurred,

"(B) such person notifies the Secretary (in such manner as he may prescribe) that such failure has occurred within 10 days after the date of such failure, and

"(C) such notification was before any notice by the Secretary to any person with respect to such failure.

"(2) DEFINITIONS.—For purposes of paragraph (1)—

"(A) SIGNIFICANT OWNER.—The term 'significant owner' means—

"(i) any person holding an interest as a proprietor in a trade or business carried on as a proprietorship, and

"(ii) in the case of a trade or business conducted by a corporation or partnership, any person who is a 5-percent owner (as defined in section 416(i)(1)) in such corporation or partnership, as the case may be.

"(B) HIGHLY COMPENSATED EMPLOYEE.—The term 'highly compensated employee' means any employee who receives compensation from the employer at an annual rate in excess of $75,000."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply in the case of failures after the date of the enactment of this Act.

SEC. 5603. DISCLOSURE OF CERTAIN INFORMATION WHERE MORE THAN 1 PERSON SUBJECT TO PENALTY.

(a) IN GENERAL.—Subsection (e) of section 6103 (relating to disclosure to persons having material interest), as amended by section 5301, is amended by adding at the end thereof the following new paragraph:

"(9) DISCLOSURE OF CERTAIN INFORMATION WHERE MORE THAN 1 PERSON SUBJECT TO PENALTY UNDER SECTION 6672.—If the Secretary determines that a person is liable for a penalty under section 6672(a) with respect to any failure, upon request in writing of such person, the Secretary shall disclose in writing to such person—

"(A) the name of any other person whom the Secretary has determined to be liable for such penalty with respect to such failure, and

"(B) whether the Secretary has attempted to collect such penalty from such other person, the general nature of such collection activities, and the amount collected."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

SEC. 5604. PENALTIES UNDER SECTION 6672.

(a) PUBLIC INFORMATION REQUIREMENTS.—The Secretary of the Treasury or the Secretary's delegate (hereafter in this section referred to as the "Secretary") shall take such actions as may be appropriate to ensure that employees are aware of their responsibilities under the Federal tax depository system, the circumstances under which employees may be liable for the penalty imposed by section 6672 of the Internal Revenue Code of 1986, and the responsibility to promptly report to the Internal Revenue Service any failure referred to in subsection (a) of such section 6672. Such actions shall include—

(1) printing of a warning on deposit coupon booklets and the appropriate tax returns that certain employees may be liable for the penalty imposed by such section 6672, and

(2) the development of a special information packet.

(b) BOARD MEMBERS OF TAX-EXEMPT ORGANIZATIONS.—

(1) VOLUNTARY BOARD MEMBERS.—The penalty under section 6672 of the Internal Revenue Code of 1986 shall not be imposed on unpaid, volunteer members of any board of trustees or directors of an organization referred to in section 501 of such Code to the extent such members are solely serving in an honorary ca-

pacity and do not participate in the day-to-day or financial operations of the organization.

(2) DEVELOPMENT OF EXPLANATORY MATERIALS.—The Secretary shall develop materials explaining the circumstances under which board members of tax-exempt organizations (including voluntary and honorary members) may be subject to penalty under section 6672 of such Code. Such materials shall be made available to tax-exempt organizations.

(3) IRS INSTRUCTIONS.—The Secretary shall clarify the instructions to Internal Revenue Service employees on the application of the penalty under section 6672 of such Code with regard to voluntary members of boards of trustees or directors of tax-exempt organizations.

(c) PROMPT NOTIFICATION.—To the maximum extent practicable, the Secretary shall notify all persons who have failed to make timely and complete deposit of any taxes of such failure within 30 days after the date on which the Secretary is first aware of such failure.

Subtitle H—Awarding of Costs and Certain Fees

SEC. 5701. MOTION FOR DISCLOSURE OF INFORMATION.

Paragraph (4) of section 7430(c) (defining prevailing party) is amended by adding at the end thereof the following new subparagraph:

> *"(C) MOTION FOR DISCLOSURE OF INFORMATION.—Once a taxpayer substantially prevails as described in subparagraph (A)(ii), the taxpayer may file a motion for an order requiring the disclosure (within a specified period) of all information and copies of relevant records in the possession of the Internal Revenue Service with respect to such taxpayer's case and the substantial justification for the position taken by the Internal Revenue Service."*

SEC. 5702. INCREASED LIMIT ON ATTORNEY FEES.

Paragraph (1) of section 7430(c) (defining reasonable litigation costs) is amended—

(1) by striking "$75" in clause (iii) of subparagraph (B) and inserting "$110",

(2) by striking "an increase in the cost of living or" in clause (iii) of subparagraph (B), and

(3) by adding after clause (iii) the following:

"In the case of any calendar year beginning after 1992, the dollar amount referred to in clause (iii) shall be increased by an amount equal to such dollar amount multiplied by the cost-of-living adjustment determined under section 1(f)(3) for such calendar year. If any dollar amount after being increased under the preceding sentence is not a multiple of $10, such dollar amount shall be rounded to the nearest multiple of $10 (or, if such dollar amount is a multiple of $5, such dollar amount shall be increased to the next higher multiple of $10)."

SEC. 5703. FAILURE TO AGREE TO EXTENSION NOT TAKEN INTO ACCOUNT.

Paragraph (1) of section 7430(b) (relating to requirement that administrative remedies be exhausted) is amended by adding at the end thereof the following new sentence: "Any failure to agree to an extension of the time for the assessment of any tax shall not be taken into account for purposes of determining whether the prevailing party meets the requirements of the preceding sentence."

SEC. 5704. INTERNAL REVENUE SERVICE EMPLOYEES PERSONALLY LIABLE IN CERTAIN CASES.

Section 7430 is amended by adding at the end thereof the following new subsection:

"(g) PERSONAL LIABILITY OF INTERNAL REVENUE SERVICE EMPLOYEES IN CERTAIN CASES.—In any proceeding in which the prevailing party is awarded a judgment for reasonable litigation costs under this section, the court may assess a portion of such costs against any Internal Revenue Service employee (and such employee shall not be reimbursed by the United States for the costs so assessed) if the court determines that such proceeding resulted from any arbitrary, capricious, or malicious act of such employee."

SEC. 5705. EFFECTIVE DATE.

The amendments made by this subtitle shall apply in the case of proceedings commenced after the date of the enactment of this Act.

Subtitle I—Other Provisions

SEC. 5801. REQUIRED CONTENT OF CERTAIN NOTICES.

(a) GENERAL RULE.—Subsection (a) of section 7522 (relating to content of tax due, deficiency, and other notices) is amended by striking "shall describe the basis for, and identify" and inserting "shall set forth the adjustments which are the basis for, and shall identify".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to notices sent after the date 6 months after the date of the enactment of this Act.

SEC. 5802. TREATMENT OF SUBSTITUTE RETURNS UNDER SECTION 6651.

(a) GENERAL RULE.—Section 6651 (relating to failure to file tax return or to pay tax) is amended by adding at the end thereof the following new subsection:

"(h) TREATMENT OF RETURNS PREPARED BY SECRETARY UNDER SECTION 6020(b).—In the case of any return made by the Secretary under section 6020(b)—

"(1) such return shall be disregarded for purposes of determining the amount of the addition under paragraph (1) of subsection (a), but

"(2) such return shall be treated as the return filed by the taxpayer for purposes of determining the amount of the addition under paragraphs (2) and (3) of subsection (a)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply in the case of any return the due date for which (determined without regard to extensions) is after the date of the enactment of this Act.

SEC. 5803. RELIEF FROM RETROACTIVE APPLICATION OF TREASURY DEPARTMENT REGULATIONS.

(a) IN GENERAL.—Subsection (b) of section 7805 (relating to rules and regulations) is amended to read as follows:

"(b) RETROACTIVITY OF REGULATIONS.—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, any temporary or proposed regulation issued by the Secretary shall apply prospectively from the date of publication of such regulation in the Federal Register.

"(2) PREVENTION OF ABUSE.—The Secretary may provide that any temporary or proposed regulation may apply retroactively to prevent abuse of the statute to which the regulation relates.

"(3) CORRECTION OF PROCEDURAL DEFECTS.—The Secretary may provide that any temporary or proposed regulation may apply retroactively to correct a procedural defect in the issuance of any prior regulation.

"(4) CONGRESSIONAL AUTHORIZATION.—The prospective only treatment of paragraph (1) may be superseded by a legislative grant from Congress authorizing the Secretary to prescribe the effective date with respect to a statutory provision.

"(5) ELECTION TO APPLY RETROACTIVELY.—The Secretary may provide for any taxpayer to elect to apply any temporary or proposed regulation retroactively from the date of publication of such regulation in the Federal Register.

"(6) APPLICATION TO FINAL REGULATIONS.—The Secretary may provide that any final regulation relating to any temporary or proposed regulation take effect from the date of publication of such temporary or proposed regulation in the Federal Register."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendment made by this section shall apply with respect to—

(A) any temporary or proposed regulation published on or after February 20, 1992, and

(B) any temporary or proposed regulation published before February 20, 1992, and published as a final regulation after such date.

(2) REGULATIONS RELATING TO EXCHANGE RATES.—The amendment made by this section shall not apply to any regulation issued pursuant to paragraph (1)(C) or (3) of section 986(a), as added by section 4421.

SEC. 5804. REQUIRED NOTICE OF CERTAIN PAYMENTS.

If any payment is received by the Secretary of the Treasury or the Secretary's delegate (hereafter in the section referred to as the "Secretary") from any taxpayer and the Secretary cannot associate such payment with any outstanding tax liability of such taxpayer, the Secretary shall make reasonable efforts to notify the taxpayer of such inability within 60 days after the receipt of such payment.

SEC. 5805. UNAUTHORIZED ENTICEMENT OF INFORMATION DISCLOSURE.

(a) IN GENERAL.—Part I of chapter 75 of subtitle F (relating to crimes, other offenses, and forfeitures) is amended by adding at the end thereof the following section:

"SEC. 7217. UNAUTHORIZED ENTICEMENT OF INFORMATION DISCLOSURE.

"Any officer or employee of the United States who willfully defers or offers to defer, or forgives or offers to forgive, the determination or collection of any tax due from an attorney, certified public accountant, or enrolled agent representing a taxpayer, in exchange for information concerning such taxpayer, shall be guilty of a felony, and upon conviction thereof, shall be fined not more than $5,000, or imprisoned not more than 5 years, or both, together with the costs of the prosecution."

(b) CLERICAL AMENDMENT.—The table of sections for part I of chapter 75 of subtitle F is amended by adding at the end thereof the following new item:

"Sec. 7217. Unauthorized enticement of information disclosure."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to actions after the date of the enactment of this Act.

Subtitle J—Form Modifications; Studies

SEC. 5900. DEFINITIONS.

For purposes of this subtitle:

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

(2) 1986 CODE.—The term "1986 Code" means the Internal Revenue Code of 1986.

(3) TAX-WRITING COMMITTEES.—The term "tax-writing Committees" means the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate.

PART I—FORM MODIFICATIONS

SEC. 5901. EXPLANATION OF CERTAIN PROVISIONS.

(a) GENERAL RULE.—The Secretary shall take such actions as may be appropriate to ensure that taxpayers are aware of the provisions of the 1986 Code permitting payment of tax in installments, extensions of time for payment of tax, and compromises of tax liability. Such actions shall include revising the instructions for filing income tax returns so that such instructions include an explanation of—

(1) the procedures for requesting the benefits of such provisions, and

(2) the terms and conditions under which the benefits of such provisions are available.

(b) COLLECTION NOTICES.—In any notice of an underpayment of tax or proposed underpayment of tax sent by the Secretary to any taxpayer, the Secretary shall include a notification of the availability of the provisions of sections 6159, 6161, and 7122 of the 1986 Code.

SEC. 5902. IMPROVED PROCEDURES FOR NOTIFYING SERVICE OF CHANGE OF ADDRESS OR NAME.

The Secretary shall provide improved procedures for taxpayers to notify the Secretary of changes in names and addresses. Not later *than December 31, 1992, the Secretary shall institute procedures for timely updating all Internal Revenue Service records with change-of-address information provided to the Secretary by taxpayers.*

SEC. 5903. RIGHTS AND RESPONSIBILITIES OF DIVORCED INDIVIDUALS.

The Secretary shall include in the Internal Revenue Service publication entitled "Your Rights As A Taxpayer" a section on the rights and responsibilities of divorced individuals.

PART II—STUDIES

SEC. 5911. PILOT PROGRAM FOR APPEAL OF ENFORCEMENT ACTIONS.

(a) GENERAL RULE.—The Secretary shall establish a 1-year pilot program for appeals of enforcement actions (including lien, levy, and seizure actions) to the Appeals Division of the Internal Revenue Service—

(1) where the deficiency was assessed without actual knowledge of the taxpayer,

(2) where the deficiency was assessed without an opportunity for administrative appeal, and

(3) in other appropriate circumstances.

(b) REPORT.—Not later than December 31, 1992, the Secretary shall submit to the tax-writing Committees a report on the pilot program established under subsection (a), together with such recommendations as he may deem advisable.

SEC. 5912. STUDY ON TAXPAYERS WITH SPECIAL NEEDS.

(a) GENERAL RULE.—The Secretary shall conduct a study on ways to assist the elderly, physically impaired, foreign-language speaking, and other taxpayers with special needs to comply with the internal revenue laws.

(b) REPORT.—Not later than December 31, 1992, the Secretary shall submit to the tax-writing Committees a report on the study conducted under subsection (a), together with such recommendations as he may deem advisable.

SEC. 5913. REPORTS ON TAXPAYER-RIGHTS EDUCATION PROGRAM.

Not later than August 1, 1992, the Secretary shall submit a report to the tax-writing Committees on the scope and content of the Internal Revenue Service's taxpayer-rights education program for its officers and employees. Not later than December 31, 1992, the Secretary shall submit a report to the tax-writing Committees on the effectiveness of the program referred to in the preceding sentence.

SEC. 5914. BIENNIAL REPORTS ON MISCONDUCT BY INTERNAL REVENUE SERVICE EMPLOYEES.

During December of 1992 and during December of each second calendar year thereafter, the Secretary shall report to the tax-writing Committees on all cases involving complaints about misconduct of Internal Revenue Service employees and the disposition of such complaints.

SEC. 5915. STUDY OF NOTICES OF DEFICIENCY.

(a) GENERAL RULE.—The Comptroller General shall conduct a study on—

(1) the effectiveness of current Internal Revenue Service efforts to notify taxpayers with regard to tax deficiencies under section 6212 of the 1986 Code,

(2) the number of registered or certified letters and other notices returned to the Internal Revenue Service as undeliverable,

(3) any follow-up action taken by the Internal Revenue Service to locate taxpayers who did not receive actual notice,

(4) the effect that failures to receive notice of such deficiencies have on taxpayers, and

(5) recommendations to improve Internal Revenue Service notification of taxpayers.

(b) REPORT.—Not later than December 31, 1992, the Comptroller General shall submit to the tax-writing Committees a report on the study conducted under subsection (a), together with such recommendations as he may deem advisable.

SEC. 5916. NOTICE AND FORM ACCURACY STUDY.

(a) GENERAL RULE.—The Comptroller General shall conduct annual studies of the accuracy of 25 of the most commonly used Internal Revenue Service forms, notices, and publications. In conducting any such study, the Comptroller General shall examine the suitability and usefulness of Internal Revenue Service telephone numbers on Internal Revenue Service notices and shall solicit and consider the comments of organizations representing taxpayers, employers, and tax professionals.

(b) REPORTS.—The Comptroller General shall submit to the tax-writing Committees a report on each study conducted under subsection (a), together with such recommendations as he may deem advisable. The first such report shall be submitted not later than December 31, 1992.

SEC. 5917. INTERNAL REVENUE SERVICE EMPLOYEES' SUGGESTIONS STUDY.

(a) GENERAL RULE.—The Comptroller General shall conduct a study of the Internal Revenue Service employee-suggestion programs. Such study shall include a review of the suggestions which were accepted and rewarded by the Internal Revenue Service, an analysis as to how many of the suggestions were implemented, and an analysis of why other suggestions were not implemented.

(b) REPORT.—Not later than December 31, 1992, the Comptroller General shall submit to the tax-writing Committees a report on the study conducted under subsection (a), together with such recommendations as he may deem advisable.

TITLE VI—HEALTH CARE OF COAL MINERS

SEC. 6001. SHORT TITLE.

This title may be cited as the "Coal Industry Retiree Health Benefit Act of 1992".

SEC. 6002. FINDINGS AND DECLARATION OF POLICY.

(a) FINDINGS.—The Congress finds that—

(1) coal provides a significant portion of the energy used in the United States;

(2) the production, transportation and use of coal affects interstate and foreign commerce and the national public interest;

(3) a significant portion of the national work force has been employed in the production of coal for interstate and foreign commerce and in the national interest;

(4) the Government of the United States has regulated the coal industry, employment in the industry, and the provision of retirement benefits within the industry;

(5) the continued well-being and security of employees, retirees and their dependents within the coal industry are directly affected by the provision of health benefits to retirees and their dependents;

(6) for many decades, the provision of adequate health care for retirees has been an essential element in maintaining a stable and strong coal industry as an important component in a strong United States economy;

(7) an important element in the privately maintained benefit plans now experiencing financial difficulty has been the provision of health benefits for retirees of companies no longer in business; and

(8) withdrawals of contributing employers from privately maintained benefit plans under collective bargaining agreements derived from an agreement with the United States, covering retirees within the coal industry, result in substantially increased funding burdens for employers that continue to contribute to such plans, adversely affect labor-management relations and the stability and strength of the coal industry, and impair the provision of health care to retirees.

(b) ADDITIONAL FINDINGS.—The Congress further finds that—

(1) it is necessary to modify and reform the current private benefit plan structure for retirees within the coal industry in order to stabilize the provision of health care benefits to such retirees; and

(2) it is necessary to supplement the current private benefit plan structure with a benefit protection program that will assure continued funding and contain program costs.

(c) DECLARATION OF POLICY.—It is hereby declared to be the policy of this title—

(1) to remedy problems that discourage the provision, funding, and delivery of health care to coal industry retirees;

(2) to provide reasonable protection for the health benefits of coal industry retirees;

(3) to require use of state-of-the-art cost containment and managed care measures as part of the overall package of health care delivery and financing; and

(4) to provide a financially self-sufficient program for the provision of retiree health benefits in the coal industry.

SEC. 6003. COAL INDUSTRY HEALTH BENEFITS PROGRAM.

(a) IN GENERAL.—The Internal Revenue Code of 1986 is amended by adding at the end thereof the following new subtitle:

"Subtitle J—Coal Industry Health Benefits

"CHAPTER 99. Coal industry health benefits.

"CHAPTER 99—COAL INDUSTRY HEALTH BENEFITS

"SUBCHAPTER A. Coal Industry Retiree Health Benefits Corporation.
"SUBCHAPTER B. Eligibility for and payment of benefits.
"SUBCHAPTER C. Other provisions.

"Subchapter A—Coal Industry Retiree Health Benefit Corporation

"Sec. 9701. Establishment of the Corporation.
"Sec. 9702. Directors of Corporation.
"Sec. 9703. Powers; tax status.
"Sec. 9704. Operation of Corporation.

"SEC. 9701. ESTABLISHMENT OF THE CORPORATION.

"There is hereby created the Coal Industry Retiree Health Benefit Corporation (hereafter in this chapter referred to as the 'Corporation'), which shall be a governmental body corporate under the direction of a board of directors. Within the limitations of law and regulation, the board of directors shall determine the general policies that govern the operations of the Corporation. The principal office of the Corporation shall be in the District of Columbia or at any other place determined by the Corporation.

"SEC. 9702. DIRECTORS OF CORPORATION.

"(a) APPOINTMENT.—The board of directors of the Corporation shall consist of 5 persons, who shall be appointed by the Secretary of Labor. The board shall at all times have the following as members:

"(1) 2 persons from employers in the coal-mining industry (only 1 of whom shall be from an entity that is or was a settlor of a plan described in section 404(c));

"(2) 1 person from an organization that represents coal industry employees (and that is or was a settlor of a plan described in section 404(c));

"(3) 1 person from another labor organization representing employees (whether or not in the coal industry); and

"(4) 1 other person who shall serve as the chairman.

"(b) TERMS OF OFFICE, SUCCESSORS.—Each director shall be appointed for a term of 3 years, except for the initial term. The initial terms of the directors shall be as follows:

"Coal industry employee representative (section 404(c) settlor)	4 years
Coal-mining industry employer (section 404(c) settlor)	3 years
Other employee representative	3 years
Other coal-mining industry employer	2 years
Chairman	1 year.

A vacancy on the board shall be filled in the same manner as the original appointment was made. Any director appointed to fill a vacancy occurring prior to the expiration of the term for which the predecessor was appointed shall be appointed for the remainder of such term. A director may serve after the expiration of a term until a successor has taken office.

"(c) Quorums.—Vacancies on the board shall not impair the powers of the board to execute the functions of the Corporation so long as there are 3 members in office. The presence of 3 members shall constitute a quorum for the transaction of the business of the board.

"(d) Independent Audit.—The Corporation shall annually employ an independent certified or licensed public accountant who shall examine and audit the books and financial transactions of the Corporation. The Corporation shall, not later than June 30 of each year, submit to the Congress a report describing the activities of the Corporation under this chapter.

"(e) Adoption of Bylaws; Amendment; Alteration; Publication in the Federal Register.—As soon as practicable, but not later than 180 days after the date of the enactment of this chapter, the board shall adopt initial bylaws and rules relating to the conduct of the business of the Corporation. Thereafter, the board may alter, supplement or repeal any existing bylaw or rule, and may adopt additional bylaws and rules from time to time as may be necessary. Any bylaw or rule relating to the conduct or business of the Corporation shall be adopted in compliance with the Administrative Procedure Act, including the notice and comment provisions thereof.

"SEC. 9703. POWERS; TAX STATUS.

"(a) Powers of Corporation.—The Corporation shall have power—

"(1) to adopt, alter, and use a corporate seal;

"(2) to have succession until dissolved by Act of Congress;

"(3) to make and enforce such bylaws, rules, and regulations as may be necessary or appropriate to carry out the purposes or provisions of this chapter;

"(4) to make and perform contracts, agreements, and commitments;

"(5) to prescribe and impose fees and charges for services by the Corporation;

"(6) to settle, adjust, and compromise, and with or without consideration or benefit to the Corporation, to release or waive in whole or in part, in advance or otherwise, any claim, demand, or right of, by, or against the Corporation;

"(7) to sue and be sued, complain and defend, in any State, Federal, or other court;

"(8) to acquire, take, hold, and own, and to deal with and dispose of any property;

"(9) to determine its necessary expenditures and the manner in which the same shall be incurred, allowed, and paid, and to appoint, employ, and fix and provide for the compensation and benefits of officers, employees, attorneys, and agents;

"(10) to borrow funds from the United States Treasury for startup and operating costs;

"(11) to collect delinquent accounts; and

"(12) to execute instruments, to incur liabilities, and to do any and all other acts and things as may be necessary or incidental to the conduct of its business and the exercise of all

other rights and powers granted to the Corporation by this chapter.

"(b) EXEMPTION FROM TAXATION.—The Corporation, its property, its franchise, capital, reserves, surplus, and its income (including but not limited to, any income of any fund established under section 9704(f)), shall be exempt from all taxation now or hereafter imposed by the United States (other than taxes imposed under chapter 21, relating to the Federal Insurance Contributions Act and chapter 23, relating to the Federal Unemployment Tax Act) or by any State or local taxing authority, except that any real property and any tangible personal property (other than cash and securities) of the Corporation shall be subject to State and local taxation to the same extent according to its value as other real and tangible personal property is taxed.

"(c) CORPORATION AS AGENCY.—Notwithstanding section 1349 of title 28 or any other provision of law—

"(1) the Corporation shall be deemed to be an agency included in sections 1345 and 1442 of such title 28;

"(2) all civil actions to which the Corporation is a party shall be deemed to arise under the laws of the United States, and the district courts of the United States shall have original jurisdiction of all such actions, without regard to amount or value; and

"(3) any civil or other action, case or controversy in a court of a State, or any court other than a district court of the United States, to which the Corporation is a party may at any time before the trial thereof be removed by the Corporation to the United States district court for the district and division embracing the place where the same is pending, or if there is no such district court, to the district court of the United States for the district in which the principal office of the Corporation is located, by following any procedure for removal of causes in effect at the time of such removal. No attachment or execution shall be issued against the Corporation or any of its property before final judgment in any State, Federal, or other court.

"(d) REPORT TO CONGRESS.—No later than 1 year after the effective date of this chapter, the Corporation shall present a report to Congress on its activities, including an evaluation of the economic impact of this chapter on small coal companies and an evaluation of the effectiveness of the Corporation in achieving its goals, and recommending any changes to this chapter as it considers beneficial, including any recommended changes in premiums considered warranted to minimize any undue economic impact on small coal companies. At such time, Congress shall review the activities and operations of the Corporation.

"SEC. 9704. OPERATION OF CORPORATION.

"(a) INVESTIGATORY AUTHORITY.—

"(1) The Corporation may make such investigations as it deems necessary to enforce any provision of this chapter or any rule or regulation thereunder, and may require or permit any person to file with it a statement in writing, under oath or otherwise as the Corporation shall determine, as to all the facts and circumstances concerning the matter to be investigated.

"(2) The Corporation shall keep strictly confidential all information received relating to—

"(A) trade secrets or financial or commercial information pertaining specifically to a given person, the disclosure of which could cause competitive injury to such person, or

"(B) personnel or medical data or similar data, the disclosure of which would constitute a clearly unwarranted invasion of personal privacy,

unless the portions containing such matters, information, or data have been excised, but may use such information to the extent necessary to enforce the premium obligation imposed under subsection (g).

"(b) DISCOVERY POWERS VESTED IN BOARD OR DESIGNATED OFFICERS.—For the purpose of any investigation described in subsection (a), or any other proceeding under this chapter, the board or any officer designated by the board, may administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence and require the production of any books, papers, correspondence, memoranda or other records which the Corporation deems relevant or material to the inquiry.

"(c) CONTEMPT.—In case of contumacy by, or refusal to obey, a subpoena issued to any person, the Corporation may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on (or where such person resides or carries on business) in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda and other records. The court may issue an order requiring such person to appear before the Corporation, and to produce records or to give testimony related to the matter under investigation or in question. Any failure to obey such order of the court may be punished by the court as a contempt thereof. All process in any such case may be served in the judicial district in which such person is an inhabitant or may be found.

"(d) COOPERATION WITH GOVERNMENTAL AGENCIES.—In order to avoid unnecessary expense and duplication of functions among government agencies, the Corporation may make such arrangements or agreements for cooperation or mutual assistance in the performance of its functions under this chapter as is practicable and consistent with law. The Corporation may utilize the facilities or services of any department, agency or establishment of the United States or of any State or political subdivision of a State, including the services of any of its employees, with the lawful consent of such department, agency or establishment. The head of each department, agency or establishment of the United States shall cooperate with the Corporation and, to the extent permitted by law, provide such information and facilities as it may request for its assistance in the performance of its functions under this chapter.

"(e) CIVIL ACTIONS.—

"(1) Civil actions may be brought by the Corporation for appropriate relief, legal or equitable or both, to enforce the provisions of this chapter.

"(2) Except as otherwise provided in this chapter, if an action is brought in a district court of the United States, it may be brought in the district where the Corporation is administered,

where the violation took place, or where a defendant resides or may be found, and process may be served in any other district where a defendant resides or may be found.

"(3) The district courts of the United States shall have jurisdiction of actions brought by the Corporation under this chapter without regard to the amount in controversy in any such action.

"(4)(A) An action under this subsection may not be brought after the later of—

"(i) 6 years after the date on which the cause of action arose; or

"(ii) 3 years after the applicable date specified in subparagraph (B).

"(B) The applicable date specified in this subparagraph is the earliest date on which the Corporation acquired or should have acquired actual knowledge of the existence of such cause of action.

"(C) For purposes of this paragraph, in an action by the Corporation to collect premiums due under this chapter, the cause of action shall be treated as having arisen no earlier than the date on which the premium was due.

"(5) In any action brought under this chapter, whether to collect premiums, penalties (in the amount determined by the Corporation, which shall be no greater than the greater of interest on the unpaid premium or 20 percent of the amount of the unpaid premium), or interest (at the rate determined by the Corporation) or for any other purpose, in which a judgment in favor of the Corporation is awarded, the court shall award the Corporation its costs and reasonable counsel fees.

"(f) Establishment of Coal Industry Retiree Benefit Fund.—

"(1) Except as provided in paragraph (2), the Corporation shall establish a Coal Industry Retiree Benefit Fund (hereafter in this chapter referred to as the 'Fund'). All amounts received by the Corporation shall be deposited in the Fund, and all expenditures made by the Corporation shall be made out of the Fund.

"(2) The Corporation shall transfer to the Secretary of the Treasury for deposit in the general fund of the Treasury of the United States any portion of the premiums received under subsection (g) which are allocable to the portion of such premiums which are imposed to offset Federal revenue losses by reason of deductions being allowed under chapter 1 with respect to such premiums.

"(3) Except as otherwise provided in this chapter, the balance of the Fund shall at any time consist of the aggregate at such time of the following items:

"(A) Cash on hand or on deposit.

"(B) Amounts invested in United States Government or agency securities.

"(g) Imposition of Premium Payment Obligation.—

"(1)(A) There is hereby imposed on each person that produces bituminous coal for use or for sale the obligation to pay to the Corporation an hourly premium equal to—

"(i) in the case of bituminous coal produced in an eastern State, the rate for each hour worked in coal production work by such person's employees determined in accordance with the following:

"In the case of calendar year:	*The rate is:*
1992	*$0.99*
1993	*$1.09*
1994	*$1.20*
1995	*$1.32*
1996 or thereafter	*$1.45*

, or

"(ii) in the case of bituminous coal produced in a western State, 15 cents on each hour worked in coal production work by such person's employees.

"(B)(i) There is hereby imposed on bituminous coal imported to the United States, for use or for sale, a per-ton premium obligation to be paid to the Corporation. Such premium is intended to be equivalent to the premium imposed on domestically produced bituminous coal.

"(ii) The amount of the per-ton premium shall be equal to 25 percent of the hourly premium imposed pursuant to subparagraph (A).

"(iii) For purposes of this subparagraph, the term 'ton' means 2,000 pounds, and the term 'United States' means any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, American Samoa, Guam, Wake Island, the Canal Zone, and the Outer Continental Shelf lands defined in the Outer Continental Shelf Lands Act (43 U.S.C. 1331–1343).

"(C)(i) In addition to the amounts specified in subparagraphs (A) and (B), each last signatory operator and each other employer referred to in this subparagraph shall pay to the Corporation an annual per beneficiary premium. The amount of the annual per beneficiary premium shall be the product of the total number of orphan miners, spouses, surviving spouses, and dependents (determined under section 9711) attributable to such last signatory operator or employer and the per beneficiary premium as calculated in clause (iii).

"(ii) For purposes of this subparagraph, an orphan miner (and his spouse, surviving spouse and dependents) shall be attributable—

"(I) to an employer if his employment with such employer resulted in his eligibility under section 9711(b)(1)(E); or

"(II) to a last signatory operator meeting the conditions described in section 9723(6) with respect to such orphan miner.

"(iii) The amount of the per beneficiary premium shall be determined in accordance with the following table:

"In the case of calendar year:	*The premium is:*
1992	*$1,646*
1993	*$2,512*
1994	*$2,878*
1995	*$3,295*
1996 or thereafter	*$3,772.*

"(iv) A last signatory operator shall have no liability under this subparagraph if—

"(I) as of November 5, 1990, and for all periods thereafter, such last signatory operator, and the persons described in section 9723(5) (B) and (C) with respect to such last signatory operator, have ceased all involvement in the mining, production, preparation, marketing, sale, distribution, transportation, leasing or licensing of coal; and

"(II) such last signatory operator, and the persons described in section 9723(5) (B) and (C) with respect to such last signatory operator, were, in the aggregate, involved in the production of fewer than 50,000 tons of coal during each of the 3 years immediately preceding the cessation of such involvement.

The limitation of liability set forth in the preceding sentence shall cease to apply at any time that a last signatory operator, or any persons described in section 9723(5) (B) and (C) with respect to such last signatory operator, ceases to meet the conditions described in subclause (I).

"(v) The annual per beneficiary premium shall be payable in equal monthly installments, due by the tenth day of each month. In no event shall a last signatory operator be obligated to pay a per beneficiary premium for an individual for any month for which the last signatory operator has paid its required assessment for such individual under section 9713(d).

"(vi) A last signatory operator shall have no liability under this subparagraph if as of January 1, 1992, such last signatory operator and the persons described in section 9723(5) (B) and (C) with respect to such last signatory operator, have ceased all involvement in the production, sale, distribution, transportation, or use in processes for producing products of the operator and such persons, of bituminous and sub-bituminous coal (other than the sale or leasing of any interest in coal reserves).

"(2)(A) In the event that a person required to make payments under paragraph (1) fails to do so, the Corporation shall assess liability against the person, based upon the Corporation's estimate of the person's liability.

"(B) No later than 90 days after the assessment of liability by the Corporation, the person may request administrative review of the Corporation's assessment, in accordance with procedures adopted by the Corporation.

"(C) Notwithstanding the pendency of administrative review of any assessment of liability, the person shall, no later than 30 days after the assessment of such liability, pay all amounts required by the assessment in accordance with any payment schedule applied by the Corporation. In the event a person fails to make such payments, all amounts owed by the person shall become immediately due and payable.

"(D) In the event the person that has made payments in accordance with subparagraph (C) is ultimately determined, in accordance with subparagraph (B), to have paid in excess of the amounts actually due, the person shall receive a refund of such excess amounts, with interest.

"(3) The Corporation shall report to the Congress before the close of any calendar year with respect to any adjustment in the amount of the premiums imposed under subparagraphs (A)(i) and (B) of paragraph (1) for the following calendar year which the Corporation determines necessary to enable the provision of benefits under section 9712. Any recommendation with respect to any adjustment shall reflect the reduction in Federal revenues by reason of deductions being allowed under chapter 1 with respect to such premiums.

"(4) Premiums owed under subparagraphs (A) and (B) of paragraph (1) shall be due on the tenth day of each calendar month immediately following the month in which the coal is produced or imported, and shall be paid to the Corporation in accordance with forms and schedules promulgated by the Corporation.

"(5) The premium obligation imposed under this section shall take effect on the date of the enactment of this chapter. Premiums paid under this section shall be deemed to be fully deductible under this title without regard to any limitation on deductibility set forth in this title.

"(6) For purposes of this subsection—

"(A) the term 'bituminous coal' means coal classified as bituminous coal according to the publication of the American Society for Testing and Materials under the title 'Standard Classification of Coals by Rank' (ASTM D 388–91a), as in effect on the date of the enactment of this chapter, and

"(B) the term "Eastern States" includes Alabama, Connecticut, Delaware, the District of Columbia, Florida, Georgia, Illinois, Indiana, Kentucky, Maine, Maryland, Massachusetts, Michigan, Mississippi, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont, Virginia, West Virginia, and Wisconsin; and

"(C) the term "Western States" includes Alaska, Arizona, Arkansas, California, Colorado, Hawaii, Idaho, Iowa, Kansas, Louisiana, Minnesota, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oklahoma, Oregon, South Dakota, Texas, Utah, Washington, and Wyoming.

"Subchapter B—Eligibility for and Payment of Benefits

"Sec. 9711. Eligibility; orphan miners.
"Sec. 9712. Payment of benefits.
"Sec. 9713. Establishment of Coal Industry 1991 Benefit Fund.
"Sec. 9714. Obligation of last signatory operator to provide benefits to retirees.
"Sec. 9715. Transition benefits; premium nonpayment; transfers between 1991 Fund and Corporation.

"SEC. 9711. ELIGIBILITY; ORPHAN MINERS.

"(a) IN GENERAL.—Any person who is an orphan miner, as defined in subsection (b), or who meets the conditions set forth in subsection (c), shall be eligible to receive benefits provided by the Corporation pursuant to section 9712, except that no person shall be eligi-

ble to receive benefits from the Corporation because of a failure to receive benefits resulting from a temporary labor dispute.

"(b) ORPHAN MINER STATUS.—For purposes of this section—

"(1) An orphan miner is any person who—

"(A)(i) as of the date of enactment of this chapter, was eligible to receive benefits as a retiree from a plan described in section 9721(d) (or, but for the enactment of this chapter, would be eligible to receive benefits as a retiree from the plan described in section 9721(d)(2)(A)), and

"(ii) is not receiving benefits as a retiree from a plan described in section 9721(d) or from the plan established pursuant to section 9713;

"(B) is not described in subparagraph (A), but was eligible to receive benefits as a retiree from the plan established pursuant to section 9713 and is not receiving benefits from such plan;

"(C)(i) is receiving a pension from the defined benefit pension plan maintained pursuant to the agreement described in section 9723(7) (other than the plan described in section 9721(c)),

"(ii) but for the enactment of this chapter, would be eligible to receive medical benefits as a retiree as of February 1, 1993, from the plan described in section 9721(d)(2)(B), and

"(iii) is not receiving medical benefits as a retiree from the plan described in section 9721(d)(2)(B) or from any other plan;

"(D)(i) is receiving a pension from the defined benefit pension plan maintained pursuant to the agreement described in section 9723(7) (other than the plan described in section 9721(c));

"(ii) as of February 1, 1993, had earned 20 years of credited service under such plan;

"(iii) is at any time after beginning to receive such pension not receiving retiree medical benefits equal to the benefits in effect as that time under the plans described in section 9712(b)(3); and

"(iv) meets the eligibility requirements for retiree medical benefits then in effect under such plans; or

"(E)(i) was eligible as a result of coal production work performed in the bituminous, sub-bituminous or lignite coal industry to receive retiree medical benefits from a health care plan that met the requirements of subparagraphs (D) and (E) of paragraph (2);

"(ii) initially ceased to receive retiree medical benefits on or after the date of enactment of this chapter, despite continued eligibility therefore;

'(iii) had been receiving such benefits from a plan that had been in existence for at least 3 years prior to the cessation of benefits; and

"(iv) was included in a category of retirees that had been eligible to receive benefits for at least 3 years prior to the cessation of benefits.

"(2) For purposes of paragraph (1)(E), the following rules shall apply:

"(A) Eligibility is continuing where benefits ceased incident to an employer's cessation of operations, but is not continuing where benefits ceased pursuant to a lawful termination or modification of a plan (under circumstances other than a cessation of operations).

"(B) In the case of any individual who has 20 years of credited service under a defined benefit pension plan maintained pursuant to the agreement described in section 9723(7), or who was otherwise eligible to receive retiree medical benefits from a single employer health care plan pursuant to a coal wage agreement, all health care plans in which such individual was a participant during a period of such credited service or during such period of eligibility shall be taken into account in determining whether the 3-year tests have been met.

"(C) In the case of an employer that established a new health care plan as a replacement for a prior plan, such prior plan shall be taken into account in determining whether the 3-year tests have been met.

"(D) A health care plan meets the requirements of this subparagraph if the employer maintaining the plan, a labor organization representing the employees of the employer, or an employee of the employer submits a copy of the plan to the Corporation within 180 days from the later of—

"(i) the date of establishment of the plan; or

"(ii) the date of enactment of this chapter.

"(E) A health care plan meets the requirements of this subparagraph if the employer maintaining the plan, a labor organization representing the employees of the employer, or an employee of the employer submits a copy of any amendment or modification to the plan to the Corporation within 180 days from the later of—

"(i) the date of such amendment or modification; or

"(ii) the date of enactment of this chapter.

"(c) ELIGIBILITY OF SPOUSES AND DEPENDENTS.—

"(1) A spouse, surviving spouse or dependent of an orphan miner or a deceased coal miner meets the conditions of this section if such individual was eligible to receive benefits from a plan described in section 9721(d) as of the date of enactment of this chapter, and is not receiving benefits from that plan or from the plan established pursuant to section 9713.

"(2) A spouse, surviving spouse or dependent of an orphan miner or a deceased coal miner meets the conditions of this section if such individual is not described in paragraph (1), but was eligible to receive benefits from the plan established pursuant to section 9713 and is not receiving benefits from such plan.

"(3) In the case of any spouse, surviving spouse or dependent of an orphan miner described in subsection (b)(1)(A) or (b)(1)(C) of this section, eligibility shall be based upon the rules set forth in the plans described in section 9721(d) as of the date of enactment of this chapter. In the case of any spouse, surviving spouse or dependent of an orphan miner described in subsection (b)(1)(D), eligibility shall be based upon the rules set forth in individual employer plans maintained pursuant to the agreement

described in section 9723(7) on the date that the orphan miner first became eligible for benefits from the Corporation. In all other cases, eligibility shall be based upon the rules of the plan that was or would have been applicable to the orphan miner or deceased coal miner for the 3-year period preceding eligibility for benefits from the Corporation. The Corporation is authorized to promulgate regulations consistent with this paragraph establishing the eligibility of other spouses, surviving spouses and dependents of orphan miners or deceased coal miners for health benefits.

"(d) REENROLLMENT OF ORPHAN MINERS AND BENEFICIARIES.— The Corporation and the joint board of trustees of the plan established pursuant to section 9713 shall cooperate to review the eligibility of individuals under this section. Pending such review, any individual receiving benefits from a plan described in section 9721(d) as of the date of enactment of this chapter shall be presumed to meet the first part of the eligibility tests of subsections (b)(1)(A) and (c)(1). However, no individual shall be considered eligible to receive benefits provided by the Corporation unless a determination is made that such individual in fact met or meets all eligibility requirements necessary to receive benefits as required under subsection (b) or (c). No individual shall be eligible under subsection (b)(1)(A) or (c)(1) if such individual was finally determined to be ineligible to receive benefits from a plan described in section 9721(d) prior to the date of enactment of this chapter.

"SEC. 9712. PAYMENT OF BENEFITS.

"(a) IN GENERAL.—The Corporation shall provide medical benefits to orphan miners, their spouses, surviving spouses and dependents, who meet the eligibility requirements of section 9711, and shall provide coverage for death benefits to orphan miners eligible for such benefits. The board shall establish schedules of benefits applicable to classes of orphan miners, their spouses, surviving spouses and dependents, in accordance with this section. All benefit obligations of the Corporation shall be contingent upon the continued imposition of an hourly premium payment obligation as specified in section 9704(g)(1)(A).

"(b) BENEFIT LEVELS.—

"(1) An orphan miner eligible for benefits pursuant to section 9711(b)(1)(A) or 9711(b)(1)(C) shall be entitled to benefit coverage that is substantially the same as (but not exceeding) the coverage provided by the plans described in section 9721(d) as of the date of enactment of this chapter, and shall be subject to all limitations of such coverage. Such orphan miner shall also be eligible for death benefits, which shall be equal to the death benefits provided as of the date of enactment of this chapter under the plan described in section 9721(c).

"(2) An orphan miner eligible for benefits pursuant to section 9711(b)(1)(B) or 9711(b)(1)(E) shall be entitled to a level of benefits and benefit coverage that is substantially the same as (but not exceeding) the retiree benefit coverage applicable to him immediately preceding his eligibility for benefits from the Corporation, and shall be subject to all limitations of such coverage. Notwithstanding the foregoing, the following rules shall apply:

"(A) The level of benefits and benefit coverage provided under this paragraph shall not exceed that which is provided under paragraph (1) of this subsection.

"(B) In determining the retiree benefit coverage applicable to an orphan miner for purposes of this paragraph, the Corporation shall disregard any increases or decreases in benefits or benefit coverage that were in effect for fewer than 3 years preceding the orphan miner's eligibility for benefits from the Corporation, except that—

"(i) any death benefit applicable to an orphan miner as a result of 1991 amendments to the agreement described in section 9723(7) shall not be disregarded; and

"(ii) increases or decreases in benefits or benefit coverage that were the subject of a collective bargaining agreement shall not be disregarded.

"(3) An orphan miner eligible for benefits pursuant to section 9711(b)(1)(D) shall be entitled to a level of benefits and benefit coverage equivalent to the level of benefits and benefit coverage, if any, provided under individual employer plans maintained pursuant to the agreement described in section 9723(7) on the date that the orphan miner first became eligible for benefits from the Corporation, and shall be subject to all limitations of such coverage.

"(4) An individual eligible for benefits pursuant to section 9711(c) shall be entitled to medical benefit coverage that does not exceed the medical benefit coverage that is or would have been applicable to the coal miner through whom the individual claims eligibility, and the individual shall be subject to all limitations of such coverage.

"(5) The Corporation may make increases to its schedules of benefits that are desirable for efficiency of administration, except that such adjustments to benefits may not result in an increase in cost to the Corporation or an increase in any premium under section 9704(g).

"(c) MANDATORY MANAGED CARE.—The Corporation shall develop managed care rules which shall be applicable to the payment of benefits under this section. The rules shall preserve freedom of choice while reinforcing managed care network use by allowing a point of service decision as to whether a network medical provider will be used. Major elements of such rules shall include, but not be limited to—

"(1) implementing formulary for drugs and subjecting the prescription program to a rigorous review of appropriate use;

"(2) obtaining a unit price discount in exchange for patient volume and preferred provider status, with the amount of the potential discount varying by geographic region;

"(3) limiting benefit payments to physicians to the medicare allowable charge, while protecting beneficiaries from balance billing by providers;

"(4) utilizing Medicare's 'appropriateness of service' protocols in the claims payment function where they are more stringent;

"(5) creating mandatory utilization review (UR) procedures, but placing the responsibility to follow such procedures on the physician or hospital, not the beneficiaries;

"(6) selecting the most efficient physicians and state-of-the-art utilization management techniques, including ambulatory care techniques, for medical services delivered by the managed care network; and

"(7) utilizing a managed care network provider system as practiced in the health care industry at the time medical services are needed (point-of-service) in order to receive maximum benefits available under this section.

Any managed care or cost containment program shall have as its primary goal the provision of quality medical care. In no event shall any such program result in the reduction of the quality of care provided to participants and beneficiaries consistent with sound medical practice.

"(d) EFFECTIVE DATE.—Benefits shall be payable under this section as of January 1, 1992. Pursuant to section 9715, the Corporation shall pay the trustees of the plans described in section 9721(d) and the plan established pursuant to section 9713 for all benefit and administrative costs expended with respect to eligible orphan miners, spouses, surviving spouses and dependents, from the effective date to the date that such individuals are transferred to the Corporation.

"(e) ELECTIVE COVERAGE.—

"(1) An employer may elect to provide retirement health coverage to its employees by meeting the following conditions:

"(A) The employer must employ workers in the coal industry.

"(B) The employer agrees to pay an annual premium, as determined by the Corporation, sufficient to provide retirement health coverage to all of its employees who perform classified work as determined under the agreement described in section 9723(7), or any successor agreement, who have worked a total of 20 years, including both service with that employer, service for any other employer described in this subsection, and service for any other employer that is credited for purposes of eligibility by a plan described in section 404(c).

"(C) The employer is not currently obligated by a collective bargaining agreement to make contributions to the plan established pursuant to section 9713.

"(D) The employer's election, once made, is irrevocable.

"(2) Upon the retirement of an employee of an employer described in paragraph (1), with 20 or more years of service, upon such terms and conditions as established by the Corporation, such employee and his or her dependents shall receive benefits, upon such terms and conditions as determined by the Corporation.

"SEC. 9713. ESTABLISHMENT OF UNITED MINE WORKERS OF AMERICA 1991 BENEFIT FUND.

"(a) MERGER OF RETIREE BENEFIT PLANS.—

"(1) As soon as practicable after the enactment of this chapter, and in no event later than 60 days, the settlors of the plans described in section 9721(d) shall cause such plans to be merged, and shall appoint a joint board of trustees to manage

the operation and administration of the merged plan. The merged plan shall be known as the United Mine Workers of America 1991 Benefit Fund (hereinafter referred to as the '1991 Fund'). The 1991 Fund shall be an employee welfare benefit plan within the meaning of section 3(1) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(1)) and a multiemployer plan within the meaning of section 3(37) of such Act (29 U.S.C. 1002(37)).

"(2) The settlors shall design the structure and administration of the 1991 Fund. The settlors may at any time and for any reason change the number and identity of the members comprising the board of trustees of the 1991 Fund.

"(b) ELIGIBILITY.—

"(1) The following individuals shall be eligible to receive benefits from the 1991 Fund:

"(A) Any individual who, as of the date of enactment of this chapter, was eligible to receive benefits from the plan described in section 9721(d)(2)(A) (or who, but for the enactment of this chapter, would be eligible for benefits from such plan), and with respect to whom the last signatory operator is and remains signatory to an agreement that is described in section 9723(7) or that contains provisions relating to pension and health care benefits that are the same as those contained in such agreement.

"(B) Any individual who retired from classified employment under an agreement that is described in section 9723(7) or that contains provisions relating to pension and health care benefits that are the same as those contained in such agreement, and any spouse, surviving spouse or dependent of such retiree, with respect to whom the last signatory operator makes an election prior to February 1, 1993, to pay premiums to the 1991 Fund for such benefits and is and remains signatory to an agreement that is described in section 9723(7) or that contains provisions relating to pension and health care benefits that are the same as those contained in such agreement. Any election made pursuant to this subparagraph must cover, at a minimum, all of the last signatory operator's retirees who retired from classified employment as of February 1, 1993.

"(2) No individual shall be eligible under subparagraph (A) of paragraph (1) unless the joint board of trustees of the 1991 Fund determines that such individual in fact met all eligibility requirements of the plan described in section 9721(d)(2)(A) as of the date of enactment of this chapter. Any individual who was finally determined to have been ineligible for benefits from a plan described in section 9721(d)(2)(A) prior to such date of enactment shall be ineligible under subparagraph (A) of paragraph (1).

"(c) BENEFITS.—

"(1) Except as otherwise provided in this subsection, health care benefits provided under the 1991 Fund shall be identical to the benefits provided under the plans described in section 9721(d). The 1991 Fund shall provide coverage for death bene-

fits to retirees, equal to the death benefits provided under the plan described in section 9721(c).

"(2) The joint board of trustees of the 1991 Fund shall develop managed care rules, subject to section 9714(b), which shall be applicable to the payment of benefits under this section. The rules shall preserve freedom of choice while reinforcing managed care network use by allowing a point of service decision as to whether a network medical provider will be used. The board of trustees shall permit any last signatory operator subject to section 9714 to utilize the managed care and cost containment rules and programs developed pursuant to this paragraph, at the election of such last signatory operator. Major elements of such rules shall include, but not be limited to—

"(A) implementing formulary for drugs and subjecting the prescription program to a rigorous review of appropriate use;

"(B) obtaining a unit price discount in exchange for patient volume and preferred provider status, with the amount of the potential discount varying by geographic region;

"(C) limiting benefit payments to physicians to the medicare allowable charge, while protecting beneficiaries from balance billing by providers;

"(D) utilizing medicare's 'appropriateness of service' protocols in the claims payment function where they are more stringent;

"(E) creating mandatory utilization review (UR) procedures, but placing the responsibility to follow such procedures on the physician or hospital, not the beneficiaries;

"(F) selecting the most efficient physicians and state-of-the-art utilization management techniques, including ambulatory care techniques, for medical services delivered by the managed care network; and

"(G) utilizing a managed care network provider system as practiced in the health care industry at the time medical services are needed (point-of-service) in order to receive maximum benefits available under this section.

Any managed care or cost containment program shall have as its primary goal the provision of quality medical care. In no event shall any such program result in the reduction of the quality of care provided to participants and beneficiaries consistent with sound medical practice.

"(d) ASSESSMENTS.—

"(1) As of November 30 of each plan year, the joint board of trustees of the 1991 Fund shall set a monthly assessment for each person required to pay assessments pursuant to paragraph (2). The monthly assessment for each such person shall be equal to $1/12$ of the product of—

"(A) the projected cost of operating the 1991 Fund during the succeeding plan year (less any assets received from a plan described in section 9721(c) and any other surplus assets) divided by the number of participants and beneficiaries for the current plan year; and

"(B) the projected number of the 1991 Funds' eligible participants and beneficiaries attributable to such person, determined as of the nearest November 1.

In projecting the cost of operating the 1991 Fund, the board of trustees shall take into account the anticipated benefit experience and administrative expenses of the 1991 Fund as a whole, and amounts needed to eliminate any accumulated deficit. The monthly assessment determined under this paragraph shall be verified by an independent auditor, and shall continue in effect for each month of the succeeding plan year, except that the joint board of trustees shall determine a monthly assessment for any new contributor or other person for whom a monthly assessment has not been established, and a revised monthly assessment for any last signatory operator that makes the election described in subsection (b)(1)(B) and with respect to which new participants and beneficiaries become eligible for benefits. Any new monthly assessment or revised monthly assessment shall be based upon the number of projected participants and beneficiaries attributable to the contributor as of the date the new or revised assessment is made. Each person required to pay assessments pursuant to paragraph (2) shall continue to pay to the plans described in section 9721(d) the contributions required under the applicable coal wage agreement, until the first month for which the assessment described in this paragraph in set. In no event shall a person required to pay assessments pursuant to paragraph (2) be required to make any payment to the 1991 Fund for the same period for which a contribution to a plan described in section 9721(d) is required.

"(2) Each last signatory operator with respect to any person described in subsection (b)(1)(A), and each last signatory operator with respect to any person described in subsection (b)(1)(B) that has agreed to provide benefits coverage through the 1991 Fund, shall pay to the 1991 Fund for each month the assessment determined by the joint board of trustees pursuant to paragraph (1). The assessments paid under this section shall be deemed to be fully deductible under this title without regard to any limitation on deductibility set forth in this title.

"(3) Either of the settlors shall have the right to audit the accounts, books and records, and operation of the 1991 Fund, at any time and for any reason, upon reasonable notice to the joint board of trustees. The joint board of trustees shall cooperate fully with the settlors in connection with any such audit and shall make available appropriate personnel and records deemed necessary by the auditors for inspection and copying at reasonable times and places.

"(4) Each last signatory operator obligated to pay assessments to the 1991 Fund pursuant to paragraph (2) shall be bound by all of the provisions of the plan and trust documents establishing and governing the 1991 Fund.

"(5) As of the date any assessment owed under this subsection is due, the persons described in section 9723(5) (B) or (C) with respect to any last signatory operator shall be treated as such last signatory operator and shall be jointly and severally liable for such assessment.

"(e) EXCLUSIVE OBLIGATION.—Except as provided in this chapter, no employer that was a signatory to the 1978 or any subsequent coal wage agreement and that had an obligation to provide health care benefits to coal mine retirees shall be obligated to provide benefits to individuals covered by the plans described in section 9721(d), or to make contributions to any plan described in section 9721(d), or to the 1991 Fund, with respect to work performed or coal mined after the date of enactment of this chapter, or to pay withdrawal liability to a plan described in section 9721(d) as a result of the change in the contribution obligation required by this chapter.

"SEC. 9714. OBLIGATION OF LAST SIGNATORY OPERATOR TO PROVIDE BENEFITS TO RETIREES.

"(a) DURATION OF OBLIGATION.—The last signatory operator of any individual receiving retiree health care benefits as of February 1, 1993 (including retiree, spouse, surviving spouse and dependent benefits) from an individual employer plan maintained pursuant to a coal wage agreement (or who has applied for such benefits as of February 1, 1993, and has met every eligibility requirement for such benefits as of such date) shall provide retiree health care benefits to such individual equal to the benefits required to be provided by such last signatory operator's individual employer plan as of January 1, 1992, as limited by any managed care or cost containment rules of the type described in sections 9712(c) and 9713(c)(2), and subject to subsection (b), for as long as the last signatory operator remains in business. The existence, level and duration of benefits provided to a last signatory operator's former employees (and their spouses, surviving spouses and dependents), other than those described in this subsection, who are or were covered by a coal wage agreement, shall only be as determined by and subject to collective bargaining or lawful unilateral action, except that this subsection shall not be construed to impair the eligibility of any individual described in section 9711(b)(1)(D) for the benefit coverage described in section 9712(b)(3).

"(b) MANAGED CARE PROVIDER SYSTEM QUALITY CONTROL.—Any managed care provider system adopted by a last signatory operator as permitted under subsection (a), or by the joint board of trustees of the 1991 Fund, pursuant to section 9713(c)(2), shall be subject to the following requirements of this subsection:

"(1) The settlors shall establish a medical peer review panel, which shall determine standards of quality for managed care provider systems. Standards of quality shall include accessibility to medical care, taking into account that accessibility requirements may differ depending upon the nature of the medical need. Each settlor shall have the power to appoint and remove 2 individuals who shall serve on the panel. A panel member shall be either a medical practitioner knowledgeable in managed care, or an individual who is expert in managed care.

"(2) Each last signatory operator and the joint board of trustees of the 1991 Fund shall submit a description of any managed care provider system to the panel prior to implementation of the system, and shall, on the same date or prior to such submission, provide notice of the submission to the participants of the affected employee benefit plan or plans. The last signatory em-

ployer or the joint board of trustees may implement the proposed system on a provisional basis on or after the 120th day after the submission to the panel, unless the panel issues a preliminary determination that the system has not been shown to meet the requisite standards. The requirements of this paragraph shall not apply to a last signatory operator electing to utilize the managed care provider system established by the 1991 Fund if the panel has issued a favorable determination for such system.

"(3)(A) Upon receipt of a submission by a last signatory operator or by the joint board of trustees, the panel shall conduct a preliminary examination of the managed care provider system. In the event that the preliminary review reveals a failure to show compliance with established standards such that provisional implementation by a last signatory operator or by the joint board of trustees may be detrimental to participants subject to the system, the panel shall, within 120 days of the submission, issue a preliminary determination that the system has not been shown to meet the requisite standards.

"(B) Within 240 days from the date of any submission, the panel shall issue a final determination of whether the system has been shown to meet the established standards of quality. In the event of a negative determination, the panel shall list specific steps that may be taken by the last signatory operator or by the joint board of trustees to qualify the system under the established standards.

"(C) The first-named settlor in section 9723(8) shall have the authority to review submissions made under paragraph (2), and to designate the order in which such submissions shall be considered by the panel.

"(D) In the event that the members of the panel deadlock on a determination to be made under this paragraph, they shall, by majority vote, appoint a neutral person, who would be qualified to serve as a panel member, to break such deadlock.

"(4) In the event of a negative determination by the panel, the last signatory operator shall have the options described in subparagraph (A), (B), or (C), and the joint board of trustees shall have the options described in subparagraphs (A) and (B):

"(A) implementing the specific steps outlined by the panel pursuant to paragraph (3);

"(B) consistent with the requirements of this subsection, establishing a new managed care provider system that meets the requisite standards; or

"(C) electing to utilize the managed care provider system established by the 1991 Fund if the panel has issued a favorable determination for such system.

"(5) The panel shall develop rules for the periodic review of determinations made, except that reviews shall be no more frequent than once every 3 years; and for the reconsideration of any prior determination upon a showing that the managed care provider system does not or has ceased to meet the established standards. The panel may take into account written complaints received from affected participants and beneficiaries, but the authority of the panel shall be limited to determining the con-

tinued qualification of a managed care provider system under the established standards, and shall not extend to resolving claims of medical malpractice or any other issue.

"(6) The panel shall withhold from all persons not connected with the conduct of a reconsideration or review described in paragraph (5) (other than the first-named settlor in section 9723(8) all information relating to the subject of any written complaint received by an affected participant or beneficiary; and may not be compelled in any Federal, State, or local civil, criminal, administrative, legislative, or other proceedings to identify such information. Notwithstanding the foregoing, the panel shall provide the last signatory operator or the joint board of trustees of the 1991 Fund with a copy of any written complaint relating to a managed care provider system maintained by such last signatory operator or joint board of trustees.

"(7)(A) The panel, any person acting as a member or staff to the panel, any person under a contract or other formal agreement with the panel, and any person who participates with or assists the panel with respect to any action taken pursuant to this subsection, shall not be liable in damages under any law of the United States or of any State (or political subdivision thereof) with respect to the action. The preceding sentence shall not apply to damages under any law of the United States or any State relating to the civil rights of any person or persons, including the Civil Rights Act of 1964 (42 U.S.C. 2000e et seq.) and the Civil Rights Acts (42 U.S.C. 1981 et seq.). Nothing in this subparagraph shall prevent the United States or any attorney general of a State from bringing an action, where such an action is otherwise authorized.

"(B) Notwithstanding any other provision of law, no person (whether as a witness or otherwise) providing information to the panel regarding the competence or professional conduct of a physician shall be held, by reason of having provided such information, to be liable in damages under any law of the United States or of any State (or political subdivision thereof) unless such information is false and the person providing it knew that such information was false.

"(8) The joint board of trustees of the 1991 Fund and each last signatory operator that makes a submission pursuant to subsection (b)(2) shall be liable for reasonable fees assessed by the panel in connection with the review of managed care provider systems.

"(c) Satisfaction of Obligations.—Subject to the provisions of sections 9711 and 9713, the obligations of a last signatory operator under this section may be satisfied for any period with respect to any individual by payment of the required assessment under section 9713(d) or the premium under section 9704(g)(1)(C), or by the provision of the required benefits under an individual employer plan.

"(d) Control Group Liability.—As of the date that any benefit obligation owed pursuant to this section is due, the persons described in section 9723(5) (B) and (C) with respect to any last signatory operator shall be treated as such last signatory operator, and shall be jointly and severally liable for such benefit obligation.

"SEC. 9715. TRANSITION BENEFITS; PREMIUM NONPAYMENT; TRANSFERS BETWEEN 1991 FUND AND CORPORATION.

"(a) PAYMENT OF BENEFITS TO ORPHAN MINERS.—The plans described in section 9721(d) and the 1991 Fund shall continue to provide benefits to orphan miners, spouses, surviving spouses and dependents described in section 9711 (b) and (c), until the end of the second month beginning after the effective date of section 9712(d). Such orphan miners, spouses, surviving spouses and dependents shall be transferred to the Corporation as of the first day of the third month following the effective date of section 9712(d). The defined benefit pension plans maintained pursuant to the agreement described in section 9723(7) shall, on behalf of the Corporation and the 1991 Fund, continue to provide death benefits to orphan miners described in section 9711(b) and to retirees described in section 9713(b)(1) until the end of the second month beginning after the effective date of section 9712(d). Such pension plans shall have no liability for death benefits for the orphan miners described in section 9711(b), or for the retirees described in section 9713(b)(1), as of the first day of the third month following the effective date of section 9712(d). The Corporation may elect to pay the plans described in section 9721(d), the 1991 Fund, or the defined benefit pension plans maintained pursuant to the agreement described in section 9723(7) to continue to provide transition benefits after the end of the second month beginning after the effective date of section 9712(d), and for a period not to exceed 6 months. If the Corporation so elects, it shall pay such plans all amounts necessary to enable the provision of benefits and to cover all costs of administration associated with the provision of benefits. The schedule for such payments shall be determined by the boards of trustees of the plans, and may require advance payments. Amounts paid pursuant to this subsection shall not be included in the amounts to be reimbursed pursuant to subsection (b).

"(b) REIMBURSEMENT OF COST FOR TRANSITION BENEFITS.—No later than the first day of the fourth month after the effective date of section 9712(d), the Corporation shall reimburse the plans described in section 9721(d) and the 1991 Fund, with interest, for the amounts of benefits paid and administrative expenses incurred pursuant to subsection (a). No later than the first day of the fourth month after the effective date of section 9712(d), the Corporation and the 1991 Fund shall reimburse the defined benefit pension plans maintained pursuant to the agreement described in section 9723(7), with interest, for the amount of death benefits paid and administrative expenses incurred pursuant to subsection (a).

"(c) ACCESS TO RECORDS.—The joint boards of trustees of the plans described in section 9721(d) and the 1991 Fund shall share with the Corporation all records, files and documents related to the orphan miners, spouses, surviving spouses and dependents transferred to the Corporation, to the extent necessary for the Corporation to administer the payment of benefits to such individuals.

"(d) PREMIUM NONPAYMENT.—

"(1) No individual shall be eligible for benefits from the 1991 Fund during any month for which the assessments required under section 9713(d) have not been paid by such individual's last signatory operator. Such individual shall be immediately

eligible to receive benefits from the Corporation and the Corporation shall have a cause of action against such individual's last signatory operator for the per beneficiary premium imposed under section 9704(g)(1)(C).

"(2) The 1991 Fund shall continue to treat an individual described in paragraph (1) as if he or she were eligible for benefits until the end of the third month for which an assessment due has not been paid. If the last signatory operator with respect to such individual has not paid its assessments due by the end of such month (with such interest and liquidated damages imposed by the board of trustees in their discretion, up to the amounts provided in section 9722(d)(2) (B) and (C)), the 1991 Fund shall notify the Corporation that the individual is transferred to the Corporation pursuant to paragraph (1), and the Corporation shall reimburse the 1991 Fund, with interest, for any benefits paid to or on behalf of such individual for all months for which assessments have not been paid.

"Subchapter C—Other Provisions

"Sec. 9721. Determination and disposition of excess assets.
"Sec. 9722. Civil enforcement.
"Sec. 9723. Definitions.
"Sec. 9724. Sham transactions.

"SEC. 9721. DETERMINATION AND DISPOSITION OF EXCESS PENSION ASSETS.

"(a) DETERMINATION OF EXCESS PENSION ASSETS.—

"(1) Within 30 days after the enactment of this chapter, the joint board of trustees of the plan described in subsection (c) shall, through the independent actuaries of the plan, calculate the amount of the excess pension assets. The trustees of the plan described in subsection (c) shall recalculate the excess pension assets at any time that they are directed to do so by the settlors.

"(2) Immediately following the calculation (or recalculation) of the excess pension assets, the trustees of the plan described in subsection (c) shall segregate the excess pension assets from the remaining assets of such plan. The segregated excess pension assets (including all earnings thereon) shall be held in the plan until disbursed pursuant to subsection (b).

"(b) DISPOSITION OF EXCESS PENSION ASSETS.—Notwithstanding any other provision of law, the excess pension assets (including all earnings thereon) shall be expended in the following order:

"(1) Fifty million dollars shall be added to the general assets of the Corporation.

"(2) The deficits in the plans described in subsection (d) as of the date of enactment of this chapter shall be reduced to zero.

"(3) Fifty million dollars shall be added to the general assets of the 1991 Fund.

"(4) The remainder of the excess pension assets, if any, shall be added to the general assets of the 1991 Fund, at such times and in such amounts as may be directed by the settlors.

"(c) PLAN CONTAINING EXCESS PENSION ASSETS.—A plan is described in this subsection if it is a pension plan and—

"(1) it is a plan described in section 404(c) or a continuation thereof; and

"(2) participation in the plan is substantially limited to individuals who retired prior to January 1, 1976.

"(d) Related Welfare Plans.—A plan is described in this subsection if—

"(1) it is a plan described in section 404(c) or a continuation thereof; and

"(2) it provides health benefits to retirees and beneficiaries of the industry which maintained the plan described in subsection (c); and

"(A) participation in the plan is substantially limited to individuals who retired prior to January 1, 1976; or

"(B) participation in the plan is substantially limited to individuals who retired on or after January 1, 1976.

"(e) Tax Treatment, Validity of Transfer of Excess Pension Assets.—

"(1) No deduction shall be allowed under this title with respect to the expenditure of excess pension assets pursuant to subsection (a), but such transfer shall not adversely affect the deductibility (under applicable provisions of this title) of contributions previously made by employers or amounts hereafter contributed by employers to the plans described in subsection (c) or (d), or to the 1991 Fund.

"(2) The expenditure of excess pension assets pursuant to subsection (b)—

"(A) shall not be treated as an employer reversion from a qualified plan for purposes of section 4980, and

"(B) shall not be includible in the gross income of any employer maintaining a plan described in subsection (c).

"(3) Neither the segregation of excess pension assets pursuant to subsection (a)(2), the expenditure of excess pension assets pursuant to subsection (b), nor any direction made by the settlors pursuant to subsection (a)(1) or (b)(4) shall be deemed to violate or be prohibited by any provision of law, or to cause the settlors, joint board of trustees, employers or any related person to incur or be subject to taxes, fines, or penalties of any kind whatsoever.

"SEC. 9722. CIVIL ENFORCEMENT.

"(a) Civil actions may be brought by the 1991 Fund for appropriate relief, legal or equitable or both, to enforce the provisions of this chapter.

"(b) Except as otherwise provided in this chapter, where such an action is brought in a district court of the United States, it may be brought in the district where the 1991 Fund is administered, in the district where the violation took place, or where a defendant resides or may be found, and process may be served in any other district where a defendant resides or may be found.

"(c) The district courts of the United States shall have jurisdiction of actions brought by the 1991 Fund under this chapter without regard to the amount in controversy in any such action.

"(d)(1) In any action brought under subsection (a) (other than an action described in paragraph (2)), the court in its discretion may award to the 1991 Fund all or a portion of the costs of litigation, including reasonable attorneys' fees, incurred by the 1991 Fund in connection with such action.

"(2) In any action by the 1991 Fund to enforce section 9713(d)(2), in which a judgment in favor of the 1991 Fund is awarded, the court shall award the 1991 Fund—

"(A) the unpaid assessments;

"(B) interest on the unpaid assessments;

"(C) an amount equal to the greater of—

"(i) interest on the unpaid assessments; or

"(ii) liquidated damages in the amount of 20 percent of the amount determined by the court under subparagraph (A);

"(D) reasonable attorneys' fees and costs of the action, to be paid by the defendant; and

"(E) such other legal or equitable relief as the court deems appropriate.

For purposes of this paragraph, interest on unpaid assessments shall be determined by using the rate provided under the rules of the 1991 Fund, or, if none, the rate prescribed under section 6621.

"(e)(1) Except as provided in paragraph (2), an action under this subsection may not be brought after the later of—

"(A) 6 years after the date on which the cause of action arose; or

"(B) 3 years after the earliest date on which the 1991 Fund acquired or should have acquired actual knowledge of the existence of such cause of action.

"(2) In the case of fraud or concealment, the period described in paragraph (1)(b) shall be extended to 6 years after the applicable date.

"(f) Any person who is an employer, a last signatory operator, a person described in section 9723(5) (B) or (C) with respect to an employer or last signatory operator, a bituminous coal industry retiree, or any spouse, surviving spouse or dependent of a bituminous coal industry retiree, and is adversely affected by any act or omission of any party under this chapter, or who is an employee organization of which such a coal industry retiree is a member, or an employer association of which such an employer is a member, may bring an action for appropriate equitable relief in the appropriate court.

"(1) During the pendency of any proceeding under this subsection by an employer, employer association, last signatory operator, or person described in section 9723(5) (B) or (C) with respect to an employer or last signatory operator, all potentially affected retirees, spouses, surviving spouses and dependents eligible for benefits from the 1991 Fund shall be transferred to the Corporation, which shall—

"(A) provide such benefits as would have been provided from the 1991 Fund, and

"(B) have and exercise all of the rights and obligations of the 1991 Fund with respect to—

"(i) the collection of assessments relating to such retirees and spouses, surviving spouses and dependents, and

"(ii) the defense of the proceeding.

"(2) In the event that a last signatory operator or other person pays to the 1991 Fund the assessments required pursuant to section 9713(d) for any month during the pendency of a proceeding

described in paragraph (1), the 1991 Fund, and not the Corporation, shall be responsible for providing any benefits required to be paid for that month to eligible individuals under section 9713(b).

"(g) In any action brought under subsection (f), the court may award all or a portion of the costs and expenses, including reasonable attorneys' fees, incurred in connection with such action to any party that prevails or substantially prevails in such action.

"(h) This subsection shall be the exclusive means for bringing actions against the Corporation or the 1991 Fund under this chapter.

"(i)(1) Except as provided in paragraph (2), an action under this subsection may not be brought after the later of—

"(A) 6 years after the date on which the cause of action arose; or

"(B) 3 years after the earliest date on which the plaintiff acquired or should have acquired actual knowledge of the existence of such cause of action.

"(2) In the case of fraud or concealment, the period described in paragraph (1)(B) shall be extended to 6 years after the applicable date.

"(j) The district courts of the United States have jurisdiction of actions brought under this subsection without regard to the amount in controversy.

"(k) In any suit, action or proceeding in which the 1991 Fund is a party, in any State court, the 1991 Fund may, without bond or security, remove such suit, action, or proceeding from the State court to the United States district court for the district or division in which such suit, action or proceeding is pending by following any procedure for removal now or hereafter in effect.

"SEC. 9723. DEFINITIONS.

"For purposes of this chapter—

"(1) The term 'coal production work' shall mean work in which an individual engages in physical operations consisting of the mining, preparation, handling, processing, cleaning and loading of coal, including removal of overburden and coal waste, the transportation of coal (except by waterway or rail not owned by an employer engaged in the production of coal), repair and maintenance work normally performed at a mine site or central shop of an employer engaged in the production of coal, maintenance of gob piles and mine roads, construction of mine or mine-related facilities including the erection of mine tipples and sinking of mine shafts or slopes performed by employees of the employer engaged in the production of coal, and work of the type customarily related to the foregoing; except that the term shall not mean managerial, supervisory, warehouse, clerical or technical work, unless such work is performed subject to a coal wage agreement binding the employer engaged in the production of coal.

"(2) The term 'coal wage agreement' shall mean—

"(A) the National Bituminous Coal Wage Agreement;

"(B) any agreement substantially identical or substantially similar to such agreement, but only if, as of the date of enactment of this chapter, such agreement provided for con-

tributions to be made to the plans described in section 9721(d); or

"(C) any other agreement entered into between an employer in the bituminous coal industry and the United Mine Workers of America that requires the provision of health benefits to retirees of such employer, eligibility for which is based on years of service credited under a plan established by the settlors and described in section 404(c) or a continuation of such plan.

"(3) The term 'credited service' shall have the same meaning as determined under the applicable defined benefit pension plan, but only if such service was of the type used to determine eligibility under the plan described in section 9721(d)(2)(B).

section 9721(d)(2)(B).

"(4) The term 'excess pension assets' shall mean the excess of the current value of plan assets (as defined in section 3(26) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(26)) of the plan described in section 9721(c) over the actuarial present value of all benefits for all plan participants under such plan, determined as of the date of enactment, in accordance with the actuarial assumptions and methods which reflect the plan actuary's best estimate of anticipated experience under such plan, except that where excess pension assets are recalculated as required under section 9721(a)(1), the amount of excess pension assets shall be determined as of the July 1 next preceding the date of the recalculation.

"(5) A last signatory operator shall be considered to be in business for purposes of this chapter if any of the following conducts or derives revenue from any business, whether or not within the coal industry—

"(A) such last signatory operator;

"(B) any member of the controlled group of corporations (within the meaning of section 414(b)) of such last signatory operator; or

"(C) any trade or business which is under common control (as determined under section 414(c)) with such last signatory operator.

If a last signatory operator is no longer in business and there is no successor, the relationships described in paragraphs (2) and (3) shall be determined at the time it ceased to be in business.

"(6)(A) The term 'last signatory operator shall mean, with respect to any orphan miner or other coal industry retiree eligible for medical benefits, a person that meets or at one time met the following conditions:

"(i) A person meets the conditions of this clause if such person is—

"(I) an owner, lessee or other person who operates, controls or supervises a coal mine;

"(II) an independent contractor who operates, controls or supervises a coal mine; or

"(III) in the event a person described in (I) or (II) is no longer in business, any successor to such person, except that a purchaser shall not be considered to be a successor with respect to any orphan miner or other

coal industry retiree eligible for medical benefits, if responsibility for the medical benefits of such orphan miner or other coal industry retiree was retained by the seller in the purchase and sale transaction.

"(ii) A person meets the conditions of this clause if such person or, in the case of a person described in clause (i)(III), such person's predecessor—

"(I) was a signatory to a 1978 coal wage agreement, or any subsequent coal wage agreement; and

"(II) was the last coal industry employer of such orphan miner or other retiree.

"(B) Notwithstanding subparagraph (A), if, as of the date of enactment of this chapter, a person has assumed or retained responsibility for retiree medical benefit obligations for individuals who retired from employment under a coal wage agreement, then such person shall be treated as the last signatory operator with respect to such individuals for purposes of this chapter, and any person from whom such responsibility was assumed shall not be treated as the last signatory operator.

"(C) For purposes of this chapter, the last signatory operator of any orphan miner or other coal industry retiree shall be considered to be the last signatory operator with respect to such orphan miner's or other coal industry retiree's spouse, surviving spouse and dependents, if any.

"(7) The term 'National Bituminous Coal Wage Agreement' shall mean the collective bargaining agreement negotiated by the settlors.

"(8) The term 'settlors' means the United Mine Workers of America and the Bituminous Coal Operators' Association, Inc. (hereinafter referred to as the 'BCOA'), except that if the BCOA ceases to exist, members of the BCOA representing more than 50 percent of the tonnage membership of BCOA on the date of enactment of this Act shall collectively be considered a settlor.

"SEC. 9724. SHAM TRANSACTIONS.

"If a principal purpose of any transaction is to evade or avoid liability under this chapter, this chapter shall be applied (and liability shall be imposed) without regard to such transaction. A bona fide, arm's-length sale of an entity subject to liability under this chapter to an unrelated party (within the meaning of section 4204(d) of the Employee Retirement Income Security Act of 1974, as amended), shall not by itself be sufficient to establish a principal purpose to evade or avoid liability within the meaning of this section."

(b) CONFORMING AMENDMENT.—The table of subtitles for the Internal Revenue Code of 1986 is amended by adding at the end thereof the following new subtitle:

"Subtitle J. Coal Industry health benefits."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply on and after the date of the enactment of this Act.

And the Senate agree to the same.

That the Senate recede from its amendment to the title of the bill.

DAN ROSTENKOWSKI,
SAM GIBBONS,
J.J. PICKLE,
CHARLES B. RANGEL,
PETE STARK,
Managers on the Part of the House.

LLOYD BENTSEN,
GEORGE MITCHELL,
DANIEL PATRICK MOYNIHAN,
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 amendments of the Senate to the bill (H.R. 4210) to amend the Internal Revenue Code of 1986 to provide incentives for increased economic growth and to provide tax relief for families, submit the following joint statement 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 Senate amendment to the text of the bill struck out all of the House bill after the enacting clause and inserted a substitute text.

The House recedes from its disagreement to the amendment of the Senate with an amendment which is a substitute for the House bill and the Senate amendment. The differences between the House bill, the Senate amendment, and the substitute agreed to in conference are noted below, except for clerical corrections, conforming changes made necessary by agreements reached by the conferees, and minor drafting and clarifying changes.

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I. Income Tax Treatment of Working Families

1. TAX CREDIT FOR MIDDLE-INCOME TAXPAYERS

Present law

Present law provides no income tax credit based on social security tax liability. Under present law, a payroll tax is imposed to finance social security programs through the old-age, survivors, and disability insurance (OASDI) and hospital insurance (HI) trust funds. As of January 1992, the employer and employee each pay an OASDI tax equal to 6.20 percent of the first $55,500 of covered earnings and an HI tax equal to 1.45 percent of the first $130,200 of covered earnings. Self-employed individuals pay tax at the combined employer-employee rate, but are permitted to deduct one-half of the payment as a business expense in determining their income tax liability.

Present law provides no income tax credit to taxpayers on the basis of whether taxpayers have a child residing with them. However, present law permits a personal exemption deduction from gross income for each of the taxpayer's dependent children. For 1992, the amount of this deduction is $2,300 for each exemption claimed. This exemption amount is adjusted annually for inflation.

In addition, low-income workers with children are able to claim a refundable earned income tax credit (EITC) of up to 17.6 percent (18.4 percent for taxpayers with more than one qualifying child) of the first $7,520 of earned income for 1992. The maximum amount of credit for 1992 is $1,324 ($1,384 for taxpayers with more than one qualifying child). This maximum credit is reduced by 12.57 percent (13.14 percent for taxpayers with more than one qualifying child) of earned income (or adjusted gross income, if greater) in excess of $11,840. The EITC is totally phased out for workers with earned income (or adjusted gross income, if greater) over $22,370. The maximum amount of earned income on which the EITC may be claimed and the income threshold for the phaseout of the EITC are indexed for inflation. Earned income consists of wages, salaries, other employee compensation, and net self-employment income.

The credit rates for the EITC change over time under present law, as shown in the following table.

Year	One qualifying child—		Two or more qualifying children—	
	Credit rate	Phaseout rate	Credit rate	Phaseout rate
1992	17.6	12.57	18.4	13.14
1993	18.5	13.21	19.5	13.93
1994 and after	23.0	16.43	25.0	17.86

House bill

The House bill provides a refundable income tax credit in calendar years 1992 and 1993 for up to 20 percent of an employee's social security tax liability. The employee's social security tax liability equals the sum of the employee share of OASDI and HI tax liability and not the employer portion. In the case of self-employed individuals, the base of the credit will be one-half total OASDI and HI tax liability. The maximum credit is $200 for single taxpayers and $400 for married couples filing joint returns. The income tax credit will not reduce social security trust fund reserves.

Effective date.—The provision is effective for taxable years beginning after December 31, 1991. The provision will not apply to taxable years beginning after December 31, 1993.

Senate amendment

The Senate amendment provides a $300 income tax credit for each qualifying child of the taxpayer. A "qualifying child" is defined as a child under age 16 who resided with the taxpayer for more than 6 months during the taxable year. The tax credit offsets regular tax liability and is not refundable (although, through the offset of tax liability, the tax credit could act to increase the amount of refund from the earned income tax credit that a taxpayer might receive). The credit amount is indexed annually for inflation (though no indexing occurs until the inflation adjustment is greater than $50). In addition, the credit is phased out ratably for taxpayers with adjusted gross income between $47,500 and $60,000 (the phaseout range is not adjusted for inflation).

Effective date.—The provision is effective for taxable years beginning after December 31, 1991.

Conference agreement

The conference agreement follows both the House bill and the Senate amendment, with modifications.

For 1992 and 1993, the conference agreement provides an income tax credit for up to 20 percent of an employee's social security tax liability. In the case of State and local government workers who do not pay FICA taxes, contributions to a retirement plan maintained by the State or local government will be considered equivalent to social security tax liability. The maximum credit is $150 for unmarried taxpayers and $300 for married couples filing joint returns. The tax credit is phased out ratably for taxpayers with adjusted gross income between $50,000 and $70,000 (married taxpayers filing a joint return), or between $35,000 and $50,000 (unmarried taxpayers filing as single or as head of household). The tax credit is refundable to taxpayers with a "qualifying child", for purposes of this credit generally defined as a child under age 19 who resided with the taxpayer for more than 6 months during the taxable year.

For taxable years beginning in 1994 and thereafter, the conference agreement provides a nonrefundable $300 income tax credit (indexed for inflation) for each qualifying child of the taxpayer. For purposes of this credit, a "qualifying child" is defined as a child under age 16 who resided with the taxpayer for more than 6 months during the taxable year. The credit is phased out ratably for taxpayers with adjusted gross income between $50,000 and $70,000 (the phaseout range is not adjusted for inflation).

2. SIMPLIFICATION AND EXPANSION OF EARNED INCOME TAX CREDIT

Present law

Eligible low-income workers are able to claim a refundable earned income tax credit (EITC) of up to 17.6 percent of the first $7,520 of earned income for 1992 (18.4 percent for taxpayers with more than one qualifying child). The maximum amount of credit for 1992 is $1,324 ($1,384 for taxpayers with more than one qualifying child). This maximum credit is reduced by 12.57 percent of earned income (or adjusted gross income, if greater) in excess of $11,840 (13.14 percent for taxpayers with more than one qualifying child). The EITC is totally phased out for workers with earned income (or adjusted gross income, if greater) over $22,370. The maximum amount of earned income on which the EITC may be claimed and the income threshold for the phaseout of the EITC are indexed for inflation. Earned income consists of wages, salaries, other employee compensation, and net self-employment income.

The credit rates for the EITC change over time under present law, as shown in the following table.

Year	One qualifying child—		Two or more qualifying children—	
	Credit rate	Phaseout rate	Credit rate	Phaseout rate
1992	17.6	12.57	18.4	13.14
1993	18.5	13.21	19.5	13.93
1994 and after	23.0	16.43	25.0	17.86

A supplemental young child credit is available to taxpayers with qualifying children under the age of one year. This young child credit rate is 5 percent and the phase-out rate is 3.57 percent. It is computed on the same income base as the ordinary EITC. The maximum supplemental young child credit for 1992 is $376. If a taxpayer claims the supplemental young child credit, the child that qualifies the taxpayer for such credit is not a qualifying individual for purposes of the dependent care tax credit (sec. 21).

A supplemental health insurance credit is available to taxpayers who provide health insurance coverage for their qualifying children. This health insurance credit rate is 6 percent and the phaseout rate is 4.285 percent. It is computed on the same income base as the ordinary EITC, but the credit claimed cannot exceed the out-of-pocket cost of the health insurance coverage. In addition, the taxpayer is denied an itemized deduction for medical expenses of qualifying insurance coverage up to the amount of credit claimed. The maximum supplemental health insurance credit for 1992 is $451.

House bill

The House bill repeals the supplemental young child credit and the supplemental health insurance credit and increases the basic EITC rate for taxpayers with two or more qualifying children as shown in the following table.

Year	One qualifying child—		Two or more qualifying children—	
	Credit rate	Phaseout rate	Credit rate	Phaseout rate
1992	17.6	12.57	22.2	15.84
1993	18.5	13.21	23.3	16.64
1994 and after	23.0	16.43	28.8	20.58

Effective date.—The provision is effective for taxable years beginning after December 31, 1991.

Senate amendment

The Senate amendment repeals the supplemental young child credit and increases the basic EITC rate for taxpayers with two or more qualifying children as shown in the following table.

Year	One qualifying child—		Two or more qualifying children—	
	Credit rate	Phaseout rate	Credit rate	Phaseout rate
1992	17.6	12.57	20.15	14.39
1993	18.5	13.21	21.25	15.17
1994 and after	23.0	16.43	26.75	19.10

The Senate amendment permits taxpayers to include all health insurance expenses as medical expenses, subject to the 7.5 percent of adjusted gross income floor on deductible medical expenses, regardless of whether these expenses had been used to claim the health insurance component of the EITC. The amendment also permits a self-employed taxpayer to claim the allowable deduction for health insurance costs and to use the full amount of these expenses that are related to coverage of dependent children to claim the health insurance component of the EITC.

Effective date.—Same as the House bill.

Conference agreement

The conference agreement generally follows the Senate amendment except that the basic EITC credit rates are increased for families with two or more qualifying children as shown in the following table:

Year	One qualifying child—		Two or more qualifying children—	
	Credit rate	Phaseout rate	Credit rate	Phaseout rate
1992	17.6	12.57	18.9	13.49
1993	18.5	13.21	20.5	14.64
1994 and after	23.0	16.43	26.0	18.56

3. EMPLOYER-PROVIDED TRANSPORTATION BENEFITS

Present law

Under Treasury regulations, monthly transit passes, tokens, etc., provided by an employer are excludable from an employee's income (for both income and payroll tax purposes) as a de minimis fringe benefit if the total value of the transit pass does not exceed $21. If the total value of such benefits exceeds $21 per month, the full value of the benefits is includible in income.

Parking at or near the employer's business premises that is paid for by the employer is excludable from the gross income of the employee (for both income and payroll tax purposes) as a working condition fringe benefit, regardless of the value of the parking.

House bill

Under the House bill, gross income and wages (for both income and payroll tax purposes) does not include qualified transportation fringe benefits. In general, a qualified transportation fringe is (1) transportation in a commuter highway vehicle if such transportation is in connection with travel between the employee's residence and place of employment, (2) a transit pass, or (3) qualified parking. The maximum amount of qualified parking that is excludable from an employee's gross income is $160 per month (regardless of the total value of the parking). Other qualified transportation fringes are excludable from gross income to the extent that the aggregate value of the benefits does not exceed $60 per month (regardless of the total value of the benefits).

A transit pass includes any pass, token, farecard, voucher, or similar item entitling a person to transportation on mass transit facilities (whether publicly or privately owned). Types of transit facilities that may qualify for the exclusion include, for example, rail, bus, and ferry.

Qualified parking is parking provided to an employee on or near the business premises of the employer or on or near a location from which the employee commutes to work by mass transit, in a commuter highway vehicle, or by carpool.

Effective date.—The provision applies to benefits provided by the employer on or after January 1, 1992, except that the $160 per month limit on the exclusion for qualified parking benefits applies to benefits provided after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill, except that the $60 and $160 limits are indexed for inflation. The limits as indexed are rounded down to the next whole dollar.

Conference agreement

The conference agreement follows the Senate amendment.

II. Economic Growth Tax Incentives

A. Temporary Cost Recovery Provisions

1. TEMPORARY INCREASE IN AMOUNT OF EXPENSING FOR SMALL BUSINESSES

Present law

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $10,000 of the cost of qualifying property placed in service for the taxable year. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The $10,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. In addition, the amount eligible to be expensed for a taxable year may not exceed the taxable income of the taxpayer for the year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations).

House bill

For taxable years beginning after December 31, 1991, and before January 1, 1994, the $10,000 amount allowed to be expensed is increased to $25,000.

Effective date—The provision is effective for taxable years beginning after December 31, 1991, and before January 1, 1994.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill except that the amount allowed to be expensed is $20,000 (rather than $25,000).

2. SPECIAL DEPRECIATION ALLOWANCE FOR CERTAIN EQUIPMENT ACQUIRED IN 1992

Present law

Depreciation deductions

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the accelerated cost recovery system ("ACRS"), as modified by the Tax Reform Act of 1986. Under ACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property (generally tangible property other than residential rental property and nonresidential real property) range from 3 to 20 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which depreciation deduction would be maximized.

For purposes of the alternative minimum tax ("AMT"), tangible personal property generally is depreciated using the 150-percent declining balance method over useful lives that are typically longer than the applicable recovery periods for regular tax purposes. In addition, for purposes of the adjusted current earnings ("ACE") component of the corporate AMT, tangible personal property is depreciated using the straight-line method over these longer useful lives.

Expensing election

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $10,000 of the cost of qualifying property placed in service for the taxable year. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The $10,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. In addition, the amount eligible to be expensed for a taxable year may not exceed the taxable income of the taxpayer for the year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations).

House bill

The House bill allows an additional first-year depreciation deduction equal to 15 percent of the adjusted basis of certain qualified property that is placed in service before July 1, 1993. The additional depreciation deduction is allowed for both regular tax and AMT purposes for the taxable year in which the property is placed in service. The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. A taxpayer may elect to not claim the additional first-year depreciation for qualified property.

Property qualifies for the additional first-year depreciation deduction if (1) the property is section 1245 property to which ACRS applies (other than property that is required to be depreciated under the alternative depreciation system of ACRS) and (2) the original use of the property commences with the taxpayer on or after February 1, 1992.[1] In addition, the property must be acquired by the taxpayer (1) on or after February 1, 1992, and before January 1, 1993, but only if no binding written contract for the acquisition is in effect before February 1, 1992, or (2) pursuant to a binding written contract which was entered into on or after February 1, 1992, and before January 1, 1993. Finally, property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer will qualify if the taxpayer begins the manufacture, construction, or production of the property on or after February 1, 1992, and before January 1, 1993 (and all other requirements are met).

The limitations on the amount of depreciation deductions allowed with respect to certain passenger automobiles (sec. 280F of the Code) are adjusted to reflect the additional first year depreciation deduction. Thus, the limitation on the amount of depreciation allowable for the taxable year that the automobile is placed in service with respect to which this provision applies will be increased by 15 percent and subsequent year depreciation allowances will be decreased to reflect this first year increase.

The following examples illustrate the operation of the provision.

Example 1.—Assume that on July 1, 1992, a calendar year taxpayer acquires and places in service qualified property that costs $1 million. Under the provision, the taxpayer is allowed an additional first-year depreciation deduction of $150,000. The remaining $850,000 of adjusted basis is to be recovered in 1992 and subsequent years pursuant to the depreciation rules of present law.

Example 2.—Assume that on July 1, 1992, a calendar year taxpayer acquires and places in service qualified property that costs $45,000. In addition, assume that the property qualifies for the expensing election under section 179 (as amended by the House bill). Under the provision, the taxpayer is first allowed a $25,000 deduction under section 179. The taxpayer then is allowed an additional first-year depreciation deduction of $3,000 based on $20,000 ($45,000 original cost less the section 179 deduction of $25,000) of adjusted basis. Finally, the remaining adjusted basis of $17,000 ($20,000 adjusted basis less $3,000 additional first-year depreciation) is to be recovered in 1992 and subsequent years pursuant to the depreciation rules of present law.

[1] A special rule applies in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was placed in service, the property is to be treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback.

Effective date.—The provision applies to property placed in service on or after February 1, 1992.

Senate amendment

The Senate amendment is the same as the House bill, with two exceptions. The Senate amendment allows an additional first-year depreciation deduction equal to 10 percent of the adjusted basis of certain qualified property (rather than 15 percent as provided in the House bill). In addition, under the Senate amendment, 50 percent of the amount of the additional first-year depreciation deduction is allowed as a deduction in the year the property is placed in service and 50 percent is allowed as a deduction in the succeeding taxable year.

Conference agreement

The conference agreement follows the Senate amendment with the following clarifications. First, except as otherwise provided in regulations, repaired or reconstructed property is not qualified property. Second, if property that qualifies for additional first-year depreciation is disposed of in the year that the property is placed in service, the amount of the additional first-year depreciation deduction that would have been allowed in the succeeding taxable year is not allowed, and the adjusted basis of the property immediately before the disposition is increased by the amount of the disallowed deduction. Finally, property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.

B. Individual Retirement Arrangements (IRAs)

1. RESTORATION OF IRA DEDUCTION

Present law

Under present law, an individual that is not an active participant in an employer-sponsored retirement plan (and whose spouse also is not an active participant in such a plan) may make deductible contributions to an individual retirement arrangement (IRA) up to the lesser of $2,000 or 100 percent of compensation. The amounts held in an IRA, including earnings on contributions, generally are not included in taxable income until withdrawn.

If the individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the $2,000 deduction limit is phased out over certain adjusted gross income (AGI) levels. The limit is phased out between $25,000 and $35,000 for individuals, and between $40,000 and $50,000 for joint filers. An individual may make nondeductible IRA contributions (up to the contribution limit) to the extent the individual is not permitted to make deductible IRA contributions.

House bill

No provision.

Senate amendment

The Senate amendment restores the deductibility of IRA contributions for all taxpayers under the rules in effect prior to the Tax Reform Act of 1986, and provides for the indexing of the limits on contributions to IRAs, in increments of $500. In addition, the limit on contributions (deductible and nondeductible) to IRAs is coordinated with the limit on elective deferrals to a qualified cash or deferred arrangement (sec. 401(k) plan), tax-sheltered annuity (sec. 403(b) annuity), simplified employee pension (SEP), or a section 501(c)(18) plan. Under the coordinated limit, IRA contributions cannot exceed the difference (if any) between the limit on elective deferrals ($8,728 in 1992) and the amount in fact deferred. For example, if the limit were in effect in 1992, a taxpayer who elected to defer $8,000 under a 401(k) plan could contribute only $728 to an IRA. (A taxpayer who elected to defer $5,000 under a 401(k) plan could still only contribute $2,000 (indexed) to an IRA.)

Effective date.—The provision applies to taxable years beginning after December 31, 1992.

Conference agreement

The conference agreement follows the Senate amendment.

2. SPECIAL IRA'S

Present law

Under present law, certain individuals may make deductible contributions to an IRA up to the lesser of $2,000 or 100 percent of compensation. The amounts held in an IRA, including earnings on contributions, generally are not included in taxable income until withdrawn.

House bill

No provision.

Senate amendment

The Senate amendment permits individuals to establish and maintain new "special IRAs" to which they can make nondeductible contributions. Withdrawals from a special IRA are not includible in income if attributable to contributions that have been held in the special IRA for at least 5 years.

The limits on contributions to deductible IRAs and special IRAs are coordinated. Thus, the sum of contributions to a deductible IRA and a special IRA cannot exceed the lesser of $2,000 (indexed) or 100 percent of compensation. In addition, this limit is coordinated with the limit on elective deferrals.

The Senate amendment also permits transfers from deductible IRAs to special IRAs without imposition of the 10-percent tax on early withdrawals. The amount transferred to a special IRA generally is includible in income in the year withdrawn from the deductible IRA. However, in the case of a transfer before January 1, 1994, the transferred amount is includible in income ratably over the 4-

taxable year period beginning in the taxable year in which the distribution was made.

Effective date.—The provision generally applies to taxable years beginning after December 31, 1992. However, the provision permitting transfers from deductible IRAs to special IRAs is effective for taxable years beginning after December 31, 1991. Thus, special IRAs can be established and maintained in taxable years beginning before January 1, 1993, only with funds transferred from a deductible IRA.

Conference agreement

The conference agreement follows the Senate amendment.

3. PENALTY-FREE DISTRIBUTIONS

Present law

Under present law, withdrawals from an IRA (other than withdrawals of nondeductible contributions) are includible in gross income. In addition, amounts withdrawn prior to age 59½, death, or disability are subject to an additional 10-percent income tax, unless the withdrawals are in the form of substantially equal periodic payments over the life (or life expectancy) of the IRA owner or over the joint lives (or life expectancies) of the IRA owner and his or her beneficiary. The 10-percent additional tax also applies to early withdrawals from tax-qualified retirement plans.

There is an exception to the additional 10-percent income tax on early withdrawals for distributions from a tax-qualified retirement plan that do not exceed the amount allowable as a deduction for medical care for the year. This exception does not apply to IRAs.

House bill

First-time home purchasers

The House bill waives the 10-percent additional income tax on early withdrawals from an IRA with respect to the first $10,000 of withdrawals applied within 60 days of the date of distribution for the purchase or construction of a principal residence of the purchaser. This provision applies to an individual if the individual (and, if married, the individual's spouse) (1) did not own any interest in a residence at any time within the 36-month period ending on the date on which a principal residence is purchased or constructed and (2) is not in an extended period for rolling over gain from the sale of a principal residence.

In addition, the waiver of the early withdrawal tax is available for withdrawals from an IRA by a parent on behalf of a child, provided the child (and, if married, the child's spouse) qualifies as a first-time homebuyer. However, in no event will the waiver of the tax apply to more than $10,000 per principal residence purchased.

The waiver of the early withdrawal tax does not apply to withdrawals of amounts (1) from an inherited IRA or (2) that had been previously rolled over from a qualified retirement plan.

If any IRA distribution fails to satisfy the requirements for the early withdrawal tax exception solely because of a delay or cancellation of the purchase or construction of the residence, the amount that was distributed from the IRA may be recontributed to an IRA and treated as a qualifying rollover contribution except that (1) the contribution is not treated as failing to satisfy the requirements for a rollover contribution if the contribution is made within 120 days of the original IRA withdrawal, (2) the rule that prohibits more than one IRA rollover per year does not apply, and (3) the amount contributed is not taken into account for purposes of determining whether any other contribution to an IRA qualifies as a rollover contribution or for purposes of the dollar limit on subsequent withdrawals from an IRA for a first home purchase.

Under the provisions, if the total amount withdrawn exceeds $10,000, then the excess over $10,000 is subject to the 10-percent additional tax.

Education expenses

The House bill provides an exception to the 10-percent additional tax for withdrawals from an IRA for amounts that do not exceed the amount of qualifying educational expenses of the taxpayer or the taxpayer's spouse or dependent. Qualifying educational expenses are expenses for higher education and post-economy vocational education. The amount of qualified higher educational expenses for any taxable year is reduced by any amount excludable from gross income under the provision in the Code pertaining to U.S. education savings bonds (sec. 135). As in the case of the waiver of the early withdrawal tax for first home purchases, the waiver does not apply to withdrawals of amounts from an inherited IRA or amounts that had been previously rolled over from a qualified retirement plan.

Deductible medical expenses

The House bill extends to IRAs the present-law exception to the 10-percent additional income tax for distributions from qualified retirement plans used to pay deductible medical expenses. Moreover, for purposes of the medical expense exception (with regard to both IRAs and qualified retirement plans), a child, grandchild, or ancestor of the taxpayer is treated as a dependent of the taxpayer in determining whether medical expenses are deductible.

5-year holding period

No provision.

Effective date

The provisions are effective for withdrawals on or after February 1, 1992.

Senate amendment

First-time home purchasers

The Senate amendment allows withdrawals from an IRA and from amounts attributable to elective deferrals under (1) a cash or deferred arrangement (sec. 401(k) plan), (2) a tax-sheltered annuity (sec. 403(b) annuity), or (3) a section 501(c)(18) plan without imposition of the 10-percent additional income tax on early withdrawals (and without disqualification of the 401(k) plan or 403(b) annuity) to the extent the amount withdrawn is used to pay qualified acquisition, construction, or reconstruction costs with respect to a principal residence of a first-time homebuyer who is the taxpayer, the taxpayer's spouse, or the taxpayer's child or grandchild. There is no dollar limitation on the amount that can be withdrawn without penalty.

A first-time homebuyer is any individual (and if married, such individual's spouse) who (1) did not own an interest in a principal residence during the 2 years prior to the purchase of a home and (2) is not in an extended period for rolling over gain from the sale of a principal residence.

If any IRA distribution fails to satisfy the requirements for the early withdrawal tax exception solely because of a delay or cancellation of the purchase or construction of the residence, the amount that was distributed from the IRA may be recontributed to an IRA and treated as a qualifying rollover contribution except that (1) the contribution is not treated as failing to satisfy the requirements for a rollover contribution if the contribution is made within 120 days of the original IRA withdrawal, (2) the rule that prohibits more than one IRA rollover per year does not apply, and (3) the amount recontributed is not taken into account for purposes of determining whether any other contribution to an IRA qualifies as a rollover contribution.

Education expenses

The Senate amendment is generally the same as the House bill, except the Senate provision also allows penalty-free withdrawals from amounts attributable to elective deferrals under (1) a section 401(k) plan, (2) a sec. 403(b) annuity, or (3) a section 501(c)(18) plan. The Senate amendment also provides that qualifying educational expenses of the taxpayer's grandchild qualify for the exception.

Deductible medical expenses

The Senate amendment is the same as the House bill.

5-year holding period

The Senate amendment provides that the present-law rule permitting penalty-free IRA withdrawals after an individual reaches 59½ does not apply in the case of amounts attributable to contributions made during the previous 5 years. Thus, contributions to a deductible IRA generally must remain in the account for at least 5 years to avoid withdrawal penalties. This restriction only applies to contributions (and earning allocated thereto) that are made after December 31, 1992. Moreover, for purposes of applying the rule, distributions are treated as having been made first from the earliest contributions (and earnings) remaining in the account, and then from other contributions in the order in which made.

Effective dates

The provisions generally are effective for withdrawals after December 31, 1991. The provision requiring a 5-year holding period to avoid withdrawal penalties applies to contributions (and earnings allocable thereto) made after December 31, 1992.

Conference agreement

First-time home purchasers

The conference agreement follows the House bill, except that the provision also applies to a first-time homebuyer who is the taxpayer's spouse or grandchild.

Education expenses

The conference agreement follows the House bill, except that the provision applies to qualifying education expenses of the taxpayer's child or grandchild without regard to whether they are dependents.

Deductible medical expenses

The conference agreement follows the House bill and the Senate amendment.

5-year holding period

The conference agreement follows the Senate amendment.

Effective dates

The provisions are generally effective for withdrawals on or after February 1, 1992. The provision requiring a 5-year holding period to avoid withdrawal penalties applies to contributions (and earnings allocable thereto) made after December 31, 1992.

4. PENALTY-FREE IRA AND QUALIFIED PLAN WITHDRAWALS FOR THE LONG-TERM UNEMPLOYED

Present law

Under present law, withdrawals from an IRA (other than withdrawals of nondeductible contributions) are includible in gross income. In addition, amounts withdrawn prior to age 59½, death, or disability are subject to an additional 10-percent income tax, unless the withdrawals are in the form or substantially equal periodic payments over the life (or life expectancy) of the IRA owner or over the joint lives (or life expectancies) of the IRA owner and his or her beneficiary. The 10-percent additional tax also applies to early withdrawals from tax-qualified retirement plans.

House bill

No provision.

Senate amendment

The Senate amendment permits distributions from an IRA and from amounts attributable to elective deferrals under (1) a cash or deferred arrangement (sec. 401(k) plan), (2) a tax-sheltered annuity (sec. 403(b) annuity), or (3) a section 501(c)(18) plan without imposition of the 10-percent additional income tax on early withdrawals (and without disqualification of the 401(k) plan or 403(b) annuity) to the extent distributions are made to an individual after separation from employment, if (1) the individual has received unemployment compensation for 12 consecutive weeks under any Federal or State unemployment compensation law by reason of the separation and

(2) the distributions are made during the taxable year during which such unemployment compensation is received or the succeeding taxable year.

Effective date.—Distributions made on or after December 31, 1991.

Conference agreement

The conference agreement follows the Senate amendment, except that penalty-free distributions are permitted only from an IRA (not from an employer-provided plan), and the waiver of the early withdrawal tax does not apply to withdrawals of amounts (1) from an inherited IRA or (2) that had been previously rolled over from a qualified retirement plan.

Effective date.—Distributions made on or after February 1, 1992.

5. PENALTY-FREE WITHDRAWALS FROM IRAS AND RETIREMENT PLANS THROUGH 1992

Present law

Under present law, withdrawals from an IRA (other than withdrawals of nondeductible contributions) are includible in gross income. In addition, amounts withdrawn prior to age 59½, death, or disability are subject to an additional 10-percent income tax, unless the withdrawals are in the form of substantially equal periodic payments over the life (or life expectancy) of the IRA owner or over the joint lives (or life expectancies) of the IRA owner and his or her beneficiary. The 10-percent additional tax also applies to early withdrawals from tax-qualified retirement plans.

House bill

No provision.

Senate amendment

The Senate amendment permits certain individuals to make withdrawals totalling no more than $10,000 from an IRA or from amounts attributable to elective deferrals under (1) a cash or deferred arrangement (sec. 401(k) plan), (2) a tax-sheltered annuity (sec. 403(b) annuity), or (3) a section 501(c)(18) plan without imposition of the 10-percent additional income tax on early withdrawals (and without disqualification of the 401(k) plan or 403(b) annuity) to the extent the amount withdrawn is used to purchase a first home or a new passenger automobile (a "qualified withdrawal"). The provision applies to individuals whose adjusted gross income (AGI) in 1991 did not exceed $75,000 ($100,000 for joint filers).

For Federal income tax purposes, qualified withdrawals are treated as made first from amounts that are includible in gross income when distributed, and then from amounts not so includible. The taxable portion of a qualified withdrawal generally is includible in income ratably over the 4-taxable year period beginning with the taxable year in which the withdrawal occurs. However, the amount required to be included in income for any taxable year is reduced by any designated recontribution that is made not later than the due date (without extension) for such taxable year. A designated recontribution is a contribution to an IRA or any retirement plan from which a qualified withdrawal can be made which is designated by the taxpayer as in lieu of all (or any portion of) the amount that would otherwise be included in gross income for the taxable year. The recontribution would not be treated as a contribution to an IRA or retirement plan. Thus no deduction would be permitted for the recontribution, nor would the recontribution reduce the amount that the individual could otherwise contribute to an IRA or retirement plan.

A first-time homebuyer is any individual (and if married, such individual's spouse) who did not own an interest in a principal residence during the 2 years prior to the purchase of a principal residence. Parents and grandparents can make withdrawals to help their children or grandchildren purchase a first home (but *not* a new automobile). In this case, the AGI limits are applied by reference to the income of the child or grandchild.

If any qualified withdrawal fails to satisfy the requirements for the early withdrawal tax exception solely because of a delay or cancellation of the purchase or construction of the residence, the amount that was withdrawn may be recontributed to an IRA and treated as a qualifying rollover contribution except that (1) the rule that prohibits more than one IRA rollover per year does not apply, and (2) the amount recontributed is not taken into account for purposes of determining whether any other contribution to an IRA qualifies as a rollover contribution.

The provision applies only to withdrawals made in 1992 that are used to purchase a first home or new automobile within 6 months of withdrawal.

Effective date.—The provision applies to withdrawals after December 31, 1991.

Conference agreement

The conference agreement does not include the Senate amendment.

C. Education Provisions

1. TAX BENEFIT FOR INTEREST ON STUDENT LOANS

Present law

The Tax Reform Act of 1986 repealed the deduction for personal interest. Student loan interest is generally treated as personal interest and thus is not allowable as an itemized deduction from income. There is no tax credit allowed for student loan interest paid by a taxpayer.

House bill

In general

The House bill allows individuals a nonrefundable credit against regular tax liability generally equal to 15 percent of the interest paid on qualified education loans. The amount of the credit is subject to certain dollar limits and is phased out based upon the taxpayer's income.

A qualified education loan generally is any indebtedness [1] incurred to pay for qualified higher education expenses of the taxpayer or the taxpayer's spouse or dependents with respect to higher education institutions and certain area vocational education schools (i.e., eligible educational institutions defined in Code section 135(c)(3)). The qualified higher education expenses must be paid or incurred within a reasonable period of time before or after the indebtedness is incurred and must be attributable to education furnished during a period of time that the individual benefiting from the loan proceeds was at least a half-time student. Indebtedness that is used to refinance a qualified education loan is also treated as a qualified education loan.

Qualified higher education expenses include tuition, fees, books, supplies, and reasonable living expenses while the student lives away from home. At the time the expenses are incurred, the student must be the taxpayer or the taxpayer's spouse or dependent (as defined under Code section 152). Qualified higher education expenses taken into account for the purpose of this credit are reduced by the amount excluded from gross income under Code section 135 (relating to the redemption of United States savings bonds to pay for higher education expenses).

Limit on size of credit

In general

In general, the maximum credit in a taxable year is $300 with respect to the interest paid with respect to each individual whose qualified higher education expenses were financed by a qualified education loan. For example, for a taxpayer who, during the taxable year, paid $2,500 of qualified education loan interest with respect to one child and $1,000 of qualified education loan interest with respect to a second child, the credit generally would be limited to $450.[2]

For taxpayers whose education loan interest payments are large relative to the taxpayer's income, the maximum credit is increased. If interest paid on qualified education loans exceeds 10 percent of the taxpayer's modified adjusted gross income (AGI), the maximum credit is determined according to the following scale:

If the ratio of interest to modified AGI is—	The maximum credit is—
At least 10% but less than 11%	$350
At least 11% but less than 12%	400
At least 12% but less than 13%	450
At least 13%	500

[1] Indebtedness with respect to related parties as defined in Code sections 267(b) and 707(b)(1) will not be treated as a qualified education loan.

[2] The $300 maximum is applied separately with respect to each child's interest. Fifteen percent of the $2,500 of interest paid with respect to the first child is $375. That exceeds the $300 maximum, so the amount of the credit for that child's education loan interest is $300. Fifteen percent of the $1,000 of interest paid with respect to the second child is $150, so the amount of the credit for that child's education loan interest is $150. Thus the taxpayer may claim a total credit of $450.

Modified AGI is defined as in section 86(b)(2).[3]

Carryover of excess interest and of unused credit

If 15 percent of the amount of qualified education loan interest paid in a given taxable year exceeds the limit on the maximum credit for such taxable year, the excess is carried forward to the next taxable year and treated as interest paid during that next taxable year.

If the taxpayer's income tax liability for a given taxable year is reduced to zero because of the credit allowed for that taxable year, any unused portion of the credit may be carried forward for the next 5 taxable years.

Limitations on claiming credit

In general

No credit is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year beginning in the calendar year in which such individual's taxable year begins.

No credit is allowed for interest on any amount of education loan indebtedness for which a deduction is claimed under any other provision.

Credit claimed for interest on borrowing for expenses of taxpayer or spouse

In the case of qualified education loans used to pay the qualified higher education expenses of the taxpayer or the taxpayer's spouse, no credit is allowed for any taxable year after the first five taxable years (whether or not consecutive) with respect to which the taxpayer or spouse (as the case may be) is not at least a half-time student. For purposes of this rule, an individual is treated as a half-time student during any period in which payment of interest is deferred under Federal or State law.

The amount of the otherwise allowable credit is phased out ratably for taxpayers with modified AGI in the following ranges: $50,000–$75,000 for married individuals filing joint returns, $30,000–$55,000 for unmarried individuals, and $25,000–$37,500 for married individuals filing separate returns.

If the taxpayer is under 23 years old (or, in the case of a joint return, if both spouses are under 23) at the end of the calendar year ending with or within the taxable year, the amount of the credit is not to exceed the taxpayer's regular tax liability multiplied by the ratio of the taxpayer's earned income (defined in sec. 911(d)(2)) to the taxpayer's modified AGI.

[3] AGI plus (1) tax-exempt interest received or accrued during the taxable year, (2) amounts earned in a foreign country, a United States possession, or Puerto Rico that are excluded from gross income, (3) housing cost amounts of individuals living abroad that are excluded from gross income, and (4) amounts of redemptions of United States savings bonds that are excluded from gross income under Code section 135, minus amounts of Social Security and tier 1 railroad retirement benefits included in gross income under Code section 86.

Credit claimed for interest on borrowing for expenses of taxpayer's dependent

In the case of qualified education loans used to pay the qualified higher education expenses of an individual other than the taxpayer or the taxpayer's spouse, no credit is allowed unless the individual is claimed as a dependent of the taxpayer for that taxable year and the individual is at least a half-time student during that taxable year.

The amount of the otherwise allowable credit is phased out ratably for taxpayers with modified AGI in the following ranges: $75,000–$100,000 for married individuals filing joint returns, $45,000–$70,000 for unmarried individuals, and $37,500–$50,000 for married individuals filing separate returns.

Effective date

The provision is effective for taxable years beginning after December 31, 1991. Interest paid after the effective date on indebtedness incurred before January 1, 1992, is eligible for the credit if it satisfies all of the requirements above for qualified education loan indebtedness.[4]

Senate amendment

In general

The Senate amendment allows individuals who have paid interest on qualified education loans to choose either a deduction for such interest or a nonrefundable credit against regular tax liability generally equal to 15 percent of such interest, subject to a maximum credit of $300. Unused amounts of credit may not be carried forward or backward to other taxable years.

A qualified education loan generally is any indebtedness [5] incurred to pay for qualified higher education expenses of the taxpayer or the taxpayer's spouse or dependents (within the definition of section 152) with respect to higher education institutions and certain area vocational education schools (i.e., eligible educational institutions defined in sec. 135(c)(3)) and institutions conducting internship or residency programs leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training.

The qualified higher education expenses must be paid or incurred within a reasonable period of time before or after the indebtedness is incurred and must be attributable to education furnished during a period of time that the individual benefiting from the loan proceeds was at least a half-time student. Indebtedness that is used to refinance any indebtedness described in the previous sentence is also treated as a qualified education loan.

[4] In particular, the taxpayer must satisfy the limitations described above on the number of years the credit may be claimed. If the interest is on borrowing for the education expenses of the taxpayer or the taxpayer's spouse, no credit can be claimed if the first five taxable years (whether or not consecutive) with respect to which the taxpayer or spouse (as the case may be) is not at least a half-time student have elapsed. If the interest is on borrowing for the education expenses of the taxpayer's dependent, such dependent must be at least a half-time student during the taxable year.

[5] Indebtedness incurred by a student from borrowing from a related party (as defined in secs. 267(b) and 707(b)(1)) will not be treated as a qualified education loan.

Qualified higher education expenses are defined as the student's cost of attendance.[6] At the time the expenses are incurred, the student must be the taxpayer or the taxpayer's spouse or dependent (as defined under Code section 152). Qualified higher education expenses taken into account for the purpose of this credit are reduced by (1) amounts excluded from gross income under Code section 135 (relating to the redemption of United States savings bonds to pay for higher education expenses), (2) the amount of the reduction described in sec. 135(d)(1) (relating to certain scholarships and veterans benefits), and (3) amounts withdrawn from individual retirement arrangements used to pay education expenses.

Deduction or credit claimed for interest on borrowing for expenses of taxpayer or spouse

In the case of qualified education loans used to pay the qualified higher education expenses of the taxpayer or the taxpayer's spouse, the credit or deduction is allowed only with respect to interest paid on a qualified education loan that is allocable to the first 48 months during which interest accrued on the loan.[7]

Deduction or credit claimed for interest on borrowing for expenses of taxpayer's dependent

In the case of qualified education loans used to pay the qualified higher education expenses of an individual other than the taxpayer or the taxpayer's spouse, no deduction or credit is allowed unless the individual is claimed as a dependent of the taxpayer for that taxable year and the individual is at least a half-time student during that taxable year.

Limitation on claiming deduction

A taxpayer may not claim a deduction for interest on any amount of education loan indebtedness for which a credit or deduction is allowed under any other provision.

Limitations on claiming credit

No credit is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year beginning in the calendar year in which such individual's taxable year begins.

No credit is allowed for interest on any amount of education loan indebtedness for which a deduction is claimed under any other provision.

Effective date

The provision is effective for taxable years beginning after December 31, 1991, and only for loans whose first payments are due after that date.

[6] For purposes of the Senate amendment, "cost of attendance" is defined in section 472 of the Higher Education Act of 1965 as in effect on the day before the date of enactment of this provision (generally, tuition, fees, room and board, and related expenses).

[7] For purposes of counting the 48 months, any qualified education loan and all refinancing (that is treated a qualified education loan) of such loan is treated as a single loan.

Conference agreement

The conference agreement follows the House bill with the following modifications. The rate of the credit is 25 percent, with a maximum credit of $400 with respect to the interest paid with respect to each individual whose qualified higher education expenses were financed by a qualified education loan. The maximum credit is not adjusted for taxpayers whose education loan interest payments are large relative to the taxpayer's income. There is no carryforward of either excess interest or unused credit.

In the case of qualified education loans used to pay the qualified higher education expenses of the taxpayer or the taxpayer's spouse, the credit or deduction is allowed only with respect to the interest paid on a qualified education loan that is allocable to the first 48 months during which interest accrued on the loan.[8]

There is the same phaseout range for the credit regardless of the relationship of the taxpayer to the student. The amount of the otherwise allowable credit is phased out ratably for taxpayers with modified AGI in the following ranges: $60,000–$85,000 for married individuals filing joint returns, $40,000–$65,000 for unmarried individuals, and $30,000–$42,500 for married individuals filing separate returns.

No credit is allowed for interest on any amount of education loan indebtedness for which a deduction is claimed under any other provision.

Effective date.—Follows the Senate amendment.

2. INCOME-DEPENDENT EDUCATION ASSISTANCE: SELF-RELIANCE LOANS

Present law

The Department of Education subsidizes guaranteed student loans under the Stafford, Parent Loans to Undergraduate Students (PLUS), and Supplemental Loans for Students (SLS) programs. These loan programs generally are available for certain postsecondary educational expenses and, in the cases of the PLUS and SLS programs, are available regardless of a student's financial need. The subsidies provided under the guaranteed student loan programs generally take three forms. First, the Department of Education guarantees repayment of qualified student loans made by banks. Second, the Department pays special allowance payments as an interest subsidy on qualifying student loans so that student borrowers are required to pay less interest on the loans. Third, with Stafford loans the Department of Education pays an additional interest subsidy on qualified loans while the student is attending school.[1]

[8] For purposes of counting the 48 months, any qualified education loan and all refinancing (that is treated a qualified education loan) of such loan is treated as a single loan.

[1] In the case of Supplemental Loans for Students there is no in-school interest subsidy provided by the Federal government. SLS loans are available only to independent students (as defined in the Higher Education Act of 1965).

Stafford loans generally are limited to $3,500 for freshmen and sophomores, $5,500 for juniors and seniors, with a total undergraduate cap of $23,000. SLS loans generally are limited to $4,000 for freshmen and sophomores, $5,000 for juniors and seniors, with a total undergraduate cap of $23,000.

In addition, through the National Direct Student Loan (NDSL) program, the Federal government has made available revolving, direct-loan funds at certain participating educational institutions. Such loans (commonly referred to as "Perkins loans") are available only to low-income students with significant demonstrated financial need. The schools participating in the NDSL program are responsible for collecting amounts due from student borrowers.

Federal agencies are authorized to notify the IRS that a person owes a past-due, legally enforceable debt (such as a delinquent student loan) to that agency. The IRS then is required to reduce the amount of any Federal tax refund due such person by the amount of the debt and pay that amount to the agency. The refund offset program applies with respect to debts of individuals and corporations (sec. 6402(d)).

House bill

No provision.

Senate amendment

In general

The Senate amendment creates a program ("Income-Dependent Education Assistance") of direct loans ("Self-Reliance Loans") for higher education expenses. The Secretary of Education will make payments to participating institutions on the basis of estimated borrowing needs of the students at such institution. Eligible students who borrow funds under the program will have an account established with the Secretary of Education to record interest on and repayment of the Self-Reliance Loans. Such borrowers will make income-dependent repayment installments through the income tax system by means of a specially computed addition to tax that generally represents principal and interest on the loan.

Eligible students

Eligible students are United States citizens at least 17 years old, but not yet 51 years old, who are enrolled at a participating institution (which are selected by the Secretary of Education). Eligible students are able to receive Self-Reliance Loans without regard to financial need. Notwithstanding any other provision of law, an eligible student may not receive a Self-Reliance Loan in any fiscal year unless such student's eligibility for assistance under section 428 and subpart 1 of part A of the Higher Education Act has been assessed.

Limits on amounts borrowed

In general

The maximum amount of Self-Reliance Loans that may be borrowed by a student in his or her lifetime is $30,000, with no more than $25,000 of that amount for undergraduate education. A student may receive Self-Reliance Loans in the amount of no more than $5,000 per fiscal year in the case of an undergraduate student and no more than $15,000 per fiscal year in the case of a graduate student.

Coordination with other Federal loan programs

The combined maximum amount of loans a student may borrow under the Income-Dependent Education Assistance program, Part B (Stafford and Perkins loans), and Part E (Supplemental Loans for Students) of the Higher Education Act of 1965 may not exceed $52,000 for a dependent undergraduate, $62,000 for an independent undergraduate[2] who borrows at least $10,000 in Self-Reliance Loans, and $115,000 for a graduate student.

Limit by cost of attendance

In any fiscal year, a student may not receive Self-Reliance Loans in an amount greater than such student's cost of attendance[3] at a postsecondary school[4] less any other Federal educational financial assistance received by such student.

Interest rate on loans

The interest rate on a Self-Reliance Loan is established at the time of issuance and is equal to the average market yield on the 10-year and 30-year Treasury bonds. The Secretary of Education will establish the interest rate on Self-Reliance Loans at the same time (and with the same frequency) as is done for the Supplemental Loans for Students program.[5]

Repayment procedure

In general

Repayment on an individual's Self-Reliance Loan obligations is collected through the individual income tax. For a taxpayer in repayment status, the taxpayer's income tax liability generally is increased by the applicable Self-Reliance Loan repayment rate multiplied by the taxpayer's adjusted gross income (AGI).[6] The repayment installments are treated as a tax imposed by section 1 of the Code except for purposes of determining the amount of any tax credit or the amount of minimum tax.

The applicable repayment rate for a loan obligation is fixed at the time the taxpayer first enters repayment status and depends upon the taxpayer's amount of outstanding Self-Reliance Loan indebtedness.[7] Students with "high" indebtedness (as determined by

[2] As determined in section 428A of the Higher Education Act of 1965.

[3] As defined in section 472 of the Higher Education Act of 1965 (generally, tuition, fees, room and board, and related expenses).

[4] As defined in section 481(a) of the Higher Education Act of 1965.

[5] If, during a continuous period of study, the student incurs multiple Self-Reliance loan obligations bearing different interest rates, the Secretary of Education will provide for a consolidation of the loan obligations into one loan bearing an interest rate that is the weighted average of the interest rates on the multiple loan obligations.

[6] In the case of a married individual whose spouse has not received a Self-Reliance Loan and who files a joint return, the income tax liability on the joint return is increased by the individual's repayment rate multiplied by the AGI on the joint return. In the case of a married individual whose spouse has not received a Self-Reliance Loan and who files a separate return, such individual's income tax liability is increased by the individual's repayment rate multiplied by the sum of the AGI of that individual and the AGI of the individual's spouse (from the spouse's separate return).

[7] If the taxpayer in repayment status later takes out another Self-Reliance loan, the repayment rate may be changed to reflect the new, larger amount of outstanding Self-Reliance Loan indebtedness.

the Secretary of Education) will have a repayment rate of 7 percent. Students with "moderate" indebtedness will choose between a repayment rate of 5 percent or 7 percent. Students with "low" indebtedness will choose among a repayment rate of 3 percent, 5 percent, or 7 percent. The Secretary of Education will make the determination of "low" and "moderate" indebtedness ranges so that the average borrower in each indebtedness status will be projected to repay the Self-Reliance Loan over a similar number of years as the average borrower with "high" indebtedness status.

With respect to any Self-Reliance Loan, the borrower enters repayment status in the first taxable year following the taxable year in which the borrower ceases (after the loan was incurred) to be at least a half-time student. The borrower remains in repayment status until the loan obligation is repaid or, if earlier, the end of the 25th taxable year after entering repayment status.

A borrower may prepay all or part of a Self-Reliance Loan without penalty.

Repayment tax payments received on or before the due date (without regard to any extension) for filing of the income tax return for a given taxable year are credited to the taxpayer's Self-Reliance Loan account as if received on the last day of the previous taxable year. Repayment tax payments received after the due date (without regard to any extension) for filing of the income tax return for a given taxable year are credited to the taxpayer's Self-Reliance Loan account as if received on the last day of the following taxable year.

Exception for borrowers not required to file a tax return

No repayment of a Self-Reliance Loan is required in any year in which the borrower is not required to file an income tax return.

Discharge of liability of the borrower

In general.—The Secretary of Education will discharge the liability to repay a Self-Reliance Loan in the event of the death or total permanent disability of a borrower. If a loan were discharged because of expiration of the 25-year repayment status period, the borrower (or his or her estate) is not considered to have discharge of indebtedness income.

Bankruptcy.—A Self-Reliance Loan will not be dischargeable in bankruptcy. The Secretary of the Treasury, however, may postpone payment on past-due amounts owed by bankrupt individuals.

Delinquent taxpayers

Borrowers who are delinquent in repaying their Self-Reliance Loan and who subsequently make interest payments to the Secretary of the Treasury on their underpayment are entitled to have interest that is properly allocable to such loans credited by the Secretary of Education to their Self-Reliance Loan repayment.

Administration of the loan program

The Secretary of the Treasury will enter into an agreement with the Secretary of Education to process information on repayments and credit such repayments to the Department of Education.

The Secretary of the Treasury will make appropriate provisions to require borrowers to make Self-Reliance Loan repayments through payroll withholding and estimated tax payments to the extent practicable and will determine the liability of borrowers for incorrect withholding according to rules on estimated tax payments.

The Secretary of Education will develop a central data system to administer the Income-Dependent Education Assistance program. Such data system will provide borrowers with information on their Self-Reliance Loan balance and on prepayment options, on at least an annual basis.

Not later than January 1 of each year, the Secretary of Education will certify to the Secretary of the Treasury a list of borrowers in repayment status for that year and such borrowers' repayment rates. The Secretary of the Treasury will report to the Secretary of Education the amount of loan repayment installments made by the borrower.

Not later than January 31 of each calendar year, the Secretary of Education will certify to each borrower the amount of interest and principal paid on such loans for the second preceding calendar year.[8]

Any borrower who receives the certifications described above relating to principal, interest, or balances and who believes such certification contains an error of statement or omission or believes that such certification asserts a debt not owed will be required to notify the Secretary of Education within 60 days of receipt. The Secretary of Education will, within 30 days of receipt of such objection, affirm, adjust, or withdraw such certification and send notice to the borrower and the Secretary of the Treasury. Such decisions will be reviewable by the appropriate district court as a final agency decision.

Demonstration program

In general

The Secretary of Education will select institutions of higher education for participation in the Self-Reliance Loan program from those institutions submitting applications that are eligible to participate in part B loan programs. Not later than May 1, 1993, the Secretary will select not more than 500 institutions to participate in the program. The participating institutions will be chosen so as to represent a cross-section by educational sector, length of academic program, default experience, annual loan volume, highest degree offered, enrollment size, and geographic location. The Secretary will also select participating institutions in such a manner that the volume of student borrowing under the demonstration program would not exceed the following amounts:

$450,000,000 in fiscal year 1994.
$550,000,000 in fiscal year 1995.
$650,000,000 in fiscal year 1996.
$900,000,000 in fiscal year 1997.

[8] Thus, under the provision in section 2121 of the Senate amendment that allows a credit or deduction for student loan interest, interest paid on Self-Reliance Loans will be treated as paid in the taxable year beginning in the calendar year following the calendar year in which such interest was paid.

Each institution wishing to offer an Income-Dependent Education Assistance program is required to submit an application to the Secretary of Education and, if accepted, enter into an agreement with the Secretary of Education for receipt of funds. Each participating school must agree to follow procedures specified by the Secretary of Education in consultation with the Secretary of the Treasury in disbursing such loans; to accept liability stemming from mismanagement of loans or false origination of loans; to provide the Secretary of Education at least once a month with a list of Self-Reliance Loan participants and any change in their enrollment status; and to counsel borrowers on their repayment options and their obligations.

The Secretary of Education has the same authority to limit, suspend, or terminate an institution's participation in the Income-Dependent Education Assistance program as applies to an institution's participation in loan programs under Part B of the Higher Education Act of 1965, and may also impose additional regulations or criteria for participation. The demonstration program concludes at the end of fiscal year 1997.

Administrative costs

There will be available to the Secretaries of Education and the Treasury for administrative costs amounts not to exceed the following:

Fiscal year	Treasury	Education
1992	0	0
1993	$1,000,000	$40,000,000
1994	7,500,000	20,000,000
1995	4,500,000	20,000,000
1996	3,600,000	20,000,000
1997	4,000,000	20,000,000

It is expected that if, in a given fiscal year, amounts less than the above maxima are appropriated, the unused balance will be devoted to deficit reduction.

Evaluation and reporting

Beginning one year after enactment, the Secretary of Education, in consultation with the Secretary of the Treasury, will make annual reports to Congress describing and evaluating the implementation and administration of the Income-Dependent Education Assistance program and identifying problems that require legislative action.

Not later than January 1, 1997, the Secretary of Education, in consultation with the Secretary of the Treasury, will make a report to the Senate Committee on Labor and Human Resources and the House Committee on Education and Labor analyzing the administrative capacity of the Departments of Education and of the Treasury to operate this program; the administrative burden and costs imposed on the Departments of Education and of the Treasury by this program; the accuracy of information provided by the Secretary of Education; the administrative and financial factors that would affect the ability of all schools to participate in the program; the impact of this program on repayments, delinquencies and defaults under all federal student loan programs; and any other relevant information. The report will also (1) publish the tuition and cost of attendance at each institution participating in the program and analyze changes in those costs compared to changes occurring at institutions not participating in the program, (2) examine the feasibility of including individuals over age 50 as eligible students and of adjusting repayment rates and schedules to insure such individuals' repayment before retirement, (3) examine the feasibility of integrating the Income-Dependent Education Assistance program with a national service program, and (4) make recommendations for criteria to govern institutional eligibility if the Income-Dependent Education Assistance program were continued or later expanded to all eligible institutions of higher education.

Effective date

The provision generally is effective on the date of enactment. Amendments made to the Internal Revenue Code are effective for taxable years beginning after December 31, 1992. The first Self-Reliance Loans may be issued on or after September 1, 1993. No Self-Reliance Loans may be issued after September 30, 1997.

Conference agreement

The conference agreement does not include the Senate amendment.

3. WORKFORCE TRAINING: FORMATION OF, AND CONTRIBUTIONS TO, TAX-EXEMPT YOUTH TRAINING ORGANIZATIONS AND ESTABLISHMENT OF NATIONAL BOARD FOR PROFESSIONAL AND TECHNICAL STANDARDS

Present law

In order to qualify as a tax-exempt organization under section 501(c)(3) and be eligible to receive tax-deductible contributions, an organization must be organized and operated exclusively for charitable, educational, or other exempt purposes specified in section 501(c)(3), and no part of the organization's net earnings may inure to the benefit of any private shareholder or individual. Section 501(c) also provides tax-exempt status for other types of organizations (e.g., social welfare organizations and business associations), provided certain requirements are satisfied.

Charitable contributions to organizations described in section 501(c)(3) are allowed as an itemized deduction, subject to certain percentage limitations (sec. 170). In addition, donations to States or political subdivisions are deductible as charitable contributions, provided that the donation is made for exclusively public purposes. Depending on the type of property contributed and the type of the donee organization, the amount of a taxpayer's charitable contribution deduction generally is allowed in an amount up to the contributed property's fair market value. However, special rules provide for an augmented charitable contribution deduction for certain contributions made by corporations of inventory property used for the care of the ill, the needy, or infants, and certain scientific research property donated to educational or scientific organizations (sec. 170(e)(3) and (4)). The deduction allowed for such donations is equal to the corporation's basis in the property plus one-half of the amount of ordinary income that would have been realized if the property had been sold (but in no event may the deduction exceed twice the basis in the contributed property).

Payments made by a taxpayer to a tax-exempt organization are deductible as ordinary and necessary business expenses under section 162, provided that the taxpayer has a reasonable expectation of financial return to his trade or business commensurate with the amount of the transfer. In such a case, a "gift or contribution" has not been made for purposes of section 170.[1]

House bill

No provision.

Senate amendment

Tax-exempt status

The Senate amendment specifically provides tax-exempt status for certain youth skills training and education organizations meeting the following requirements: (1) the organization is organized and operated solely for the purpose of administering a program that qualifies as a youth skills training and education program under subtitle B of title II of the Wagner-Peyser Act; (2) the organization is controlled by a board of directors consisting of representatives of employers contributing to such program (and certain of their employees),[2] schools and higher education institutions participating in the program, and State and local governments; and (3) the organization does not pay for, and prohibits the use of any contributions it receives for, employment training expenses or compensation for any student participating in the youth skills training and employment program.[3]

Augmented deduction

The Senate amendment also provides an augmented deduction for cash contributions made by a corporation or partnership to a tax-exempt youth skills training and education organization.[4] The allowable deduction under the provision is 150 percent of the contributed amount.

National Board for Professional and Technical Standards

The Senate amendment amends the Wagner-Peyser Act (29 U.S.C. 49 et seq.) to establish a National Board for Professional and

[1] See Treas. Reg. sec. 1.170A-1(c)(5); Rev. Rul. 84-110, 1984-2 C.B. 35.

[2] Representatives of employers (and certain of their employees) may not constitute more than 50 percent of the members of the board of directors.

[3] The Senate amendment specifically provides tax-exempt status under new section 501(c)(26) of the Internal Revenue Code for qualifying youth skills training and education organizations meeting the requirements of the bill. No inference is intended as to the required characteristics for any tax-exempt educational organization described in present-law section 501(c)(3).

[4] For purposes of this provision, amounts paid by a corporation or partnership to a tax-exempt youth skills training and education organization are treated as a charitable contribution under section 170.

Technical Standards ("National Board"), which will be an independent national board to develop a system of industry-based, occupational proficiency standards and certifications of mastery for occupations within each major industry (and occupations that involve more than one industry), for which no recognized training standards currently exist. The bill specifies criteria for the composition of the membership of the National Board, and requires that the National Board develop proficiency standards, assessments, and curricula for certain industrial or occupational categories. Such proficiency standards, assessments, and curricula will be made available for voluntary use by institutions of postsecondary education offering professional and technical education, labor organizations, trade and technical associations, employers and labor-management organizations providing formalized training, private training providers, and other organizations likely to benefit from such proficiency standards, assessments, and curricula.

Youth skills training and education programs

The Senate amendment also amends subtitle B of title II of the Wagner-Peyser Act to specify the criteria for qualified youth skills training and education programs. In general, a qualified youth skills training program is one that provides eleventh and twelfth grade high school students with the opportunity to voluntarily enter into a course of study that integrates academic instruction with supervised on-the-job training and instruction in the workplace in a curriculum designed to lead to a high school diploma and to qualify the student for further education or an advanced technical or professional training program. The program must be certified by a State or local educational agency as meeting the educational standards established and approved by such agency. In addition, the program must be certified by a State agency responsible for occupational training as meeting certain occupational-related requirements, including conforming to standards registered with the Department of Labor's Bureau of Apprenticeship or established by the National Board (or if such standards are not available, the provision of broad-based competencies and skills for career progression), coordination with participating schools, review and evaluation by the program of the student's progress in job performance and related academic instruction, and certain other labor requirements governing the terms and conditions of employment of students by employers participating in the program.

Department studies

The Treasury, Labor, and Education Departments are directed to jointly study and report to Congress within three years after enactment on the effects of the provisions and any recommendations for further legislative modifications.

Effective date

The provisions amending the Internal Revenue Code are effective for taxable years beginning after the date of enactment.

The National Board is required to develop, not later than December 31, 1993, proficiency standards, assessments, and criteria for at least 30 identified industrial or occupational categories. In addition, the National Board is required to develop a program to ensure that the proficiency standards, assessments, and curricula for all remaining identified industrial or occupational categories are completed not later than January 1, 1997.

Conference agreement

The conference agreement does not include the Senate amendment.

4. EXPANSION OF EDUCATION SAVINGS BOND PROVISIONS

Present law

Code section 135 provides that interest income earned on a qualified U.S. Series EE savings bond issued after December 31, 1989, is excludible from gross income if the proceeds of the bond upon redemption do not exceed qualified higher education expenses paid by the taxpayer during the taxable year.[1] "Qualified higher education expenses" include tuition and required fees for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer at an eligible educational institution.[2] A taxpayer cannot qualify for the interest exclusion by paying for the education expenses of another person (such as a grandchild or other relative) who is not a dependent of the taxpayer.

The exclusion provided by section 135 is phased out for certain higher-income taxpayers. A taxpayer's AGI for the year the bond is redeemed (not the year the bond was issued) determines whether or not the phaseout applies. For taxpayers filing a joint return, the phaseout range is for AGI between $60,000 and $90,000 (adjusted for inflation). For single taxpayers and heads of households, the phaseout range is for AGI between $40,000 and $55,000 (adjusted for inflation).

To prevent taxpayers from effectively avoiding the income phaseout limitation (through the issuance of bonds directly in the child's name), section 135(c)(1)(B) provides that the interest exclusion is available only with respect to U.S. Series EE savings bonds issued to taxpayers who are at least 24 years old.

The interest rate on Series EE savings bonds varies, depending on how long the bonds are held. The interest rate on such bonds held for more than five years is based on the market rate for Treasury outstanding obligations with five years to maturity. Bonds held for less than five years earn interest on a fixed, graduated scale (generally below current rates on comparable Treasury instruments). Interest earned on Series EE bonds is paid when the bonds are redeemed.

[1] If the aggregate redemption amount (i.e., principal plus interest) of all Series EE bonds redeemed by a taxpayer during the taxable year exceeds the qualified education expenses incurred, then the excludable portion of interest income is based on the ratio that the education expenses bears to the aggregate redemption amount (sec. 135(b)).

[2] Eligible educational institutions are defined in section 1201(a) and 481(a)(1)(C) and (D) of the Higher Education Act of 1965, as in effect on October 21, 1988, and in the Carl D. Perkins Vocational Education Act (subparagraph (C) or (D) of section 521(3)), as in effect on October 21, 1988. An eligible educational institution does not include proprietary institutions.

"Qualified higher education expenses" do not include expenses with respect to any course or other education involving sports, games, or hobbies other than as part of a degree program (sec. 135(c)(2)(B)).

House bill

No provision.

Senate amendment

The Senate amendment expands the definition of "qualified higher education expenses" under section 135 to include tuition and required fees paid by a taxpayer for the enrollment or attendance of *any* individual (not simply dependents) at an eligible educational institution.

The Senate amendment also repeals the present-law AGI phaseout limitation under section 135 (and the related rule requiring that bonds be issued to a person who is at least 24 years old). Thus, interest earned on a Series EE savings bond is not subject to tax regardless of the taxpayer's AGI during the year the bond is redeemed if, during that year, the taxpayer pays for qualified higher education expenses of any individual and such expenses exceed the proceeds (principal plus interest) received upon redemption.[3]

Effective date.—The provision applies to U.S. Series EE savings bonds issued after December 31, 1989, and redeemed after December 31, 1991.

Conference agreement

The conference agreement follows the Senate amendment.

5. EXTENSION OF EXCLUSION FOR EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE

Present law

An employee's gross income and wages for income and employment tax purposes do not include amounts paid or incurred by the employer for education assistance provided to the employee if such amounts are paid or incurred pursuant to an educational assistance program that meets certain requirements. This exclusion, which expires with respect to amounts paid after June 30, 1992, is limited to $5,250 of educational assistance with respect to an individual during a calendar year.

In the absence of this exclusion, an employee generally would be required to include in income and wages, for income and employment tax purposes, the value of educational assistance provided by an employer to the employee, unless the cost of such assistance qualified as a deductible job-related expense of the employee.

House bill

The exclusion for employer-provided educational assistance is permanently extended.

[3] Present-law section 135(b) prorates the excludible interest when aggregate proceeds from bonds redeemed by a taxpayer during the taxable year exceed qualified education expenses paid by the taxpayer during that year. Consistent with this rule, it is expected that the Treasury Department will prescribe procedures for allocating the income exclusion provided for by section 135 in cases where, with respect to a particular taxable year, two (or more) taxpayers redeem savings bonds and claim to have paid qualified education expenses for the same student, but the aggregate redemption proceeds received by the taxpayers exceed the student's qualified education expenses.

Effective date.—The provision is effective for taxable years ending after June 30, 1992.

Senate amendment

The exclusion for employer-provided educational assistance is extended through December 31, 1993.

Effective date.—The provision is effective for taxable years ending after June 30, 1992.

Conference agreement

The conference agreement extends the exclusion for employer-provided educational assistance through June 30, 1993.

Effective date.—The provision is effective for taxable years ending after June 30, 1992.

D. Health Insurance and Health Care Provisions

1. EXTEND HEALTH INSURANCE DEDUCTION FOR SELF-EMPLOYED

Present law

Present law provides a deduction for 25 percent of the amount paid for health insurance for a self-employed individual (e.g., a partner in a partnership or a sole proprietor) and the individual's spouse and dependents. The 25-percent deduction is also available to more than 2-percent shareholders of S corporations. The amount of expenses in excess of the deductible amount can be taken into account in determining whether the individual is entitled to a medical expense deduction (sec. 213).

The 25-percent deduction expires for taxable years beginning after June 30, 1992. In the case of years beginning in 1992, only amounts paid before July 1, 1992, for coverage before July 1, 1992, are taken into account in determining the amount of the deduction.

House bill

The House bill extends the 25-percent deduction through December 31, 1992.

Effective date.—The provision is effective for taxable years ending after June 30, 1992.

Senate amendment

The Senate amendment increases and makes permanent the deduction for health insurance expenses of self-employed individuals. For 1992, the deduction is 75 percent. For 1993 and thereafter, the deduction is 100 percent.

Effective date.—The provision is effective for taxable years ending after June 30, 1992.

Conference agreement

The conference agreement extends the 25-percent deduction for health insurance expenses of self-employed individuals through June 30, 1993.

Effective date.—The provision is effective for taxable years ending after June 30, 1992.

2. IMPROVEMENTS IN HEALTH INSURANCE AFFORDABILITY FOR SMALL EMPLOYERS

a. Grants to States for small employer health insurance purchasing programs

Present law

Currently, there is no Federal grant program to finance group purchasing arrangements to assist small employers in purchasing health insurance. Several States have undertaken related initiatives.

House bill

No provision.

Senate amendment

The Senate amendment would establish a grant program to assist States in developing small employer health insurance group purchasing arrangements. Funds could be expended for administrative costs including marketing and outreach efforts, negotiations with insurers, and performance of administrative functions such as eligibility screening, claims administration and customer service. In awarding grants to States, the Secretary of Health and Human Services (HHS) would be required to fund qualified applications employing a variety of approaches to group purchasing.

Such sums as necessary would be authorized for fiscal years 1993 through 1995 for the purpose of funding grant applications.

The Secretary of HHS would be required to conduct an evaluation and report to the Congress by January 1, 1995, on the impact of these programs on the number of uninsured and the price of insurance available to small employers.

Effective date.—Date of enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

b. Study use of Medicare rates by private health insurance plans

Present law

In general, prices paid for health care services are arranged privately between insurers and health care providers. No Federal law directs these prices. Some States have laws regulating payments to hospitals by private insurers.

House bill

No provision.

Senate amendment

The Senate amendment directs the Secretary of Health and Human Services (the Secretary) to study and report to the Congress by January 1, 1993, on the feasibility and desirability of developing prices based on Medicare payment methodologies for use by private health insurance. In developing the study, the Secretary would take into account the findings and views of the Prospective Payment Assessment Commission and the Physician Payment Review Commission.

The study would include an evaluation of (1) the appropriateness of using Medicare payment rules to determine payments for services provided to the non-Medicare population, with particular emphasis on services furnished to children; (2) the potential impact of such prices on health insurance premiums, access to health care services by Medicare beneficiaries and others and national health care spending; and (3) the advantages and disadvantages of alternative mechanisms for enforcing the use of such rates when private insurers opt to use them.

Effective date.—Date of enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

3. IMPROVEMENTS IN HEALTH INSURANCE FOR SMALL EMPLOYERS: STANDARDS AND REQUIREMENTS OF SMALL EMPLOYER HEALTH INSURANCE; EXCISE TAX ON PREMIUMS RECEIVED ON HEALTH INSURANCE POLICIES WHICH DO NOT MEET CERTAIN REQUIREMENTS; GAO STUDY AND REPORT ON RATING REQUIREMENTS AND BENEFIT PACKAGES FOR SMALL GROUP HEALTH INSURANCE

Present law

There is no Federal law regulating the terms of sale of private health insurance sold to small employers. The National Association of Insurance Commissioners (NAIC) has adopted model legislation for State laws governing premium rates and renewability of coverage for health insurance sold to small employers, and guaranteeing availability of health insurance sold to small employers. Fourteen States have enacted legislation similar to the NAIC model on rating and renewability of coverage. Another four States have enacted additional legislation to guarantee the availability of health insurance sold to small employers.

House bill

No provision.

Senate amendment

Standards and requirements of small employer health insurance

The Senate amendment would establish minimum Federal requirements for State laws regarding the sale of health insurance to small employers. The requirements would apply to insurance sold to employers with between 2 and 50 employees working at least 30 hours a week.

Development of standards.—The Secretary of Health and Human Services would request the National Association of Insurance Commissioners (NAIC) to develop standards for State implementation of the statutory requirements by September 30, 1992. If the NAIC fails to act in time, or if the Secretary finds that the NAIC standards do not meet the statutory requirements, the Secretary will develop standards by December 31, 1992.

State adoption and enforcement.—States would be required to establish a regulatory program for adoption and enforcement of the standards, subject to approval and oversight by the Secretary of HHS. The General Accounting Office would conduct periodic reviews to evaluate State compliance.

States could enact more stringent standards. The Secretary of HHS would be authorized to provide waivers for rating band requirements in the case of a State with equally stringent but not identical standards in effect prior to January 1, 1992.

The standards would apply to all entities subject to State insurance laws and regulation, including multiple employer welfare arrangements. In the case of a multiple employer welfare arrangement that is fully insured, the standards would apply to the insurer of the arrangement. Self-funded multiple employer welfare arrangements would be subject to State regulation in the same way as under current law. Nothing in the Federal requirements is intended to interfere with a State's ability to regulate licensure or financial solvency of insurers.

Standards would provide for guaranteed eligibility, guaranteed renewability, limits on pre-existing condition exclusions, restrictions on rating practices, requirements for benefit package offerings, and guaranteed availability of coverage.

Guaranteed eligibility.—Eligible employees or their dependents could not be excluded from coverage under a small group health insurance plan.

Guaranteed renewability.—Insurance sold to small employers could not be canceled due to claims experience or health conditions.

Pre-existing condition exclusions.—Newly covered employees and dependents with previous health insurance coverage would generally be protected against pre-existing condition exclusions. In the case of an individual without coverage for a particular service within the 90-day period prior to beginning employment, insurers could exclude coverage for that service for a one-time period of up to 6 months for any pre-existing condition. A pre-existing condition would be defined as one that was diagnosed or treated within 3 months of the beginning of coverage. Individuals with previous health insurance coverage would be given credit for each month of coverage toward the pre-existing condition exclusion period. Pre-existing condition exclusions could not be applied to services furnished to newborns.

Rating requirements.—Minimum Federal requirements for rating of small employer premiums would limit variation in premiums for health insurance sold to small employers on account of health status, claims experience, duration since issue, industry and occupation.

Rating bands would be established such that the highest premium charged to the lowest premium charged to a small employer with similar demographic characteristics (age, sex and family size) for the same or similar benefits could not exceed 1.5 for the first three years the law is in effect, and 1.35 in subsequent years.

Under limited circumstances, insurers could sort small employers into separate blocks of business, and the rating bands would apply independently to each block of business. Variation in premiums charged between all blocks of business could not exceed 20 percent. Insurers would be allowed to create no more than six blocks of business to segregate plans purchased from another insurer, plans provided through an association of small employers, and plans marketed through direct mail or another marketing approach.

These rating bands would not apply to differences in premiums due to age and sex, or geography. Adjustments to premiums based on these factors would have to be applied consistently across small employers. In addition, demographic rating factors would have to be consistent with guidelines developed by the National Association of Insurance Commissioners.

Insurers would disclose to the employer information on rating practices, the impact of rating factors on the employer's premiums, and the potential for future rate changes.

Annual rate increases.—Premiums for a small employer could increase by no more than 5 percent above the underlying trend in health care costs, as measured by the increase in the lowest rate charged by the insurer for the block of business.

Benefit packages.—All insurers offering coverage to small employers must make available at least a standard and a basic benefit package to all small employers in all blocks of business. State laws requiring the coverage of specified items and services would not apply to either benefit package. State laws involving the coverage of newborn children, adopted children or other individuals would continue to govern. Neither does the Finance Committee intend to preclude State requirements with respect to continuation and conversion benefits.

The standard benefit package would provide for the following benefits:

(1) inpatient and outpatient hospital services, except that mental health services could be limited annually to at least 45 days of inpatient treatment and 20 outpatient visits;

(2) physician services and diagnostic tests; and

(3) preventive services limited to prenatal care, well baby care for children under 1 year, well child care, Pap smears, mammograms and colorectal screening services.

Physician services would be defined to include services lawfully provided by a physician under State medical practice acts, and includes services provided by a dentist, licensed advance-practice nurse, physician assistant, optometrist, podiatrist, or chiropractor acting within the scope of their practices as determined under State law. Outpatient psychotherapy and counseling could be provided by a physician, clinical psychologist, clinical social worker or other licensed providers operating within the scope of State law. Mental health services would include treatment of alcohol and drug dependency.

Out-of-pocket costs would be limited in several ways. The annual deductible could not exceed $400 for an individual and $700 for a family in 1993. These limits would be indexed to the consumer price index. Coinsurance could not exceed 20 percent, except in the case of outpatient mental health services for which a 50-percent coinsurance rate would apply. An overall annual cap on deductibles and coinsurance would be established at $3,000 for individuals and families in 1993, indexed to the consumer price index thereafter.

The basic benefit package would provide for inpatient and outpatient hospital care, including emergency services; inpatient and outpatient physician services, preventive services which may include prenatal and well-baby care, well-child care, mammograms, Pap smears and colorectal screening. Nothing in the Federal requirements prohibits the inclusion of mental health services in the basic benefit package. Deductibles and coinsurance could be imposed. A limit on out-of-pocket spending would be required.

Within the scope of these Federal requirements, a State could choose to define a specific basic benefit package that all insurers must offer, or a State could allow insurers to offer alternative basic benefit packages. The intent of the basic benefit package requirement is to encourage the development of affordable health benefit packages for small employers.

Guaranteed availability of coverage.—Insurance coverage would be made available to every small employer within a state. States could choose among alternative approaches to guarantee availability of coverage. The National Association of Insurance Commissioners (or the Secretary) would develop standards to implement at least the four alternatives, including (1) mandating that all insurers issue insurance to any small employer, and be required to participate in a reinsurance pool designed to spread risk among insurers, and (2) mandating that all insurers issue insurance to any small employer and allowing voluntary participation in a reinsurance pool, (3) requiring participation in a system for allocating high-risk groups among insurers, and (4) allowing insurers to choose between issuing insurance to any small employer and participating in an allocation system. In addition, the Secretary may approve other programs guaranteeing the availability of insurance to small employers. For example, a State could require insurers to issue insurance to any small employer without establishing a reinsurance pool. Under each approach, States would be required to adopt standards to assure fair marketing of insurance sold to small employers.

Enforcement of standards: Excise tax on premiums on health insurance policies not meeting certain requirements

Insurers violating standards would be subject to a Federal excise tax equal to 25 percent of premiums received on all policies sold to small employers. Insurers in States having a regulatory program approved by the Secretary would be exempt from the tax, as would insurers in other States that are individually certified by the Secretary as meeting the Federal standards.

Effective date

The requirements take effect for health insurance plans offered, issued, or renewed to a small employer on or after January 1, 1994, except in States with a legislature that does not meet during 1993. In these States, the requirements would be effective on first day of the first calendar quarter after the close of the first regular legislative session occurring after January 1, 1994.

GAO Study

The General Accounting Office (GAO) would report to the Congress on (1) the impact of the standards for small group insurance on the availability and price of insurance offered to small employers, differences in available benefit packages, and the number of small employers choosing standard or basic benefit packages; (2) differences in State laws and regulations affecting the price of health insurance plans sold to individuals; and (3) the impact of the standards on the number of small employers offering insurance to employees through a self-funded group health plan.

The GAO would also make recommendations with respect to adjusting the minimum rating requirements to eliminate experience rating based on health status and claims experience and to eliminate variation in premiums associated with age and sex.

Conference agreement

The conference agreement does not include the Senate amendment.

4. IMPROVEMENTS IN THE PORTABILITY OF PRIVATE HEALTH INSURANCE: EXCISE TAX IMPOSED ON FAILURE TO PROVIDE FOR PREEXISTING CONDITION

Present law

Group health plans often exclude coverage for a period of time for services related to a preexisting medical condition of a newly covered employee or his or her dependents, regardless of previous health insurance coverage.

House bill

No provision.

Senate amendment

All group health insurance and self-insured employer group health plans would be prohibited from denying or limiting coverage on the basis of medical history or health status, except that a limited preexisting condition exclusion could apply to individuals with respect to services for which they did not previously have health insurance coverage.

Newly covered employees and dependents with previous health insurance coverage would generally be protected against preexisting condition exclusions. In the case of an individual without coverage for a particular service within the 90 day period prior to beginning employment, insurers could exclude coverage for that service for a one-time period of up to 6 months for any preexisting condition. Preexisting conditions would be defined as those that were diagnosed or treated during the three months prior to enrollment.

Individuals would be given credit for previous health insurance coverage. A period of preexisting condition exclusion would be reduced by one month for each month of previous coverage with respect to particular services. Credit would be given for previous coverage ending up to three months prior to the start of coverage under the new health plan.

Insurers or self-insured employer group health plans offering health plans not in compliance with these requirements would be required to retroactively cover any illegally excluded services and pay a tax penalty of $100 a day for each violation.

Effective Date.—Date of enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

5. HEALTH CARE COST CONTAINMENT

a. Establishment of Health Care Cost Commission

Present law

No provision.

House bill

No provision.

Senate amendment

The Senate amendment would establish a Health Care Cost Commission to advise the Congress and the President on strategies for reducing health care costs.

The Commission would consist of 11 members appointed by the President and confirmed by the Senate. The term of the Chairman would be 4 years and coincident with the term of the President. Other members would serve for three-year terms, except that the terms of initial appointees would be staggered so that the terms of no more than 4 members would expire each year.

The President would be required to appoint members within six months of enactment of this provision, and would be required to assure representation of consumers of health services, large and small employers, State and local governments, labor organizations, health care providers, health care insurers, and experts on the development of medical technology.

The Commission would report by March 30th each year on trends in health care spending, the cost of private health insurance, sources of increases in health care costs and comparative trends in other countries. The report would also include the Commission's assessment of public and private strategies for reducing growth in health spending and its recommendations for cost containment efforts.

As part of its first annual report, the Commission would, in consultation with the Secretary of Health and Human Services, recommend a national model uniform claims form and uniform standards for the collection of medical and billing records for use by insurers and providers. The Commission would recommend a strategy and schedule for implementing by January 1, 1996, national use of these forms and standards, taking into account the need for patient confidentiality and special implementation issues, including those of providers in rural areas. The Commission would consider the use of electronic cards or other technology that allows expedited access to medical records and insurance information.

The Commission would also make recommendations to the Secretary of Health and Human Services with respect to the development and ongoing review of standards for managed care plans and utilization review programs.

Effective date.—Date of enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

b. Federal certification of managed care plans and utilization review programs

Present law

Under present law, a health maintenance organization meeting certain standards may apply to the Health Care Financing Administration for certification as a federally qualified health maintenance organization.

House bill

No provision.

Senate amendment

The Secretary of HHS would be directed to establish a voluntary certification program for managed care plans and utilization review programs.

Standards for certification of qualified managed care plans would include standards related to the qualification and selection of participating providers, the distribution of providers necessary to assure that plan enrollees have access to needed health services, the provision of benefits for emergency services and the establishment of an ongoing quality assurance program. In order to be certified as a qualified managed care plan, a managed care plan would also have to meet standards identical to those established for designation of qualified utilization review programs.

Standards for certification of qualified utilization review programs include standards related to the qualification of individuals performing utilization review, the utilization review criteria and procedures for evaluating the necessity and appropriateness of health services, the timeliness of utilization review determinations and procedures for operating an appeals process and standards related to the expenses associated with requests from providers for information needed to conduct utilization review. The Secretary would be required to periodically review these criteria, taking into account recommendations of the Health Care Cost Commission.

The Secretary could consider a plan or utilization review program accredited if it meets the requirements of a State licensure program or national accreditation body that the Secretary determines are at least as stringent as the Federal standards.

Certain State laws would not apply with respect to qualified managed care plans and qualified utilization review programs. These include laws that prohibit a qualified managed care plan from including financial incentives for enrollees to use the services of participating providers, laws that prohibit a qualified managed care plan from requiring that services be authorized by a participating primary care physician selected by the enrollee, and laws that prohibit the use of utilization review procedures by a qualified utilization review program or a qualified managed care plan.

Effective date.—Date of enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

c. Additional funding for outcomes research

Present law

The Omnibus Budget Reconciliation Act of 1989 authorized funding in the Department of Health and Human Services, through the Agency for Health Care Policy and Research, for research on the outcomes, effectiveness, and appropriateness of health care services and procedures. Authorization for appropriations for these activities are set at $110 million for fiscal year 1992, two thirds of which is appropriated from the Medicare trust funds; $148 million for 1993, 70 percent of which is appropriated from the Medicare trust funds; and $185 million for 1994, 70 percent of which is appropriated from the Medicare trust funds.

House bill

No provision.

Senate amendment

The Senate amendment increases authorization of appropriations to $175 million in fiscal year 1992, $225 million in fiscal year 1993, $275 million in fiscal year 1994, and $300 million in fiscal year 1995. The amount contributed from the Medicare trust funds in fiscal years 1993 and 1994 would be reduced to 50 percent of the total appropriation.

Effective date.—Date of enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

6. MEDICARE PREVENTION BENEFITS

a. Coverage of certain immunizations

Present law

With certain exceptions, Medicare does not generally cover preventive health services. OBRA 1987 established a demonstration project to test the cost effectiveness of including influenza vaccine under the Medicare program. The legislation required that a report on the cost effectiveness of the benefit be submitted to the Congress by October 1, 1990. If the results were inconclusive, the demonstration would be extended an additional two years with a final report submitted to the Congress by April 1, 1993. The demonstration is slated to end September 1992. Medicare will not pay for influenza vaccines except at the designated sites.

House bill

No provision.

Senate amendment

The Senate amendment would provide for coverage of annual influenza vaccinations and for tetanus-diphtheria boosters every 10 years.

Effective date.—Applies to for influenza vaccinations furnished on or after October 1, 1992, and for tetanus-diphtheria boosters furnished on or after January 1, 1993.

Conference agreement

The conference agreement does not include the Senate amendment.

b. Coverage of well-child care

Present law

As has been explained in the preceding item, the Medicare program generally does not cover preventive services. Medicare coverage is provided for persons suffering from end-stage renal disease. Included in this group are approximately 300 children under the age of 7.

House bill

No provision.

Senate amendment

The Senate amendment would provide for coverage of pediatric well-child care, including appropriate immunizations, for children entitled to Medicare who have not attained 7 years of age. This would benefit the approximately 300 children who are entitled to Medicare because they have end-stage renal disease.

Effective date.—Applies to well-child services provided on or after January 1, 1993.

Conference agreement

The conference agreement does not include the Senate amendment.

c. Demonstration projects for coverage of other preventive services

Present law

Section 9314 of the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), as amended by OBRA 1990, requires the Secretary to establish a five-year demonstration program to measure the costs and benefits of providing preventive services to Medicare beneficiaries. The program must be conducted at no fewer than five demonstration sites. An interim report is due April 1993, and a final report (including a comprehensive evaluation of the long-term effects of the program) is due April 1995.

House bill

No provision.

Senate amendment

The Senate amendment would provide for the establishment of an on-going series of demonstrations to evaluate the appropriateness of covering additional preventive services under Medicare. A different service would be provided at each site, so that the effect of that service on life expectancy and Medicare costs could be isolated. The Secretary would be required to evaluate specific services but could extend the demonstrations to include other services as well. Services that the Secretary would be required to evaluate include: glaucoma screening; cholesterol screening and cholesterol reducing drug therapies; screening and treatment for osteoporosis, including tests for bone-mass measurement and hormone replacement therapy; screening services for pregnant women, including ultrasound and clamydial testing and maternal serum alfa-protein; one-time comprehensive assessment for individuals beginning at age 65 or 75; and prostate-specific antigen (PSA) testing for prostate cancer. Although the Secretary would be required to use the sites at which the COBRA demonstrations are currently being conducted, he could designate other sites as well.

Effective date.—Date of enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

d. OTA study of process for review of medicine coverage of preventive services

Present law

The Department of HHS has established a process for making coverage decisions for medical procedures and technologies, which, if approved, could be included under one of the covered service categories (such as physicians' services).

House bill

No provision.

Senate amendment

The Senate amendment would require an Office of Technology Assessment (OTA) study of the process by which Medicare should decide whether to cover new preventive services in the event that the current statutory exclusion of preventive services from Medicare coverage is repealed. The OTA study would be subject to the approval of the Technology Assessment Board.

Effective date.—Date of enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

e. *Financing of new benefits*

Present law

Ordinarily, the basic part B premium paid by enrollees is the lower of: (1) an amount sufficient to cover one-half of the projected costs of the program for aged enrollees, or (2) the previous year's premium increased by the percentage increase in Social Security cash benefits payments.

This general requirement has been superseded since 1984. For the period 1984–1990, the Congress approved a series of amendments which set the part B premium equal to 25 percent of program costs for the aged. OBRA 1990 established specific dollar amounts for calendar years 1991-1995; these amounts were based on projections of 25 percent of program costs. The premiums established by OBRA 1990 are: $29.90 for 1991; $31.80 for 1992; $36.60 for 1992; $41.10 for 1994; and $46.10 for 1995.

The calculation of the Part B premium will revert to the basic rules beginning in 1996.

House bill

No provision.

Senate amendment

The new preventive benefits would be financed in the same manner as other part B services currently are paid for, with beneficiaries paying 25 percent of the increased program costs attributable to the benefits. CBO estimates that this would increase monthly part B premiums 10 cents above current law levels for each of the years 1993 through 1997.

Effective date.—Date of enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

7. HEALTH BENEFITS FOR RETIRED COAL MINERS

Present law

The United Mine Workers of America (UMWA) health and retirement funds were established in 1974 pursuant to an agreement between the UMWA and the Bituminous Coal Operator's Association (BCOA) to provide pension and health benefits to retired coal miners. The funds have been maintained for this purpose through a series of collective bargaining agreements. The funds created in 1974 were a restructuring of the original benefit fund, which was established in 1946.

The funds consists of four different plans, each of which is funded through a separate trust. The 1950 Pension Plan provides retirement benefits to miners who retired on or before December 31, 1975, and their beneficiaries. The 1950 Benefit Plan provides health benefits for retired mine workers who receive pensions from the 1950 Pension Plan and their dependents. The 1974 Benefit Plan provides health benefits to miners who retired after December 31, 1975. It also provides benefits to miners whose last employers are not longer in business or, in some cases, no longer signatory to the applicable bargaining agreement. These miners are generally referred to as "orphan" retirees.

House bill

No provisions.

Senate amendment

The Senate amendment creates a Coal Industry Retiree Health Benefit Corporation (the Corporation), a government corporation, to provide retiree health benefits for certain retired mine workers (and their spouses and dependents)—generally retirees whose last employer is out of business or not currently paying for retiree health benefits. The Corporation's health plan is financed by a cents/hour tax on certain coal production, a per-ton tax on imported coal, and a per-participant tax on certain former signatories to bargaining agreements who were the last employer of someone covered under the Corporation plan. The Senate amendment also (1) creates a new fund (the United Mine Workers of America (UMWA) 1991 Benefit Fund) to provide retiree health benefits to retirees of current signatories to the UMWA agreements, and (2) authorizes the tax-free transfer of excess assets from UMWA pension trusts to the Corporation and the 1991 Benefit Fund.

Effective date.—The provision is generally effective on the date of enactment.

Conference agreement

The conference agreement generally follows the Senate amendment. The conference agreement modifies the definition of Western States, eliminates the ability of the Corporation to set tax rates and premiums, and eliminates certain provisions relating to interaction with titles XVIII and XIX of the Social Security Act. As has historically been the case, retiree health benefits provided by the program would be secondary to benefits paid under other governmental programs, except as otherwise provided by law. It is anticipated that the Corporation and the 1991 Fund will have at least the same rights to coordinate benefits with other benefit plans and programs as the UMWA Benefit Plans have exercised in the past.

E. Capital Gains Provisions

1. INDIVIDUAL CAPITAL GAINS

Present law

Tax rate on net capital gain

Under present law, ordinary income of an individual is taxed at a maximum marginal rate of 31 percent. Net capital gain of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent. Net capital gain is the excess of net long-term capital gain for the taxable year over net short-term capital loss for the year. Gain or loss from the sale or exchange of a capital asset is treated as long term if the asset is held for more than one year.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications.

The Tax Reform Act of 1986 repealed a provision allowing a noncorporate taxpayer a deduction for 60 percent of its net capital gain for the taxable year.

The amount taken into account under present law in computing gain from the disposition of any asset is the sales price of the asset reduced by the taxpayer's basis in that asset. The taxpayer's basis reflects his actual cost in the asset adjusted for depreciation, depletion, and certain other amounts. No adjustment is allowed for inflationary increases in the value of the asset.

Depreciation recapture

In general, gain on the sale or other disposition of section 1245 property (depreciable personal property) is taxed as ordinary income to the extent of all previous depreciation or amortization allowances with respect to the property. Gain on the sale or other disposition of section 1250 property (depreciable real property) is taxed as ordinary income to the extent of the excess of accelerated depreciation allowances over the depreciation that would have been available under the straight-line method.

House bill

In general

The House bill generally provides for an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain (but not loss) upon sale or other disposition. Assets eligible for the inflation adjustment generally include corporate stock and tangible property which are capital assets or property used in a trade or business. The adjustment generally applies only to assets held for more than one year and which are acquired on or after February 1, 1992.

The provision generally applies to assets held by taxpayers other than C corporations, and to assets held by regulated investment companies and real estate investment trusts. Thus, for example, assets held by individuals, trusts, estates, S corporations, and partnerships are eligible for indexing, to the extent gain is taken into account by taxpayers other than corporations.

The adjustment is based on the increase in the consumer price index (CPI) between the calendar year prior to the year in which the asset was acquired and the year prior to the year in which the disposition takes place.

Indexed assets

The House bill generally provides for the indexing of corporate stock. For this purpose, options, warrants, or other contract rights with respect to stock are not considered stock. The inflation adjustment does not apply to stock in an S corporation, or generally to stock in a foreign corporation.[1]

The bill provides for the indexing of tangible personal property and real property which are capital assets or property used in a trade or business. This is intended to include leasehold interests in such property, and in the case of real property, includes land, structures, various mineral interests with respect to real property, and timber. However, it does not include any contract rights with respect to real property nor any mortgage or other creditor's interest.

The basis of debt is not indexed in order to avoid the complexity required to provide an inflation adjustment for both parties to the transaction. For example, in the case of a loan, the precise inflation adjustment would require the lender to deduct a loss from inflation and the borrower to report a gain. Similarly, the bill excludes from indexing intangible assets, such as options, where there is an option writer and option buyer who have offsetting inflation adjustments. The lessor's interest in property subject to a net lease is also not eligible for indexing.

The bill does not allow indexing of collectibles (as defined in sec. 408(m)).

Computation of inflation adjustment

The inflation adjustment under the House bill is computed by multiplying the taxpayer's adjusted basis in the indexed asset by the ratio of the CPI for the calendar year (as determined under sec. 1(f)) prior to the year in which disposition of the asset takes place to the CPI for the calendar year prior to the year in which the asset was acquired. The prior years' CPI is used in order to allow taxpayers to know the applicable inflation adjustment at the time at which the asset is disposed.

Under the bill, indexing is allowed for the number of years equal to the full number of years the taxpayer held the asset. For exam-

[1] See further discussion below relating to these entities.

ple, assume that an asset was purchased on November 1, 1993, and disposed of on March 1, 1997. For purposes of computing the inflation ratio, the bill treats the taxpayer as having disposed of the asset on December 31, 1997 and having acquired the asset in 1994, thus providing for indexing for three years. The inflation ratio is determined by dividing the CPI for 1996 by the CPI for 1993. If, instead, the asset had been purchased on February 1, 1993, the bill treats the asset as having been acquired in 1993 for this purpose. The denominator of the ratio would be the CPI for 1992, thus allowing for four years of indexing.

The inflation ratio is rounded to the nearest one-thousandth. For example, if the CPI is 48.34 percent higher at the time of sale than at the time of acquisition, the gain is determined by multiplying the original basis by 1.483 and subtracting this adjusted basis from the sales proceeds. It is intended that the Internal Revenue Service publish a table setting forth the applicable inflation ratios each year.

Indexing with respect to any asset is to end at the time the asset is treated as disposed of for tax purposes. Thus, with respect to installment sales, the inflation adjustment to the seller does not take into account any periods after the sale is made. The purchaser is entitled to inflation adjustments beginning with the date of purchase.

In computing the inflation ratio, periods of time for which an asset is not an indexed asset are not taken into account. For example, if convertible debt is converted into common stock, the period prior to conversion is disregarded in determining the inflation ratio applicable to the disposition of the common stock.

For purposes of determining the amount of depreciation, depletion, etc. recapture under sections 1245, 1250, and 1254, indexing does not apply.[2] The amount recaptured is added to the basis for purposes of then computing the indexing adjustment. The indexing adjustment does not apply to dispositions between related parties (as defined in sec. 465(b)(3)(C)) if the property is of a character subject to an allowance for depreciation in the hands of the transferee.

Example 1—An individual purchases depreciable property at a cost of $100 for use in his trade or business, claims $60 of depreciation, and then sells the property for $175. The applicable inflation ratio is 1.500. The taxpayer has $60 of gain attributable to recapture. The remaining gain is determined by using a $150 basis (i.e., $100 (the sum of $40 basis before recapture plus $60 recapture) multiplied by 150 percent). Thus, in addition to the $60 of recapture, the taxpayer has $25 of capital gain.

Special entities

RICs and REITs

In the case of a regulated investment company (RIC) or a real estate investment trust (REIT), the indexing adjustments provided

[2] Under the bill, the amount of recapture with respect to indexed assets that are section 1250 property (i.e., real property) is determined in the same manner as section 1245 property (i.e., personal property).

by this provision generally apply in computing the taxable income and the earnings and profits of the RIC or REIT.

However, for certain specified purposes the indexing adjustments do not apply. First, in order to deny the benefit of indexing to corporate shareholders of the RIC or REIT, the House bill provides that, under regulations, (a) the determination of whether a distribution to a corporate shareholder is a dividend is made without regard to this provision, (b) the amount treated as a capital gain dividend is increased to take into account that the amount distributed was reduced by reason of the indexing adjustment, and (c) such other adjustments as are necessary shall be made to ensure that the benefits of indexing are not allowed to corporate shareholders. Second, the indexing adjustments do not apply in determining whether a corporation qualifies as a RIC or REIT. Third, the indexing adjustment does not apply in determining the taxes imposed under section 857(b) (4), (5), or (6) in the case of a REIT, and the tax imposed on the failure to distribute gain under section 852(b)(3)(A) or section 857(b) (2) or (3) is properly increased in order to eliminate the benefit of the indexing adjustment.

In the case of stock held in a RIC or REIT, partial indexing is provided by the bill based on the ratio of the value of indexed assets held by the entity to its total assets.[3] This ratio is determined every month. However, in the case of a REIT, an actual valuation is required only once every three years because of the cost and difficulty of more frequent valuations. Where the ratio of indexed assets to total assets exceeds 90 percent in any month, full indexing of the stock is allowed for that month. Where less than 10 percent of the assets are indexed assets in any month, no indexing is allowed that month for the stock.

Partnerships and S corporations, etc.

Under the House bill, stock in a S corporation or an interest in a partnership is not an indexed asset. This rule is adopted because of the complexity which would result in determining the proper measure of the basis adjustment if indexing were to take into account the fluctuating basis of the S corporation stock or partnership interest attributable to earnings and distributions. Also, the mix of assets (i.e., indexed assets and other assets) held by the entity can fluctuate greatly over time. Under the bill, the shareholder[4] or partner receives the benefit of the indexing adjustment to his or her stock or partnership interest to the extent the corporation or partnership disposes of indexed assets.[5] Under the bill, any inflation adjustments at the entity level flow through to the holders and result in a corresponding increase in the basis of the holder's interest in the entity. Where a partnership has a section 754 election in effect, a partner transferring his interest in the partnership is entitled to any indexing adjustment that has accrued at the partnership level with respect to the partner and the transferee part-

[3] This determination is made without regard to whether the holding period of the indexed assets began on or after February 1, 1992.

[4] Indexing does not apply for purposes of the taxes imposed by sections 1374 and 1375 on S corporations.

[5] Similar rules apply to common trust funds.

ner is entitled to the benefits of indexing for inflation occurring after the transfer.

Example 2.—A, B, and C form an equal partnership, and each contributes $50 cash. The partnership purchases common stock in corporation X for $150. At a time when the indexed basis to the partnership for the stock is $240, the partnership sells the stock for $300. Under the bill, the partnership recognizes $60 gain. Each partner takes into account $20 gain and increases his basis in his partnership interest by the $20 gain (under present law sec. 705). In addition, under the bill, each partner increases his basis for purposes of determining gain on his partnership interest by $30 (his share of the $90 indexing adjustment made by the partnership). Thus, if any partner sells his partnership interest for $100, no gain or loss is recognized to the partner.

Example 3.—Same facts as in Example 2, except that the partnership does not sell the stock. Rather, partner A sells his partnership interest to D for $100. The partnership does not have an election under section 754 in effect. Partner A recognizes $50 of gain. Partner D's basis in the partnership is the $100 purchase price. Assume that after the sale by A, the partnership sells the stock for $300 (at a time when the indexed basis is $240). The partnership recognizes $60 of gain and each partner takes into account $20 gain and makes the same adjustments as in the above example. If partner D then sold his partnership interest for $100, he will recognize a loss of $20 ($100 amount realized less adjusted basis for purposes of determining loss of $120).

Example 4.—Same facts as in Example 3, except that the partnership has an election under section 754 in effect. When A sells his partnership interest to D, A recognizes $20 of gain, because under the bill, A's share of the partnership indexing adjustment is available to A at that time. Upon the sale of the stock by the partnership, D recognizes no gain or loss since the adjustment under section 743(b) had been made with respect to his share of the partnership properties. No adjustment is made by D to the basis in his partnership interest as a result of the sale by the partnership.

Foreign corporations

Stock of a foreign corporation is generally not an indexed asset. This exception is included to prevent investors from placing nonindexed assets in a foreign corporation (which is generally not subject to United States tax) and, in effect receiving an inflation adjustment for those assets by selling their stock in the foreign corporation at a later date. However, an exception is made in the case of stock of a foreign corporation traded on an established domestic securities market, because there is little potential for the shareholders to transfer nonindexed assets to the corporation to obtain the adjustment. This exception does not apply to passive foreign corporations, which may hold substantial debt, or to stock held by persons subject to possible dividend treatment on the sale of their stock.

Other rules

Short sales

The bill provides that in the case of a short sale of an indexed asset with a short sale period in excess of one year, the amount realized is indexed for inflation in the same manner that the basis would be indexed to the holder of the property. If the taxpayer (or taxpayer's spouse) sells short substantially identical property to an asset held by the taxpayer (i.e., sells short "against the box") no indexing adjustments are allowed during the short sale period.

Investment interest limitation

The bill provides that gains and losses from the disposition of indexed assets are not taken into account as investment income in computing the limitation on the deductibility of investment interest. This rule is added to account for the fact that interest deductions are allowed in full, without an indexing adjustment. A taxpayer may elect to not index the basis of an asset and to treat the gain as investment income.

Depreciation recapture

Under the bill, a special rule applies with respect to gain on the disposition of section 1250 property (depreciable real property) eligible for indexing that is realized by any taxpayer other than a corporation or by an S corporation, RIC or REIT. Such gain is taxed as ordinary income to the extent of all previous depreciation allowances with respect to the property (as opposed to recapturing only the excess of accelerated depreciation over straight-line depreciation, as under present law). The bill does not change the installment sale treatment of recapture income in the case of section 1250 property (under sec. 453(i)).

Effective date

The provisions apply to dispositions of property the holding period of which begins on or after February 1, 1992.

The provisions do not apply to property acquired on or after February 1, 1992, from a related party (as defined in section 465(b)(3)(C)) at less than fair market value if the provisions did not apply to the property immediately before the acquisition.

A taxpayer holding any readily tradable security on February 1, 1992, may elect to treat such security as having been sold on the last business day before such date for an amount equal to its closing market price, and as having been reacquired for an amount equal to such closing price. If the election is made, the security would be eligible for indexing under the provision. Any gain resulting from the election is treated as received on the date of the deemed sale, and any loss is not allowed. An election may be made with respect to some securities and not others. For these purposes, the term "readily tradable" means readily tradable on an established securities market or otherwise.

Senate amendment

Progressive rates

Under the Senate amendment, the present law maximum 28 percent marginal rate is repealed and replaced with a new progressive rate system. The progressive rates apply to a noncorporate taxpayer's qualified capital gain.[6]

In general, the amendment imposes a capital gain marginal tax rate of 5, 19, 23, or 28 percent, depending on the individual's taxable income. The applicable capital gain tax rate is determined by first taking into account taxable income computed without regard to qualified capital gain. Qualified capital gain then is added to such amount. The portion of qualified capital gain otherwise taxed at a 15-percent rate is taxed at a rate of 5 percent; the portion otherwise taxed at a 28-percent rate is taxed at a rate of 19 percent; the portion otherwise taxed at a 31-percent rate is taxed at a rate of 23 percent; and the portion otherwise taxed at the 36-percent rate [7] is taxed at a rate of 28 percent.

The regular tax rates and the progressive capital gain rates for 1992 for married individuals filing a joint return are set forth below as an illustration of the new rates:

Regular tax schedule

Taxable income	*Tax liability*
0–$35,800	15%.
35,800–86,500	$5,370 plus 28% of the excess over 35,800.
86,500–175,000	$19,566 plus 31% of the excess over 86,500.
175,000 and over	$47,001 plus 36% of the excess over 175,000.

Progressive capital gain tax schedule

Taxable income	*Tax liability*
0–$35,800	5%.
35,800–86,500	$1,790 plus 19% of the excess over 35,800.
86,500–175,000	$11,423 plus 23% of the excess over 86,500.
175,000 and over	$31,778 plus 28% of the excess over 175,000.

The following examples illustrate the progressive capital gain rates (using the rate schedules set forth above). Gain from the sale or other disposition of property is the excess of the amount realized (generally, the sales price) over the taxpayer's adjusted basis (generally, the cost) in the property.

Example 1.—A has $35,000 of ordinary income, $5,000 of qualified capital gain, and deductions, adjustments and personal exemptions of $15,000. Under present law, the $5,000 of net capital gain is taxed at 15 percent, for a tax of $750.

Under the Senate amendment, the $5,000 of qualified capital gain is taxed at five percent, for a tax of $250.

[6] Qualified capital gain is the net capital gain determined without regard to any gain taken into account in computing the 50-percent exclusion of gain from the sale of certain small business stock (as added by section 2311 of the Senate amendment).

[7] Another provision of the Senate amendment increases the maximum marginal rate on ordinary income to 36 percent.

Example 2.—B has $40,000 of ordinary income, $150,000 of qualified capital gain, and deductions, adjustments and personal exemptions of $20,000. Under present law, the first $15,800 of net capital gain is taxed at 15 percent, and the remaining $134,200 is taxed at 28 percent, for a total tax on net capital gain of $39,946.

Under the Senate amendment, the first $15,800 of qualified capital gain is taxed at five percent, the next $50,700 is taxed at 19 percent, and the remaining $83,500 is taxed at 23 percent, for a total tax on qualified capital gain of $29,628.

Example 3.—C has $225,000 of ordinary income, $150,000 of qualified capital gain, and deductions, adjustments and personal exemptions of $50,000. Under present law, the $150,000 of gain is taxed at 28 percent, for a tax of $42,000.

Under the Senate amendment, the $150,000 of qualified capital gain is taxed at 28 percent, for a tax of $42,000, the same as under present law.

Example 4.—D has $150,000 of ordinary income, $50,000 of qualified capital gain, and deductions, adjustments and personal exemptions of $40,000. Under present law, the $50,000 of net capital gain is taxed at 28 percent, for a tax of $14,000.

Under the Senate amendment, the $50,000 of qualified capital gain is taxed at 23 percent, for a tax of $11,500.

Holding period

The Senate amendment lengthens the holding period defining long term capital gain or loss from "more than one year" to "more than two years."

Treatment of collectibles

Gain or loss from the sale or exchange of collectibles (as defined in section 408(m)) is treated as short-term gain or loss without regard to the actual holding period, for all purposes of the Code other than in determining the amount of the charitable deduction. Thus, gain from the sale or exchange of collectibles is not eligible for the progressive capital gain rates. Any gain from the sale or exchange of an interest in a partnership, S corporation or trust which is attributable to unrealized appreciation in the value of collectibles is treated as gain from the sale of a collectible.

Minimum tax

The entire amount of qualified capital gain is included in alternative minimum taxable income.

Depreciation recapture

Gain on the disposition of section 1250 property (depreciable real property) is taxed as ordinary income to the extent of all previous depreciation allowances with respect to the property, subject to a maximum marginal rate of 31 percent in the case of individuals. Thus, depreciation previously allowed with respect to such property under any method, straight-line or accelerated, is taken into account as ordinary income in the same manner as depreciation and amortization are recaptured under section 1245 (personal property), subject, however, to the 31-percent maximum marginal rate in the case of individuals. The amendment does not change the installment sale treatment of recapture income in the case of section 1250 property (under sec. 453(i)).

Effective date

The capital gain rate provision applies to taxable years ending after January 31, 1992. For a taxable year beginning on or before that date, the new rates apply to the lesser of (i) the net capital gain for the taxable year, or (ii) the net capital gain determined by taking into account only gain or loss properly taken into account (including installment payments received) for the portion of the year after January 31, 1992. The excess, if any, of the amount described in (i) over the amount described in (ii), is taxed at a maximum rate of 28 percent as under present law. In determining when gain is taken into account in the case of a pass-through entity (i.e., a regulated investment company, a REIT, an S corporation, a partnership, an estate or trust, or a common trust fund), the date taken into account by the entity is the appropriate date. Thus, for example, if a fiscal year partnership sells a qualified capital asset on November 1, 1991, the gain from which partners take into account for the calendar year 1992, the gain will not qualify for the progressive capital gain rates.

The provisions relating to collectibles and depreciation recapture apply to dispositions after January 31, 1992.

The holding period provision applies to taxable years beginning after December 31, 1992.

Conference agreement

The conference agreement generally follows the Senate amendment, with the following modifications: (1) the new capital gain marginal tax rates are zero, 14, 21 and 28 percent; and (2) the maximum marginal rate on depreciation recapture in the case of individuals is 28 percent.

2. SMALL BUSINESS STOCK

Present law

Under present law, ordinary income of an individual is taxed at a maximum marginal rate of 31 percent. Net capital gain of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent. For corporations, the maximum rate on net capital gain is the same as the maximum rate on ordinary income, i.e., 34 percent.

Net capital gain is the excess of net long-term capital gain for the taxable year over net short-term capital loss for that year. Gain or loss from the sale or exchange of a capital asset is treated as long term if the asset is held for more than one year.

The Tax Reform Act of 1986 repealed a provision allowing a noncorporate taxpayer a deduction for 60 percent of its net capital gain for the taxable year. Also under prior law, corporations were subject to an alternative tax of 28 percent on net capital gain.

House bill

In general

The House bill generally provides taxpayers other than C corporations with a capital gains exclusion with respect to dispositions of qualified small business stock. Such taxpayers who hold qualified small business stock for more than five years can exclude 50 percent of their gain from the sale or exchange of such stock.[8]

Qualified small business stock

In order to qualify as small business stock, the following requirements must be met.

Eligible corporation

The stock generally is any stock (such as common and preferred stock) in a domestic C or S corporation. Such a corporation does not include a corporation predominantly engaged in a disqualified business. Such a business means any farming business, any business involving the production or extraction of products for which percentage depletion allowances are allowable, any business of operating a hotel, motel, restaurant or similar property, or any banking, insurance, financing or similar business. In addition, an eligible corporation does not include a corporation with more than 10 percent of its assets in portfolio stock investments [9] or real property not used in an active business,[10] a corporation the principal activity of which is the performance of personal services, a DISC, a 936 company, a regulated investment company, a real estate investment trust, a REMIC, or any cooperative.

A corporation must constitute an eligible corporation as of the date of issuance and during substantially all of the period that the taxpayer holds the stock.

Active business

The corporation must be engaged in the active conduct of a trade or business and substantially all of its assets must be used in the active conduct of a trade or business, as of the date of issuance and during substantially all of the period that the taxpayer holds the stock. If in connection with any future trade or business, a corporation is engaged in certain start-up activities, research and experimental expenditures or in-house research expenses, the corporation is treated as satisfying the active business requirement with respect to such activities.

[8] For purposes of determining the amount of gain eligible for the exclusion, no reduction is to be made for any capital loss, whether from disposition of small business stock or other asset. Also, any gain excluded under this provision is not to be taken into account in computing long-term capital gain as defined in section 1222(3) since the excluded portion of the gain is not taken into account in computing gross income. In addition, any excluded gain is not taken into account in applying the capital loss rules of sections 1211 and 1212. The taxable portion of the gain is taxed at a maximum marginal rate of 28 percent.

The basis of qualified small business stock eligible for indexing under another provision of the bill is indexed prior to determining the amount excluded under this provision.

[9] It is understood that a small business investment company operating under the Small Business Investment Act of 1958 generally would not qualify as an eligible corporation, either due to the restriction regarding portfolio stock investments, or due to the restriction regarding engaging in a financing or similar business.

[10] The ownership of, dealing in, or renting of real property is not treated as the active conduct of a trade or business.

Any assets held for investment that are to be used to finance future research and experimentation or working capital needs of the corporation are treated as used in the active conduct of a trade or business. In addition, certain rights to computer software are treated as an asset used in the conduct of a trade or business.

Gross assets

As of the date of issuance, the excess of (1) the amount of cash and the aggregate adjusted bases of other property held by the corporation, over (2) the aggregate amount of indebtedness of the corporation which does not have an original maturity of more than one year (such as short-term payables), cannot exceed $100 million. For these purposes, amounts received in the issuance are taken into account.

If a corporation satisfies the gross assets test as of the date of issuance but subsequently exceeds the $100 million threshold, stock that otherwise constitutes qualified small business stock would not lose such characterization solely as a result of such subsequent event. If a corporation (or a predecessor corporation) exceeds the $100 million threshold at any time on or after February 1, 1992, such corporation can never issue stock that would qualify for the exclusion.[11]

Original issue

The stock must be originally issued on or after February 1, 1992, and acquired by the taxpayer at such original issuance (directly or through an underwriter) in exchange for money, other property (not including stock) or as compensation for services (other than services performed as an underwriter of such stock).

In order to prevent the evasion of the requirement that the stock be newly issued, the exclusion does not apply if the issuing corporation purchases any of its stock either one year before or one year after the new issuance, unless the corporation has a business purpose for the redemption. For these purposes, purchases made by any corporation that is a member of the same affiliated group as the issuing corporation of any stock in any corporation that is a member of such group is treated as a purchase by the issuing corporation of its stock.

Subsidiaries of issuing corporation

In the case of a corporation that owns at least 50 percent of the vote or value of a subsidiary, the parent corporation is deemed to own its ratable share of the subsidiary's assets, to conduct its ratable share of the subsidiary's activities and to be liable for a ratable share of the subsidiary's indebtedness, for purposes of the "eligible corporation," "active business" and "gross assets" tests described above.

[11] The Secretary of the Treasury is authorized to prescribe regulations to carry out the purposes of the provision, including preventing the evasion of the gross assets test. Thus, for example, it is intended that a corporation that exceeds the threshold cannot split itself into smaller companies in an attempt to qualify new stock issued by such companies for the exclusion. It is also intended that if a corporation acquires substantially all the assets of a trade or business from another corporation that exceeds the threshold, stock in the acquiring corporation would not qualify for the exclusion.

Options, nonvested stock and convertible instruments

Stock acquired by the taxpayer through the exercise of options or warrants, or through the conversion of convertible debt, is treated as acquired at original issue. However, the determination whether the gross assets test is met is made at the time of exercise or conversion. In addition, the holding period of such stock is treated as beginning on the date of exercise or conversion.

In the case of convertible preferred stock, the gross assets determination is made at the time the convertible stock is issued, and the holding period of the convertible stock is added to that of the common stock acquired upon conversion.

Stock received in connection with the performance of services is treated as issued by the corporation and acquired by the taxpayer when included in the taxpayer's gross income in accordance with the rules of section 83.

Certain tax-free and other transfers

If qualified small business stock is transferred by gift or at death, the transferee is treated as having acquired the stock in the same manner as the transferor, and as having held the stock during any continuous period immediately preceding the transfer during which it was held by the transferor. Transferees in other cases are not eligible for the exclusion. Thus, for example, if qualified small business stock is transferred to a partnership or corporation and such entity disposes of the stock, any gain from the disposition will not be eligible for the exclusion.

In the case of certain incorporations and reorganizations where qualified small business stock is transferred for other stock, the transferor treats the stock received as qualified small business stock. The holding period of the original stock is added to that of the stock received. However, the amount of gain eligible for the exclusion is limited to the gain accrued as of the date of the incorporation or reorganization. In addition, in the case of certain other reorganization transactions (such as those described in sections 368(a)(1) (E) and (F)), the stock issued in exchange for qualified small business stock will be treated as qualified small business stock.

Special basis rules

If property (other than money or stock) is transferred to a corporation in exchange for its stock, the basis of the stock received is treated as equal to the fair market value of the property exchanged. Thus, only gains that accrue subsequent to the transfer are eligible for the exclusion.

For purposes of determining the amount of gain eligible for the exclusion, the adjusted basis of stock in an S corporation shall not be less than its adjusted basis determined without regard to the basis adjustments of section 1367.

Pass-through entities

Gain from the disposition of qualified small business stock by a partnership, S corporation, regulated investment company or common trust fund that is taken into account by a partner, shareholder or participant (other than a C corporation) is eligible for the exclusion, provided that (i) all eligibility requirements with respect to qualified small business stock are met, (ii) the stock was held by the entity for more than five years, and (iii) the partner, shareholder or participant held its interest in the entity beginning on the date the entity acquired the stock and at all times thereafter before the disposition of the stock.

Investment interest

The amount treated as investment income for purposes of the investment interest limitation does not include any gain excluded under the provision.

Minimum tax

The qualified small business capital gain exclusion is treated as a preference for purposes of the alternative minimum tax.

Effective date

The provision applies to stock issued on or after February 1, 1992.

Senate amendment

The Senate amendment generally is the same as the House bill, except for the following: (1) corporate shareholders are also eligible for the exclusion (other than a corporate shareholder that owned at any time more than 50 percent of the voting power or value of the stock of the corporation issuing the small business stock); (2) any gain eligible for the exclusion is not also eligible for the new progressive capital gains rate system under section 2311 of the Senate amendment (the result being that the taxable portion of the gain is taxed at ordinary income rates); (3) a disqualified farming business does not include the business of raising or harvesting trees; (4) a business involving the production or extraction of products for which percentage depletion allowances are allowable is not treated *per se* as disqualified; (5) a corporation is treated as a subsidiary only if the parent owns more than 50 percent (as opposed to 50 percent or more) of its stock; (6) certain transfers of qualified small business stock from a partnership to a partner or from a subsidiary corporation to its parent in complete liquidation, are allowed; and (7) a taxpayer's share of gain eligible for the exclusion from the disposition of qualified small business stock by a pass-through entity cannot exceed the amount that would be eligible if the determination were made by reference to the interest the taxpayer held in the entity on the date the stock was acquired by the entity.

Conference agreement

The conference agreement follows the Senate amendment, except that any business involving the production or extraction of products for which percentage depletion allowances are allowable is a disqualified business.

F. Real Estate Provisions

1. EXCLUSION OF GAIN ON THE SALE OF A PRINCIPAL RESIDENCE

Present law

In general, a taxpayer may elect to exclude from gross income up to $125,000 of gain from the sale of a principal residence if the taxpayer (1) has attained age 55 before the sale and (2) has owned and used the residence as a principal residence for three or more years of the five years preceding sale of the residence. Generally, farmland does not qualify under the definition of principal residence for purposes of the exclusion. The taxpayer may only make the election once in his or her lifetime.

House bill

The House bill makes three modifications to the one-time exclusion of gain from the sale of principal residence by individuals who have attained age 55.

First, the bill indexes the $125,000 exclusion amount for inflation. The inflation index is calculated in the same manner as provided in present law for determining the inflation index for purposes of adjusting the standard deduction, personal exemptions, and rate brackets.

Second, the bill repeals the age limit if the individual or the individual's spouse was permanently and totally disabled at the time of the sale.

Third, the exclusion is extended to include up to 160 contiguous acres of farmland on which the principal residence is located. Also, the exclusion only applies to farmland which has been actively farmed by the taxpayer or his family.[1]

Effective date.—Generally, the provision is effective for sales or exchanges after December 31, 1991. The $125,000 exclusion amount is indexed for sales or exchanges after December 31, 1991, for inflation occurring since 1990.

Senate amemdment

No provision.

Conference agreement

The conference agreement follows the House bill.

2. TAX CREDIT FOR FIRST-TIME HOMEBUYERS

Present law

There is no tax credit for the purchase of a principal residence under present law.

[1] For purposes of satisfying the active farming requirement, the taxpayer or a member of his family must materially participate in the farm operation. For these purposes, rules similar to those included in sec. 2032A(b)(1)(c)(ii) shall apply.

House bill

No provision.

Senate amendment

Under the Senate amendment, individuals who purchase a new principal residence are eligible to receive a tax credit equal to 10 percent of the purchase price of the residence, up to a maximum credit of $5,000. The credit applies to a new principal residence if the original use of the residence commences with the taxpayer and if the taxpayer (1) acquires such residence on or after February 1, 1992, and before January 1, 1994, or (2) enters into a binding contract to acquire the residence on or after February 1, 1992, and before January 1, 1994, and purchases the residence within 90 days of entering into that binding contract. Only one tax credit may be claimed per residence.

First-time homebuyers are defined as individuals who did not have a present interest in a residence in the 3 years preceding the purchase of a home. If an individual is deferring tax on gain from the sale of a previous principal residence and is permitted an extended rollover period, he or she is not considered a first-time homebuyer until after the end of the extended rollover period.

The first-time homebuyer credit is nonrefundable, and thus is available only to the extent the taxpayer had income tax liability to offset. However, any unused portion of the credit may be carried forward for up to 5 years and applied against future income tax liability.

The credit is recaptured if the residence on which the credit was claimed is sold or otherwise disposed of within 3 years of the date the residence was purchased. The recapture rule does not apply, however, to dispositions by reason of the taxpayer's death or divorce. If the taxpayer sells the residence within 3 years but purchases a new home within the rollover period, the credit is recaptured to the extent the amount of the credit that the taxpayer could have claimed under this section (had the new home been eligible for the credit) is less than the amount of credit claimed by the taxpayer on the purchase of the initial residence.

Effective date.—The provision is effective for purchases on or after February 1, 1992.

Conference agreement

The conference agreement does not include the Senate amendment.

3. MODIFICATION OF PASSIVE LOSS RULES FOR CERTAIN REAL ESTATE PERSONS

Present law

The passive loss rules limit deductions and credits from passive trade or business activities. Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income, such as wages, portfolio income, or business income that is not derived from a passive activity. Credits from passive activities may not reduce the taxpayer's tax liability, to the extent such credits exceed regular tax liability from passive activities. Deductions and credits that are suspended under these rules are carried forward and treated as deductions and credits from passive activities in the next year. The suspended losses from a passive activity are allowed in full when a taxpayer disposes of his entire interest in the passive activity to an unrelated person.

The passive loss rules apply to individuals, estates and trusts, closely held C corporations, and personal service corporations. A special rule permits closely held C corporations to apply passive activity losses and credits against active business income (or tax liability allocable thereto) but not against portfolio income.

Passive activities are defined to include trade or business activities in which the taxpayer does not materially participate. To materially participate in an activity, a taxpayer must be involved in the operations of the activity on a regular, continuous, and substantial basis. Except as provided in regulations, a taxpayer is treated as not materially participating in an activity held through a limited partnership interest.[1]

Rental activities (including rental real estate activities) are also treated as passive activities, regardless of the level of the taxpayer's participation. In general, rental activities cannot be treated as part of a larger activity that includes nonrental activities. A special rule permits the deduction of up to $25,000 of losses from rental real estate activities (even though they are considered passive), if the taxpayer actively participates in them. This $25,000 amount is allowed for taxpayers with adjusted gross incomes of $100,000 or less, and is phased out for taxpayers with adjusted gross incomes between $100,000 and $150,000. Active participation is a lesser standard of involvement than material participation. A taxpayer is treated as actively participating if, for example, he participates, in a significant and bona fide sense, in the making of management decisions or arranging for others to provide services (such as repairs). The active participation standard is not satisfied, however, if the taxpayer's interest is less than 10 percent (by value) of all interests in the activity. A taxpayer generally is deemed not to satisfy the active participation standard with respect to property he holds through a limited partnership interest.

If the taxpayer has suspended losses from a former passive activity (an activity that is not a passive activity for the current taxable year but was a passive activity for the taxable year in which the loss arose), the losses are offset against the income from such activity for the taxable year, and any excess after the offset continues to be treated as a loss from a passive activity.

[1] Treas. Reg. section 1.469-5T(e) provides exceptions to this general rule for limited partnership interests in certain circumstances, including the circumstance where an individual taxpayer is both a general and a limited partner, or where the taxpayer meets certain of the material participation tests (including the 500 hour test) applicable to persons other than limited partners.

House bill

The House bill changes the tax treatment of rental real estate under the passive loss rules in the case of an individual or closely held C corporation meeting the definition of a person engaged in the real property business. For such persons, the determination of what constitutes an activity and whether an activity is a passive activity generally is made by treating the taxpayer's rental real property operations, undertakings, and activities in the same manner as nonrental trade or business operations, undertakings, and activities.

An individual is deemed to be engaged in the real property business under the bill if the individual meets a 2-part test: (1) he spends at least 50 percent of his working time in real property operations; and (2) he spends more than 500 hours during the taxable year in real property operations. For this purpose, real property operations means any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, brokerage, appraisal, and finance operations. Working time means time spent working as an employee, sole proprietor, S corporation shareholder, partner in a partnership, or beneficiary of a trust or estate.

A closely held C corporation is deemed to be engaged in the real property business if it meets either of 2 tests. The first test is satisfied if one or more shareholders owning stock representing more than 50 percent (by value) of the outstanding stock of such corporation materially participate in the aggregate real property activities of the corporation. The second test is satisfied if, with respect to the corporation's aggregate real property activities, (1) during the entire 12-month period ending on the last day of the taxable year, it had at least one full-time employee substantially all of whose services were in the active management of such activities; (2) during the entire 12-month period ending on the last day of the taxable year, it had at least 3 full-time, nonowner employees substantially all of whose services were directly related to such activities; and (3) the amount of the deductions attributable to such activities that are allowable to the corporation solely by reason of sections 162 and 404 of the Code for the taxable year exceeds 15 percent of the gross income from such activities for the year.

The bill provides that 80 percent of the items of income, gain, loss deduction or credit allocable to a rental real property activity to which it applies shall be treated in the same manner as items from a nonrental trade or business activity. Twenty percent of the items allocable to a rental real property activity continue to be treated as from a passive activity and may be offset against items from other passive activities. In the case of a loss from a rental real property activity, if the 20 percent portion such loss exceeds the income from other passive activities in the current taxable year, the difference is carried forward as a suspended passive activity loss. The carried over loss may be offset against future income (including both income treated as passive and income treated as nonpassive under this provision of the bill [2]) from the rental real

[2] The order in which the loss is applied against different categories of income is to be determined in a manner consistent with present law.

property activity in which it arose. For this purpose, the holding and renting of each separate property is treated as a separate activity that may not be aggregated with other rental property or with any other real property operations of the taxpayer. For example, if a taxpayer owns three condominium apartments that he rents out, two in one building and one in another building, each apartment is treated as a separate activity for this purpose. When the taxpayer disposes of the activity (as so determined) in a fully taxable transaction with an unrelated party, any remaining suspended losses allocable to the activity (as so determined) are allowed in full.

The bill does not apply with respect to any real property originally placed in service (by the taxpayer or another person) after the date of enactment. Thus, for example, the bill does not apply to property constructed after the date of enactment. The Treasury Department is directed to provide guidance with respect to the determination of what constitutes property placed in service after the date of enactment.

The bill also does not apply with respect to any interest held as a limited partner. No inference is intended that an interest held as a limited partner generally is treated as nonpassive under present law.

A special rule applies with respect to suspended losses from any rental real property activity that is treated as not passive by reason of the provision. Such suspended losses generally are treated as losses from a former passive activity, but for this purpose, the holding and renting of each separate property is treated as a separate activity that may not be aggregated with other rental property or with any other real property operations of the taxpayer. When the taxpayer disposes of his entire interest in the activity (as so determined) in a fully taxable transaction with an unrelated party, any remaining suspended losses allocable to the activity (as so determined) are allowed in full.

Effective date.—The provision is effective with respect to taxable years beginning after December 31, 1991.

Senate amendment

The Senate amendment modifies the present-law passive loss rules to treat a taxpayer's performance of certain qualified real estate services and rental of certain qualified real property as a single activity. If the taxpayer materially participates in this activity, net losses from the rental of the qualified real property generally are allowed to the extent of a portion of the taxpayer's income.

In particular, losses from rental activities with respect to qualified real property are allowed to the extent of the sum of (1) income from such activities and (2) net income [3] from other passive activities. Losses in excess of this sum are allowed in an amount equal to 80 percent of the lesser of (1) the taxpayer's net income from activities consisting of the performance of qualified real estate services, or (2) the taxpayer's taxable income (determined

[3] This net income is to be determined after taking into account suspended losses, if any, from such other passive activities.

without regard to any item of income, gain, loss or deduction from rental activities with respect to qualified real property). Credits from rental activities with respect to qualified real property are allowed subject to a similar rule.

Qualified real estate services means services in the construction, substantial renovation, and management of real property or in the lease-up and sale of qualified real property in which the taxpayer owns more than a de minimis interest.[4] Services as an employee are not taken into account unless the taxpayer owns more than a de minimis interest in the employer.

Qualified real property means real property if during the taxable year the taxpayer actively participates in rental activities with respect to the property. Active participation has the same meaning as under present law, except that the taxpayer is required to have an interest in the property that is not de minimis, rather than to meet the 10 percent test of present law. Thus, as under present law, for determining active participation (as well as for determining material participation), except as provided in regulations,[5] no interest as a limited partner in a limited partnership shall be treated as an interest with respect to which the taxpayer actively (or materially) participates. Similarly, in determining whether a taxpayer actively (or materially) participates, the participation of the taxpayer's spouse is taken into account, and active participation is not required with respect to rehabilitation and low income housing credits.

The determination of whether an item is from the rental of qualified real property is made in the same manner as the determination of whether an item is from a rental real estate activity under present law. Thus, for example, gain or loss from sale or exchange of qualified real property generally is treated as from the rental of qualified real property.

Suspended passive activity losses and credits arising in a prior taxable year from the rental of property that is qualified real property in the current year are not treated as former passive activity losses and credits, but rather are treated in the same manner as losses and credits from the rental of qualified property.

The Senate amendment does not apply with respect to any real property originally placed in service (by the taxpayer or another person) after March 3, 1992. Property that is substantially renovated after that date is treated as originally placed in service after that date. Property is treated as substantially renovated after that date if, during any 24-month period beginning after that date, expenditures for renovation equal or exceed the adjusted basis of the property at the start of the 24-month period. Expenditures for ren-

[4] For example, an ownership interest is considered de minimis under the provision if it was acquired principally for the purpose of qualifying the taxpayer's activities as qualified real estate services, or if the taxpayer's interest is disproportionately small in relation to the value of the taxpayer's services with respect to the property. Ownership interests acquired through stock options, employee stock ownership plans, or other similar compensation arrangements, for example, are also considered de minimis.

[5] It is anticipated that any Treasury regulations setting forth circumstances in which a taxpayer may be treated as actively participating in a rental real property activity through a limited partnership interest (provided he otherwise actively participates) will include among such circumstances those in which the taxpayer performs significant qualified real estate services with respect to the real property, and those in which the taxpayer is a general partner in the partnership at all times he holds a limited partnership interest in the same partnership.

ovation are any expenditures that are added to the basis of the property. Thus, generally, if the renovation expenditures double the basis of the property within any 24-month period beginning after March 3, 1992, then the property is thereupon treated as having been placed in service after March 3, 1992.

The provision applies to taxpayers subject to the passive loss rule, other than closely held C corporations.

Effective date.—The provision is effective with respect to taxable years beginning after December 31, 1991.

Conference agreement

The conference agreement follows the Senate amendment, with the following modifications.

Under the conference agreement, qualified real estate services means services in the construction, substantial renovation, and management of real property or in the leasing and brokerage of real property provided the taxpayer spends more than 500 hours during the taxable year performing such leasing or brokerage services. Services as an employee are not taken into account unless the taxpayer owns more than a de minimis interest (within the meaning of the Senate amendment) in the employer, except in the case of services consisting of leasing and brokerage of real property. Thus, under the conference agreement, the services that determine taxpayer eligibility for the provision, and the income that may be offset under the provision, are modified by the change in the definition of qualified real estate services.

The conference agreement modifies the Senate amendment to provide that the provision does not apply with respect to any real property originally placed in service (by the taxpayer or another person) after the date of enactment, but retains the Senate amendment rule that property that is substantially renovated after that date is treated as originally placed in service after that date.

The conference agreement also provides several technical modifications and clarifications. For purposes of the 80 percent limitation on income that rental activity losses or credits may offset, the conference agreement clarifies that taxable income is determined without regard to any loss allowable by reason of the provision, without regard to items of income, gain, loss, or deduction from rental of qualified real property or from passive activities to which the provision does not apply, and without regard to any net income from passive activities to which the provision does not apply. Suspended passive activity losses and credits arising in a prior taxable year from the rental of property that is qualified real property in the current year are not treated as former passive activity losses and credits, but rather are carried forward to the next taxable year and treated in the same manner as losses and credits from the rental of qualified property. The conference agreement also provides that modified adjusted gross income is determined without regard to any loss allowable by reason of this provision, for purposes of the present-law $25,000 allowance of losses and deduction-equivalent credits from certain rental activities.

4. CHANGES RELATING TO REAL ESTATE INVESTMENTS BY PENSION FUNDS AND OTHERS

a. Modification of the rules related to debt-finance income

Present law

In general, a qualified pension trust or an organization that is otherwise exempt from Federal income tax is taxed on any income from a trade or business that is unrelated to the organization's exempt purposes (Unrelated Business Taxable Income or "UBTI") (sec. 511). Certain types of income, including rents, royalties, dividends, and interest are excluded from UBTI, except when such income is derived from "debt-financed property." Income from debt-financed property generally is treated as UBTI in proportion to the amount of debt financing (sec. 514(a)).

An exception to the rule treating income from debt-financed property as UBTI is available to pension trusts, educational institutions, and certain other exempt organizations (collectively referred to as "qualified organizations") that make debt-financed investments in real property (sec. 514(c)(9)(A)). Under this exception, income from investments in real property is not treated as income from debt-financed property. Mortgages are not considered real property for purposes of the exception.

The real property exception to the debt-financed property rules is available for investments in debt-financed property, only if the following six restrictions are satisfied: (1) the purchase price of the real property is a fixed amount determined as of the date of the acquisition (the "fixed price restriction"); (2) the amount of the indebtedness or any amount payable with respect to the indebtedness, or the time for making any payment of any such amount, is not dependent (in whole or in part) upon revenues, income, or profits derived from the property (the "participating loan restriction"); (3) the property is not leased by the qualified organization to the seller or to a person related to the seller (the "leaseback restriction"); (4) in the case of a pension trust, the seller or lessee of the property is not a disqualified person (the "disqualified person restriction"); (5) the seller or a person related to the seller (or a person related to the plan with respect to which a pension trust was formed) is not providing financing in connection with the acquisition of the property (the "seller-financing restriction"); and (6) if the investment in the property is held through a partnership, certain additional requirements are satisfied by the partnership (the "partnership restrictions") (sec. 514(c)(9)(B)(i) through (vi)).

House bill

Relaxation of the leaseback and disqualified person restrictions

The House bill relaxes the leaseback and disqualified person restrictions to permit a de minimis leaseback of debt-financed real property to the seller (or a person related to the seller) or to a disqualified person.[1] The de minimis exception applies only where (1)

[1] As under present law, a leaseback to a disqualified person remains subject to the prohibited transaction rules set forth in section 4975.

no more than 10 percent of the leasable floor space in a building is leased back to the seller (or related party) or to the disqualified person, and (2) the lease is on commercially reasonable terms.

Relaxation of the seller-financing restriction

The bill relaxes the seller-financing restriction to permit seller financing on terms that are commercially reasonable. The bill grants authority to the Treasury Department to issue regulations for the purpose of determining commercially reasonable financing terms.

The bill does not modify the present-law fixed price and participating loan restrictions. Thus, for example, income from real property acquired with financing where the timing or amount of payment is based on revenue, income, or profits from the property generally will continue to be treated as income from debt-financed property, unless some other exception applies.

Relaxation of the fixed price and participating loan restriction for property foreclosed on by financial institutions

The bill relaxes the fixed price and participating loan restrictions for certain sales of real property foreclosed upon by financial institutions.[2] The relaxation of these rules is limited to cases where: (1) a qualified organization acquires the property from a financial institution that acquired the real property by foreclosure (or after an actual or imminent default); (2) the property is not a capital asset of the financial institution; (3) the stated principal amount of the seller financing does not exceed the financial institution's outstanding indebtedness (including accrued but unpaid interest) with respect to the property at the time of foreclosure; and (4) the value of any participation feature at the time of sale does not exceed 25 percent of the value of the property.

The bill grants authority to the Treasury Department to issue regulations for the purpose of clarifying these limitations. In particular, these regulations are expected to establish standards for determining what constitutes a participation feature and how to determine whether the value of a participation feature at the time of sale exceeds 25 percent of the value of the property. For example, a participation feature that provides the seller with less than a 25 percent interest in net proceeds, net income, or gain on sale of the property is expected to be valued at less than 25 percent of the value of the property.

Elimination of the section 514(c)(9)(B) restrictions for investments through certain large partnerships

The bill eliminates the six section 514(c)(9)(B) restrictions for qualified organizations that invest in real property through certain "large" partnerships.

A "large" partnership is a partnership having at least 250 partners that satisfies the following three tests: (1) interests in the partnership are registered with the Securities and Exchange Commission; (2) a significant percentage (at least 50 percent) of each class of interests is owned by taxable individuals; and (3) a principal pur-

[2] For this purpose, financial institutions include financial institutions in conservatorship or receivership and certain affiliates of financial institutions.

pose of the partnership allocations is not tax avoidance. Partnership interests that are subject to the same terms are considered to be in the same class, regardless of whether the interests are subject to different ownership restrictions (a partnership can therefore monitor the 50-percent ownership restriction by requiring that designated interests be held only by taxable persons).

Effective date

The provision is effective for debt-financed acquisitions of real estate on or after February 1, 1992, and for partnership interests acquired on or after February 1, 1992.

Senate amendment

The Senate amendment is the same as the House bill, except that (1) the de minimis leaseback may be no more than 20% of leasable space, (2) seller financing that is on terms that include a down payment of at least 15 percent of the sales price and an interest rate of at least 150 percent of the applicable Federal rate is deemed to be commercially reasonable, and (3) mortgages are treated as real property for purposes of section 514(c)(9) under the following conditions: (a) the mortgages have been acquired from a financial institution that is in conservatorship or receivership, (b) the mortgages have been acquired with a cash down payment of at least 50 percent of the sales price (i.e., the acquisition indebtedness is less than 50 percent of the price of the mortgages), (c) the mortgages are not debt-financed property except on account of acquisition indebtedness that is granted by the seller, and (d) the mortgages are acquired prior to January 1, 1994. Mortgages are eligible for treatment as real property for two-and-a-half years after they are acquired by the tax-exempt purchaser.

Conference agreement

The conference agreement follows the House bill with the following modifications: (1) the de minimis leaseback may be no more than 20% of leasable space, (2) the value of a participation feature at the time of sale cannot exceed 30% of the value of property, (3) the property eligible for the relaxation of the fixed price and participating loan restrictions is expanded to include all real property owned by a financial institution at the time that it goes into conservatorship or receivership.[3]

b. Repeal of the automatic UBTI rule for publicly-traded partnerships

Present law

In general, the character of a partner's distributive share of partnership income is the same as if the income had been directly realized by the partner. Thus, whether a tax-exempt organization's share of income from a partnership (other than from a publicly-

[3] The definition of financial institution is modified to include those subsidiaries of financial institution that, by virtue of being affiliated with a financial institution, are subject to supervision and examination by a Federal or State financial regulatory agency.

traded partnership) is treated as unrelated business income depends on the underlying character of the income (sec. 512(c)(1)). However, a tax-exempt organization's distributive share of gross income from a publicly-traded partnership (that is not otherwise treated as a corporation) automatically is treated as UBTI (sec. 512(c)(2)(A)). The organization's share of the partnership deductions is allowed in computing the organization's taxable unrelated business income (sec. 512(c)(2)(B)).

House bill

The House bill repeals the rule that automatically treats income from publicly-traded partnerships as UBTI. Thus, under the provision, investments in publicly-traded partnerships are treated the same as investments in other partnerships for purposes of the UBTI rules.

Effective date.—The provision is effective for partnership interests acquired on or after February 1, 1992.

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. Permit title-holding companies to receive small amounts of UBTI

Present law

Section 501(c)(2) provides tax-exempt status to certain corporations organized for the exclusive purpose of holding title to property and turning over any income from the property to one or more related tax-exempt organizations. Section 501(c)(25) provides tax-exempt status to certain corporations and trusts that are organized for the exclusive purposes of acquiring and holding title to real property, collecting income from such property, and remitting the income therefrom to no more than 35 shareholders or beneficiaries that are: (1) qualified pension, profit-sharing, or stock bonus plans (sec. 401(a)); (2) governmental pension plans (sec. 414(d)); (3) the United States, a State or political subdivision, or governmental agencies or instrumentalities; or (4) tax-exempt charitable, educational, religious, or other organizations described in section 501(c)(3). However, the IRS has taken the position that a title-holding company described in section 501(c)(2) or 501(c)(25) will lose its tax-exempt status if it generates any amount of UBTI.[4]

House bill

The House bill permits a title-holding company that is exempt from tax under sections 501(c)(2) or 501(c)(25) to receive UBTI up to 10 percent of its gross income for the taxable year, provided that the UBTI is incidentally derived from the holding of real property.

[4] IRS Notice 88-121, 1988-2 C.B. 457. See also Treas. Reg. sec. 1.501(c)(2)-1(a).

For example, income generated from parking or operating vending machines located on real property owned by a title-holding company generally would qualify for the 10-percent de minimis rule, while income derived from an activity that is not incidental to the holding of real property (e.g., manufacturing) would not qualify. In cases where unrelated income is incidentally derived from the holding of real property, receipt by a title-holding company of such income (up to the 10-percent limit) will not jeopardize the title-holding company's tax-exempt status, but nonetheless, will be subject to tax as UBTI.

In addition, the bill provides that a section 501(c)(2) or 501(c)(25) title-holding company will not lose its tax-exempt status if UBTI that is incidentally derived from the holding of real property exceeds the 10-percent limitation, provided that the title-holding company establishes to the satisfaction of the Secretary of the Treasury that the receipt of UBTI in excess of the 10-percent limitation was inadvertent and reasonable steps are being taken to correct the circumstances giving rise to such excess UBTI.

Effective date.—The provision is effective for taxable years beginning after December 31, 1991.

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. Exclusion from UBTI any gains from the disposition of property acquired from financial institutions in conservatorships or receiverships

Present law

In general, gains or losses from the sale, exchange or other disposition of property are excluded from UBTI (sec. 512(b)(5)). However, gains or losses from the sale, exchange or other disposition of property held primarily for sale to customers in the ordinary course of a trade or business are not excluded from UBTI (the "dealer UBTI rule") (sec. 512(b)(5)(B)).

House bill

The House bill provides an exception to the dealer UBTI rule by excluding gains from the sale, exchange or other disposition of real property acquired from financial institutions that are in conservatorship or receivership. The exclusion is limited to properties designated as disposal property within six months of acquisition, and disposed of within two-and-a-half years of acquisition. The exclusion is not available for properties that are substantially improved or renovated after acquisition and before disposition.

Effective date.—The provision is effective for property acquired after February 1, 1992.

Senate amendment

The Senate amendment is the same as the House bill, except that the exception applies both to real property and to mortgages acquired from financial institutions that are in conservatorship or receivership. In addition, the Senate amendment provides that the two-and-a-half-year disposition period may be extended by the Treasury Secretary if an extension is necessary for the orderly liquidation of the property.

Conference agreement

The conference agreement follows the Senate amendment with the following modifications: (1) property cannot be developed in any significant manner and be eligible for the exception (thus, for example, property that is developed by the securing of zoning permits is not eligible for the exception); (2) property must be owned by a financial institution (or be security for a loan extended by the financial institution) at the time that the institution entered conservatorship or receivership to be eligible for the exception; and (3) no more than one-third by value of properties acquired in a single transaction may be designated as disposal property.

e. *Exclusion of loan commitment fees and certain option premiums from UBTI*

Present law

Income from a trade or business that is unrelated to an exempt organization's purpose generally is UBTI. Passive income such as dividends, interest, royalties, and gains or losses from the sale, exchange or other disposition of property generally is excluded from UBTI (sec. 512(b)). In addition, gains on the lapse or termination of options on securities are explicitly exempted from UBTI (sec. 512(b)(5)).

Present law is unclear on whether loan commitment fees and premiums from unexercised options on real estate are UBTI.

House bill

No provision.

Senate amendment

The Senate amendment provides that loan commitment fees and premiums from unexercised options on real estate are excluded from UBTI. For purposes of this provision, loan commitment fees are non-refundable charges made by a lender to reserve a sum of money with fixed terms for a specified period of time. These charges are to compensate the lender for the risk inherent in committing to make the loan (e.g., for the lender's exposure to interest rate changes and for potential lost opportunities).

Effective date.—The provision is effective for premiums or loan commitment fees that are received after February 1, 1992.

Conference agreement

The conference agreement follows the Senate amendment.

f. Exclusion of certain hotel rental income from UBTI

Present law

Rents from real property generally are excluded from UBTI unless the rents are measured by reference to the net income derived by any person from the leased property (sec. 512(b)(3)). Payments for the use or occupancy of rooms and other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, do not constitute rents from real property (Treas. Reg. sec. 1.512(b)–1(c)(5)).

House bill

No provision.

Senate amendment

The Senate amendment excludes from UBTI any hotel rental income when (1) the hotel has been acquired from a financial institution in receivership or conservatorship, (2) the hotel has been designated as disposal property within six months of acquisition, and (3) the hotel either is disposed within two-and-a-half years of acquisition or, after two-and-a-half years, any related services are rendered by an independent contractor pursuant to a contract that does not permit the exempt organization to share any of the income of the independent contractor.

Effective date.—The provision is effective for hotels acquired after February 1, 1992.

Conference agreement

The conference agreement does not include the Senate amendment.

g. Relaxation of limitations on investments in real estate investment trusts by pension funds

Present law

A real estate investment trust ("REIT") is not taxed on income distributed to shareholders. A corporation does not qualify as a REIT if at any time during the last half of its taxable year more than 50 percent in value of its outstanding stock is owned, directly or indirectly, by five or fewer individuals ("the five or fewer rule"). A domestic pension trust is treated as a single individual for purposes of this rule.

Dividends paid by a REIT are not UBTI,[5] unless the stock in the REIT is debt-financed. Depending on its character, income earned by a partnership may be UBTI (sec. 512(c)). Special rules treat debt-financed income earned by a partnership as UBTI (sec. 514(c)(9)(B)(vi)).

[5] See Rev. Rul. 66–151, 1966–1 C.B. 151.

House bill

Qualification as a REIT

The House bill provides that a pension trust generally is not treated as a single individual for purposes of the five-or-fewer rule. Rather, the House bill treats beneficiaries of the pension trust as holding stock in the REIT in proportion to their actuarial interests in the trust. This rule does not apply if disqualified persons, within the meaning of section 4975(e)(2), together own five percent or more of the value of the REIT stock and the REIT has earnings and profits attributable to a period during which it did not qualify as a REIT.[6]

In addition, the House bill provides that a REIT cannot be a personal holding company and, therefore, is not subject to the personal holding company tax on its undistributed income.

Unrelated business taxable income

Under the House bill, certain pension trusts owning 10 percent or more of the value of a REIT determine their UBTI as if the REIT were a partnership (the "UBTI rule").

The UBTI rule applies only if the REIT qualifies as a REIT by reason of the above modification of the five or fewer rule. Moreover, the UBTI rule applies only if (1) stock in the REIT is not readily tradable on an established securities market (the REIT is "privately-traded"), (2) at least one pension trust owns more than 25 percent of the value of the REIT, or (3) a group of pension trusts individually holding at least 10 percent of the value of the REIT collectively own more than 50 percent of the value of the REIT.

Effective date

The House bill applies to taxable years beginning after December 31, 1991.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill, with the following modifications. First, the conference agreement eliminates the distinction between privately-traded and publicly-traded REITs. Dividends from a privately-traded REIT give rise to UBTI in the same circumstances as would dividends from a publicly-traded REIT. Thus, dividends from a privately-traded REIT give rise to UBTI only if (1) one pension trust owns more than 25 percent of the value of the REIT, or (2) a group of pension trusts individually holding more than 10 percent of the value of the REIT collectively own more than 50 percent of the value of the REIT.

Second, the conference agreement modifies the determination of UBTI received by a pension trust from its investment in a REIT.

[6] Moreover, as under present law, any investment by a pension trust must be in accordance with the fiduciary rules of the Employee Retirement Security Act ("ERISA") and the prohibited transaction rules of the Code and ERISA.

Under the agreement, UBTI is not determined as if the REIT were a partnership; rather, the pension trust treats a percentage of dividends from the REIT as UBTI. This percentage is the gross income derived from an unrelated trade or business (determined as if the REIT were a pension trust) divided by the gross income of the REIT for the year in which the dividends are paid. Dividends are not treated as UBTI, however, unless this percentage is at least five percent.

Third, the conference agreement raises the threshold that triggers the UBTI from 10 percent to more than 10 percent. Accordingly, only pension trusts owning more than 10 percent of the REIT would receive UBTI and the determination of 50 percent collective ownership is made only by reference to trusts owning more than 10 percent of the REIT.

Fourth, the conference agreement modifies the definition of disqualified person contained in the House bill. Under this modification, a disqualified person does not include a person providing services to the relevant pension plan or a 10 percent or more partner of a disqualified person.

5. INCREASE RECOVERY PERIOD FOR DEPRECIATION OF REAL PROPERTY

Present law

In general

A taxpayer is allowed to recover, through annual depreciation allowances, the cost or other basis of real property (other than land) that is used in a trade or business or that is held for the production of rental income.

Residential rental property

For regular tax purposes, the amount of the depreciation deduction allowed with respect to residential rental property for any taxable year generally is determined using the straight-line method and a recovery period of 27.5 years. For alternative minimum tax purposes, the amount of the depreciation deduction allowed with respect to residential rental property for any taxable year is determined using the straight-line method and a recovery period of 40 years. Residential rental property is defined as any building or structure if 80 percent or more of the gross rental income from the building or structure for the taxable year is rental income from dwelling units. For this purpose, a dwelling unit does not include a unit in a hotel, motel, or other establishment more than one-half of the units in which are used on a transient basis.

Nonresidential real property

For regular tax purposes, the amount of the depreciation deduction allowed with respect to nonresidential real property for any taxable year generally is determined using the straight-line method and a recovery period of 31.5 years. For alternative minimum tax purposes, the amount of the depreciation deduction allowed with respect to nonresidential real property for any taxable year is determined using the straight-line method and a recovery period of

40 years. Nonresidential real property is generally defined as any real property that is not residential rental property.

House bill

The House bill requires the depreciation deduction for residential rental property (other than property with respect to which the low-income housing credit of section 42 of the Code is allowable) to be determined by using a recovery period of 31 years.[1] In addition, the House bill requires the depreciation deduction for nonresidential real property to be determined by using a recovery period of 40 years. The House bill does not change the determination of the depreciation allowances for alternative minimum tax purposes.

Effective date.—The provision of the House bill relating to real property depreciation generally applies to property placed in service after February 12, 1992. The provision does not apply to property that is placed in service by a taxpayer before January 1, 1995, if: (1) the taxpayer or a qualified person entered into a binding written contract to purchase or construct the property before February 13, 1992; or (2) construction of the property was commenced by or for the taxpayer or a qualified person before February 13, 1992. For this purpose, a qualified person is defined as any person who transfers his or her rights in such a contract or in the property to the taxpayer, but only if the property is not placed in service by such person before such rights are transferred to the taxpayer.

Senate amendment

The Senate amendment is the same as the House bill, except that the Senate amendment does not change the recovery period for residential rental property.

Conference agreement

The conference agreement follows the House bill.

6. EXTENSION OF THE LOW-INCOME HOUSING TAX CREDIT

a. Extension of credit

Present law

A tax credit is allowed in annual installments over ten years for qualifying newly constructed or substantially rehabilitated low-income rental housing. The credit is scheduled to expire after June 30, 1992.

House bill

The House bill permanently extends the low-income housing credit.

[1] In the case of property with respect to which the low-income housing credit is allowable, the depreciation deduction is to continue to be determined using the present-law recovery period of 27.5 years.

Senate amendment

The Senate amendment extends the credit for 18 months (through December 31, 1993).

Conference agreement

The conference agreement follows the House bill.

b. Maximum rent

Present law

The maximum rent that may be charged a family in a low-income housing credit unit depends on the number of bedrooms in that unit. Prior to 1990, maximum rent was determined on the actual family size of the occupants.

House bill

The House bill allows an irrevocable election by the owner of a building placed-in-service before 1990 to use either apartment size or family size in determining maximum allowable rent. This election must be made within 180 days after the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

c. Community service areas

Present law

The basis on which the low-income housing credit is computed is determined as a percentage of the eligible basis of a qualified low-income building that is attributable to low-income rental units.

House bill

No provision.

Senate amendment

The Senate amendment provides that community service buildings in projects in qualified census tracts are included in eligible basis as functionally related and subordinate facilities if (a) the size of the facilities is commensurate with tenant needs, (b) the use of the facilities is predominantly (although not exclusively) by tenants and employees of the project owner, and (c) no more than 20 percent of the housing project's eligible basis is attributable to such facilities.

Conference agreement

The conference agreement follows the Senate amendment.

d. Limit on eligible basis

Present law

There is no per-housing unit limitation on the amount of eligible basis.

House bill

No provision.

Senate amendment

The maximum eligible basis of each unit in a credit project is limited to $124,875 (indexed for inflation). In high-cost areas, this maximum basis amount can be increased to 130 percent of the otherwise allowable maximum amount.

Conference agreement

The conference agreement follows the Senate amendment.

e. Ten-year anti-churning rule

Present law

The low-income housing credit is not allowed with respect to buildings that have been previously placed in service within ten years of placement in service for credit purposes. Waivers from the ten-year rule may be granted by the Treasury Department under certain circumstances (e.g., certain buildings which are substantially assisted, financed, or operated under section 221(d)(3) of the National Housing Act).

House bill

No provision.

Senate amendment

The Senate amendment authorizes the Treasury Department to grant waivers from the credit's ten-year anti-churning rule for certain projects substantially assisted, financed, or operated under section 221(d)(4) of the National Housing Act.

Conference agreement

The conference agreement follows the Senate amendment.

f. Minimum set-aside rule: De minimis errors

Present law

Under the general low-income tenant occupancy requirement, a residential rental project qualifies for the tax credit only if at least: (1) 20 percent or more of the aggregate residential rental units in the project are occupied by individuals with incomes of 50 percent or less of area median income or (2) 40 percent or more of the aggregate residential rental units in the project are occupied by individuals with incomes of 60 percent or less of area median income.

House bill

No provision.

Senate amendment

The Senate amendment authorizes the Treasury Department to provide a waiver of penalties for de minimis errors in the application of the low-income tenant occupancy requirement.

Conference agreement

The conference agreement follows the Senate amendment.

g. Minimum set-aside rule: annual recertification

Present law

Generally, tenant incomes must be annually recertified to meet the low-income tenant occupancy requirements regardless of whether the building is entirely devoted to low-income tenants.

House bill

No provision.

Senate amendment

The Senate amendment authorizes the Treasury Department to grant a waiver from the annual recertification of tenant income for tenants in buildings, if the buildings are devoted entirely to low-income tenants.

Conference agreement

The conference agreement follows the Senate amendment.

h. Student housing

Present law

A housing unit generally is not eligible for the low-income housing tax credit if the tenants are full-time students who are not married individuals filing joint returns. Exceptions to this rule allow the credit to be claimed on housing units occupied by persons who are enrolled in certain job training programs or by students who are receiving Aid to Families with Dependent Children (AFDC) payments.

House bill

No provision.

Senate amendment

The Senate amendment provides that a housing unit occupied entirely by full-time students may qualify for the credit if the full-time students are a single parent and his or her minor children and none of the tenants is a dependent of a third party. The amendment also codifies the present-law exception regarding married students filing joint returns (which continues to apply to all buildings placed in service since original enactment of the low-income housing credit by the Tax Reform Act of 1986).

Conference agreement

The conference agreement follows the Senate amendment.

i. State credit authority limitation

Present law

Each State receives an annual low-income housing credit volume ceiling of $1.25 per resident. To qualify for the credit, a building owner generally must receive a credit allocation from the appropriate State credit authority. An exception is provided for property which is substantially financed with the proceeds of tax-exempt bonds subject to the State's private-activity bond volume limitation. That portion of a State's credit authority which is unallocated in the year in which it originally arises may be carried forward and added to the State's credit authority for the subsequent calendar year. If allocations in the subsequent year exceed that year's annual credit authority, but do not exhaust the sum of that year's annual credit authority plus any credit authority carried forward from the preceding year, any remaining carried-forward credit authority is allocated in the next subsequent year to the national pool.

House bill

No provision.

Senate amendment

For purposes of the carryforward rule, the Senate amendment treats credits carried forward from previous years as used before current year credits.

Conference agreement

The conference agreement follows the Senate amendment.

j. Effective dates

Present law

The credit is scheduled to expire after June 30, 1992.

House bill

The provision relating to the extension of the credit is effective after June 30, 1992. The provision relating to maximum rent is effective on the date of enactment.

Senate amendment

The provision relating to the extension of the credit is effective after June 30, 1992. The provisions relating to modification of the credit are also effective after June 30, 1992 except in three cases.

The two provisions relating to the Treasury Department's authority to grant waivers are effective on date of enactment. The provision relating to the credit carryforward rules is effective on or after January 1, 1992.

Conference agreement

The conference agreement follows the Senate amendment except that it also includes a date of enactment effective date for the provision of the House bill relating to maximum rent.

7. QUALIFIED MORTGAGE BONDS AND MORTGAGE CREDIT CERTIFICATES

Present law

Qualified mortgage bonds

Qualified mortgage bonds ("QMBs") are bonds the proceeds of which are used to finance the purchase, or qualifying rehabilitation or improvement, of single-family, owner-occupied residences located within the jurisdiction of the issuer of the bonds. Persons receiving QMB loans must satisfy principal residence, purchase price, borrower income, first-time homebuyer, and other requirements. Part or all of the interest subsidy provided by QMBs is recaptured if the borrower experiences substantial increases in income and disposes of the subsidized residence within nine years after it was purchased.

The volume of QMBs that a State may issue is limited by an annual State private activity bond volume limit.

Mortgage credit certificates

Qualified governmental units may elect to exchange private activity bond volume authority for authority to issue mortgage credit certificates ("MCCs"). MCCs entitle home buyers to nonrefundable income tax credits for a specified percentage of the interest paid on mortgage loans on their principal residences. Once issued, an MCC remains in effect as long as the loan remains outstanding and the residence being financed continues to be the MCC-recipient's principal residence. MCCs are subject to the same targeting requirements as QMBs. MCCs also are subject to the same recapture rules as QMBs.

Expiration

Authority to issue QMBs and to elect to trade in private activity bond volume authority to issue MCCs is scheduled to expire after June 30, 1992.

House bill

(1) The House bill permanently extends the authority to issue QMBs and to elect to trade in bond volume authority to issue MCCs.

(2) The House bill also clarifies the treatment of certain housing affordability programs. Specifically, it provides that, in high housing cost areas, the fact that an issuer of QMBs or MCCs also provides certain second mortgage loans to homebuyers in conjunction

with QMB or MCC financing will not preclude availability of the QMB- or MCC-assistance on the purchase of a residence.

Effective date.—The extension of the QMB and MCC programs is effective for bonds issued after June 30, 1992.

The provision relating to treatment of certain housing affordability programs applies to QMB and MCC financing provided after the date of enactment.

Senate amendment

(1) The Senate amendment extends the authority to issue QMBs and to elect to trade in bond volume authority to issue MCCs for 18 months (through December 31, 1993).

(2) No provision.

Effective date.—The extension of the QMB and MCC programs is effective for bonds issued after June 30, 1992.

Conference agreement

The conference agreement provides an extension of authority for the QMB and MCC programs for 12 months (through June 30, 1993). Also, the conference agreement follows the House bill with respect to the treatment of certain housing affordability programs.

8. TREATMENT OF CONTRIBUTIONS IN AID OF CONSTRUCTION

Present law

In general

The gross income of a corporation does not include contributions to its capital. A contribution to the capital of a taxpayer does not include any contribution in aid of construction or any other contribution as a customer or potential customer.

Prior law

Prior to the enactment of the Tax Reform Act of 1986, a regulated public utility that provided electric energy, gas, water, or sewage disposal services was allowed to treat any amount of money or property received from any person as not includible in the gross income of the taxpayer so long as such amount: (1) was a contribution in aid of construction and (2) was not included in the taxpayer's rate base for rate-making purposes. A contribution in aid of construction did not include a connection fee. The adjusted basis of any property acquired with a contribution in aid of construction was zero.

If the contribution was in property other than an electric energy, gas, steam, water, or sewage disposal facility, such contribution was not includible in the gross income of the taxpayer so long as: (1) an amount at least equal to the amount of the contribution was expended for tangible property which was the purpose motivating the contribution and which was used predominantly in the trade or business of furnishing utility services; (2) the expenditure occurred before the end of the second taxable year after the year that the contribution was received; and (3) certain records were kept with respect to the contribution and the expenditure. In addition, the statute of limitations for the assessment of deficiencies was extended in the case of certain contributions of property other than an electric energy, gas, steam, water, or sewage disposal facility.

These rules were repealed by the Tax Reform Act of 1986.

House bill

No provision.

Senate amendment

The Senate amendment restores the contributions in aid of construction rules that were repealed by the Tax Reform Act of 1986 for amounts received by a regulated public utility that provides water or sewerage disposal services.

Effective date.—The provision is effective for amounts received after the date of enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

9. REQUIRE REPORTING OF TAXPAYER IDENTIFICATION NUMBERS OF PARTIES IN SELLER-FINANCED MORTGAGE TRANSACTIONS

Present law

Taxpayers are generally allowed an itemized deduction from adjusted gross income for the amount of qualified residence interest paid. If qualified residence interest is paid to an individual, the name and address (but not the taxpayer identification number [1]) of the interest recipient must be reported on Schedule A of the payor's tax return.

Individuals receiving taxable interest in excess of $400 are required to report the amounts received and the names (but not the addresses or taxpayer identification numbers) of the payors on Schedule B of the payee's tax return.

House bill

No provision.

Senate amendment

Interest paid or accrued on any seller-provided financing is not treated as qualified residence interest unless the name, address, and taxpayer identification number of the person to whom the interest is paid or accrued are included on the return claiming the deduction for such qualified residence interest.

Effective date.—The provision is effective for taxable years beginning after December 31, 1991.

[1] An individual's taxpayer identification number is generally that individual's Social Security number.

Conference agreement

The conference agreement generally follows the Senate amendment as to the requirement of reporting taxpayer identification numbers, modified as follows. If any taxpayer claims a deduction for qualified residence interest on any seller-provided financing, such taxpayer (the buyer) shall include on his or her tax return the name, address, and taxpayer identification number of the person (the seller) to whom the interest is paid or accrued. In general, this information must be furnished on Schedule A of the buyer's tax return for every year in which the buyer deducts this interest.

If any person receives or accrues interest from seller-provided financing, such person (the seller) shall include on his or her tax return the name, address, and taxpayer identification number of the person (the buyer) from whom the interest is received or accrued. In general, this information must be furnished on Schedule B of the seller's tax return for every year in which the seller is required to include this interest in income.

If any person involved in seller-provided financing is required to include on his or her tax return the taxpayer identification number of another person, such other person is required to furnish his or her taxpayer identification number to such person.

Failure to meet the requirements for information reporting described above are subject to information reporting penalties under sec. 6723. In general, these penalties are $50 for each failure.

The conferees anticipate that all parties to real estate closings will make every effort to inform both buyers and sellers of the requirements of this provision, and will also facilitate (to the maximum extent possible) the exchange of taxpayer identification numbers between buyers and sellers.

Effective date.—Same as the Senate amendment.

G. Minimum Tax Provisions

1. AMT TREATMENT OF CHARITABLE CONTRIBUTIONS OF APPRECIATED PROPERTY

Present law

In computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct the fair-market value of property contributed to a charitable organization.[1] However, in the case of a charitable contribution of inventory or other ordinary-income property, short-term capital gain property, or certain gifts to private foundations, the amount of the deduction is limited to the taxpayer's basis in the property.[2] In the case of a charitable contribution of tangible personal property, a taxpayer's deduction is limited to the adjusted basis in such property if the use by the recipient

[1] The amount of the deduction allowable for a taxable year with respect to a charitable contribution may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer (secs. 170(b) and 170(e)).

[2] Section 170(e)(3) provides an augmented deduction for certain corporate contributions of inventory property for the care of the ill, the needy, or infants.

charitable organization is unrelated to the organization's tax-exempt purpose (sec. 170(e)(1)(B)(i)).

For purposes of computing alternative minimum taxable income (AMTI), the deduction for charitable contributions of capital gain property (real, personal, or intangible) is disallowed to the extent that the fair-market value of the property exceeds its adjusted basis (sec. 57(a)(6)). However, in the case of a contribution made in a taxable year beginning in 1991 or made before July 1, 1992, in a taxable year beginning in 1992, this rule does not apply to contributions of tangible personal property.

House bill

Repeal of AMT preference for donated appreciated property

The House bill repeals the alternative minimum tax (AMT) provision which treats as a preference item the amount by which the value of contributed capital gain property exceeds the basis of the property. Thus, if a taxpayer makes a gift to charity of property (other than inventory or other ordinary income property, short-term capital gain property, or certain gifts to private foundations) that is real property, intangible property, or tangible personal property the use of which is related to the donee's tax-exempt purpose, the taxpayer is allowed to claim a deduction for both regular tax and AMT purposes in the amount of the property's fair-market value (subject to present-law percentage limitations). Contributions of inventory or other ordinary income property, short-term capital gain property, and certain gifts to private foundations continue to be governed by present-law rules.

Advance determination of value of charitable gifts

The House bill directs the Secretary of the Treasury to develop and implement a procedure under which the value of donated property would be determined for Federal income tax purposes prior to the charitable transfer.

Effective date

The provision repealing section 57(a)(6) is effective for contributions made in taxable years beginning after 1991.

Senate amendment

Extension of AMT relief for donated appreciated property

The Senate amendment provides that charitable contributions of appreciated property (real, personal, and intangible) made during 1992 and 1993 are not treated as a tax preference item for AMT purposes.

Advance determination of IRS position of value of donated tangible personal property

The Secretary of the Treasury is directed to develop and implement a procedure under which the Secretary's position as to the value of tangible personal property could be ascertained for Federal income tax purposes prior to the transfer of such property to a qualifying charitable organization. The Secretary is required to submit a report not later than December 31, 1992, to the Senate Committee on Finance and the House Committee on Ways and Means, reporting on the development of such a procedure and the projected timetable for its implementation.

Study of tax treatment of corporate sponsorship payments to charitable organizations

The Secretary of the Treasury is directed to conduct a study on the tax treatment of corporate sponsorship payments received by charitable and other tax-exempt organizations in connection with athletic and other events, including the ramifications of IRS proposed examination guidelines contained in Announcement 92-15, 1992-5 I.R.B. 51. Within one year after the date of enactment, the Secretary is required to report the results of this study to the Senate Committee on Finance and the House Committee on Ways and Means.

Effective date

The provision governing the AMT treatment of gifts of appreciated property is effective for contributions made in 1992 and 1993.

The Secretary of the Treasury is required to report to Congress prior to December 31, 1992, on the development of an advance valuation procedure for certain donations, and within one year after the date of enactment, the results of a study of corporate sponsorship payments received by tax-exempt organizations.

Conference agreement

Extension of AMT relief for donated appreciated property

The conference agreement provides that charitable contributions of appreciated property (real, personal, and intangible) made during the period January 1, 1992, through June 30, 1993, are not treated as a tax preference item for AMT purposes.[3]

Effective date.—Contributions made during the period January 1, 1992, through June 30, 1993.

Advance determination of IRS position of value of donated tangible personal property

The conference agreement generally follows the House bill and Senate amendment, except that the directive to the Secretary of the Treasury is modified as follows: The Secretary of the Treasury is directed to develop a procedure under which taxpayers could elect to seek an agreement with the Secretary as to the value of tangible personal property prior to the donation of such property to a qualifying charitable organization (provided that time limits for donation and any other conditions contained in the agreement are satisfied). The Secretary is required to submit a report not later than December 31, 1992, to the Senate Committee on Finance and the House Committee on Ways and Means, reporting on the devel-

[3] Any carryover of an excess charitable contribution deduction from a contribution made during the period January 1, 1992, through June 30, 1993, also will not be treated as a tax preference item for AMT purposes in any succeeding taxable year to which the excess may be carried under the rules of section 170.

opment of such a procedure, including the setting of possible threshold amounts for claimed value (and the payment of fees) by a taxpayer in order to seek agreement under the procedure, possible limitations on applying the procedure only to items with significant artistic or cultural value, recommendations for legislative action needed to implement the proposed procedure, and a projected timetable for its implementation.

Study of tax treatment of corporate sponsorship payments to charitable organizations

The conference agreement follows the Senate amendment.[4]

2. ALTERNATIVE MINIMUM TAX RELIEF FOR INTANGIBLE DRILLING COSTS OF INDEPENDENT OIL AND GAS PRODUCERS

Present law

In general

Corporate and noncorporate taxpayers are subject to an alternative minimum tax ("AMT") which is payable, in addition to all other tax liabilities, to the extent that it exceeds the taxpayer's regular income tax owed. The tax is imposed at a flat rate of 20 percent (24 percent in the case of noncorporate taxpayers) on alternative minimum taxable income in excess of an exemption amount. Alternative minimum taxable income is the taxpayer's taxable income increased by tax preferences and adjusted by determining the tax treatment of certain items in a manner which negates the deferral of income resulting from the regular tax treatment of those items.

For taxable years beginning after 1989, the alternative minimum taxable income of a corporation is increased by an amount equal to 75 percent of the amount by which adjusted current earnings ("ACE") exceed pre-net operating loss alternative minimum taxable income. In general, adjusted current earnings means alternative minimum taxable income with additional adjustments. These adjustments generally follow the rules presently applicable to corporations in computing their earnings and profits.

Net operating losses and foreign tax credits generally cannot be used to offset, in the aggregate, more than 90 percent of the pre-foreign tax credit tentative minimum tax which would otherwise be determined.

Treatment of oil and gas intangible drilling costs

Independent oil and gas producers (i.e., taxpayers other than integrated oil companies (as defined in Code sec. 291(b)(4))) that pay or incur intangible drilling or development costs ("IDCs") in the development of domestic oil or gas properties or certain geothermal wells may elect either to expense or capitalize such amounts. If an

[4] The conferees are concerned about the application of the proposed examination guidelines contained in Announcement 92-15 to royalties and other payments that may be received by the U.S. Olympic Committee and the Atlanta Committee for the Olympic Games, Inc., in connection with the 1996 Games of the XXVI Olympiad. The conferees expect that, under general UBIT rules (see Rev. Rul. 81-178, 1981-2 C.B. 135), royalty income derived from licensing Olympic trademarks, emblems, and designations, as well as all income from broadcasting, filming, and videotaping the Olympics, will be treated as exempt from the UBIT.

election to expense IDCs is made, the taxpayer deducts the amount of the IDCs as an expense in the taxable year the cost is paid or incurred. Generally, if IDCs are capitalized rather than expensed, they can be recovered through depletion or depreciation, as appropriate. Alternatively, at the election of the taxpayer, IDCs may be amortized over a 60-month period.

The difference between the amount of a taxpayer's IDC deductions and the amount which would have been currently deductible had IDCs been capitalized and recovered over a 10-year period constitutes an item of tax preference for the AMT to the extent that this difference exceeds 65 percent of the taxpayer's net income from oil, gas, and geothermal properties for the taxable year.

Moreover, for purposes of computing the corporate AMT's ACE adjustment, IDCs incurred in taxable years beginning after 1989 are capitalized and amortized over the 60-month period beginning with the month in which they are paid or incurred.

AMT deduction for certain energy-related items

A portion of the IDC tax preference and ACE IDC adjustment (together with a portion of the preference and ACE adjustment related to percentage depletion from marginal properties) may operate to reduce an independent oil and gas producer's alternative minimum taxable income ("AMTI") under a provision enacted as part of the Omnibus Budget Reconciliation Act of 1990 (the so-called "special energy deduction"). The special energy deduction is initially determined by identifying the taxpayer's (1) IDC preference [1] and (2) marginal production depletion preference.[2] The IDC preference is apportioned between the portion of the preference related to IDCs on exploratory wells and the portion related to IDCs on all other wells. The portion of the preference related to exploratory IDCs is multiplied by 75 percent and the remaining portion is multiplied by 15 percent. The marginal production depletion preference is multiplied by 50 percent. These three products are then added together to arrive at the taxpayer's special energy deduction.

The special energy deduction may not reduce the taxpayer's AMTI by more than 40 percent. In addition, the combination of the special energy deduction, the alternative minimum tax net operating loss and the alternative minimum tax foreign tax credit generally may not offset, in the aggregate, more than 90 percent of a taxpayer's AMT liability determined without such attributes. Any special energy deduction amount limited by the 40-percent threshold may not be carried to another taxable year.

House bill

No provision.

[1] The IDC preference is the amount by which the taxpayer's alternative minimum taxable income would be reduced if it were computed without regard to the excess IDC preference and the ACE IDC adjustment.

[2] The marginal production depletion preference is the amount by which the taxpayer's alternative minimum taxable income would be reduced if it were computed without regard to the preference for percentage depletion claimed in excess of basis and the ACE adjustment related to depletion from marginal properties.

Senate amendment

In general

The Senate amendment contains several provisions relating to the AMT treatment of IDCs incurred by independent producers of oil and gas. Included among these provisions are amendments to (1) the computation of the AMT preference for IDCs, (2) the ACE adjustment, and (3) the AMT special energy deduction. These provisions are not applicable to integrated oil companies (as defined in section 291(b)(4) of the Code).

AMT preference for IDCs

For purposes of computing the AMT preference for IDCs, the Senate amendment raises the 65-percent net oil and gas income offset to 70 percent. Thus, the difference between the amount of an independent oil and gas producer's IDC deductions and the amount which would have been currently deductible had IDCs been capitalized and recovered over a 10-year period constitutes an item of tax preference to the extent that this difference exceeds 70 percent of the producer's net income from oil and gas properties for the taxable year.

ACE adjustment for IDCs

For purposes of computing the ACE adjustment, the Senate amendment eliminates the requirement that independent oil and gas producers make an adjustment to AMTI for IDCs.

AMT special energy deduction

Under the Senate amendment, the IDC component of the special energy deduction would be computed by multiplying the IDC preference by 50 percent. Thus, any necessity to apportion the IDC preference between exploratory and all other IDCs is eliminated. Under the Senate amendment, the IDC preference for purposes of the special energy deduction is the amount by which the taxpayer's AMTI would be reduced if it were computed without regard to the excess IDC preference.[3]

The Senate amendment does not affect the computation of the marginal depletion component of the special energy deduction. As under present law, the special energy deduction may not reduce a taxpayer's AMTI by more than 40 percent.

Effective date

The provisions of the Senate amendment related to AMT relief for IDCs are effective for taxable years beginning after December 31, 1991.

Conference agreement

The conference agreement follows the Senate amendment.

[3] In contrast to present law, calculation of the IDC preference for purposes of the special energy deduction does not take into account an ACE IDC adjustment since that adjustment is repealed by the Senate amendment with respect to independent producers.

3. ELIMINATION OF ACE DEPRECIATION ADJUSTMENT

Present law

Under present law, a corporation is subject to an alternative minimum tax ("AMT") which is payable, in addition to all other tax liabilities, to the extent that it exceeds the corporation's regular income tax liability. Alternative minimum taxable income ("AMTI") is the corporation's taxable income increased by the corporation's tax preferences and adjusted by determining the tax treatment of certain items in a manner which negates the deferral of income resulting from the regular tax treatment of those items. For a corporation, the amount of AMT paid in a year may be carried forward as a credit and used to reduce the corporation's regular tax liability (but not below the corporation's tentative minimum tax for the year).

One of the adjustments that is made to taxable income to arrive at AMTI relates to depreciation. Depreciation on most personal property to which the modified ACRS system adopted in 1986 applies is calculated using the 150-percent declining balance method (switching to straight line in the year necessary to maximize the deduction) over the life described in Code section 168(g) (generally the ADR class life of the property).

For taxable years beginning after 1989, AMTI is increased by an amount equal to 75 percent of the amount by which adjusted current earnings ("ACE") exceeds AMTI (as determined before this adjustment). The ACE adjustment replaced the book-income adjustment applicable to tax years 1987 through 1989. In general, ACE equals AMTI with additional adjustments that generally follow the rules presently applicable to corporations in computing their earnings and profits. For purposes of ACE, depreciation is computed using the straight-line method over the class life of the property. Thus, a corporation generally must make two depreciation calculations for purposes of the AMT—once using the 150-percent declining balance method and again using the straight-line method.

House bill

Effective for property placed in service on or after February 1, 1992, the House bill would eliminate the depreciation component of ACE for corporate AMT purposes. Thus, in computing ACE, a corporation would use the same depreciation methods and lives that it uses in computing AMTI (generally, the 150-percent declining balance method for tangible personal property).

Effective date.—The provision is effective for property placed in service on or after February 1, 1992.

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.

H. Extension of Other Expiring Tax Provisions

1. RESEARCH AND EXPERIMENTATION TAX CREDIT

Present law

A 20-percent tax credit is allowed to the extent that a taxpayer's qualified research expenditures for the current year exceed its base amount for that year. The credit will not apply to amounts paid or incurred after June 30, 1992.

The base amount for the current year generally is computed by multiplying the taxpayer's "fixed-base percentage" by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenditures and had gross receipts during each of at least three years from 1984 through 1988, then its "fixed-base percentage" is the ratio that its total qualified research expenditures for the 1984–1988 period bears to its total gross receipts for that period (subject to a maximum ratio of .16). All other taxpayers (such as "start-up" firms) are assigned a fixed-base percentage of .03.

In computing the credit, a taxpayer's base amount may not be less than 50 percent of its current-year qualified research expenditures.

Qualified research expenditures eligible for the credit consist of: (1) "in-house" expenses of the taxpayer for research wages and supplies used in research; (2) certain time-sharing costs for computer use in research; and (3) 65 percent of amounts paid by the taxpayer for contract research conducted on the taxpayer's behalf. Expenditures attributable to research that is conducted outside the United States do not enter into the credit computation. In addition, the credit is not available for research in the social sciences, arts, or humanities, nor is it available for research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

In addition, the 20-percent tax credit also applies to the *excess* of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for university basic research *over* (2) the sum of (a) the greater of two fixed research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation.

Deductions for qualified research expenditures allowed to a taxpayer under section 174 are reduced by an amount equal to 100 percent of the taxpayer's research credit determined for that year.

House bill

The House bill extends permanently the 20-percent research tax credit for qualified research expenditures and university basic research expenditures.

The technical explanation accompanying the House bill states that, in making permanent the research credit, Congress wishes to reaffirm its intent that neither the enactment of the credit in 1981 nor the "targeting" modifications to the credit in 1986 affect the definition of "research or experimental expenditures" for purposes of section 174. Thus, the various new credit limitations enacted in the Tax Reform Act of 1986 (such as the "process of experimentation" requirement) apply in determining eligibility for the credit (in taxable years beginning after December 31, 1985), and do not determine eligibility of product development costs under section 174.

Effective date.—The provision applies to taxable years ending after June 30, 1992.

Senate amendment

The Senate amendment extends the research tax credit for 18 months (i.e., for qualified research expenditures and university basic research expenditures incurred through December 31, 1993).

Effective date.—The provision applies to qualified expenditures incurred during the period July 1, 1992, through December 31, 1993.

Conference agreement

The conference agreement extends the research tax credit for one year (i.e., for qualified research expenditures and university basic research expenditures incurred through June 30, 1993).

In extending the research tax credit, the conferees wish to reaffirm Congressional intent that neither the enactment of the credit in 1981 nor the "targeting" modifications to the credit in 1986 affect the definition of "research or experimental expenditures" for purposes of section 174.

Effective date.—The provision applies to qualified expenditures incurred during the period July 1, 1992, through June 30, 1993.

2. EXTENSION OF TARGETED JOBS TAX CREDIT

Present law

Tax credit

The targeted jobs tax credit is available on an elective basis for hiring individuals from several targeted groups. The credit is scheduled to expire for individuals who begin work for an employee after June 30, 1992.

Authorization of appropriations

Present law authorizes appropriations for administration and publicity expenses relating to the credit through June 30, 1992. These monies are to be used by the Internal Revenue Service and the Department of Labor to inform employers of the credit program.

House bill

The House bill permanently extends the targeted jobs tax credit and the authorization for appropriations.

Effective date.—The provision is effective for individuals who begin work for an employer after June 30, 1992.

Senate amendment

The Senate amendment extends the targeted jobs tax credit and the authorization for appropriations for 18 months (through December 31, 1993).

Effective date.—The provision is effective for individuals who begin work for an employer after June 30, 1992.

Conference agreement

The conference agreement follows the Senate amendment except that the credit and authorization for appropriations is only extended for 12 months (through June 30, 1993).

3. QUALIFIED SMALL-ISSUE BONDS

Present law

Interest on small issues of private activity bonds issued by States or local governments ("qualified small-issue bonds") is excluded from gross income if certain conditions are met. First, at least 95 percent of the bond proceeds must be used to finance manufacturing facilities or certain agricultural land or equipment. Second, the bond issue must have an aggregate face amount of $1 million or less, or alternatively the aggregate face amount of the issues, together with the aggregate amount of certain related capital expenditures during the six-year period beginning three years before the date of the issue and ending three years after that date, must not exceed $10 million.

Issuance of qualified small-issue bonds, like most other private activity bonds, is subject to annual State volume limitations and to other rules.

Authority to issue qualified small-issue bonds is scheduled to expire after June 30, 1992.

House bill

The House bill permanently extends the authority to issue qualified small-issue bonds.

Effective date.—The provision is effective for bonds issued after June 30, 1992.

Senate amendment

The Senate amendment extends the authority to issue qualified small-issue bonds for 18 months (through December 31, 1993).

Effective date.—The provision is effective for bonds issued after June 30, 1992.

Conference agreement

The conference agreement provides an extension of authority to issue qualified small-issue bonds for 12 months (through June 30, 1993).

4. BUSINESS ENERGY TAX CREDITS FOR SOLAR AND GEOTHERMAL PROPERTY

Present law

Nonrefundable business energy tax credits are allowed for ten percent of the cost of qualified solar and geothermal energy property (sec. 48(a)). Solar energy property that qualifies for the credit includes any equipment that uses solar energy to generate electricity, to heat or cool (or provide hot water for use in) a structure, or to provide solar process heat. Qualifying geothermal property includes equipment that produces, distributes, or uses energy derived from a geothermal deposit, but, in the case of electricity generated by geothermal power, only up to (but not including) the electrical transmission stage.[1]

The business energy tax credits are scheduled to expire with respect to property placed in service after June 30, 1992.

The business energy tax credits are components of the general business credit (sec. 38(b)(1)). The business energy tax credits, when combined with all other components of the general business credit, generally may not exceed for any taxable year the excess of the taxpayer's net income tax over the greater of (1) 25 percent of net regular tax liability above $25,000 or (2) the tentative minimum tax. An unused general business credit generally may be carried back three years and carried forward 15 years.

House bill

No provision.

Senate amendment

The Senate amendment extends the business credits for investments in solar and geothermal property for 18 months, through December 31, 1993.

Effective date.—Qualifying solar and geothermal property placed in service after June 30, 1992.

Conference agreement

The conference agreement generally follows the Senate amendment, except that the business energy tax credits are only extended for 12 months, through June 30, 1993.

5. EXCISE TAX ON CERTAIN VACCINES FOR THE VACCINE INJURY COMPENSATION TRUST FUND

Present law

Vaccine Injury Compensation Trust Fund

The Vaccine Injury Compensation Trust Fund ("Vaccine Trust Fund") provides a source of revenue to compensate individuals who are injured (or die) as a result of the administration of certain vac-

[1] For purposes of the credit, a geothermal deposit is defined as a domestic geothermal reservoir consisting of natural heat which is stored in rocks or in an aqueous liquid or vapor, whether or not under pressure (sec. 613(e)(2)).

cines: diphtheria, pertussis, and tetanus ("DPT"); diphtheria and tetanus ("DT"); measles, mumps, and rubella ("MMR"); and polio. The Vaccine Trust Fund provides the funding source for the National Vaccine Injury Compensation Program ("Program"), which provides a substitute, Federal "no-fault" insurance system for the State-law tort and private liability insurance systems otherwise applicable to vaccine manufacturers.[1]

Under the Program, all persons who were immunized with a covered vaccine after the effective date of the Program, October 1, 1988, are prohibited from commencing a civil action in State court for vaccine-related damages unless they first file a petition with the United States Claims Court, where such petitions are assigned to a special master and governed by streamlined procedural rules designed to expedite the proceedings.[2] In these cases, the Federal Government is the respondent party in the proceedings, and the claimant generally must show only that certain medical conditions (or death) followed the administration of a covered vaccine and that the first onset of symptoms occurred within a prescribed time period.[3] Compensation under the Program generally is limited to actual and projected unreimbursed medical, rehabilitative, and custodial expenses, lost earnings, pain and suffering (or, in the event of death, a recovery for the estate) up to $250,000, and reasonable attorney's fees.[4] Only if the final settlement under the Program is rejected may the claimant proceed with a civil tort action in the appropriate State court, where recovery generally will be governed by State tort law principles [5], subject to certain limitations and specifications imposed by the National Childhood Vaccine Injury Act of 1986.[6]

[1] Congress created the National Vaccine Injury Compensation Program as part of the National Childhood Vaccine Injury Act of 1986, in view of concerns that the combination of significantly higher prices and uncertain compensation for injuries could result in reduced compliance with the nation's childhood immunization efforts. The Program became effective following enactment of a Federal funding source. This funding source was provided by the enactment of vaccine excise taxes in the Omnibus Budget Reconciliation Act of 1987, with the excise taxes imposed on sales of covered vaccines on or after January 1, 1988. The Program for administering claims became effective on October 1, 1988, but was not fully operational until February 1, 1989. Several procedural aspects of the Program were amended by section 6601 of the Omnibus Budget Reconciliation Act of 1989.

[2] Persons who received vaccines before the Program's effective date of October 1, 1988 ("retrospective cases") also may be eligible for compensation under the Program if they had not yet received compensation and elected to file a petition with the United States Claims Court on or before January 31, 1991. Under the Program, awards in retrospective cases are somewhat limited compared to "prospective cases" (i.e., those where the vaccine was administered on or after October 1, 1988). Awards in retrospective cases are not paid out of the Vaccine Trust Fund but are paid out of funds specially authorized by Congress. See 42 U.S.C. sec. 300aa-15(i), (j) (appropriating $80 million for fiscal year 1989 and for each subsequent year). To date, most of the dispositions under the Program have involved retrospective cases. See Mariner, Wendy K., *Innovation and Challenge: The First Year of the National Vaccine Injury Compensation Program*, May 1991, report prepared for consideration by the Administrative Conference of the United States.

[3] Compensation may not be awarded, however, if there is a preponderance of the evidence that the claimant's condition or death resulted from factors unrelated to the vaccine in question.

[4] 42 U.S.C. sec. 300aa-15.

[5] In most State proceedings, significant issues arise whether injuries suffered by a child after immunization were, in fact, caused by the vaccine administered and whether the manufacturer was at fault in either the manufacture or marketing of the vaccine.

[6] Title III, P.L. 99-660. This Act preempts State tort law to a limited extent by imposing limits on recovery from vaccine manufacturers. Among the limitations are a prohibition on compensation if the injury or death resulted from side effects that were unavoidable; a presumption that manufacturers are not negligent in manufacturing or marketing vaccines if they complied, in all material respects, with Federal Food and Drug Administration requirements; and limits on punitive damage awards.

Amounts in the Vaccine Trust Fund are available for the payment of compensation under the Program with respect to vaccines administered after September 30, 1988, and before October 1, 1992.

Vaccine excise tax

The Vaccine Trust Fund is funded by a manufacturer's excise tax on DPT, DT, MMR, and polio vaccines (and any other vaccines used to prevent these diseases). The excise tax per dose is $4.56 fer DPT, $0.06 for DT, $4.44 for MMR, and $0.29 for polio vaccines.

The vaccine excise tax will expire after the later of: (1) December 31, 1992; or (2) the date on which the Vaccine Trust Fund revenues exceed the projected liabilities with respect to compensable injuries from vaccines administered before October 1, 1992.

House bill

Extension of vaccine excise tax and Program funding

The House bill extends the present-law excise taxes imposed on certain vaccines for two years (i.e., through December 31, 1994). Authorization for compensation to be paid from the Vaccine Trust Fund for certain damages resulting from vaccines administered after September 30, 1988, and before October 1, 1992, also is extended for two years (i.e., for vaccines administered after September 30, 1988, and before October 1, 1994).[7]

Study

The Secretary of the Treasury, in consultation with the Secretary of Health and Human Services, is directed to conduct a study of: (1) the estimated amount that will be paid from the Vaccine Trust Fund with respect to vaccines administered after September 30, 1988, and before October 1, 1994; (2) the rates of vaccine-related injury or death with respect to various types of vaccines; (3) new vaccines and immunization practices being developed or used for which amounts may be paid from the Vaccine Trust Fund; and (4) whether additional vaccines should be included in the Program. The Secretary of the Treasury must submit a report detailing his findings no later than January 1, 1994, to the House Committee on Ways and Means and the Senate Committee on Finance.

Effective date

The provisions are 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 Senate amendment.

[7] The technical explanation accompanying the House bill clarifies that amounts received by a claimant from the Vaccine Trust Fund constitute damages received on account of personal injuries or sickness for purposes of the exclusion from gross income provided by the general rules of section 104(a)(2).

6. PERMANENT EXTENSION OF GENERAL FUND TRANSFER TO RAILROAD RETIREMENT TIER 2 FUND

Present law

The proceeds from the income taxation of railroad retirement Tier 2 benefits are transferred from the general fund of the Treasury to the Railroad Retirement Account. This transfer applies only to proceeds from the taxation of benefits which have been received prior to October 1, 1992. Proceeds from the taxation of benefits received after this date remain in the general fund.

House bill

The transfer of proceeds from the income taxation of railroad retirement Tier 2 benefits from the general fund of the Treasury to the Railroad Retirement Account is made permanent.

Effective date.—The provision is effective beginning September 30, 1992.

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. TAX CREDIT FOR ORPHAN DRUG CLINICAL TESTING EXPENSES

Present law

A 50-percent nonrefundable tax credit is allowed for a taxpayer's qualified clinical testing expenses paid or incurred in the testing of certain drugs for rare diseases, generally referred to as "orphan drugs." Qualified testing expenses are costs incurred to test an orphan drug after the drug has been approved for human testing by the Food and Drug Administration (FDA) but before the drug has been approved for sale by the FDA. Present law defines a rare disease or condition as one that (1) affects less than 200,000 persons in the United States or (2) affects more than 200,000 persons, but there is no reasonable expectation that businesses could recoup the costs of developing a drug for it from U.S. sales of the drug. These rare diseases and conditions include Huntington's disease, myoclonus, ALS (Lou Gehrig's disease), Tourette's syndrome, and Duchenne's dystrophy (a form of muscular dystrophy).

The orphan drug tax credit is scheduled to expire after June 30, 1992.

House bill

No provision.

Senate amendment

The Senate amendment extends the orphan drug tax credit for 18 months (i.e., for qualified clinical testing expenses incurred through December 31, 1993).

Effective date.—The provision is effective for expenses incurred during the period July 1, 1992, through December 31, 1993.

Conference agreement

The conference agreement follows the Senate amendment, except that the orphan drug tax credit is extended for one year (i.e., for qualified clinical testing expenses incurred through June 30, 1993).

Effective date.—The provision is effective for expenses incurred during the period July 1, 1992, through June 30, 1993.

8. ACCESS TO TAX INFORMATION BY THE DEPARTMENT OF VETERANS AFFAIRS

Present law

The Internal Revenue Code prohibits disclosure of tax returns and return information of taxpayers, with exceptions for authorized disclosure to certain Governmental entities in certain enumerated instances (sec. 6103). Unauthorized disclosure is a felony punishable by a fine not exceeding $5,000 or imprisonment of not more than five years, or both (sec. 7213). An action for civil damages also may be brought for unauthorized disclosure (sec. 7431).

Among the disclosures permitted under the Code is disclosure to the Department of Veterans Affairs (DVA) of self-employment tax information and certain tax information supplied to the IRS and SSA by third-parties. Disclosure is permitted to assist DVA in determining eligibility for, and establishing correct benefit amounts under, certain of its needs-based pension and other programs (sec. 6103(l)(7)(D)(viii)). The income tax returns filed by the veterans themselves are not disclosed to DVA.

The DVA disclosure provision is scheduled to expire after September 30, 1992.

House bill

No provision.

Senate amendment

The Senate amendment extends this authority to disclose tax information for six years.

Effective date.—The DVA disclosure provision expires after September 30, 1998.

Conference agreement

The conference agreement follows the Senate amendment, except that the provision expires after September 30, 1997.

9. EXCLUSION FOR EMPLOYER-PROVIDED GROUP LEGAL SERVICES AND TAX EXEMPTION FOR GROUP LEGAL SERVICES ORGANIZATIONS

Present law

Certain amounts contributed by an employer to and benefits provided under a qualified group legal services plan are excluded from an employee's gross income for income and employment tax purposes. The exclusion is limited to an annual premium value of $70. The exclusion expires after June 30, 1992.

Present law provides tax-exempt status for an organization the exclusive function of which is to provide legal services or indemnification against the cost of legal services as part of a qualified group legal services plan. The tax exemption for such an organization expires after June 30, 1992.

House bill

No provision.

Senate amendment

The Senate amendment extends the exclusion from income for employer-provided group legal services and the tax exemption for group legal services organizations through December 31, 1993.

Effective date.—Taxable years beginning after June 30, 1992.

Conference agreement

The conference agreement extends the exclusion from income for employer-provided group legal services and the tax exemption for group legal services organizations through June 30, 1993.

Effective date.—Taxable years beginning after June 30, 1992.

10. ALLOCATION AND APPORTIONMENT OF RESEARCH EXPENSES

Present law

U.S. persons are taxable on their worldwide income, including their foreign income. Foreign source taxable income equals foreign source gross income less the expenses, losses and other deductions properly apportioned or allocated to that income. The Internal Revenue Code generally articulates only the broad principles of how expenses reduce U.S. and foreign source gross income, leaving the Treasury Department to provide detailed rules for the task of allocating and apportioning expenses.

Treasury regulations issued in 1977 described methods for allocating expenses between U.S. and foreign source income, including rules for the allocation of research and development (R&D) expenses. Upon issuance of these regulations, a significant dispute regarding the appropriate allocation of R&D expenses developed between taxpayers and the Treasury Department. This unresolved dispute between taxpayers and the Treasury Department precipitated Congressional involvement on this issue, and since 1981, the R&D allocation regulations have been subject to a series of eight suspensions and temporary modifications. The current temporary provision is applicable generally for the first six months of the first taxable year beginning after August 1, 1991, and among other rules, automatically allocates 64 percent of U.S. performed R&D to U.S. source income, and generally permits a greater amount of taxable income to be classified as foreign source than under the 1977 regulations. This will increase the benefits of the foreign tax credit to many taxpayers.

House bill

The House bill contains no provision on the allocation and apportionment of R&D expenses. However, the Technical Explanation of H.R. 4287 (WMCP 102-35) states that Congress believes that the Administration has broad authority under current law to revise the current R&D allocation regulations. The Technical Explanation of H.R. 4287 states that since the Administration has indicated its support of an allocation system that provides incentives to increase the performance of U.S.-based research activities, the Congress expects, and in the strongest terms, urges the Treasury Department to revise its permanent regulations in a manner consistent with the Administration's objectives and proposals as set forth in the *General Explanations of the President's Budget Proposals Affecting Receipts* (January 1992). The Technical Explanation of H.R. 4287 states that the Congress believes that such a revision would be consistent both with current law regulatory authority and with the stated goals of the Administration.

The Technical Explanation of H.R. 4287 states that the Congress further urges the Treasury Department, when revising its regulations, to take into consideration that taxpayers, in appropriate circumstances, are required for business purposes to conduct significant amounts of R&D at foreign sites and should not be penalized by the allocation rules.

The Technical Explanation of H.R. 4287 states that the Congress expects and requests the Treasury Department to issue regulations no later than June 1, 1992, to be effective for all periods after the termination of the current temporary rules.

Senate amendment

The Senate amendment contains no provision on the allocation and apportionment of R&D expenses. The Technical Explanation of the Senate Finance Committee amendment to H.R. 4210 (S. Prt. 102-77) states views of the committee which are the same as the views expressed in the Technical Explanation of H.R. 4287, except with respect to the committee's view as to the effective date of the regulations to be issued. In that connection, the Technical Explanation of the Senate Finance Committee amendment to H.R. 4210 states that the committee expects and requests the Treasury Department to issue regulations no later than June 1, 1992, to be effective after the termination of the current temporary rules.

Conference agreement

The conference agreement follows the House bill and Senate amendment. The conferees adopt the common views expressed in the Technical Explanations of the two bills. The conferees expect that final regulations will adopt the substantive rules set forth in the Administration proposal, that such regulations will be issued no later than June 1, 1992, and that such regulations will take effect without delay upon expiration of the current temporary statutory R&D allocation rules.

I. Urban Tax Enterprise Zones and Rural Development Investment Zones

Present law

In general, the Internal Revenue Code does not contain rules that target specific geographic areas for special Federal income tax treatment. Within certain Code sections, however, there are definitions of targeted areas for limited purposes. For example, the provisions relating to qualified mortgage bonds define targeted areas for the purpose of promoting housing development within economically distressed areas. Similarly, for purposes of the low-income housing credit, certain geographic areas are designated as high cost or difficult to develop for the purpose of increasing the rate of credit applicable to such areas. In addition, present law provides favorable Federal income tax treatment for certain U.S. corporations that operate in Puerto Rico, the U.S. Virgin Islands, or a possession of the United States as a means to encourage the conduct of trades or businesses within these areas.

House bill

Designation of tax enterprise zones

In general.—The House bill provides that, during the period 1993 through 1995, 35 tax enterprise zones may be designated. Tax enterprise zones may be either urban tax enterprise zones or rural development investment zones. The Secretary of Housing and Urban Development may designate 10 areas as urban tax enterprise zones. The Secretary of Agriculture (in consultation with the Secretary of Commerce) may designate 25 areas as rural development investment zones. All designated areas shall be selected from areas each of which will have been nominated by State and local governments, a State-chartered economic development corporation (or similar entity), or the governing body of an Indian reservation. Designation of an area as a tax enterprise zone generally will remain in effect for 15 years.

Eligibility criteria for urban tax enterprise zones.—To be eligible for designation as an urban tax enterprise zone, a nominated area is required to have all of the following characteristics: (1) a population of at least 4,000; (2) a condition of pervasive poverty, unemployment, and general economic distress, which may include the distress resulting from a high incidence of crime and narcotics use; (3) with respect to size, (a) does not exceed 12 square miles, (b) consists of not more than three noncontiguous parcels, and (c) is located entirely within one State; (4) an unemployment rate at least 1.5 times the national unemployment rate; (5) poverty rates of at least 20 percent in each of 90 percent of the area's census tracts; and (6) a satisfactory course of action (described below) adopted by the

State or local governments for the nominated area designed to promote economic development in the zone.

Eligibility criteria for rural development investment zones.—To be nominated as a rural development investment zone, an area is required to be either outside a standard metropolitan statistical area or determined by the Secretary of Agriculture (in consultation with the Secretary of Commerce) to be a rural area. To be eligible for designation, a nominated rural area is required to possess the following four characteristics: (1) a population of at least 1,000; (2) a condition of general economic distress; (3) with respect to size, (a) does not exceed 10,000 square miles, (b) is located within not more than four contiguous counties, (c) consists of not more than three noncontiguous parcels, and (d) is located entirely within one State;[1] and (4) a satisfactory course of action (described below) adopted by State or local governments for the nominated area. In addition, a rural area is required to meet at least two of the following four requirements: (1) an unemployment rate at least 1.5 times the national unemployment rate; (2) poverty rates of at least 20 percent in each of 90 percent of the area's census tracts;[2] (3) a decline in employment (as measured by total wages) of more than five percent over the five-year period prior to the zone's designation; and (4) a decline in population of 10 percent or more over the period from 1980 to 1990.

Course of action.—In order for any nominated area to be eligible to be designated as a tax enterprise zone, the local government and State in which the area is located are required to agree in writing that they will follow a specified course of action designed to reduce burdens borne by employers or employees in the area. A specified course of action may include one or more of the following actions with respect to a nominated area: reduced tax rates or fees; increased delivery of local public services; simplified government paperwork requirements; involvement in the program by public or private entities (e.g., community groups), including a commitment to provide jobs and job training, and technical, financial, or other assistance to employers, employees, and residents of the area; special preferences granted to minority contractors; donations of surplus land to community organizations agreeing to operate businesses on the land; programs to encourage employers to purchase health insurance for employees on a pooled basis; certain programs to encourage local financial institutions to make loans to area businesses (with emphasis on start-up firms and other small businesses); and special preferences for projects within the area in allocations of the State's low-income housing credit ceiling and private activity bonds ceiling. Programs which serve as part of the required course of action with respect to a nominated zone may not be funded from proceeds from any Federal program.[3]

[1] In the case of a nominated area which is located on one or more Indian reservations, the nominated area need not be located entirely within one State.

[2] If the areas in question are not tracted, the analogous divisions as defined by the Bureau of the Census for purposes of defining poverty areas should be used.

[3] In addition, the course of action implemented generally may not include any action to assist any business establishment in relocating into the zone from another area. However, this limitation will not be construed to prohibit assistance for the expansion of an existing business if the Secretary of Housing and Urban Development (in the case of an urban tax enterprise zone) or

Continued

Selection process and criteria.—The Secretary of Housing and Urban Development may designate a total of ten urban tax enterprise zones, consisting of five urban zones designated in 1993, three in 1994, and two in 1995. The Secretary of Agriculture (in consultation with the Secretary of Commerce) may designate a total of 25 rural development investment zones, consisting of 12 rural zones designated in 1993, seven in 1994, and six in 1995.[4]

All designated tax enterprise zones shall be selected from nominated areas on the basis of the following criteria (each of which is to be given equal weight): (1) the strength and quality of promised contributions by State and local governments relative to their fiscal ability; (2) the effectiveness and enforceability of the guarantees that the promised course of action actually will be implemented; (3) the level of commitments by private entities of additional resources to the economy of the nominated area, including the creation of new or expanded business activities; (4) the average ranking (relative to other nominated areas) with respect to (a) in the case of a nominated urban tax enterprise zone, the degree of poverty and unemployment, or (b) in the case of a nominated rural development investment zone, two of the following criteria that give the area a higher average ranking: poverty, unemployment, job loss, or population loss; and (5) the potential for revitalization of the nominated area (including the potential reduction in the incidence of crime and narcotics use and traffic), taking into account particularly the number of jobs to be created and retained.

Period designation in effect.—Designation of an area as a tax enterprise zone generally will remain in effect for a period of 15 years. However, an area's designation as a tax enterprise zone will be revoked if it is determined (after a hearing on the record) by the Secretary of Housing and Urban Development (in the case of an urban tax enterprise zone) or the Secretary of Agriculture (in the case of a rural development investment zone) that the local government or State in which the area is located has significantly modified the boundaries of the zone or is not complying substantially with commitments made as part of the required course of action.

Regulations.—Within four months after the date of enactment, the Secretary of Housing and Urban Development and the Secretary of Agriculture must issue regulations regarding: (1) procedures for nominating tax enterprise zones, (2) the method for comparing the enumerated selection criteria; and (3) recordkeeping requirements to assist in the preparation of Congressionally mandated studies (described below).

Secretary of Agriculture (in the case of a rural development investment zone) finds that establishment of a new branch or subsidiary will not increase unemployment in an area where the existing business conducts business operations and that there is no reason to believe that the new branch or subsidiary is being established with the intention of closing down the operations of the existing business in other locations.

[4] For both urban tax enterprise zones and rural development investment zones, any shortfall in designations below the annual maximum for 1993 and 1994 may be carried forward by the respective Secretaries, but may not be carried beyond 1995.

A designation made during any calendar year will be treated as made on January 1 of the following calendar year if so provided in the designation.

Tax incentives for enterprise zones

Wage credit.—A 7.5-percent nonrefundable tax credit is provided to certain small employers for qualified enterprise zone wages. Qualified zone wages are paid to an individual who does not receive annual wages or salary exceeding $30,000, resides in the tax enterprise zone, and performs substantially all services for the employer trade or business within the tax enterprise zone. However, wages are not eligible for the credit if paid to certain relatives of the employer or, if the employer is a corporation, certain relatives of a person who owns more than 50 percent of the corporation. In addition, wages are not eligible for the credit if paid to a person who owns more than five percent of the stock of the employer (or if·the employer is not a corporation, more than five percent of the capital or profits interest in the employer).[5]

For purposes of this credit, a "small employer" is defined as an employer that, on average, did not employ more than 100 full-time employees during the taxable year.[6] If an employee is terminated less than one year after initial employment, the amount of credits previously claimed by the employer with respect to that employee generally is recaptured.[7]

The wage credit is not available for wages or salary paid to an employee beyond five years after the date such employee first began work for the employer (whether or not in a tax enterprise zone). The total wage credit that may be claimed by any small employer for any taxable year cannot exceed the credit amount allocated to that employer by the tax enterprise zone allocating official (whose functions are described below). The employer's deductions for wages or salaries paid are reduced by the amount of credit determined for the taxable year. For alternative minimum tax (AMT) purposes, the wage credit is not allowed to offset tentative minimum tax.[8]

Deduction for purchase of enterprise zone stock.—An individual is allowed an itemized deduction for the amount paid in cash during any taxable year to purchase enterprise zone stock. The amount allowed as a deduction for any taxable year is limited to the lesser of (1) $25,000, or (2) the enterprise zone stock amount allocated to the taxpayer for the taxable year by the tax enterprise zone allocating official (whose functions are described below). If the amount paid in cash during any taxable year to purchase enterprise zone stock exceeds the limitation for such year, then the excess amount is treated as paid for such stock during the immediately succeeding tax-

[5] In addition, wages are not eligible for the credit if attributable to services rendered by an employee during the first year he or she begins employment if any portion of such wages are qualified wages for purposes of the targeted jobs tax credit (sec. 51).

[6] For purposes of the credit, certain related employers that are considered to be part of a controlled group under section 52(a) or (b) are treated as a single employer.

[7] However, this rule does not apply if the employee voluntarily leaves the employment, becomes disabled to perform the services of such employment (unless the disability is removed before the close of the one-year period and the employer fails to offer reemployment), or if it is determined under applicable State unemployment compensation law that the termination was due to misconduct by the employee.

Moreover, employment relationships generally will not be treated as terminated merely because of an acquisition of the employer or other transaction that changes the form in which the employer conducts business, provided that the employee continues to be employed for the requisite one-year period.

[8] The wage credit is subject to the general business credit limitations of section 38.

able year. In no event, however, is the amount of the deduction allowed under the provision with respect to any one individual to exceed $250,000.[9] In addition, the maximum amount of enterprise zone stock that may be issued by any corporation is limited to $5 million.[10]

Enterprise zone stock is defined as stock of a C corporation which is acquired on original issue from a corporation that is a qualified issuer, but only to the extent that the cash paid for the stock is used by the corporation within a 12-month period to acquire qualified enterprise zone property. A qualified issuer is defined as a domestic C corporation that satisfies the following requirements: (1) the corporation does not have more than one class of stock outstanding; (2) the sum of (a) the unadjusted bases of the assets owned by the corporation and (b) the value (as determined under Treasury regulations) of the assets leased by the corporation does not exceed $5 million; (3) more than 20 percent of the total value and total voting power of the stock of the corporation is owned by individuals (directly or through partnerships or trusts) or by estates; and (4) the corporation satisfies the enterprise zone business requirements.

A corporation satisfies the enterprise zone business requirements for any taxable year if: (1) at least 80 percent of the gross income of the corporation for the taxable year is derived from the active conduct of a trade or business within a tax enterprise zone; [11] (2) substantially all of the use of the tangible property of the corporation (whether owned by the corporation or leased by the corporation) during the taxable year occurs within a tax enterprise zone; (3) substantially all of the services performed for the corporation by employees of the corporation during the taxable year are performed in a tax enterprise zone; (4) less than 10 percent of the average of the aggregate unadjusted bases of the property owned by the corporation during the taxable year is attributable to securities (as defined in section 165(g)(2)); [12] and (5) no more than an insubstantial portion of the property owned by the corporation during the taxable year constitutes collectibles that are not held primarily for sale to customers in the ordinary course of an active trade or business.

For purposes of determining whether a corporation satisfies these requirements, leasing real property that is located within a tax enterprise zone to (or otherwise holding real property for use by) persons that are not related to the corporation is treated as the active conduct of a trade or business. In addition, a corporation is treated as failing to satisfy the enterprise zone business requirements for any taxable year if either: (1) more than 50 percent of the property or services acquired by the corporation during any taxable year is acquired from persons that are related to the corporation and that are not qualified issuers; or (2) more than 50 percent of the gross income of the corporation for the taxable year is

[9] For purposes of the $25,000 annual limitation and the $250,000 lifetime limitation, an individual and all members of his or her family (as defined in section 267(c)(4)) are treated as a single individual.

[10] For this purpose, two or more corporations that are related are treated as a single corporation.

[11] This requirement does not apply to the first taxable year of a corporation.

[12] This requirement does not apply to the first taxable year of a corporation.

derived from property or services provided to persons that are related to the corporation and that are not qualified issuers.[13]

Qualified enterprise zone property is defined as tangible property (whether real or personal) to which section 168 of the Code applies, but only if the original use of the property commences with the qualified issuer and substantially all of the use of the property is in the tax enterprise zone.

Special "recapture" rules apply if, at any time after the acquisition of the enterprise zone stock, the stock is disposed of,[14] or, if, at any time during the 10-year period beginning on the date of the acquisition of the enterprise zone stock, either (1) the issuer of the enterprise zone stock ceases to satisfy the definition of a qualified issuer;[15] or (2) the amount paid for the enterprise zone stock ceases to be invested by the qualified issuer in qualified enterprise zone property. First, the amount realized on the disposition of the enterprise zone stock is required to be recognized notwithstanding any other provision of the Code and is to be treated as ordinary income to the extent that the amount realized does not exceed the amount allowed as a deduction.[16] Second, if enterprise zone stock is disposed of within five years after the date of acquisition of the stock, the taxpayer is required to pay interest on the amount of tax that would otherwise have been due if a deduction had not been allowed for the purchase of the enterprise zone stock.

The basis of enterprise zone stock is reduced by the amount of the deduction allowed under this provision. In addition, the deduction for the purchase of enterprise stock is an adjustment that is required to be taken into account by individuals in computing alternative minimum taxable income (i.e., the deduction is to be added to taxable income in determining alternative minimum taxable income).

Additional first-year depreciation allowance.—An additional depreciation allowance equal to 25 percent of the adjusted basis of certain qualified zone property is allowed for the taxable year that the property is placed in service.[17] The additional depreciation, however, is allowed only with respect to the adjusted basis of qualified zone property for which the taxpayer has received an additional first-year depreciation allowance from the tax enterprise zone allocating official (whose functions are described below). In addition, the adjusted basis of any qualified zone property with respect to

[13] For purposes of these rules, a person is related to another person if: (1) the person bears a relationship to that person which would be specified in section 267(b) or 707(b)(1) of the Code if those sections were amended by substituting 33 percent for 50 percent; or (2) the persons are engaged in trades or businesses under common control (within the meaning of subparagraphs (A) and (B) of section 41(f)(1) of the Code).

[14] A transfer by reason of death is not considered a disposition for this purpose.

[15] The determination of whether a corporation ceases to satisfy the definition of a qualified issuer is to be made without regard to the requirement that the sum of (1) the unadjusted bases of the assets owned by the corporation and (2) the value (as determined under Treasury regulations) of the assets leased by the corporation does not exceed $5 million. In addition, a corporation is not to be treated as ceasing to satisfy the definition of a qualified issuer solely by reason of a termination or a revocation of a tax enterprise zone designation.

[16] In the case of an issuer that ceases to satisfy the definition of a qualified issuer or in the case where the amount paid for the enterprise zone stock ceases to be invested by the qualified issuer in qualified enterprise zone property, the taxpayer is treated as disposing of his or her stock during the taxable year in which the cessation occurs at a price equal to the fair market value of the stock as of the first day of such taxable year.

[17] The additional first-year depreciation allowance for qualified zone property is added to any other additional first-year depreciation allowance provided for by the bill.

which the additional first-year depreciation allowance is allowed is reduced by the amount of such allowance before computing the amount otherwise allowable as a depreciation deduction with respect to the property for the taxable year that the property is placed in service and for any subsequent taxable year.

For this purpose, qualified zone property is defined as any tangible property to which section 168 of the Code applies (other than property that is required to be taken into account under the alternative depreciation system of section 168(g)) but only if: (1) the property is section 1245 property (generally tangible personal property and certain real property other than buildings and structural components of buildings); (2) the original use of the property commences with the taxpayer in a tax enterprise zone; [18] and (3) substantially all of the use of the property is in a tax enterprise zone and in the active conduct of a trade or business by the taxpayer in a tax enterprise zone.

The additional depreciation allowance is to be taken into account for regular tax purposes and for purposes of the alternative minimum tax.

Overall limitation on zone tax incentives

In general.—Each tax enterprise zone is subject to an annual overall limitation on the amount of tax incentives that can be provided with respect to that zone. Urban tax enterprise zones generally have an annual limitation of $13 million, and rural development investment zones generally have an annual limitation of $5 million. However, this annual limitation is increased with respect to a zone by up to an additional 10 percent (i.e., an additional $1.3 million for an urban tax enterprise zone, and an additional $.5 million for a rural development investment zone) if certain expenditures are made to promote development in the zone (e.g., for public improvements or additional police protection) and certain incentives are provided (e.g., property or sales tax abatements) by the local governments and State in which the zone is located.

Allocation of tax incentives.—With respect to each tax enterprise zone, the local governments and the State in which the zone is located must designate a government official (the "allocating official") with responsibility for making allocations of employment wage credits, deductible enterprise zone stock amounts, and additional first-year depreciation allowance amounts. Enterprise zone tax incentives are available to a taxpayer only if the allocating official provides a specific allocation to that taxpayer. For instance, a wage credit may be claimed by a small employer only up to the amount for which that employer has received an allocation for that taxable year. Similarly, the allocating official must specify the particular stock purchases for which the deduction provided for by the bill may be claimed, as well as the specific property for which the additional first-year depreciation allowance may be claimed.[19]

[18] A special rule applies in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold and leased back by such person within three months after the date that the property was placed in service, the property is treated as originally placed in service not earlier than the date that the property is used under the leaseback.

[19] In making such allocations, the allocating official is to give preference to certain small business concerns.

The allocating official for each tax enterprise zone may make total allocations for each calendar year up to an amount which corresponds with the overall zone limitation on tax incentives for that year. Total allocations made in a year may be for one or more of the three tax incentives provided in the bill, depending on the combination of incentives determined by the allocating official to be appropriate for the particular enterprise zone during that year. To the extent the allocating official allocates less than the total amount of allowable tax incentives for any year, unused allocations may be carried forward to the following year (except that total unused allocations carried forward from previous years may not exceed 70 percent of the otherwise applicable zone limitation). Allocations of tax incentives made by the allocating official are counted towards the annual overall zone limitation in the following manner: for each allocated dollar of employment wage credit, the zone limitation is reduced by 67 cents; for each allocated dollar of deduction for enterprise zone stock, the zone limitation is reduced by 35 cents; and for each allocated dollar of adjusted basis of property with respect to which the additional first-year depreciation is allowed, the zone limitation is reduced by 1.5 cents.[20]

Studies

The Secretary of the Treasury and Comptroller General each are directed to submit an interim report by July 1, 1996, and a final report by July 1, 2001, to the House Committee on Ways and Means and the Senate Committee on Finance, analyzing the effectiveness of the tax enterprise zones.

Effective date

Tax enterprise zone designations can be made only during calendar years 1993 through 1995. Designations generally will remain in effect through the 15th calendar year after the year in which the designation first becomes effective.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill, except that the Secretary of Agriculture (in consultation with the Secretary of Commerce) is required to designate at least one rural development investment zone located on an Indian reservation.

[20] These amounts by which the overall zone limitation is reduced are designed to represent the approximate revenue cost of each of the enterprise zone tax incentives provided for by the bill.

J. Excise Taxes

1. REPEAL OF LUXURY EXCISE TAX ON BOATS, AIRCRAFT, JEWELRY, AND FURS; INDEXING OF LUXURY EXCISE TAX ON AUTOMOBILES

Present law

Present law imposes a ten-percent excise tax on the portion of the retail price of the following items that exceeds the thresholds specified: automobiles above $30,000; boats above $100,000; aircraft above $250,000; jewelry above $10,000; and furs above $10,000.

The tax applies to sales before January 1, 2000.

House bill

Repeal of tax on boats, aircraft, jewelry, and fur

The House bill repeals the luxury excise tax imposed on boats, airplanes, jewelry, and furs.

Indexing of tax on automobiles

The House bill modifies the luxury excise tax on automobiles to provide that the $30,000 threshold is indexed annually for inflation occurring after 1990. Consequently, the applicable threshold for 1992 will be $30,000 increased by the 1991 inflation rate.

Effective date

The repeal of the luxury excise taxes on boats, aircraft, jewelry, and furs is effective for sales on or after February 1, 1992. The indexation of the threshold applicable to automobiles is effective for sales on or after February 1, 1992.

Persons entitled to a refund may request it from the seller from whom they purchased the taxed item, who then obtains the refund as provided under present-law Code section 6416.

Senate amendment

The Senate amendment is the same as the House bill, except for its effective date. The Senate amendment repeals the luxury excise taxes on boats, aircraft, jewelry, and furs effective for sales on or after January 1, 1992. The Senate amendment indexes the threshold applicable to automobiles effective for sales on or after January 1, 1992.

Persons entitled to a refund may request it from the seller from whom they purchased the taxed item, who then obtains the refund as provided under present-law Code section 6416.

Conference agreement

The conference agreement follows the Senate amendment.

2. IMPOSE EXCISE TAX ON DIESEL FUEL USED IN NONCOMMERCIAL BOATS

Present law

Federal excise taxes generally are imposed on gasoline and special motor fuels used in highway transportation and by boats (14 cents per gallon). A Federal excise tax also is imposed on diesel fuel (20 cents per gallon) used in highway transportation. Diesel fuel used in trains generally is taxed at 2.5 cents per gallon.

The revenues from these taxes, minus 2.5 cents per gallon, are deposited in the Highway Trust Fund ("HTF") through September 30, 1999. The revenues attributable to the taxes on boat and small engine gasoline fuels deposited in the HTF are transferred to the Aquatic Resources Trust Fund.

Revenues from the remaining 2.5 cents per gallon are retained in the General Fund through September 30, 1995, after which time the 2.5 cents-per-gallon portion of the taxes (including the tax on diesel fuel used in trains) is scheduled to expire.

An additional 0.1-cent-per-gallon tax applies to these fuels to finance the Leaking Underground Storage Trust Fund ("LUST Fund"), generally through December 31, 1995.

Diesel fuel used in boats is not taxed.

House bill

The House bill extends the diesel fuel excise taxes to diesel fuel used by boats. Fuel used by boats for commercial fishing, transportation for compensation or hire, or for business use other than predominantly for entertainment, amusement, or recreation, remains exempt.

As under the President's budget proposal, the tax is collected at the same point in the distribution chain as the highway diesel fuel tax (i.e., on sale to a retailer). However, to prevent unnecessary tax-paid sales followed by refunds, retailers that sell diesel fuel exclusively to commercial (i.e., nonpleasure) boats are permitted to buy and sell the fuel tax-free.

The revenues from the taxes on diesel fuel used by boats will be retained in the General Fund.

Effective date.—The provision is effective after June 30, 1992.

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. INCREASE BASE TAX RATE ON OZONE-DEPLETING CHEMICALS

Present law

An excise tax is imposed on certain ozone-depleting chemicals. The amount of tax generally is determined by multiplying the base tax rate applicable for the calendar year by an ozone-depleting factor assigned to the chemical. Certain chemicals are subject to a reduced rate of tax for years prior to 1994.

Between 1992 and 1995 there are two base tax rates applicable, depending upon whether the chemicals were initially listed in the Omnibus Budget Reconciliation Act of 1989 or whether they were newly listed in the Omnibus Budget Reconciliation Act of 1990. The base tax rate applicable to initially listed chemicals is $1.67 per pound for 1992, $2.65 per pound for 1993 and 1994, and an additional 45 cents per pound per year for each year thereafter. The base tax rate applicable to newly listed chemicals is $1.37 per pound for 1992, $1.67 per pound for 1993, $3.00 per pound for 1994, $3.10 per pound for 1995, and an additional 45 cents per pound per year for each year thereafter.

House bill

No provision.

Senate amendment

The Senate amendment increases and applies the same base tax rate to both initially listed chemicals and newly listed chemicals. The new base tax rate is $1.85 per pound for 1992, $2.75 per pound in 1993, $3.65 per pound in 1994, and $4.55 per pound in 1995. For years after 1995, the base tax amount will increase (as under present law) by 45 cents per pound per year.

In addition, the Senate amendment reduces the applicable percentage used in the computation of the tax applied to chemicals used in rigid foam insulation in 1992 and 1993. The provision reduces the applicable percentage from 15 percent to 13.5 percent for 1992, and reduces the applicable percentage from 10 percent to 9.6 percent for 1993. The effect of this provision is to continue present-law rates on these chemicals for 1992 and 1993.

Effective date.—The provision is effective for taxable chemicals sold or used on or after July 1, 1992. Floor stocks taxes are imposed on taxed chemicals held on the effective dates of changes in the base tax rate.

Conference agreement

The conference agreement follows the Senate amendment.

K. Trade-Related Provisions

1. CLASSIFICATION OF MULTI-PURPOSE VEHICLES

Present law

Under present regulations, multi-purpose vehicles (MPVs) such as mini-vans and sport utility vehicles are inconsistently classified as autos or trucks. For purposes of emission and fuel economy standards, most MPVs are classified as trucks. However, for customs purposes, MPVs with more than two doors are generally classified under the Harmonized Tariff System (HTS) as vehicles "principally designed for the transport of persons" (HTS heading 8703), subject to a 2.5-percent duty. Two-door MPVs are generally classified as "vehicles for the transport of goods" (HTS heading 8704), subject to a 25-percent duty.

House bill

No provision.

Senate amendment

The Senate amendment incorporates into the HTS language from the regulations of the Environmental Protection Agency and the Department of Transportation such that MPVs classified as trucks for emission and fuel economy standards would be classified under HTS heading 8704.

Effective date.—Effective 15 days after enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

2. WESTERN HEMISPHERIC TRADE CENTER

Present law

No provision.

House bill

No provision.

Senate amendment

The Senate amendment amends the Caribbean Basin Economic Recovery Act, as amended, 19 U.S.C. 2701 et seq., to establish a new Center for the Study of Western Hemispheric Trade (the Center). The Center is to be established not later than December 31, 1992. The Commissioner of Customs and the United States International Trade Commission, after consultation with appropriate public and private sector authorities, are authorized and directed to select an institution of higher education, as that term is defined in 20 U.S.C. 1141(a), or a consortium or such institutions, located in the State of Texas, to operate the Center, which will be affiliated with such institution or institutions. The Senate amendment authorizes to be appropriated $10 million for the first fiscal year, and such sums as may be necessary in the three succeeding fiscal years, to assist in establishing and operating the Center.

Conference agreement

The conference agreement does not include the Senate amendment.

III. Tax Payments by High-Income Taxpayers

A. Treatment of High-Income Taxpayers

1. INDIVIDUAL INCOME TAX RATES

Present law

For 1992, the individual income tax rate schedules are as follows—

If taxable income is:	Then income tax equals:
Single individuals	
$0–$21,450	15 percent of taxable income.
$21,450–$51,900	$3,217.50 plus 28% of the amount over $21,450.
Over $51,900	$11,743.50 plus 31% of the amount over $51,900.
Heads of household	
$0–$28,750	15 percent of taxable income.
$28,750–$74,150	$4,312.50 plus 28% of the amount over $28,750.
Over $74,150	$17,024.50 plus 31% of the amount over $74,150.
Married individuals filling joint returns	
$0–$35,800	15 percent of taxable income.
$35,800–$86,500	$5,370 plus 28% of the amount over $35,800.
Over $86,500	$19,566 plus 31% of the amount over $86,500.
Married individuals filling separate returns	
$0–$17,900	15 percent of taxable income.
$17,900–$43,250	$2,685 plus 28% of the amount over $17,900.
Over $43,250	$9,783 plus 31% of the amount over $43,250.
Estates and trusts	
$0–$3,600	15 percent of taxable income.
$3,600–$10,900	$540 plus 28% of the amount over $3,600.
Over $10,900	$2,584 plus 31% of the amount over $10,900.

The individual income tax brackets are indexed for inflation.

Under present law, an individual taxpayer is subject to an alternative minimum tax (AMT) to the extent it exceeds the taxpayer's regular tax liability. The AMT liability generally equals 24 percent of alternative minimum taxable income (generally the taxpayer's adjusted gross income plus certain preferences and adjustments).

House bill

The House bill creates a 35-percent tax bracket for taxable incomes above: $85,000 for unmarried individuals filing single returns; $125,000 for unmarried individuals filing as heads of households; $145,000 for married individuals filing joint returns; $72,500 for married individuals filing separate returns; and $7,000 for estates and trusts. The thresholds for the 35-percent bracket are adjusted for inflation in the same manner as under present law. Under the bill, the individual rate schedules for 1992 are as follows—

If taxable income is:	Then income tax equals:
Single individuals	
$0–$21,450	15 percent of taxable income.
$21,450–$51,900	$3,217.50 plus 28% of the amount over $21,450.
$51,900–$85,000	$11,743.50 plus 31% of the amount over $51,900.
Over $85,000	$22,004.50 plus 35% of the excess over $85,000.
Heads of household	
$0–$28,750	15 percent of taxable income.
$28,750–$74,150	$4,312.50 plus 28% of the amount over $28,750.
$74,150–$125,000	$17,024.50 plus 31% of the amount over $74,150.
Over $125,000	$32,788.50 plus 35% of the excess over $125,000.
Married individuals filing joint returns	
$0–$35,800	15 percent of taxable income.

If taxable income is:	Then income tax equals:
$35,800-$86,500	$5,370 plus 28% of the amount over $35,800.
$86,500-$145,000	$19,566 plus 31% of the amount over $86,500.
Over $145,000	$37,701 plus 35% of the excess over $145,000.
Married individuals filing separate returns	
$0-17,900	15 percent of taxable income.
$17,900-$43,250	$2,685 plus 28% of the amount over $17,900.
$43,250-$72,500	$9,783 plus 31% of the amount over $43,250.
Over $72,500	$18,850.50 plus 35% of the excess over $72,500.
Estates and trusts	
$0-$3,000	15 percent of taxable income.
$3,000-$5,000	$450 plus 28% of the amount over $3,000.
$5,000-$7,000	$1,010 plus 31% of the amount over $5,000.
Over $7,000	$1,630 plus 35% of the amount over $7,000.

The House bill also increases the individual alternative minimum tax rate from 24 percent to 25 percent.

Effective date.—The provision is effective for taxable years beginning after December 31, 1991.

Senate amendment

The Senate amendment creates a 36-percent bracket for taxable incomes above: $150,000 (unmarried individuals filing single returns); $162,500 (unmarried individuals filing as heads of households); $175,000 (married individuals filing joint returns); $87,500 (married individuals filing separate returns); and $3,500 (estates and trusts). In addition, the Senate amendment reduces the number of tax brackets for estates and trusts from four to two. The thresholds for the 36-percent bracket are adjusted for inflation in the same manner as under present law. The individual income tax rate schedules for 1992 are as follows—

If taxable income is:	Then income tax equals:
Single individuals	
$0-$21,450	15 percent of taxable income.
$21,450-$51,900	$3,217.50 plus 28% of the amount over $21,450.
$51,900-$150,000	$11,743.50 plus 31% of the amount over $51,900.
Over $150,000	$42,154.50 plus 36% of the amount over $150,000.
Heads of household	
$0-$28,750	15 percent of taxable income.
$28,750-$74,150	$4,312.50 plus 28% of the amount over $28,750.
$74,150-$162,500	$17,024.50 plus 31% of the amount over $74,150.
Over $162,500	$44,413 plus 36% of the amount over $162,500.
Married individuals filing joint returns	
$0-$35,800	15 percent of taxable income.
$35,800-$86,500	$5,370 plus 28% of the amount over $35,800.
$86,500-$175,000	$19,566 plus 31% of the amount over $86,500.
Over $175,000	$47,001 plus 36% of the amount over $175,000.
Married individuals filing separate returns	
$0-$17,900	15 percent of taxable income.
$17,900-$43,250	$2,685 plus 28% of the amount over $17,900.
$43,250-$87,500	$9,783 plus 31% of the amount over $43,250.
Over $87,500	$23,500.50 plus 36% of the amount over $87,500.
Estates and trusts	

If taxable income is:	Then income tax equals:
$0–$3,500	15 percent of taxable income.
Over $3,500	$525 plus 36% of the amount over $3,500.

Effective date.—Same as the House bill.

Conference agreement

The conference agreement creates a 36-percent bracket for taxable incomes above: $115,000 (unmarried individuals filing single returns); $127,500 (unmarried individuals filing as heads of households); $140,000 (married individuals filing joint returns); $70,000 (married individuals filing separate returns); and $7,000 (estates and trusts). The thresholds for the 36-percent bracket are adjusted for inflation in the same manner as under present law. The individual income tax rate schedules for 1992 are as follows—

If taxable income is:	Then income tax equals:
Single individuals	
$0–$21,450	15 percent of taxable income.
$21,450–$51,900	$3,217.50 plus 28% of the amount over $21,450.
$51,900–$115,000	$11,743.50 plus 31% of the amount over $51,900.
Over $115,000	$31,304.50 plus 36% of the amount over $115,000.
Heads of household	
$0–$28,750	15 percent of taxable income.
$28,750–$74,150	$4,312.50 plus 28% of the amount over $28,750.
$74,150–$127,500	$17,024.50 plus 31% of the amount over $74,150.
Over $127,500	$33,563 plus 36% of the amount over $127,500.
Married individuals filing joint returns	
$0–$35,800	15 percent of taxable income.
$35,800–$86,500	$5,370 plus 28% of the amount over $35,800.
$86,500–$140,000	$19,566 plus 31% of the amount over $86,500.
Over $140,000	$36,151 plus 36% of the amount over $140,000.
Married individuals filing separate returns	
$0–$17,900	15 percent of taxable income.
$17,900–$43,250	$2,685 plus 28% of the amount over $17,900.
$43,250–$70,000	$9,783 plus 31% of the amount over $43,250.
Over $70,000	$18,075.50 plus 36% of the amount over $70,000.
Estates and trusts	
$0–$3,000	15 percent of taxable income.
$3,000–$5,000	$450 plus 28% of the amount over $3,000.
$5,000–$7,000	$1,010 plus 31% of the amount over $5,000.
Over $7,000	$1,630 plus 36% of the amount over $7,000.

The conference agreement does not include an increase in the individual alternative minimum tax rate.

Effective date.—The provision is effective for taxable years beginning after December 31, 1991.

2. SURTAX ON TAXABLE INCOME IN EXCESS OF $1 MILLION

Present law

Under present law, there is no surtax imposed on higher-income individuals.

House bill

The House bill imposes a 10-percent surtax on individuals with taxable income over $1,000,000 ($500,000 for married taxpayers filing separate returns). The surtax equals 10 percent of otherwise computed tax liability multiplied by the ratio of taxable income in excess of $1,000,000 to total taxable income. The effect of the proposal is that the more that taxable income exceeds $1,000,000, the closer the surtax approaches a 10-percent increase in total tax liability.

A 2.5-percentage point surtax applies to individuals with alternative minimum taxable income above $1,000,000 ($500,000 for married taxpayers filing separate returns). The surtax is applied by increasing the taxpayer's tentative minimum tax by 2.5 percent of the amount by which the taxpayer's alternative minimum taxable income exceeds $1,000,000 ($500,000 for married taxpayers filing separate returns). The bill includes trusts and estates as individuals for purposes of the surtax.

Effective date.—The provision is effective for taxable years beginning after December 31, 1991.

Senate amendment

The Senate amendment is the same as the House bill except: (1) the surtax rate for alternative minimum tax purposes is 2.4 percent; and (2) the surtax does not apply to trusts and estates.

Conference agreement

The conference agreement follows the House bill, except that the surtax rate for alternative minimum tax purposes is 2.4 percent.

3. EXTENSION OF ITEMIZED DEDUCTION LIMITATION

Present law

Under present law, individuals who do not elect the standard deduction may claim itemized deductions (subject to certain limitations) for certain nonbusiness expenses incurred during the taxable year. Among these deductible expenses are unreimbursed medical expenses, casualty and theft losses, charitable contributions, qualified residence interest, State and local income and property taxes, unreimbursed employee business expenses, and certain other miscellaneous expenses.

Certain itemized deductions are allowed only to the extent that the amount exceeds a specified percentage of the taxpayer's adjusted gross income (AGI). Unreimbursed medical expenses for care of the taxpayer and the taxpayer's spouse and dependents are deductible only to the extent that the total of these expenses exceeds 7.5 percent of the taxpayer's AGI. Nonbusiness casualty or theft losses are deductible only to the extent that the amount of loss arising from each casualty or theft exceeds $100 and only to the extent that the net amount of casualty and theft losses exceeds 10 percent of the taxpayer's AGI. Unreimbursed employee business expenses and certain other miscellaneous expenses are deductible only to the extent that the total of these expenses exceeds 2 percent of the taxpayer's AGI.

The total amount of otherwise allowable itemized deductions (other than medical expenses, casualty and theft losses, and investment interest) is reduced by 3 percent of the amount of the taxpayer's AGI in excess of $105,250 in 1992 (indexed for inflation). Under this provision, otherwise allowable itemized deductions may not be reduced by more than 80 percent. In computing the reduction of total itemized deductions, all present-law limitations applicable to such deductions are first applied and then the otherwise allowable total amount of deductions is reduced in accordance with this provision.

The reduction of otherwise allowable itemized deductions does not apply to taxable years beginning after December 31, 1995.

House bill

The House bill delays the expiration date of the present-law itemized deduction limitation applicable to higher-income individuals for two years. That is, under the bill, the reduction of itemized deductions will not apply to taxable years beginning after December 31, 1997.

Effective date.—The provision is effective for taxable years beginning in 1996 and 1997.

Senate amendment

The Senate amendment extends permanently the present-law itemized deduction limitation applicable to higher-income individuals.

Effective date.—The provision is effective for taxable years beginning in 1996 and thereafter.

Conference agreement

The conference agreement follows the House bill.

4. EXTENSION OF PERSONAL EXEMPTION PHASEOUT

Present law

Present law permits a personal exemption deduction from gross income for an individual, the individual's spouse, and each dependent. For 1992, the amount of this deduction is $2,300 for each exemption claimed. This exemption amount is adjusted for inflation. The deduction for personal exemptions is phased out for taxpayers with adjusted gross income (AGI) above a threshold amount (indexed for inflation) which is based on filing status. For 1992, the threshold amounts are $157,900 for married taxpayers filing joint returns, $78,950 for married taxpayers filing separate returns, $131,550 for unmarried taxpayers filing as head of household, and $105,250 for unmarried taxpayers filing as single.

The total amount of exemptions which may be claimed by a taxpayer is reduced by 2 percent for each $2,500 (or portion thereof) by which the taxpayer's AGI exceeds the applicable threshold (the phaseout rate is 4 percent for married taxpayers filing separate returns). Thus, the personal exemptions claimed are phased out over a $122,500 range, beginning at the applicable threshold.

This provision does not apply to taxable years beginning after December 31, 1995.

House bill

The House bill delays the expiration date for the personal exemption phaseout applicable to higher-income individuals for two years. That is, under the bill, the phaseout of personal exemptions will not apply to taxable years beginning after December 31, 1997.

Effective date.—The provision is effective for taxable years beginning in 1996 and 1997.

Senate amendment

The Senate amendment extends permanently the present-law personal exemption phaseout applicable to higher-income individuals.

Effective date.—The provision is effective for taxable years beginning in 1996 and thereafter.

Conference agreement

The conference agreement follows the Senate amendment.

B. Administrative Provisions

1. MODIFY INDIVIDUAL ESTIMATED TAX REQUIREMENTS

Present law

Under present law, an individual taxpayer generally is subject to an addition to tax for any underpayment of estimated tax. An individual generally does not have an underpayment of estimated tax if he or she makes timely estimated tax payments at least equal to: (1) 100 percent of the tax liability of the prior year (the "100 percent of last year's liability safe harbor") or (2) 90 percent of the tax liability of the current year. Income tax withholding from wages is considered to be a payment of estimated taxes.

In addition, under a special rule, for taxable years beginning after 1991 and before 1997, a taxpayer that has an adjusted gross income (AGI) in the current year that exceeds the taxpayer's AGI in the prior year by more than $40,000 ($20,000 in the case of a separate return by a married individual) and (2) the taxpayer has an AGI in excess of $75,000 in the current year ($37,500 in the case of a separate return by a married individual) generally may not use the 100 percent of last year's liability safe harbor.

House bill

The special rule that denies the use of the 100 percent of last year's liability safe harbor is repealed. In addition, the 100 percent of last year's liability safe harbor is modified to be a 115 percent of last year's liability safe harbor.

Thus, under the House bill, an individual generally does not have an underpayment of estimated tax if he or she makes timely estimated tax payments at least equal to: (1) 115 percent of the tax liability of the prior year or (2) 90 percent of the tax liability of the current year.

Effective date.—The provision is effective for estimated tax payments applicable to taxable years beginning after December 31, 1991. Taxpayers may continue to use the 100 percent of last year's liability safe harbor for the estimated tax payment for the first quarter of 1992 (with a catch-up in the subsequent payment).

Senate amendment

The special rule that denies the use of the 100 percent of last year's liability safe harbor is made permanent.

In addition, the bill clarifies that for purposes of the special rule, an estate or a trust is to calculate its AGI (and modified AGI) pursuant to rules similar to those of section 67(e) of the Code.

Effective date.—The provision is effective for estimated tax payments applicable to taxable years beginning after December 31, 1991.

Conference agreement

The conference agreement follows the House bill.

2. MODIFY ESTIMATED TAX PAYMENT RULES FOR LARGE CORPORATIONS

Present law

A corporation is subject to an addition to tax for any underpayment of estimated tax. For taxable years beginning in 1993, 1994, 1995, and 1996, a corporation does not have an underpayment of estimated tax if it makes four equal timely estimated tax payments that total at least 95 percent of the tax liability shown on the return for the current taxable year. In addition, a corporation may annualize its taxable income and make estimated tax payments based on 95 percent of the tax liability attributable to such annualized income.

For taxable years beginning in 1992, the 95 percent requirement is a 93 percent requirement; the 95 percent requirement becomes a 90 percent requirement for taxable years beginning in 1997 and thereafter.

A corporation that is not a "large corporation" generally may avoid the addition to tax if it makes four timely estimated tax payments each equal to at least 25 percent of its tax liability for the preceding taxable year (the "100 percent of last year's liability safe harbor"). A large corporation may use this rule with respect to its estimated tax payment for the first quarter of its current taxable year. A large corporation is one that had taxable income of $1 million or more for any of the three preceding taxable years.

House bill

For taxable years beginning after 1996, a corporation that does not use the 100 percent of last year's liability safe harbor for its estimated tax payments is required to base its estimated tax payments on 95 percent (rather than 90 percent) of its current year tax liability, whether such liability is determined on an actual or annualized basis.

The House bill does not change the present-law availability of the 100 percent of last year's liability safe harbor for large or small corporations.

Effective date.—The provision is effective for estimated tax payments with respect to taxable years beginning after December 31, 1993.

Senate amendment

The Senate amendment is the same as the House bill, except the Senate amendment is effective for estimated tax payments with respect to taxable years beginning after December 31, 1992. There is no substantive effect from the difference in the effective dates between the House bill and the Senate amendment, since both provisions do not have an effect until taxable years beginning after 1996.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

3. EXPANSION OF 45-DAY INTEREST-FREE PERIOD

Present law

No interest is paid by the Government on a refund arising from an income tax return if the refund is issued by the 45th day after the later of the due date for the return (determined without regard to any extensions) or the date the return is filed (Code sec. 6611(e)).

There is no parallel rule for refunds of taxes other than income taxes (i.e., employment, excise, and estate and gift taxes), for refunds of any type of tax arising from amended returns, or for claims for refunds of any type of tax.

If a taxpayer files a timely original return with respect to any type of tax and later files an amended return claiming a refund, and if the IRS determines that the taxpayer is due a refund on the basis of the amended return, the IRS will pay the refund with interest computed from the due date of the original return.

House bill

The House bill provides that no interest is to be paid by the Government on a refund arising from any type of tax return (including amended returns and claims for refunds) if the refund is issued by the 45th day after the later of the due date for the return (determined without regard to any extensions) or the date the return is filed.

The House bill also provides that, if interest is not refunded within 45 days after the date the taxpayer files an amended return or claim for refund with respect to any type of tax, interest is to be paid only for periods after the date on which the amended return or claim for refund is filed by the taxpayer.

Effective date.—The extension of the 45-day processing rule is effective for returns required to be filed (without regard to extensions) on or after July 1, 1992. The amended return rule is effective for amended returns and claims for refunds filed on or after July 1, 1992 (regardless of the taxable period to which they relate).

Senate amendment

No interest is to be paid by the Government on a refund arising from any type of original tax return if the refund is issued by the 45th day after the later of the due date for the return (determined without regard to any extensions) or the date the return is filed.

A parallel rule applies to amended returns and claims for refunds: if the refund is issued by the 45th day after the date the amended return or claim for refund is filed, no interest is to be paid by the Government for that 45-day period (interest would continue to be paid for the period from the due date of the return to the date the amended return or claim for refund is filed). If the IRS does not issue the refund by the 45th day after the date the amended return or claim for refund is filed, interest would be paid (as under present law) for the period from the due date of the original return to the date the IRS pays the refund.

A parallel rule also applies to IRS-initiated adjustments (whether due to computational adjustments or audit adjustments). With respect to these adjustments, the IRS is to pay interest for 45 fewer days than it otherwise would.

Effective date.—The extension of the 45-day processing rule is effective for returns required to be filed (without regard to extensions) on or after July 1, 1992. The amended return rule is effective for amended returns and claims for refunds filed on or after July 1, 1992 (regardless of the taxable period to which they relate). The rule relating to IRS-initiated adjustments is applicable to refunds paid on or after July 1, 1992 (regardless of the taxable period to which they relate).

Conference agreement

The conference agreement follows the Senate amendment.

C. Other Revenue-Increase Provisions

1. MARK TO MARKET ACCOUNTING METHOD FOR DEALERS IN SECURITIES

Present law

A taxpayer that is a dealer in securities is required for Federal income tax purposes to maintain an inventory of securities held for sale to customers. A dealer in securities is allowed for Federal income tax purposes to determine (or value) the inventory of securities held for sale based on: (1) the cost of the securities; (2) the lower of the cost or market value of the securities; or (3) the market value of the securities.

If the inventory of securities is determined based on cost, unrealized gains and losses with respect to the securities are not taken into account for Federal income tax purposes. If the inventory of securities is determined based on the lower of cost or market value, unrealized losses (but not unrealized gains) with respect to the securities are taken into account for Federal income tax purposes. If the inventory of securities is determined based on market value, both unrealized gains and losses with respect to the securities are taken into account for Federal income tax purposes.

For financial accounting purposes, the inventory of securities generally is determined based on market value.

House bill

The House bill generally requires any dealer in securities that holds any security or hedge as of the close of any taxable year (1) to recognize gain or loss as if the security or hedge were sold on the last business day of the taxable year, and (2) to take into account any such gain or loss in determining gross income for such year (the "mark-to-market requirement"). If gain or loss is taken into account with respect to a security or hedge for any taxable year by reason of the mark-to-market requirement, then the amount of gain or loss subsequently realized as a result of a sale, exchange, or other disposition of such security or hedge or as a result of the application of the mark-to-market requirement is appropriately adjusted to reflect such gain or loss.

For purposes of the House bill, a dealer in securities is defined as any taxpayer that either (1) regularly purchases securities from, and sells securities to, customers in the ordinary course of a trade or business, or (2) regularly offers to enter into, assume, offset, assign, or otherwise terminate positions in securities with customers in the ordinary course of a trade or business.

In addition, for purposes of the House bill, a security is defined as: (1) any share of stock in a corporation; (2) any partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust; (3) any note, bond, debenture, or other evidence of indebtedness issued by a corporation or by a government or political subdivision thereof with interest coupons or in registered form; (4) any derivative financial instrument in a security, including an option, forward contract, short position, and any similar financial instrument in a security (but not including a futures contract); and (5) any notional principal contract and any similar financial instrument, including a currency swap, option and a forward contract on a notional principal contract, but not including any commodity-linked notional principal contract.

For purposes of the House bill, the term "hedge" is defined to include a long or short position in a security or commodity, including a futures contract and any similar financial instrument purchased, entered into, or assumed by a dealer in securities in order to reduce the dealer's risk of loss with respect to a security (or securities).

Notwithstanding the definition of security and hedge, the mark-to-market requirement does not apply to any security or hedge if, before the close of the day on which the security is acquired or the hedge is entered into (or such earlier time as specified in Treasury regulations), the security or hedge is clearly identified in the dealer's records as held for investment. This exception is to apply to a security or hedge only if the security is not, at any time after the close of such day (or such earlier time), held by the dealer for sale to customers in the ordinary course of the dealer's trade or business.[1]

The House bill also provides that the uniform cost capitalization rules of section 263A of the Code do not apply to any security or hedge to which the mark-to-market requirement applies. Finally, the House bill authorizes the Treasury Department to promulgate such regulations as may be appropriate to carry out the provisions of the House bill, including rules to prevent the use of year-end transfers, related persons, or other arrangements to avoid the provisions of the bill.

Effective date.—The provision of the House bill relating to dealers in securities applies to taxable years ending on or after December 31, 1992. A taxpayer that is required to change its method of accounting to comply with the requirements of the provision is treated as having initiated the change in method of accounting and as having received the consent of the Treasury Department to make such change. In order for a taxpayer to implement this change in accounting method, the securities and hedges to which the provision applies are to be valued at their fair market value on the last day of the first taxable year of the taxpayer ending on or after December 31, 1992, and 10 percent of any increase or decrease in the value of the securities or hedges is to be taken into account for each of the 10 taxable years beginning with the first taxable year ending on or after December 31, 1992.

Senate amendment

The Senate amendment is the same as the House bill, except as otherwise provided below.

Mark-to-market rules

The Senate amendment provides two general rules (the "mark-to-market rules") that apply to certain securities that are held by a dealer in securities. First, any such security that is inventory in the hands of the dealer is required to be included in inventory at market value. Second, any such security that is not inventory in the hands of the dealer and that is held as of the close of any taxable year is treated as sold for its fair market value on the last business day of the taxable year and any gain or loss is required to be taken into account in determining gross income for that taxable year.[2]

If gain or loss is taken into account with respect to a security by reason of the second mark-to-market rule, then the amount of gain or loss subsequently realized as a result of a sale, exchange, or other disposition of the security, or as a result of the application of the mark-to-market rules, is to be appropriately adjusted to reflect such gain or loss. In addition, the Senate amendment authorizes the Treasury Department to promulgate regulations that provide

[1] See section 1236(a) of the Code.

[2] For purposes of this provision, a security is treated as sold to a person that is not related to the dealer even if the security is a contract between the dealer and a related person. Thus, for example, sections 267 and 707(b) of the Code are not to apply to any loss that is required to be taken into account under this provision.

for the application of the second mark-to-market rule at times other than the close of a taxable year or the last business day of a taxable year.

The mark-to-market rules described above apply only for purposes of determining the amount of gain or loss that is taken into account by a dealer in securities for any taxable year. Thus, for example, the mark-to-market rules do not apply in determining the character of any gain or loss and do not begin a new holding period for any security. As a further example, the mark-to-market rules do not apply in determining whether gain or loss is recognized by any other taxpayer that may be a party to a contract with a dealer in securities.

For purposes of the Senate amendment, a dealer in securities is defined as any taxpayer that either (1) regularly purchases securities from, or sells securities to, customers in the ordinary course of a trade or business, or (2) regularly offers to enter into, assume, offset, assign, or otherwise terminate positions in securities with customers in the ordinary course of a trade or business.

For purposes of the Senate amendment, a security is defined as: (1) any share of stock in a corporation; (2) any partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust; (3) any note, bond, debenture, or other evidence of indebtedness; (4) any notional principal contract, including any interest rate or currency swap, but not including any other commodity-linked notional principal contract; and (5) any evidence of an interest in, or any derivative financial instrument in, a security described in (1) through (4) above, including any option, forward contract, short position, or any similar financial instrument in such a security (but not including a contract to which section 1256(a) applies).

In addition, a security is defined to include any position if: (1) the position is not a security described in the preceding paragraph; (2) the position is a hedge [3] with respect to a security described in the preceding paragraph; and (3) before the close of the day on which the position was acquired or entered into (or such other time as the Treasury Department may specify in regulations), the position is clearly identified in the dealer's records as a hedge with respect to a security described in the preceding paragraph.[4]

Exceptions to the mark-to-market rules

Notwithstanding the definition of security, the mark-to-market rules generally do not apply to: (1) any security that is held for investment; [5] (2) any evidence of indebtedness that is originated or

[3] The Senate amendment defines a hedge as any position which reduces the dealer's risk from interest rate or price changes or currency fluctuations.

[4] If at any time a dealer identifies a position as a hedge with respect to a security described in the preceding paragraph but the position is not at such time a hedge with respect to a security described in the preceding paragraph, or if a dealer fails to properly identify a position as a hedge with respect to a security described in the preceding paragraph as of the time that the identification is required, then any gain, but not any loss, with respect to the position is to be taken into account under the mark-to-market rules.

[5] To the extent provided in regulations to be promulgated by the Treasury Department, the exception to the mark-to-market rules for a security that is held for investment does not apply to any notional principal contract or any derivative financial instrument that is held by a dealer in such securities.

acquired by a dealer in the ordinary course of a trade or business of the dealer but only if the evidence of indebtedness is not held for sale; (3) any security which is a hedge with respect to a security that is not subject to the mark-to-market rules (*i.e.*, any security that is a hedge with respect to a security held for investment or that is a hedge with respect to an evidence of indebtedness described in (2)); and (4) any security which is a hedge with respect to a position or a liability that is not a security in the hands of the taxpayer.[6]

These exceptions to the mark-to-market rules do not apply unless before the close of the day on which the security (including any evidence of indebtedness) is acquired, originated, or entered into (or such other time as the Treasury Department may specify in regulations),[7] the security is clearly identified in the dealer's records as being described in one of the exceptions listed in the preceding paragraph.[8]

In addition to clearly identifying a security as qualifying for one of the exceptions to the mark-to-market rules listed above, a dealer must continue to hold the security in a capacity that qualifies the security for one of the exceptions listed above. If at any time after the close of the day on which the security was acquired, originated, or entered into (or such other time as the Treasury Department may specify in regulations), the security is held for sale to customers in the ordinary course of the taxpayer's trade or business or the security is held as a hedge with respect to a security that is subject to the mark-to-market rules, then the exception to the mark-to-market rules does not apply to the security as of such time.

Further, if at any time a dealer identifies a security as qualifying for an exception to the mark-to-market rules when, in fact, the security does not, at that time, qualify for an exception to these rules, or a dealer fails to identify a security that qualifies for an exception as qualifying for an exception as of the time that the identification is required, then any gain, but not any loss, with respect to the security is to be taken into account under the mark-to-market rules.

[6] For purposes of the mark-to-market rules, debt issued by a taxpayer is not considered to be a security in the hands of such taxpayer.

[7] Under the Senate amendment, it is anticipated that the Treasury regulations will permit a floor specialist to identify a security as held for investment before the close of the seventh business day following the day that the security is acquired, originated, or entered into (see section 1236(d)). In addition, it is anticipated that the Treasury regulations will permit a dealer that originates or acquires evidences of indebtedness in the ordinary course of a trade or business to identify such evidences of indebtedness as not held for sale based on the accounting practices of the dealer but in no event later than the date that is 60 days after any such evidence of indebtedness is originated or acquired.

[8] A security is to be treated as clearly identified in a dealer's records as being described in one of the exceptions listed in the preceding paragraph if all of securities of the taxpayer that are not so described are clearly identified in the dealer's records as not being described in such exception.

For example, assume that, in the ordinary course of its trade or business, a bank originates loans that are sold if the loans satisfy certain conditions. In addition, assume that (1) the bank determines whether a loan satisfies the conditions within 30 days after the loan is made, and (2) if a loan satisfies the conditions for sale, the bank records the loan in a separate account on the date that the determination is made. For purposes of the bill, the bank is a dealer in securities with respect to the loans that it holds for sale. In addition, by identifying these loans as held for sale, the bank is considered to have identified all other loans as not held for sale. Consequently, the loans that are not held for sale are not subject to the mark-to-market rules.

Other rules

The Senate amendment also provides that the uniform cost capitalization rules of section 263A of the Code and the rules of section 263(g) of the Code that require the capitalization of certain interest and carrying charges in the case of straddles do not apply to any security to which the mark-to-market rules apply. Finally, the Senate amendment authorizes the Treasury Department to promulgate such regulations as may be appropriate to carry out the provisions of the bill, including rules to prevent the use of year-end transfers, related persons, or other arrangements to avoid the provisions of the Senate amendment.

Effective date

The provision of the Senate amendment relating to dealers in securities applies to taxable years ending on or after December 31, 1993. A taxpayer that is required to change its method of accounting to comply with the requirements of the provision is treated as having initiated the change in method of accounting and as having received the consent of the Treasury Department to make such change. The net amount of any section 481(a) adjustment that is required by the change in method of accounting generally is to be taken into account by the taxpayer ratably over a 10-taxable year period beginning with the first taxable year ending on or after December 31, 1993.

Under the Senate amendment, it is anticipated that the provisions of section 8 of Rev. Proc. 92-20, 1992-12 I.R.B., which provides rules for the acceleration of section 481(a) adjustments, will apply to any section 481(a) adjustment that is required by reason of the enactment of this provision. In addition, it is anticipated that net operating losses will be allowed to offset the section 481(a) adjustment, tax credit carryforwards will be allowed to offset any tax attributable to the section 481(a) adjustment, and, for purposes of determining liability for estimated taxes, the section 481(a) adjustment will be taken into account ratably throughout the taxable year in question.

Conference agreement

The conference agreement follows the Senate amendment with the following modifications.

Definition of security

The conference agreement clarifies that the definition of a security includes any interest rate, currency, or equity notional principal contract but not any other notional principal contract (such as a notional principal contract that is based on the price of oil, wheat, or other commodity). In addition, under the conference agreement, the definition of a security includes any evidence of an interest in, or a derivative financial instrument in, any currency, including any option or forward contract with respect to currency.[9]

[9] The conference agreement also provides that (1) the mark-to-market rules do not apply to any section 988 transaction (generally, a foreign currency transaction) that is part of a section

Continued

Exception for certain hedges

The conference agreement contains several modifications to the exception to the mark-to-market rules for certain hedges. First, the conference agreement provides that the mark-to-market rules do not apply to any security which is a hedge with respect to a right to income that is not a security in the hands of the taxpayer, provided that before the close of the day that the security is acquired or entered into (or such other time as the Treasury Department may specify in regulations), the security is clearly identified in the dealer's records as being so described.

Second, the conference agreement provides that any security that is reasonably expected to become a hedge within 60 days after the acquisition of the security is to be treated as a hedge. Thus, under the conference agreement, the mark-to-market rules do not apply to any security that is reasonably expected to become a hedge within 60 days after the acquisition of the security with respect to (1) a security to which the mark-to-market rules do not apply, or (2) a position, right to income, or a liability that is not a security in the hands of the taxpayer, provided that before the close of the day that the security is acquired or entered into (or such other time as the Treasury Department may specify in regulations), the security is clearly identified in the dealer's records as being so described.

Third, the conference agreement provides that the exception to the mark-to-market rules for certain hedges does not apply to any security that is held by a taxpayer in its capacity as a dealer in securities. Thus, the exception to the mark-to-market rules for certain hedges does not apply to (1) any security that is held for sale in the ordinary course of a trade or business, or (2) any security that is entered into with customers in the ordinary course of a trade or business.

Fourth, the conference agreement authorizes the Treasury Department to promulgate regulations which provide for the treatment of hedges that reduce a dealer's risk of interest rate or price changes or currency fluctuations with respect to securities that are subject to the mark-to-market rules as well as with respect to securities, positions, rights to income, or liabilities that are not subject to the mark-to-market rules. The conferees anticipate that the Treasury regulations will allow taxpayers to treat any such hedge as not subject to the mark-to-market rules provided that such treatment is consistently followed from year to year.

Improper identification

The conference agreement also modifies the rules that apply in the case of a failure to comply with the identification requirements contained in the Senate amendment. Under the conference agreement, if (1) a dealer identifies a security as qualifying for an exception to the mark-to-market rules but the security does not qualify for that exception, or (2) a dealer fails to identify a position that is not a security as a hedge of a security but the position is a hedge of

988 hedging transaction, and (2) the determination of whether a transaction is a section 988 transaction is to be made without regard to whether the transaction would otherwise be marked-to-market under the conference agreement.

a security, then the mark-to-market rules are to apply to any such security or position, except that loss is to be recognized under the mark-to-market rules prior to the disposition of the security or position only to the extent of gain previously recognized under the mark-to-market rules (and not previously taken into account under this provision) with respect to the security or position.

The conferees anticipate that the identification rules with respect to hedges will be applied in such a manner as to minimize the imposition of additional accounting burdens on dealers in securities. For example, the conferees understand that certain dealers in securities use accounting systems which treat certain transactions entered into between separate business units as if such transactions were entered into with unrelated third parties. The conferees anticipate that for purposes of the mark-to-market rules, such an accounting system generally will provide an adequate identification of hedges with third parties.

Effective date

The provision applies to taxable years ending on or after December 31, 1992. The net amount of the section 481(a) adjustment is to be taken into account ratably over a 10-taxable year period beginning with the first taxable year ending on or after December 31, 1992, to the extent that such amount does not exceed the net amount of the section 481(a) adjustment that would have been determined had the change in method of accounting occurred for the last taxable year beginning before March 20, 1992.

The excess (if any) of (1) the net amount of the section 481(a) adjustment for the first taxable year ending on or after December 31, 1992, over (2) the net amount of the section 481(a) adjustment that would have been determined had the change in method of accounting occurred for the last taxable year beginning before March 20, 1992, is to be taken into account ratably over a 4-taxable year period beginning with the first taxable year ending on or after December 31, 1992.

The principles of section 8.03 of Rev. Proc. 92-20, 1992-12 I.R.B., are to apply to the section 481(a) adjustment. The conferees anticipate that section 8.03(1) of Rev. Proc. 92-20 will be applied by taking into account all securities of a dealer that are subject to the mark-to-market rules (including those securities that are not inventory in the hands of the dealer).

2. LIMIT DEDUCTION FOR EXECUTIVE COMPENSATION

Present law

Under present law, a deduction is allowed in computing Federal income tax liability for ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered.

House bill

For purposes of the regular income tax and the alternative minimum tax, the otherwise allowable deduction for compensation paid or accrued with respect to a covered employee is limited to no more than $1 million per year. A covered employee means any employee of the taxpayer who is an officer of the taxpayer, other than an employee-owner of a personal service corporation.

For purposes of the provision, an officer generally is an administrative executive who is in regular and continued service, regardless of the employee's job title. An employee who has the title of an officer but does not have the authority of an officer is not considered an officer. Similarly, an employee who does not have the title of an officer but has the authority of an officer is an officer for purposes of this rule.

An employee-owner of a personal service corporation is generally defined as under section 269A of the Code. Thus, a personal service corporation is a corporation the principal activity of which is the performance of personal services if the services are substantially performed by employee-owners. An employee-owner is any employee who owns more than 10 percent of the outstanding stock of the personal service corporation.

The term covered employee includes former employees. Thus, for example, the provision applies to compensation paid to former employees (e.g., nonqualified deferred compensation that is not paid until after termination of employment) as well as current employees.

The provision does not apply to compensation paid to employees who are not officers. Similarly, the provision does not apply to payments to partners in a partnership because they are not employees. The provision also does not apply to payments to independent contractors.

The deduction limitation generally applies to all remuneration for services, including the cash value of all remuneration (including benefits) paid in a medium other than cash. The limit does not apply to fringe benefits excludable from income under section 132, meals and lodging furnished on the business premises of the employer that are excludable under section 119, or any payment made to, or on behalf of, an employee or beneficiary (1) from or to a qualified pension, profit-sharing, or annuity plan, or (2) under a simplified employee pension (SEP) or tax-sheltered annuity (other than elective deferrals to such a plan or annuity). The deduction limitation applies to all compensation paid to a covered employee, regardless of whether the compensation is paid for services as an officer.

The deduction limitation applies at the time the deduction would otherwise be taken.

Certain related employers are treated as a single employer for purposes of the provision. In particular, employers treated as a single employer under section 52 (a) or (b) or section 414 (m) or (n) are treated as a single employer. An employee who is an officer of any of the members of a group of employers treated as a single employer is treated as an officer of the single employer. Similarly, compensation from related employers is aggregated for purposes of the $1 million limit.

It is intended that the Secretary will prevent avoidance of the rule through the use of arrangements other than employee-employer arrangements.

Effective date.—The provision is effective for taxable years beginning on or after January 1, 1992.

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. TAX TREATMENT OF CERTAIN FSLIC FINANCIAL ASSISTANCE

Present law and background

A taxpayer may claim a deduction for a loss on the sale or other disposition of property only to the extent that the taxpayer's adjusted basis for the property exceeds the amount realized on the disposition and the loss is not compensated for by insurance or otherwise (sec. 165 of the Code). In the case of a taxpayer on the specific charge-off method of accounting for bad debts, a deduction is allowable for the debt only to the extent that the debt becomes worthless and the taxpayer does not have a reasonable prospect of being reimbursed for the loss. If the taxpayer accounts for bad debts on the reserve method, the worthless portion of a debt is charged against the taxpayer's reserve for bad debts, potentially increasing the taxpayer's deduction for an addition to this reserve.

A special statutory tax rule, enacted in 1981, excluded from a thrift institution's income financial assistance received from the Federal Savings and Loan Insurance Corporation (FSLIC) [1], and prohibited a reduction in the tax basis of the thrift institution's assets on account of the receipt of the assistance. Under the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), taxpayers generally were required to reduce certain tax attributes by one-half the amount of financial assistance received from the FSLIC pursuant to certain acquisitions of financially troubled thrift institutions occurring after December 31, 1988. These special rules were repealed by FIRREA, but still apply to transactions that occurred before May 10, 1989.

Prior to the enactment of FIRREA, the FSLIC entered into a number of assistance agreements in which it agreed to provide loss protection to acquirers of troubled thrift institutions by compensating them for the difference between the book value and sales proceeds of "covered assets." "Covered assets" typically are assets that were classified as nonperforming or troubled at the time of the assisted transaction but could include other assets as well. Many of these covered assets are also subject to yield maintenance guarantees, under which the FSLIC guaranteed the acquirer a minimum

[1] Until it was abolished by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), FSLIC insured the deposits of its member savings and loan associations and was responsible for insolvent member institutions. FIRREA abolished FSLIC and established the FSLIC resolution Fund (FRF) to assume all of the assets and liabilities of FSLIC (other than those expressly assumed or transferred to the Resolution Trust Corporation (RTC)). FRF is administered by the Federal Deposit Insurance Corporation (FDIC). The term "FSLIC" is used hereafter to refer to FSLIC and any successor to FSLIC.

return or yield on the value of the assets. The assistance agreements also generally grant the FSLIC the right to purchase covered assets. In addition, many of the assistance agreements permit the FSLIC to order assisted institutions to write down the value of covered assets on their books to fair market value in exchange for a payment in the amount of the write-down.

Under most assistance agreements, one or more Special Reserve Accounts are established and maintained to account for the amount of FSLIC assistance owed by the FSLIC to the acquired entity. The assistance agreements generally specify the precise circumstances under which amounts with respect to covered assets are debited to an account. Under the assistance agreements, these debit entries generally are made subject to prior FSLIC direction or approval. When amounts are so debited, the FSLIC generally becomes obligated to pay the debited balance in the account to the acquirer at such times and subject to such offsets as are specified in the assistance agreement.

In September 1990, the Resolution Trust Corporation (RTC), in accordance with the requirements of FIRREA, issued a report to Congress and the Oversight Board of the RTC on certain FSLIC-assisted transactions (the "1988/89 FSLIC transactions"). The report recommended further study of the covered loss and other tax issues relating to these transactions. A March 4, 1991 Treasury Department report ("Treasury report") on tax issues relating to the 1988/89 FSLIC transactions concluded that deductions should not be allowed for losses that are reimbursed with exempt FSLIC assistance. The Treasury report states that the Treasury view is expected to be challenged in the courts and recommended that Congress enact clarifying legislation disallowing these deductions.[2]

The Treasury report reasoned that allowing tax deductions for losses on covered assets that are compensated for by FSLIC assistance gives thrift institutions a perverse incentive to minimize the value of these assets when sold. The FSLIC, and not the institution, bears the economic burden corresponding to any reduction in value because it is required to reimburse the thrift institution for the loss. However, the tax benefit to the thrift institution and its affiliates increases as tax losses are enhanced. The thrift institution, therefore, has an incentive to minimize the value of covered assets in order to maximize its claimed tax loss and the attendant tax savings.

House bill

General rule

Any FSLIC assistance with respect to any loss of principal, capital, or similar amount upon the disposition of an asset shall be taken into account as compensation for such loss for purposes of section 165 of the Code. Any FSLIC assistance with respect to any debt shall be taken into account for purposes of determining whether such debt is worthless (or the extent to which such debt is worthless) and in determining the amount of any addition to a re-

[2] Department of the Treasury, *Report on Tax Issues Relating to the 1988/89 Federal Savings and Loan Insurance Corporation Assisted Transactions*, March, 1991 at pp. 16–17.

serve for bad debts. For this purpose, FSLIC assistance means any assistance or right to assistance with respect to a domestic building and loan association (as defined in section 7701(a)(19) of the Code without regard to subparagraph (C) thereof) under section 406(f) of the National Housing Act or section 21A of the Federal Home Loan Bank Act (or under any similar provision of law).[3]

Thus, if a taxpayer disposes of an asset entitled to FSLIC assistance, no deduction is allowed under section 165 of the Code for a loss (if any) on the disposition of the asset to the extent the assistance agreement contemplates a right to receive FSLIC assistance with respect to the loss. Similarly, if a loan held by a taxpayer constitutes an asset entitled to FSLIC assistance, the thrift institution shall not charge off any amount of the loan covered by the assistance agreement against the bad debt reserve and no charge-off will be taken into account in computing an addition to the reserve under the experience method, to the extent the assistance agreement contemplates a right to receive FSLIC assistance on a write-down of such asset under the agreement or on a disposition. The institution also shall not be allowed to deduct such amount of the loan under the specific charge-off method.[4]

It is intended that the right to FSLIC assistance for purposes of this provision is to be determined by reference to the gross amount of FSLIC assistance that is contemplated by the assistance agreement with respect to the sale or other disposition, or write-down, without taking into account any offsets that might reduce the net amount FSLIC is obligated to pay under the agreement. For example, under an assistance agreement an institution's right to be reimbursed for a loss on the disposition or write-down of an asset may be reflected as a debit to a Special Reserve Account, while certain other items that will reduce the ultimate amount of assistance to be paid may be reflected as credits to the account. In such a case, the gross amount of FSLIC assistance contemplated by the agreement is the amount represented by the debit, without regard to any offset.

Financial assistance to which the FIRREA amendments apply

The provision does not apply to any financial assistance to which the amendments made by section 1401(a)(3) of FIRREA apply.

No inference

No inference is intended as to prior law or as to the treatment of any item to which this provision does not apply.

[3] FSLIC assistance for purposes of the provision does not include "net worth assistance". "Net worth assistance" is generally computed at the time of an acquisition, without targeting loss coverage to ultimate dispositions or write-downs with respect to particular assets.

[4] It is expected that, for purposes of the adjusted current earnings adjustment of the corporate alternative minimum tax, there will not be any net positive adjustment to the extent that FSLIC assistance is taken into account as compensation for a loss or in determining worthlessness and there is, therefore, no deductible loss or bad debt charge-off.

Effective date

In general

The provision applies to financial assistance credited on or after March 4, 1991, with respect to (1) assets disposed of and charge-offs made in taxable years ending on or after March 4, 1991; and (2) assets disposed of and charge-offs made in taxable years ending before March 4, 1991, but only for purposes of determining the amount of any net operating loss carryover to a taxable year ending on or after March 4, 1991.

For this purpose, financial assistance generally is considered to be credited when the taxpayer makes an approved debit entry to a Special Reserve Account required to be maintained under the assistance agreement to reflect the asset disposition or write-down. An amount will also be considered to be credited prior to March 4, 1991 if the asset was sold, with prior FSLIC approval, before that date.

An amount is not deemed to be credited for purposes of the provision merely because the FSLIC has approved a management or business plan or similar plan with respect to an asset or group of assets, or has otherwise generally approved a value with respect to an asset.

As an example of the application of the effective date provision, assume that a thrift institution is subject to a FSLIC assistance agreement that, through the use of a Special Reserve Account, operates to compensate the institution for the difference between the book and fair market values of certain covered assets upon their disposition or write-down. Further assume that on February 1, 1991 the thrift institution wrote down a covered asset that has a book value and tax basis of $100 to $60, the asset's fair market value. With FSLIC approval, the institution debited the Special Reserve Account prior to March 4, 1991, to reflect the write-down of $40, and properly submitted to the FSLIC a summary of the account that reflected that debit, along with other debits for the quarter ended March 31, 1991. The provision would not apply to a loss claimed by the thrift institution with respect to the write-down of the covered asset on February 1, 1991. The same result would apply if the institution had sold the asset for $60 on February 1 with prior FSLIC approval. In the sale case, the provision would not apply even if there were no debit to the Special Reserve Account prior to March 4, 1991, so long as the FSLIC approved the amount of the reimbursable loss for purposes of providing assistance under the agreement.

Application to certain net operating losses

The provision applies to the determination of any net operating loss [5] carried into a taxable year ending on or after March 4, 1991, to the extent that the net operating loss is attributable to a loss or charge-off for which the taxpayer had a right to FSLIC assistance which had not been credited before March 4, 1991.

[5] For purposes of determining any alternative minimum tax net operating loss carryover to periods ending on or after March 4, 1991 it is expected that the principles described in the preceding footnote will apply.

For example, assume a calendar year thrift institution is a party to a FSLIC assistance agreement that compensates the institution for the amount that covered loans are written down or charged off pursuant to the agreement. The agreement provides that the institution must receive the prior approval of the FSLIC to write down a loan for purposes of this compensation. Further assume that the institution uses the experience method to account for bad debts for tax purposes, and that in 1990 it charged off $100 with respect to a covered loan. Assume that this charge-off initially reduced the taxpayer's bad debt reserve balance by $100 and allowed the taxpayer to increase its addition to its reserve by $100 to bring the reserve to an appropriate balance. The taxpayer deducted this amount and utilized $20 for the year ended in 1990 (i.e., the last taxable year of the taxpayer ending before March 4, 1991). This produced a net operating loss of $80 for the remainder. The net operating loss is carried forward to 1991 (a taxable year of the taxpayer ending on or after March 4, 1991). Assume that the taxpayer did not debit the Special Reserve Account prior to March 4, 1991. The net operating loss carried to 1991 would be redetermined taking into account the provision. Applying the provision to 1990 would result in disallowing the charge-off of the $100 loan against the experience method reserve, in effect disallowing the $100 addition to the reserve. In such case, the taxpayer would continue to owe no tax for 1990, but the $80 net operating loss would be disallowed. However, the taxpayer's tax liability for 1990 would not be redetermined under the provision.

As a further example, assume that the net operating loss described in the example directly above were carried back to, and absorbed in, an earlier year ending prior to March 4, 1991 (rather than being carried forward). In that case, the provision would not apply to reduce the net operating loss carryback.

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.

4. DEDUCTION FOR MOVING EXPENSES

Present law

An employee or self-employed individual may claim a deduction from gross income for certain expenses incurred as a result of moving to a new residence in connection with beginning work at a new location (sec. 217). The deduction is not subject to the floor which generally limits a taxpayer's allowable miscellaneous itemized deductions only to those amounts which exceed 2 percent of his or her adjusted gross income. Any amount received directly or indirectly by such individual as a reimbursement of moving expenses must be included in the taxpayer's gross income as compensation (sec. 82). The taxpayer may offset this income by deducting the moving expenses that would otherwise qualify as deductible items under sec. 217.

Deductible moving expenses are the expenses of transporting the taxpayer and members of his household, as well as his household goods and personal effects, from the old to the new residence; the cost of meals and lodging en route; the expenses for pre-move househunting trips; temporary living expenses for up to 30 days in the general location of the new job; and certain expenses related to both the sale or settlement of a lease on the old residence and the purchase of a new residence in the general location of the new job.

The moving expense deduction is subject to a number of limitations. A maximum of $1,500 can be deducted for pre-move househunting and temporary living expenses in the general location of the new job. A maximum of $3,000 (reduced by any deduction claimed for househunting or temporary living expenses) can be deducted for certain qualified expenses for the sale and purchase of a residence or settlement of a lease. If both a husband and wife begin new jobs in the same general location, the move is treated as a single commencement of work. If a husband and wife file separate returns, the maximum deductible amounts available to each is one-half the amounts otherwise allowed.

Also, in order for a taxpayer to claim a moving expense deduction, his new principal place of work has to be at least 35 miles farther from his former residence than was his former principal place of work (or his former residence, if he has no former place of work).

House bill

The House bill increases the mileage limitation from 35 to 75 miles.

Effective date.—The provision is effective for moving expenses paid on or after the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with three modifications:

(1) The $1,500 limit on pre-move househunting and temporary living expenses in the general location of the new job is repealed. The overall $3,000 limit is retained.

(2) An individual is allowed an above-the-line deduction under section 62 in computing adjusted gross income for an amount equal to the otherwise allowable deduction for moving expenses but only to the extent such expenses are reimbursed and included in the gross income of the taxpayer under section 82.

(3) To the extent that moving expenses are unreimbursed, the deduction is made subject to the 2-percent floor on miscellaneous itemized deductions.

Effective date.—The provision is effective for moving expenses paid or incurred after the date of enactment.

5. TREATMENT OF PRE-CONTRIBUTION GAIN ON CERTAIN PARTNERSHIP REDEMPTIONS

Present law

Generally, if a partner contributes appreciated property to a partnership, no gain is recognized to the contributing partner at the time of the contribution, but gain recognized subsequently by the partnership with respect to that property must be allocated to the contributing partner to the extent of the pre-contribution appreciation. In addition, if the property is subsequently distributed to another partner within 5 years of the contribution, the contributing partner generally will recognize gain as if the property was sold for its fair market value at the time of the distribution (sec. 704(c)(1)(B)). Generally, the contributing partner's basis in His partnership interest is increased by the basis of the contributed property at the time of the contribution.

If a partnership distributes property to a partner, the partner does not recognize income except to the extent any cash received in the distribution exceeds such partner's basis for his partnership interest. The distributee partner's basis in distributed property is determined by reference to either the partnership's basis for the property or the partner's basis for his partnership interest depending on various factors. Present law generally does not require a partner who contributes appreciated property to a partnership to recognize pre-contribution gain upon a subsequent distribution of other property to that partner even if the value of that other property exceeds the partner's basis in his partnership interest. [1]

House bill

The House bill requires a partner who contributes appreciated property to a partnership to include pre-contribution gain in income to the extent that the value of other property distributed by the partnership exceeds his adjusted basis in his partnership interest. The bill applies whether or not the contributing partner's interest in the partnership is reduced in connection with the distribution. It generally applies only if the distribution is made within 5 years after the contribution of the appreciated property. The bill provides rules for taking into consideration multiple contributions by the same partner within the five-year period and generally permits the netting of precontribution losses against pre-contribution gains. Generally, the character of the gain or loss is determined as if the partnership had sold the distributed property.

Appropriate basis adjustments are to be made in the basis of the distributed property and the relevant contributed property to take account of gain recognized by the distributee partner under the bill.

[1] Present law does limit the use of partnerships to make disguised sales of appreciated property by providing that if there is a direct or indirect transfer of money or property by a partner to a partnership, and a related transfer of money or other property by the partnership to the transferor partner or another partner, and the transfers, viewed together, are properly characterized as a sale or exchange of property, then the transfers are treated as a transaction occurring between the partnership and a non-partner, or between non-partners (sec. 707(a)(1)(B)).

Gain recognition generally is not required to the extent the partnership distributes property which had been contributed by the distributee partner. If the property distributed consists of an interest in an entity, however, gain recognition is nevertheless required to the extent that the value of the interest in the entity is attributable to property contributed to the entity after the interest in it was contributed to the partnership. For example, contributing partner A is required to recognize pre-contribution gain in the following transaction. Partner A contributes appreciated asset X and the stock of a corporation with no substantial assets. Partner B contributes cash in an amount equal to the value of appreciated asset X. The partnership thereupon contributes the cash it received from B to the corporation, and then distributes the stock of the corporation (whose value is increased by the amount of the cash) back to A (within 5 years of A's contribution). Although A contributed the stock of the corporation to the partnership, he is subject to tax on pre-contribution gain with respect to asset X. Similarly, the bill provides that if contributed property is distributed indirectly to a partner other than its contributor, the contributing partner is subject to tax on the pre-contribution gain as if the property had been distributed directly rather than indirectly. Thus, if in the above example B (rather than A) had contributed stock of a corporation to the partnership, and the partnership had contributed appreciated asset X to the corporation and distributed the stock back to B, A would have been subject to tax on pre-contribution gain with respect to asset X.

Effective date.—The House bill applies to partnership distributions after February 14, 1992.

Senate amendment

No provision.

Conference agreement

The conference agreement does not adopt the House bill.

IV. SIMPLIFICATION PROVISIONS

A. Provisions Relating to Individuals

1. ROLLOVER OF GAIN ON SALE OF PRINCIPAL RESIDENCE IN THE CASE OF MULTIPLE ROLLOVERS AND IN CASE OF DIVORCE OR SEPARATION

Present law

No gain is recognized on the sale of a principal residence if a new residence at least equal in cost to the sales price of the old residence is purchased and used by the taxpayer as his or her principal residence within a specified period of time (sec. 1034). This replacement period generally begins two years before and ends two years after the date of sale of the old residence. The basis of the replacement residence is reduced by the amount of any gain not recognized on the sale of the old residence by reason of section 1034.

In general, nonrecognition treatment is available only once during any two-year period. In addition, if the taxpayer purchases more than one residence during the replacement period and such residences are each used as the taxpayer's principal residence within two years after the date of sale of the old residence, only the last residence so used is treated as the replacement residence. Special rules apply, however, if residences are sold in order to relocate for employment reasons. First, the number of times nonrecognition treatment is available during a two-year period is not limited. Second, if a residence is sold within two years after the sale of the old residence, the residence sold is treated as the last residence used by the taxpayer and thus as the only replacement residence. The determination whether property is used by a taxpayer as a principal residence depends upon all the facts and circumstances in each case, including the good faith of the taxpayer. No safe harbor is provided for sales of principal residences incident to divorce or marital separation.

House bill

Under the House bill, gain is rolled over from one residence to another residence in the order the residences are purchased and used, regardless of the taxpayer's reasons for the sale of the old residence. In addition, gain may be rolled over more than once within a two-year period. Thus, the rules that formerly applied only if a taxpayer sold his residence in order to relocate for employment purposes will apply in all cases. As under present law, the basis of each succeeding residence is reduced by the amount of gain not recognized on the sale of the prior residence.

Also, the bill provides a safe harbor in the determination of principal residence in certain cases incident to divorce or marital separation. Specifically, the bill provides that a residence is treated as the taxpayer's principal residence at the time of sale if (1) the residence is sold pursuant to a divorce or marital separation and (2) the taxpayer used such residence as his or her principal residence at any time during the two-year period ending on the date of sale.

Effective date.—The provision applies to sales of old residences (within the meaning of section 1034) after the date of enactment.

Senate amendment

The Senate amendment contains the provision relating to the case of divorce but not the provision relating to multiple rollovers.

Conference agreement

The conference agreement follows the House bill.

2. DE MINIMIS EXCEPTION TO PASSIVE LOSS RULE

Present law

The passive loss rules limit deductions and credits from passive trade or business activities. Deductions from passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income, such as wages, portfolio income, or business income that is not from a passive activity. Deductions that are suspended under this rule are carried forward and treated as deductions from passive activities in the next year. The suspended losses from a passive activity are allowed in full when a taxpayer disposes of the entire interest in the passive activity to an unrelated person.

Passive activities are defined to include trade or business activities in which the taxpayer does not materially participate. Material participation requires a taxpayer to be involved in the operations of the activity on a regular, continuous and substantial basis.

Rental activities are also included in the definition of passive activities. A special rule permits the deduction of up to $25,000 of losses from certain rental real estate activities in which the taxpayer actively participates (even though the activities are considered passive) for taxpayers with adjusted gross incomes of $100,000 or less. This deduction is phased out for taxpayers with adjusted gross incomes between $100,000 and $150,000. A rental activity is defined as any activity where payments are principally for the use of tangible property.

House bill

The House bill creates a $200 de minimis exception to the rule disallowing net passive activity losses. Under the exception, a taxpayer who is an individual and whose total net passive activity losses for the year do not exceed $200 for the taxable year generally may deduct such losses for the year. The exception also applies to estates for the first two taxable years following the decedent's death. Similarly to the present-law rules applicable to the $25,000 exception, the amount under the exception provided in the bill is $100 in the case of a married taxpayer filing a separate return, and the exception is not available in the case of a married taxpayer filing a separate return who does not live apart from his spouse at all times during the taxable year.

The $200 exception is available only for taxpayers with net passive activity losses totalling $200 or less; a taxpayer with $300 of passive losses for the year, for example, is not eligible for the $200 exception. The $200 exception is applied after determining the taxpayer's net passive activity loss for the year (which includes taking into account suspended losses from prior years), but before taking the $25,000 allowance for rental real estate. Thus, for example, if a taxpayer has $500 of losses from rental real estate, he is not eligible for the $200 exception but may be eligible for the $25,000 exception (assuming he otherwise meets the requirements of the $25,000 exception). In all other respects, the $200 exception is applied after all other applicable rules under the passive loss rule.

The $200 exception does not apply with respect to passive activity credits.

The $200 exception does not apply with respect to items from publicly traded partnerships, to which the passive loss rule has separate application under present law.

Effective date.—The provision applies to taxable years beginning after December 31, 1991.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

3. PERMIT PAYMENT OF TAXES BY CREDIT CARD

Present law

Payment of taxes may be made by checks or money orders, to the extent and under the conditions provided by regulations.

House bill

The House bill permits payment of taxes by credit card, to the extent and under the conditions provided by regulations.

Effective date.—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.

4. ELECTION BY PARENT TO CLAIM UNEARNED INCOME OF CERTAIN CHILDREN ON PARENT'S RETURN

Present law

The net unearned income of a child under 14 years of age is taxed to the child at the parents' statutory rate. Net unearned income means unearned income less the sum of $600 and the greater of: (1) $600 or, (2) if the child itemizes deductions, the amount of allowable deductions directly connected with the production of the unearned income. The dollar amounts are adjusted for inflation.

In certain circumstances, a parent may elect to include a child's unearned income on the parent's income tax return if the child's income is less than $5,000. A parent making this election must include the gross income of the child in excess of $1,000 in income for the taxable year. In addition, the parent must report an additional tax liability equal to the lesser of (1) $75 or (2) 15 percent of the excess of the child's income over $500. The dollar amounts for the election are not adjusted for inflation.

A person claimed as a dependent cannot claim a standard deduction exceeding the greater of $600 or such person's earned income. For alternative minimum tax purposes, the exemption of a child under 14 years of age generally cannot exceed the sum of such child's earned income plus $1,000. The $600 amount is adjusted for inflation but the $1,000 amount is not.

House bill

The House bill adjusts for inflation the dollar amounts involved in the election to claim unearned income on the parent's return. It likewise indexes the $1,000 amount used in computing the child's alternative minimum tax.

Effective date.—The provision applies to taxable years beginning after December 31, 1991.

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. SIMPLIFIED FOREIGN TAX CREDIT LIMITATION FOR INDIVIDUALS

Present law

In order to compute the foreign tax credit, a taxpayer computes foreign source taxable income and foreign taxes paid in each of the applicable separate foreign tax credit limitation categories. In the case of an individual, this requires the filing of IRS Form 1116, designed to elicit sufficient information to perform the necessary calculations.

In many cases, individual taxpayers who are eligible to credit foreign taxes may have only a modest amount of foreign source gross income, all of which is income from investments (e.g., dividends from a foreign corporation subject to foreign withholding taxes or dividends from a domestic mutual fund that can pass through its foreign taxes to the shareholder (see sec. 853)). Taxable income of this type ordinarily is subject to the single foreign tax credit limitation category known as passive income. However, under certain circumstances, the Code treats investment-type income (e.g., dividends and interest) as income in several other separate limitation categories (e.g., high withholding tax interest income, general limitation income) designed to accomplish certain policy objectives or forestall certain abuses. For this reason, any taxpayer with foreign source gross income is required to provide sufficient detail on Form 1116 to ensure that foreign source taxable income from investments, as well as all other foreign source taxable income, is allocated to the correct limitation category.

House bill

The House bill allows individuals with no more than $200 of creditable foreign taxes, and no foreign source income other than income that is in the passive basket, to elect a simplified foreign tax credit limitation equal to the lesser of 25 percent of the individual's foreign source gross income or the amount of the creditable foreign taxes paid or accrued by the individual during the taxable year. (It is intended that an individual electing this simplified limitation calculation not be required to file Form 1116 in order to obtain the benefit of the credit.) A person who elects the simplified foreign tax credit limitation is not allowed a credit for any foreign tax not shown on a payee statement (as that term is defined in sec. 6724(d)(2)) furnished to him or her. Nor is the person entitled to treat any excess credits for a taxable year to which the election applied as a carryover to another taxable year. Because the limitation for a taxable year to which the election applies can be no more than the creditable foreign taxes actually paid for the taxable year, it is also the case under the House bill that no excess credits from another year can be carried over to the taxable year to which the election applies.

For purposes of the simplified limitation, passive income generally is defined to include all types of income that would be foreign personal holding company income under the subpart F rules, plus income inclusions from passive foreign corporations (as defined by the House bill), so long as the income is shown on a payee statement furnished to the individual. Thus, for purposes of the simplified limitation, passive income includes all dividends, interest (and income equivalent to interest), royalties, rents, and annuities; net gains from dispositions of property giving rise to such income; net gains from certain commodities transactions; and net gains from foreign currency transactions that give rise to foreign currency gains and losses as defined in section 988. The statutory exceptions to treating these types of income as passive for foreign tax credit limitation purposes, such as the exceptions for high-taxed income and high-withholding-tax interest, are not applicable in determining eligibility to use the simplified limitation.

Although an estate or trust generally computes taxable income and credits in the same manner as in the case of an individual (Code sec. 641(b); Treas. Reg. sec. 1.641(b)-1), the simplified limitation does not apply to an estate or trust.

Effective date.—The provision applies to taxable years beginning after December 31, 1991.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate agreement.

6. PERSONAL TRANSACTIONS BY INDIVIDUALS IN FOREIGN CURRENCY

Present law

When a U.S. taxpayer with a U.S. dollar functional currency makes a payment in a foreign currency, gain or loss (referred to as "exchange gain or loss") arises from any change in the value of the foreign currency relative to the U.S. dollar between the time the currency was acquired (or the obligation to pay was incurred) and the time that the payment is made. Gain or loss results because foreign currency, unlike the U.S. dollar, is treated as property for Federal income tax purposes.

Exchange gain or loss can arise in the course of a trade or business or in connection with an investment transaction. Exchange gain or loss can also arise where foreign currency was acquired for personal use. For example, the IRS has ruled that a taxpayer who converts U.S. dollars to a foreign currency for personal use—while traveling abroad—realizes exchange gain or loss on reconversion of appreciated or depreciated foreign currency (Rev. Rul. 74-7, 1974-1 C.B. 198).

Prior to the Tax Reform Act of 1986 (the "1986 Act"), most of the rules for determining the Federal income tax consequences of foreign currency transactions were embodied in a series of court cases and revenue rulings issued by the Internal Revenue Service ("IRS"). Additional rules of limited application were provided by Treasury regulations and, in a few instances, statutory bills. Pre-1986 law was believed to be unclear regarding the character, the timing of recognition, and the source of gain or loss due to fluctuations in the exchange rate of foreign currency. The result of prior law was uncertainty of tax treatment for many legitimate transactions, as well as opportunities for tax-motivated transactions. Therefore, in 1986, Congress determined that a comprehensive set of rules should be provided for the U.S. tax treatment of transactions involving "nonfunctional currencies;" that is, currencies other than the taxpayer's "functional currency."

However, the 1986 Act provisions designed to clarify the treatment of currency transactions, primarily found in section 988, apply to transactions entered into by an individual only to the extent that expenses attributable to such transactions would be deductible under section 162 (as a trade or business expense) or section 212 (as an expense of producing income, other than expenses incurred in connection with the determination, collection, or refund of taxes). Therefore, the principles of pre-1986 law continue to apply to personal currency transactions.[1]

House bill

In a case where an individual acquires nonfunctional currency and then disposes of it in a personal transaction, and where exchange rates have changed in the intervening period, the House bill provides for nonrecognition of an individual's resulting exchange gain not exceeding $200. The House bill does not change the treatment of resulting exchange losses. It is understood that under other Code provisions, such losses typically are not deductible by individuals (e.g., sec. 165(c)).

Effective date.—The provision applies to taxable years beginning after December 31, 1991.

Senate amendment

The Senate amendment is the same as the House bill.

[1] See, e.g., Rev. Rul. 90-79, 1990-2 C.B. 187 (where the taxpayer purchased a house in a foreign country, financed by a foreign currency loan, and the currency appreciates before the house is sold and the loan is repaid, the taxpayer's exchange loss on repayment of the loan is not deductible under sec. 165 and does not offset taxable gain on the sale of the house).

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

7. MAKE INCOME TAX WITHHOLDING RULES PARALLEL TO RULES FOR EXCLUSION FROM INCOME FOR COMBAT PAY

Present law

Exclusion for combat pay

Gross income does not include certain combat pay of members of the Armed Forces (sec. 112). If enlisted personnel serve in a combat zone during any part of any month, military pay for that month is excluded from gross income (special rules apply if enlisted personnel are hospitalized as a result of injuries, wounds, or disease incurred in a combat zone). In the case of commissioned officers, these exclusions from income are limited to $500 per month of military pay.

Income tax withholding

There is no income tax withholding with respect to military pay for a month in which a member of the Armed Forces of the United States is entitled to the benefits of section 112 (sec. 3401(a)(2)). With respect to enlisted personnel, this income tax withholding rule parallels the exclusion from income under section 112: there is total exemption from income tax withholding and total exclusion from income. With respect to officers, however, the withholding rule is not parallel: there is total exemption from income tax withholding, although the exclusion from income is limited to $500 per month.

House bill

The House bill makes the income tax withholding exemption rules parallel to the rules providing an exclusion from income for combat pay.

Effective date.—The provision is effective as of January 1, 1993.

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. EXPANDED ACCESS TO SIMPLIFIED INCOME TAX RETURNS

Present law

There are three principal tax forms that are utilized by individual taxpayers: Form 1040EZ, Form 1040A, and Form 1040.

House bill

The House bill provides that the Secretary of the Treasury (or his delegate) shall take such actions as may be appropriate to expand access to simplified individual income tax forms and otherwise to simplify the individual income tax returns.

The bill also requires that the Secretary submit a report to the Congress on the actions undertaken pursuant to this bill, together with any recommendations he may deem advisable.

Effective date.—The report is due no 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.

9. SIMPLIFICATION OF TAX TREATMENT OF RURAL LETTER CARRIERS' VEHICLE EXPENSES

Present law

A taxpayer who uses his or her automobile for business purposes may deduct the business portion of the actual operation and maintenance expenses of the vehicle, plus depreciation (subject to the limitations of sec. 280F). If the taxpayer is an employee and these expenses are not reimbursed, the deduction is subject to the two-percent floor. Alternatively, the taxpayer may elect to utilize a standard mileage rate in computing the deduction allowable for business use of an automobile that has not been fully depreciated. Under this election, the taxpayer's deduction equals the applicable rate multiplied by the number of miles driven for business purposes and is taken in lieu of deductions for depreciation and actual operation and maintenance expenses.

An employee of the U.S. Postal Service may compute his or her deduction for business use of an automobile in performing services involving the collection and delivery of mail on a rural route by using, for all business use mileage, 150 percent of the standard mileage rate.

House bill

The House bill repeals the special rate of 150 percent of the standard mileage rate. In its place, the bill provides that the rate of reimbursement provided by the Postal Service to rural letter carriers is considered to be equivalent to their expenses. The rate of reimbursement that is considered to be equivalent to their expenses is the rate of reimbursement contained in the 1991 collective bargaining agreement, which may in the future be increased by no more than the rate of inflation.

Effective date.—The provision is effective for taxable years beginning after December 31, 1991.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate agreement.

10. EXEMPTION FROM LUXURY EXCISE TAX FOR CERTAIN EQUIPMENT INSTALLED ON PASSENGER VEHICLES FOR USE BY DISABLED INDIVIDUALS

Present law

The Code imposes a 10-percent excise tax on the portion of the retail price of a passenger vehicle that exceeds $30,000. The tax also applies to separate purchases of component parts and accessories occurring within six months of the date the vehicle is placed in service.

House bill

The House bill provides that the luxury excise tax does not apply to a part or accessory installed on a passenger vehicle to enable or assist an individual with a disability to operate the vehicle, or to enter or exit the vehicle, in order to compensate for the effect of the disability.

Persons entitled to a refund may obtain it through the dealer at which they purchased the taxed item, as provided under present-law Code section 6416.

Effective date.—The provision is effective for purchases after December 31, 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.

B. Pension Simplification

1. SIMPLIFIED DISTRIBUTION RULES

Present law

In general

Under present law, a distribution of benefits from a tax-favored retirement arrangement generally is includible in gross income in the year it is paid or distributed under the rules relating to the taxation of annuities. A tax-favored retirement arrangement includes (1) a qualified pension plan (sec. 401(a)), (2) a qualified annuity plan (sec. 403(a)) and (3)' a tax-sheltered annuity (sec. 403(b)). Special rules apply in the case of lump-sum distributions from a qualified plan, distributions that are rolled over to an individual retirement arrangement (IRA), distributions of employer securities, and employer-provided death benefits.

Rollovers

Under present law, a total or partial distribution of the balance to the credit of an employee under a qualified plan, a qualified annuity plan, or a tax-sheltered annuity may, under certain conditions, be rolled over tax free to an IRA or another qualified plan or annuity (secs. 402(a), 403(a), and 403(b)). A rollover of a partial distribution is permitted if (1) the distribution equals at least 50 percent of the balance to the credit of the employee, (2) the distribution is not one of a series of periodic payments, (3) the distribution is made on account of death, disability, or separation from service, and (4) the employee elects rollover treatment. A partial distribution may only be rolled over to an IRA and not to another qualified plan.

The maximum amount of a distribution that can be rolled over is the amount of the distribution that would otherwise be taxable. That is, after-tax employee contributions cannot be rolled over. In addition, minimum required distributions (sec. 401(a)(9)) may not be rolled over. The rollover must be made within 60 days after the distribution is received.

Lump-sum distributions

Under present law, lump-sum distributions from qualified plans and annuities are eligible for special 5-year forward income averaging (sec. 402(e)). In general, a lump-sum distribution is a distribution within one taxable year of the balance to the credit of an employee which becomes payable to the recipient (1) on account of the death of the employee, (2) after the employee attains age 59½, (3) on account of the employee's separation from service, or (4) in the case of self-employed individuals, on account of disability. In addition, a distribution is treated as a lump-sum distribution only if the employee has been a participant in the plan for at least 5 years before the year of the distribution. Lump-sum treatment is not available for distributions from tax-sheltered annuity contracts (sec. 403(b)).

A taxpayer is permitted to make an election with respect to a lump-sum distribution received on or after the employee attains age 59½ to use 5-year forward income averaging under the tax rates in effect for the taxable year in which the distribution is made. However, only one such election on or after age 59½ may be made with respect to any employee.

Special transition rules adopted in the Tax Reform Act of 1986 are available with respect to an employee who attained age 50 before January 1, 1986. Under these rules, an individual, trust, or estate may elect to use 5-year forward averaging (using present-law tax rates) or 10-year forward income averaging (using the tax rates in effect prior to the Tax Reform Act of 1986) with regard to a single lump-sum distribution, without regard to whether the employee has attained age 59½. In addition, an individual, trust, or estate receiving a lump-sum distribution with respect to such employee may elect to retain the capital gains character of the pre-1974 portion of the lump-sum distribution (using a tax rate of 20 percent).

Tax on excess distributions

Under present law, a 15 percent excise tax is imposed on excess distributions from qualified plans (sec. 4980A). Excess distributions are aggregate distributions from qualified retirement plans made with respect to an individual during any calendar year to the extent the distributions exceed the greater of (1) $150,000, or (2) $112,500 (indexed). A special higher ceiling applies for purposes of determining excess distributions for any calendar year in which an individual receives a lump-sum distribution. The higher ceiling is 5 times the otherwise applicable ceiling for the calendar year ($750,000 in 1992).

Net unrealized appreciation

Under present law, a taxpayer is not required to include in gross income amounts received in the form of a lump-sum distribution to the extent that the amounts are attributable to net unrealized appreciation in employer securities (sec. 402(a)). Such unrealized appreciation is includible in gross income when the securities are sold or exchanged. The special treatment of net unrealized appreciation applies only if a valid lump-sum distribution election is made, but disregarding the 5 plan years of participation requirement for lump-sum distributions.

In addition, gross income does not include net unrealized appreciation on employer securities attributable to employee contributions, regardless of whether the securities are received in a lump-sum distribution. Such appreciation is includible in income when the securities are disposed of.

Employer-provided death benefits

Under present law, the beneficiary or estate of a deceased employee generally can exclude up to $5,000 in benefits paid by or on behalf of an employer by reason of the employee's death (sec. 101(b)).

Recovery of basis

Qualified plan distributions other than lump-sum distributions generally are includible in gross income in the year they are paid or distributed under the rules relating to taxation of annuities (sec. 402). Amounts received as an annuity generally are includible in income in the year received, except to the extent they represent the return of the recipient's investment in the contract (i.e., basis) (sec. 72). Under present law, a pro-rata basis recovery rule generally applies, so that the portion of any annuity payment that represents nontaxable return of basis is determined by applying an exclusion ratio equal to the employee's total investment in the contract divided by the total expected payments over the term of the annuity.

The total expected payments depends on the form of the payment, e.g., a single-life annuity, an annuity with payments guaranteed for a specified number of years, or a joint and survivor annuity. For example, if benefits are paid in the form of an annuity during the life of the employee, the expected payments are calculated by multiplying the annual payment amount by the employee's life expectancy on the annuity starting date. If benefits are paid in the form of a joint and survivor annuity, then the total expected return depends on the life expectancies of both the primary annuitant and the person who is to receive the survivor annuity. The IRS has issued tables of life expectancies that are used to calculate expected returns.

Under a simplified alternative method provided by the Internal Revenue Service (IRS) (Notice 88–118) for payments from or under qualified retirement arrangements, the taxable portion of qualifying annuity payments is determined under a simplified exclusion ratio method. Under the simplified method, the portion of each annuity payment that represents nontaxable return of basis is equal to the employee's total investment in the contract (including the $5,000 death benefit exclusion under section 101(b), to the extent applicable), divided by the number of anticipated payments listed in a table published by the IRS. The number of anticipated payments listed in the table is based on the employee's age on the annuity starting date. The simplified method is available if (1) the annuity payments depend on the life expectancy of the recipient (or the joint lives of the recipient and his or her beneficiary), and (2) the recipient is less than age 75 on the annuity starting date or there are fewer than 5 years of guaranteed payments under the annuity.

Under both the pro rata and simplified alternative methods, in no event will the total amount excluded from income as nontaxable return of basis be greater than the recipient's total investment in the contract.

House bill

In general

The House bill expands the circumstances in which a distribution may be rolled over tax free and, in conjunction with such expansion, repeals 5- and 10-year averaging for lump-sum distributions from qualified plans, the special rules for unrealized appreciation in employer securities, and the $5,000 death benefit exclusion. The bill also simplifies the basis recovery rules applicable to distributions from qualified plans and requires that qualified plans give participants the option of having a distribution transferred directly to an IRA.

Rollovers

Under the bill, any portion of any distribution to the employee or the surviving spouse of the employee (other than a minimum required distribution (sec. 401(a)(9)) may be rolled over tax free to an IRA or another qualified plan or annuity, unless the distribution is part of a series of substantially equal payments made (1) over the life (or life expectancy) of the participant or the joint lives (or joint life expectancies) of the participant and his or her beneficiary, or (2) over a specified period of 10 years or more. The present-law prohibition on rolling over employee contributions is retained due to recordkeeping concerns.

Lump-sum distributions

The bill repeals the general 5-year forward averaging rule, as well as the transition rules under the Tax Reform Act of 1986 relating to 5- and 10-year averaging and capital gains treatment.

Tax on excess distributions

Under the bill, for purposes of determining the excise tax on excess distributions from qualified plans, an individual can elect in any calendar year to apply a special higher ceiling of 5 times the otherwise applicable ceiling for the calendar year ($750,000 in 1992). An individual can make such an election only once. The election is not available if the special higher ceiling applied to an individual in a taxable year prior to the effective date of the provision.

Net unrealized appreciation

The bill repeals the exclusion from income of net unrealized appreciation in employer securities. Distributions of employer securities are taxed the same as other distributions.

Employer-provided death benefits

The bill repeals the exclusion from gross income of up to $5,000 in employer-provided death benefits.

Recovery of basis

Under the bill, the portion of an annuity distribution from a qualified retirement plan, qualified annuity, or tax-sheltered annuity that represents nontaxable return of basis generally is determined under a method similar to the present-law simplified alternative method provided by the Internal Revenue Service. Under the simplified method provided in the bill, the portion of each annuity payment that represents nontaxable return of basis generally is equal to the employee's total investment in the contract as of the annuity starting date, divided by the number of anticipated payments determined by reference to the age of the participant listed in the table set forth in the bill. The number of anticipated payments listed in the table is based on the employee's age on the annuity starting date. If the number of payments is fixed under the terms of the annuity, that number is to be used instead of the number of anticipated payments listed in the table.

The simplified method does not apply if the primary annuitant has attained age 75 on the annuity starting date unless there are fewer than 5 years of guaranteed payments under the annuity. If in connection with commencement of annuity payments, the recipient receives a lump-sum payment that is not part of the annuity stream, such payment is taxable under the rules relating to annuities (sec. 72) as if received before the annuity starting date, and the investment in the contract used to calculate the simplified exclusion ratio for the annuity payments is reduced by the amount of the payment. As under present law, in no event will the total amount excluded from income as nontaxable return of basis be greater than the recipient's total investment in the contract.

Direct transfers to IRAs or other eligible transferee plans

Under the bill, a qualified retirement or annuity plan must permit participants to elect to have any distribution that is eligible for rollover treatment transferred directly to an eligible transferee plan specified by the participant. An eligible transferee plan is an IRA, a qualified defined contribution retirement plan (sec. 401(a)), or a qualified annuity plan (sec. 403(a)). Transfers to a qualified defined benefit plan (sec. 401(a)) are not permitted. As under present law, a transfer cannot be made to another qualified plan unless the terms of the transferee plan permit the acceptance of such transfer. Amounts transferred to an eligible transferee plan are includible in income when distributed from the transferee plan in accordance with the rules applicable to that plan.

Before making an eligible rollover distribution, the plan administrator is required to provide a written explanation to the participant of the direct transfer option. When making a distribution not in the form of a direct transfer, the administrator must provide a written explanation of the 60-day rollover limitation period.

Minimum required distributions

No provision.

Effective dates

The provisions are generally effective for years beginning after December 31, 1992.

The grandfather rules under the Tax Reform Act of 1986 are phased out over a number of years. In 1993, the grandfather rules apply to 60 percent of any lump-sum distribution. In 1994, the rules apply to 50 percent of any lump-sum distribution. In 1995, the rules apply to 45 percent of any lump-sum distribution. The portion of any lump-sum distribution to which the special averaging rules do not apply is subject to the rules of the bill regarding taxation of distributions and may, for example, be rolled over tax free into an IRA or another qualified plan under the rollover provisions of the bill. The 1986 Act grandfather rules do not apply to any amounts distributed in a taxable year beginning after December 31, 1995.

Senate amendment

Rollovers

The Senate amendment is the same as the House bill.

Lump-sum distributions

The Senate amendment repeals 5-year forward averaging, but maintains the transition rules under the Tax Reform Act of 1986.

Tax on excess distributions

The Senate amendment is the same as the House bill.

Net unrealized appreciation

The Senate amendment maintains present law with regard to net unrealized appreciation in employer securities.

Employer-provided death benefits

The Senate amendment is the same as the House bill.

Recovery of basis

The Senate amendment is the same as the House bill.

Direct transfer to IRAs or other eligible transferee plans

The Senate amendment generally requires that distributions in excess of $500 be transferred directly to an IRA or to a qualified defined contribution plan that provides for the acceptance of the transfer. Annuity distributions, distributions after age 55, distributions on account of the death of the employee (other than distributions to the surviving spouse), and hardship distributions are not subject to the transfer requirement.

Minimum required distributions

The Senate amendment provides that, except in the case of 5-percent owners of an employer and IRA owners, distributions are required to begin by April 1 of the calendar year following the later of the calendar year in which (1) the employee attains age 70½ or (2) the employee retires. As under present law, distributions to 5-percent owners and IRA owners are required to begin by the April 1 following the year in which the individual attains age 70½.

The benefits of participants who continue to work for an employer after attaining age 70½ are required to be actuarially increased to take into account the period after age 70½ during which the employee receives no benefits under the plan. (Age 70½ is changed to age 70 under another provision of the Senate amendment described below.)

Effective dates

The provisions are generally effective for years beginning after December 31, 1992. However, the rules relating to rollovers apply to distributions after the date of enactment, and the provision requiring that certain distributions be transferred directly to an eligible plan is effective for years beginning after December 31, 1993.

Conference agreement

Rollovers

The conference agreement follows the House bill and the Senate amendment. As under the House bill and the Senate amendment, as well as under present law, for purposes of the rule denying rollover treatment in the case of certain periodic payments, nonperiodic payments made with or after the commencement of the periodic payments are not treated as part of the stream of periodic payments. For example, if an employee receives 50 percent of his or her accrued benefit in the form of a single-sum distribution upon retirement, with the balance payable in annuity form, the single sum would not be denied rollover treatment under the provision.

Lump-sum distributions

The conference agreement follows the House bill and the Senate amendment with respect to the repeal of 5-year averaging, and the Senate amendment with respect to the transition rules under the Tax Reform Act of 1986.

Tax on excess distributions

The conference agreement follows the House bill and the Senate amendment.

Net unrealized appreciation

The conference agreement follows the Senate amendment.

Employer-provided death benefits

The conference agreement follows the House bill and the Senate amendment.

Recovery of basis

The conference agreement follows the House bill and the Senate amendment.

Direct transfers to IRAs or other eligible transferee plans

The conference agreement follows the House bill.

Effective dates

The provisions are generally effective for years beginning after December 31, 1992. The provision regarding direct transfers to IRAs or other eligible transferee plans is effective for years beginning after December 31, 1993.

2. INCREASED ACCESS TO PENSION PLANS

a. *Simplified salary reduction arrangements for small employers*

Present law

Under present law, certain employers (other than tax-exempt and governmental employers) can establish a simplified employee pension (SEP) for the benefit of their employees under which the employees can elect to have contributions made to the SEP or to receive the contributions in cash (sec. 408(k)(6)). If an employee elects to have contributions made on the employee's behalf to the SEP, the contribution is not treated as having been distributed or made available to the employee. In addition, the contribution is not treated as an employee contribution merely because the SEP provides the employee with such an election. Therefore, an employee is not required to include in income currently the amounts the employee elects to have contributed to the SEP. Elective deferrals under a SEP are to be treated in the same manner as elective deferrals under a qualified cash or deferred arrangement and, thus, are subject to the $8,728 (for 1992) cap on elective deferrals.

The election to have amounts contributed to a SEP or received in cash is available only if at least 50 percent of the employees of the employer elect to have amounts contributed to the SEP. In addition, such election is available for a taxable year only if the employer maintaining the SEP had 25 or fewer eligible employees at all times during the prior taxable year.

Under present law, elective deferrals under SEPs are subject to nondiscrimination standards. The amount eligible to be deferred as a percentage of each highly compensated employee's compensation (i.e., the deferral percentage) is limited by the average deferral percentage (based solely on elective deferrals) for all nonhighly compensated employees who are eligible to participate. The deferral percentage for each highly compensated employee (taking into account only the first $222,220 (indexed) of compensation) cannot exceed 125 percent of the average deferral percentage for all other eligible employees. Nonelective SEP contributions may not be combined with the elective SEP deferrals for purposes of this test. An employer may not make any other SEP contributions conditioned on elective SEP deferrals. If the 125-percent test is not satisfied, rules similar to the rules applicable to excess contributions to a cash or deferred arrangement are applied.

If any employee is eligible to make elective SEP deferrals, all employees satisfying the participation requirements must be eligible to make elective SEP deferrals. An employee satisfies the participation requirements if the employee (1) has attained age 21, (2) has performed services for the employer during at least 3 of the immediately preceding 5 years, and (3) received at least $363 (indexed) in compensation from the employer for the year. An employee can participate even though he or she is also a participant in one or more other qualified retirement plans sponsored by the employer. However, SEP contributions are added to the employer's contribution to the other plans on the participant's behalf in applying the limits on contributions and benefits (sec. 415).

House bill

The House bill repeals the present-law rules applying to salary reduction arrangements under a SEP and replaces them with new rules that simplify the administration of such arrangements.

Under the bill, employers (including tax-exempt employers) who do not maintain a qualified plan and who had no more than 100 employees eligible to participate in a SEP on each day of the preceding plan year can maintain a qualified salary reduction arrangement for their employees. The arrangement must satisfy the following requirements to be a qualified arrangement. First, the employer must contribute to each eligible employee's SEP an amount equal to 1 percent of the employee's compensation for the year (not in excess of $100,000 (indexed)).

Second, each eligible employee must be permitted to make salary reduction contributions to the SEP of up to a maximum of $3,000 (indexed) per year.[1]

Third, the employer is required to make matching contributions to each employee's SEP equal to 100 percent of an employee's contributions to the account up to 3 percent of compensation and 50

[1] The employer may limit contributions to the extent necessary to ensure compliance with the limits on contributions and benefits (sec. 415).

percent of an employee's contributions that are greater than 3 percent of compensation and do not exceed 5 percent of compensation.

If these conditions are satisfied, the arrangement is a qualified salary reduction arrangement that can be maintained under a SEP. The qualified arrangement is not subject to nondiscrimination testing requirements. In addition, it is intended that a qualified salary reduction arrangement will be deemed to satisfy the minimum benefit requirements of the top-heavy rules (sec. 416(c)(2)).

Under the bill, an employer maintaining a salary reduction SEP is required to provide a description of the SEP to all eligible employees.

Effective date.—The provision is generally effective with respect to years beginning after December 31, 1991.

Under a transition rule, salary reduction SEPs established before the date of enactment are not subject to the new rules contained in the bill regarding qualified salary reduction arrangements unless the employer elects to have the new rules apply for any year and all subsequent years. Employers who do not make such an election are subject to the rules in effect for years beginning before January 1, 1992.

Senate amendment

The Senate amendment conforms the eligibility requirements for SEP participation to the rules applicable to pension plans generally by providing that contributions to a SEP must be made with respect to each employee who has at least one year of service with the employer.

The Senate amendment modifies the rules relating to salary reduction SEPs by providing that such SEPs may be established by employers with 100 or fewer employees. The Senate amendment also repeals the requirement that at least half of eligible employees actually participate in a salary reduction SEP.

The Senate amendment also provides that an employer is deemed to satisfy the nondiscrimination requirements applicable to salary reduction SEPs if the plan satisfies the safe harbor nondiscrimination rules applicable to qualified cash or deferred arrangements and employees are notified of the availability and features of the SEP.

Effective date.—The provision applies to years beginning after December 31, 1992.

Conference agreement

The conference agreement follows the Senate amendment, except that the conference agreement does not adopt the provision in the Senate amendment that modifies SEP eligibility rules.

b. Repeal of limitation on ability of nongovernmental tax-exempt employers to maintain cash or deferred arrangements

Present law

Under present law, if a tax-qualified profit-sharing or stock bonus plan meets certain requirements, then an employee is not required to include in income any employer contributions to the plan merely because the employee could have elected to receive the amount contributed in cash (sec. 401(k)). Plans containing this feature are referred to as cash or deferred arrangements. Tax-exempt organizations are generally prohibited from establishing qualified cash or deferred arrangements. Because of this limitation, many of such employers are precluded from maintaining broad-based, funded, elective deferral arrangements for their employees.

House bill

The House bill allows nongovernmental tax-exempt organizations to maintain cash or deferred arrangements. As under present law, the limitation on the amount that may be deferred by an individual participating in both a cash or deferred arrangement and another elective deferral arrangement applies.

Effective date.—The provision applies to nongovernmental tax-exempt organizations with respect to years beginning after December 31, 1992. The provision does not affect the ability of certain State and local government employers to maintain qualified cash or deferred arrangements that were adopted before May 6, 1986.

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. *Duties of master and prototype plan sponsors*

Present law

The Internal Revenue Service (IRS) master and prototype program is an administrative program under which trade and professional associations, banks, insurance companies, brokerage houses, and other financial institutions can obtain IRS approval of model retirement plan language and then make these preapproved plans available for adoption by their customers, investors, or association members. Rules regarding who can sponsor master and prototype programs, the prescribed format of the model plans, and other matters relating to the program are contained in revenue procedures and other administrative pronouncements of the IRS.

The IRS also maintains related administrative programs that authorize advance approval of model plans prepared by law firms and others, i.e., the regional prototype plan program and volume submitter program.

House bill

The House bill authorizes the IRS to define the duties of organizations that sponsor master and prototype, regional prototype, and other preapproved plans, including mass submitters. These duties would become a condition of sponsoring preapproved plans. The bill is not intended to be interpreted as diminishing the IRS's administrative authority with respect to the master and prototype, regional prototype, or similar programs, including the authority to define who is eligible to sponsor prototype plans, or to create other rules relating to these programs. Rather, it is intended to create a system of sponsor accountability, subject to IRS monitoring, that will give adopters of master and prototype and other preapproved plans a level of protection, comparable to that in the regional prototype plan program, against failure of master and prototype and other plan sponsors to fulfill certain obligations.

The bill thus authorizes the IRS to prescribe duties of sponsors of prototype and other preapproved plans that include, but are not limited to, maintaining annually current lists of adopting employers and providing certain annual notices to adopting employers and to the IRS. While reflecting the IRS's own requirements in its regional prototype plan procedure, the bill does not require the IRS to mandate a master and prototype accountability system that is identical to the regional prototype plan procedure. The bill also authorizes the IRS to prescribe such other reasonable duties as are consistent with the objective of protecting adopting employers from a sponsor's failure to amend a plan in a timely manner or to communicate amendments or other notices required by the IRS's procedures.

The bill authorizes the IRS to define the duties of preapproved plan sponsors that relate to providing administrative services to the plans of adopting employers. This authorization is not intended to obligate sponsors to undertake the complete day-to-day administration of the plans they sponsor (although it does not preclude the IRS from mandating the performance of specific functions), but rather to protect employers against loss of qualification merely because they are unaware of the need to arrange for such services, or the unavailability of professional assistance from parties familiar with the sponsor's plan.

It is thus intended that, at a minimum, sponsors should (1) advise adopting employers that failure to arrange for administrative services to the plan may significantly increase the risk of disqualification and resulting sanctions, and (2) furnish employers with the name of firms that are familiar with the plan and can provide professional administrative service. This is not intended to preclude the sponsor from providing that service itself.

The bill should not be construed as creating fiduciary relationships or responsibilities under Title I of ERISA that would not exist in the absence of the provision.

To the extent deemed reasonably necessary to carry out the purposes of this provision of the bill, the Secretary is authorized to issue regulations that permit the relaxation of the anti-cutback rules contained in ERISA (sec. 204(g)) and the Code (sec. 411(d)(6)) when employers replace an individually designed plan with an IRS model plan, provided that the rights of participants to accrued benefits under the individually designed plan are not significantly impaired. This discretion will facilitate the shift by employers from individually designed plans to IRS model plans.

Effective date.—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.

3. NONDISCRIMINATION PROVISIONS

a. Simplification of nondiscrimination tests applicable under sections 401 (k) and (m)

Present law

A profit-sharing or stock bonus plan, a pre-ERISA money purchase pension plan, or a rural cooperative plan may include a qualified cash or deferred arrangement (sec. 401(k)). Under such an arrangement, an employee may elect to have the employer make payments as contributions to a plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals. The maximum annual amount of elective deferrals that can be made by an individual is $8,728 for 1992. This dollar limit is indexed annually for inflation. A special nondiscrimination test applies to cash or deferred arrangements.

The special nondiscrimination test applicable to elective deferrals under qualified cash or deferred arrangements is satisfied if the actual deferral percentage (ADP) for eligible highly compensated employees for a plan year is equal to or less than either (1) 125 percent of the ADP of all nonhighly compensated employees eligible to defer under the arrangement, or (2) the lesser of 200 percent of the ADP of all eligible nonhighly compensated employees or such ADP plus 2 percentage points. The ADP for a group of employees is the average of the ratios (calculated separately for each employee in the group) of the contributions paid to the plan on behalf of the employee to the employee's compensation.

Employer matching contributions and after-tax employee contributions under qualified defined contribution plans are subject to a special nondiscrimination test similar to the special nondiscrimination test applicable to qualified cash or deferred arrangements.

The special nondiscrimination test for employer matching contributions and after-tax employee contributions is satisfied for a plan year if the actual contribution percentage (ACP) for eligible highly compensated employees does not exceed the greater of (1) 125 percent of the ACP for all other eligible employees, or (2) the lesser of 200 percent of the contribution percentage for all other eligible employees, or such percentage plus 2 percentage points. The ACP for a group of employees for a plan year is the average of the ratios (calculated separately for each employee in the group) of the sum of matching and employee contributions on behalf of each such employee to the employee's compensation for the year.

To determine the amount of excess contributions and the employees to whom they are allocated, the elective deferrals of highly compensated employees are reduced in the order of their actual deferral percentage beginning with those highly compensated employees with the highest actual deferral percentages.

House bill

In general

The House bill modifies the present-law nondiscrimination test applicable to elective deferrals and employer matching and after-tax employee contributions to permit the use of the average deferral percentage for nonhighly compensated employees for the preceding plan year to be used in determining the permitted average deferral percentage for highly compensated employees for the current year. In the case of the first plan year of a qualified cash or deferred arrangement, the average deferral percentage for nonhighly compensated employees for the previous year is deemed to be 3 percent or, at the election of the employer, the average deferral percentage for the first plan year.

In addition, the bill adds alternative methods of satisfying the special nondiscrimination requirements applicable to elective deferrals and employer matching contributions. Under these safe harbor rules, a cash or deferred arrangement is treated as satisfying the actual deferral percentage test if the plan of which the arrangement is a part (or any other plan of the employer maintained with respect to the employees eligible to participate in the cash or deferred arrangement) meets (1) one of two contribution requirements and (2) a notice requirement. A plan satisfies the safe harbor with respect to matching contributions if (1) the plan meets the contribution and notice requirements under the safe harbor for cash or deferred arrangements and (2) the plan satisfies a special limitation on matching contributions. These safe harbors permit a plan to satisfy the special nondiscrimination tests through plan design, rather than through the testing of actual contributions.

Safe harbor for cash or deferred arrangements

Contribution requirements.—A plan satisfies the contribution requirements under the safe harbor rule for qualified cash or deferred arrangements if (1) the plan satisfies a matching contribution requirement or (2) the employer makes a nonelective contribution to a defined contribution plan of at least 3 percent of an employee's compensation on behalf of each nonhighly compensated employee who is eligible to participate in the arrangement without regard to whether the employee makes elective contributions under the arrangement.

A plan satisfies the matching contribution requirement if, under the arrangement: (1) the employer makes a matching contribution on behalf of each nonhighly compensated employee that is not less than (a) 100 percent of the employee's elective contributions up to 3 percent of compensation and (b) 50 percent of the employee's elective contributions from 3 to 5 percent of compensation; and (2) the level of match for highly compensated employees is not greater than the match rate for nonhighly compensated employees at any level of compensation.

Alternatively, if the matching contribution requirement is not satisfied at some level of employee compensation, the requirement is deemed to be satisfied if (1) the level of employer matching contributions does not increase as employee elective contributions increase and (2) the aggregate amount of matching contributions with respect to elective contributions up to that level of compensation at least equals the amount of matching contributions that would be made if matching contributions satisfied the percentage requirements. For example, the alternative test is satisfied if an employer matches 125 percent of an employee's elective contributions up to the first 3 percent of compensation, 25 percent of elective deferrals from 3 to 4 percent of compensation, and provides no match thereafter. This is because the employer match does not increase with the employee's contributions and the aggregate amount of matching contributions is at least equal to the matching contributions required under the general safe harbor rule.

Under the safe harbor, an employee's rights to employer matching contributions or nonelective contributions used to meet the contribution requirements are required to be 100-percent vested.

An arrangement does not satisfy the contribution requirements unless the requirements are met without regard to the permitted disparity rules (sec. 401(l)) and contributions used to satisfy the contribution requirements are not taken into account for purposes of determining whether an employer's plan satisfies the permitted disparity rules.

Employer matching and nonelective contributions used to satisfy the contribution requirements of the safe harbor rules are nonforfeitable and subject to the restrictions on withdrawals that apply to an employee's elective deferrals under a qualified cash or deferred arrangement (sec. 401(k)(2) (B) and (C)).

The matching or nonelective contribution safe harbor requirements are deemed satisfied if the employer maintains another qualified plan that meets such requirements.

Notice requirement.—The notice requirement is satisfied if each employee eligible to participate in the arrangement is given written notice within a reasonable period before any year of the employee's rights and obligations under the arrangement. This notice must be sufficiently accurate and comprehensive to apprise the employee of his or her rights and obligations and must be written in a manner calculated to be understood by the average employee eligible to participate.

Alternative method of satisfying special nondiscrimination test for matching contributions

The bill provides a safe harbor method of satisfying the special nondiscrimination test applicable to employer matching contributions. Under this safe harbor, a plan is treated as meeting the special nondiscrimination test if (1) the plan meets the contribution and notice requirements applicable under the safe harbor method of satisfying the special nondiscrimination requirement for qualified cash or deferred arrangements, and (2) the plan satisfies a special limitation on matching contributions.

The limitation on matching contributions is satisfied if (1) the matching contributions on behalf of any employee may not be made with respect to employee contributions or elective deferrals in excess of 6 percent of compensation and (2) the level of an employer's matching contribution does not increase as an employee's contributions or elective deferrals increase.

Effective date

The provision is effective for plan years beginning after December 31, 1992.

Senate amendment

Safe harbor for cash or deferred arrangements

The Senate amendment is the same as the House bill.

Alternative method of satisfying special nondiscrimination test for matching contributions

The Senate amendment is the same as the House bill.

Distribution of excess contributions

Under the Senate amendment, the total amount of excess contributions is determined in the same manner as under present law, but the distribution of excess contributions is required to be made on the basis of the amount of contribution by, or on behalf of, each highly compensated employee. Thus, under the Senate amendment, excess contributions are deemed attributable first to those highly compensated employees who have made the greatest dollar amount of elective deferrals under the plan.

For example, assume that an employer maintains a qualified cash or deferred arrangement under section 401(k). Assume further that the actual deferral percentage ("ADP") for the eligible non-highly compensated employees is 2 percent. In addition, assume the following facts with respect to the eligible highly compensated employees:

Employee	Compensation	Deferral	Deferral (percent)
A	$200,000	$7,000	3.5
B	200,000	7,000	3.5
C	70,000	7,000	10.0
D	70,000	5,250	7.5
E	70,000	2,100	3.0
F	70,000	1,750	2.5

Under these facts, the highly compensated employees' (A and B) ADP is 5 percent, which fails to satisfy the special nondiscrimination requirements.

Under present law, the highly compensated employees with the highest deferral percentages would have their deferrals reduced until the ADP of the highly compensated employees is 4 percent. Accordingly, C and D would have their deferrals reduced to $4,025 (i.e., a deferral percentage of 5.75 percent). Thus, the reduction under present law would be $2,975 for C and $1,225 for D, for a total reduction of $4,200.

Under the Senate amendment, the amount of the total reduction is calculated in the same manner as under present law so that the total reduction remains $4,200. However, this total reduction of

$4,200 is allocated to highly compensated employees based on the employees with the largest contributions. Thus, A, B, and C would each be reduced by $1,400 from $7,000 to $5,600. The ADP test would not be performed again.

Effective date

The Senate amendment is the same as the House bill.

Conference agreement

Safe harbor for cash or deferred arrangements

The conference agreement follows the House bill and the Senate amendment.

Alternative method of satisfying special nondiscrimination test for matching contributions

The conference agreement follows the House bill and the Senate amendment.

Distribution of excess contributions

The conference agreement follows the Senate amendment, but clarifies that it is intended that the modified distribution method also applies to excess contributions that are treated as distributed to an employee and then contributed by the employee to the plan (recharacterization). In addition, it is intended that the Secretary interpret and apply the section 401(k) and 401(m) nondiscrimination tests in a manner consistent with the modified distribution rule. For example, a plan will not fail to be a qualified cash or deferred arrangement merely because the plan fails to satisfy the section 401(k) nondiscrimination test after excess contributions are distributed or recharacterized under the modified distribution rule.

Effective date

The conference agreement follows the House bill and the Senate amendment.

b. Definition of highly compensated employee and family aggregation rules

Present law

In general

For purposes of the rules applying to qualified retirement plans under the Code, an employee, including a self-employed individual, is treated as highly compensated with respect to a year if, at any time during the year or the preceding year, the employee: (1) was a 5-percent owner of the employer; (2) received more than $93,518 in annual compensation from the employer; (3) received more than $62,345 in annual compensation from the employer and was one of the top-paid 20 percent of employees during the same year; or (4) was an officer of the employer who received compensation greater than $56,111. These dollar amounts are adjusted annually for inflation at the same time and in the same manner as the adjustments to the dollar limit on benefits under a defined benefit pension plan (sec. 415(d)). If, for any year, no officer has compensation in excess of $56,111 (indexed), then the highest paid officer of the employer for such year is treated as a highly compensated employee.

An employee is not treated as in the top-paid 20 percent, as an officer, or as receiving $93,518 or $62,345 solely because of the employee's status during the current year, unless such employee also is among the 100 employees who have received the highest compensation during the year.

Election to use simplified method

Employers are permitted to elect to determine their highly compensated employees under a simplified method. Under this method, an electing employer may treat employees who received more than $62,345 in annual compensation from the employer as highly compensated employees in lieu of applying the $93,518 threshold and without regard to whether such employees are in the top-paid group of the employer. This election is available only if at all times during the year the employer maintained business activities and employees in at least 2 geographically separate areas.

Treatment of family members

A special rule applies with respect to the treatment of family members of certain highly compensated employees. Under the special rule, if an employee is a family member of either a 5-percent owner or 1 of the top 10 highly compensated employees by compensation, then any compensation paid to such family member and any contribution or benefit under the plan on behalf of such family member is aggregated with the compensation paid and contributions or benefits on behalf of the 5-percent owner or the highly compensated employee in the top 10 employees by compensation. Therefore, such family member and employee are treated as a single highly compensated employee. An individual is considered a family member if, with respect to an employee, the individual is a spouse, lineal ascendant or descendant, or spouse of a lineal ascendant or descendant of the employee.

Similar family aggregation rules apply with respect to the $228,860 limit on compensation that may be taken into account under a qualified plan (sec. 401(a)(17)) and for deduction purposes (sec. 404(l)). However, under such provisions, only the spouse of the employee and lineal descendants of the employee who have not attained age 19 are taken into account.

House bill

The House bill replaces the present-law test for determining who is a highly compensated employee with a simplified test. The bill provides that an employee is highly compensated for a year if, at any time during the year or the preceding year, the employee (1) was a 5-percent owner of the employer, or (2) received compensation in excess of $62,345. This dollar amount is adjusted annually for inflation at the same time and in the same manner as the adjustments to the dollar limit on benefits under a defined benefit pension plan (sec. 415(d)). An employee is not treated as receiving $62,345 solely because of the employee's status during the current year, unless such employee also is among the 100 employees who have received the highest compensation during the year.

Under the bill, if no employee is treated as being highly compensated under the rules described above, then the employee with the highest compensation for the year is generally treated as a highly compensated employee. However, this rule does not apply in the case of a plan maintained by tax-exempt organization if the plan (1) provides a nonforfeitable right to 100 percent of an employee's accrued benefit, (2) covers a fair section of employees, determined on the basis of their compensation, and (3) was in effect on February 1, 1992, and at all times thereafter.

The bill repeals the family aggregation rules.

Effective date.—The provision is effective for years beginning after December 31, 1992.

Senate amendment

The Senate amendment provides that an employee is highly compensated with respect to a year if the employee (1) was a 5-percent owner of the employer at any time during the year or the preceding year, or (2) had compensation for the preceding year in excess of the dollar limit for the preceding year. The dollar limit is $50,000 (indexed). The $50,000 threshold is adjusted for cost-of-living increases in the same manner as the limitations on contributions and benefits (sec. 415(d)). Under the Senate amendment, as under present law, the dollar limit in effect (i.e., the indexed value of $50,000) for 1992 is $62,345. For example, in determining whether an employee is highly compensated in 1993, the employee's compensation for 1992 would be compared to the 1992 dollar limit, i.e., $62,345.

Under the Senate amendment, if no employee is a 5-percent owner or has compensation in excess of $50,000 (indexed), then the highest paid officer for the year is treated as a highly compensated employee. This special rule does not apply for purposes of the nondiscrimination rules applicable to elective deferrals, matching contributions, and employee contributions (secs. 401(k) and (m)), and does not apply with respect to employees of tax-exempt organizations and State and local governments (sec. 457(e)(1)).

The Senate amendment repeals the family aggregation rules.

Effective date.—The provision is effective for years beginning after December 31, 1992, except that an employer may elect not to have the provision apply to years beginning in 1993.

Conference agreement

The conference agreement follows the Senate amendment, except that there are no exceptions from the special rule that provides that if no employee is a 5-percent owner or has compensation in excess of $50,000 (indexed), then the highest paid officer for the year is treated as a highly compensated employee.

c. Election to treat base pay as compensation

Present law

Present law provides a definition of compensation that is to be used for nondiscrimination testing purposes (sec. 414(s)). Under this definition, compensation generally is defined as compensation used for purposes of the limits on contributions and benefits (sec. 415). Pursuant to statutory authority, final regulations provide alternative permissible definitions of compensation. The regulations permit certain items, such as bonuses and similar payments, to be excluded from the definition of compensation.

House bill

No provision.

Senate amendment

The Senate amendment permits an employer to elect to use base pay as a permissible definition of compensation for purposes of all provisions which specifically refer to section 414(s) of the Code. It is intended that base pay is defined generally as under Treasury regulations. Thus, subject to the applicable facts and circumstances, the employer could exclude from the definition of compensation, on a consistent basis, certain types of compensation, including (but not limited to) one or more of the following: any type of additional compensation for employees working outside their regularly scheduled duties (such as overtime pay, premiums for shift differential, and call-in premiums); bonuses; or reimbursements or other expense allowances, fringe benefits (cash and noncash), moving expenses, deferred compensation, and welfare benefits. It is intended that the resulting definition may not discriminate in favor of highly compensated employees. The election applies for purposes of all applicable provisions and to all employees, and may be revoked only with the consent of the Secretary.

Effective date.—The provision is effective for years beginning after December 31, 1992.

Conference agreement

The conference agreement does not include the Senate amendment.

d. Modification of additional participation requirements

Present law

Under present law, a plan is not a qualified plan unless it benefits no fewer than the lesser of (a) 50 employees of the employer or (b) 40 percent of all employees of the employer (sec. 401(a)(26)). This requirement may not be satisfied by aggregating comparable plans, but may be applied separately to different lines of business of the employer. A line of business of the employer does not qualify as a separate line of business unless it has at least 50 employees.

House bill

No provision.

Senate amendment

The Senate amendment provides that the minimum participation rule (sec. 401(a)(26)) applies only to defined benefit pension plans (not defined contribution plans). Under the Senate amendment, a defined benefit pension plan is not a qualified plan unless it benefits no fewer than the lesser of 25 employees or 40 percent of all employees of the employer. However, a plan maintained by an employer with only 2 employees must cover both. The excludable employee rule applies as under present law. As an illustration of the operation of the modification of the minimum participation rule, assume that an employer has 150 nonexcludable employees. Under present law, any plan of the employer is required to cover a minimum of 50 employees. Under the Senate amendment, any defined benefit plan of the employer is required to cover a minimum of 25 employees.

In the case of an employer with only 2 employees, the minimum participation rule under the Senate amendment is satisfied only if the plan covers both employees.

The Senate amendment provides that the requirement that a line of business has at least 50 employees does not apply in determining whether a plan satisfied the minimum participation rule on a separate line of business basis.

Effective date.—The provision is generally effective for years beginning after December 31, 1991. An employer may elect to have the provision apply as if it were included in section 1112(b) of the Tax Reform Act of 1986.

Conference agreement

The conference agreement follows the Senate amendment, except that the rule providing that a defined benefit pension plan does not satisfy the rule unless it benefits no fewer than the lesser of 25 employees or 40 percent of all employees of the employer is dropped.

Effective date.—The provision is generally effective for years beginning after December 31, 1991.

4. MISCELLANEOUS PENSION SIMPLIFICATION

a. Definition of leased employee

Present law

An individual (a leased employee) who performs services for another person (the recipient) may be required to be treated as the recipient's employee for various employee benefit provisions, even if the individual is not a common law employee. This leased employee relationship may exist if the services are performed pursuant to an agreement between the recipient and a third person (the leasing organization) who is otherwise treated as the individual's employer (sec. 414(n)). The individual is to be treated as the recipient's employee only if the individual has performed services for the recipient on a substantially full-time basis for a year, and the services are of a type historically performed by employees in the recipient's business field.

An individual who otherwise would be treated as a recipient's leased employee will not be treated as such an employee if the individual participates in a safe harbor plan maintained by the leasing organization meeting certain requirements. This exception does not apply if more than 20 percent of an employer's nonhighly compensated workforce is leased.

House bill

Under the House bill, the present-law "historically performed" test is replaced with a new rule defining who must be considered a leased employee. Under the bill, an individual is not considered a leased employee unless the services are performed under any significant direction or control by the service recipient. As under present law, the determination of whether someone is a leased employee is made after determining whether the individual is a common-law employee of the service recipient. Thus, an individual who is not a common-law employee of the service recipient may nevertheless be a leased employee of the service recipient. Similarly, the fact that a person is or is not found to perform services under the significant direction or control of the recipient for purposes of the employee leasing rules is not relevant in determining whether the person is or is not a common-law employee of the recipient for other tax purposes.

Whether services are performed by an individual under any significant direction or control by the service recipient depends on the facts and circumstances.

Effective date.—The provision is effective for years beginning after December 31, 1992, except that the changes do not apply to relationships that have been previously determined by an IRS ruling not to involve leased employees. In applying the leased employee rules to years beginning before the effective date, it is intended that the Secretary use a reasonable interpretation of the statute to apply the leasing rules to prevent abuse.

Senate amendment

Under the Senate amendment, the present-law historically performed test is repealed and replaced with a new rule defining who must be considered a leased employee. This change is made because the proposed regulations under the leased employee rules (sec. 414(n)) are overly broad in defining who may be a leased employee. Under the provision, the proposed regulations are no longer valid. One of the principal purposes for adopting the significant direction or control test is to relieve the unnecessary hardship and uncertainty created for employers in these circumstances. It is intended that the Secretary interpret and apply the new control test in a manner that is targeted to prevent clear abuses.

Under the provision, an individual is not considered a leased employee unless the individual is under the control of the recipient organization. The determination of whether an individual is controlled by the employer is based on all the facts and circumstances. Among the factors that are relevant in this determination are whether the recipient organization: (1) prescribes the individual's work methods; (2) supervises the individual; (3) sets the individual's working hours; and (4) sets the individual's level of compensation. Other factors that may be considered include those that are relevant for determining whether the employer is responsible for employment taxes on the compensation paid to the individual. The Secretary may designate other relevant factors. It is not necessary that all these factors indicate that the individual is under the control of the employer in order to find that such individual is a leased employee. Nor is it necessary that the recipient organization be responsible for employment taxes in order to find that the individual is a leased employee because, if the recipient organization is liable for employment taxes, the individual is an employee of the organization who generally must be taken into account. The provision does not alter the definition of a common-law employee, nor the rules that such employees are to be taken into account unless specifically excluded.

The changes made by this provision are not intended to broaden the scope of the leased employee rules. Thus, to the extent an individual is not a leased employee under present law, such employee generally will not be a leased employee under the provision. For example, in those specific situations where the Internal Revenue Service has ruled that service relationships do not involve "leased employees" under the test of present law requiring the services to be of a type historically performed, in the business field of the recipient, by employees, the recipients of those rulings may continue to rely on them.

Effective date.—The provision is effective for years beginning after December 31, 1983. In applying the leased employee rules to years beginning before the effective date, it is intended that the Secretary use a reasonable interpretation of the statute to apply the leasing rules to prevent abuse.

Conference agreement

The conference agreement generally follows the House bill. Under the conference agreement, as under the House bill, the present-law "historically performed" test is replaced with a new rule defining who must be considered a leased employee. Under the conference agreement, an individual is not considered a leased employee unless such services are performed under significant direction or control by the service recipient. As under present law, the determination of whether someone is a leased employee is made after determining whether the individual is a common-law employee of the service recipient. Thus, an individual who is not a common-law employee of the service recipient may nevertheless be a leased employee of the service recipient. Similarly, the fact that a person is or is not found to perform services under significant direction or control of the recipient for purposes of the employee leasing rules is not determinative of whether the person is or is not a common-law employee of the recipient.

Whether services are performed by an individual under significant direction or control by the service recipient depends on the facts and circumstances. Factors that are relevant in determining whether significant direction or control exists include whether the individual is required to comply with instructions of the service recipient about when, where, and how he or she is to perform the services, whether the services must be performed by a particular person, whether the individual is subject to the supervision of the service recipient, and whether the individual must perform services in the order or sequence set by the service recipient. Factors that would generally not be relevant in determining whether such direction or control exists include whether the service recipient has the right to hire or fire the individual and whether the individual works for others.

For example, an individual who works under the direct supervision of the service recipient would be considered to be subject to significant direction or control of the service recipient even if another company hired and trained the individual, had the ultimate (but unexercised) legal right to control the individual, paid his wages, withheld his employment and income taxes, and had the exclusive right to fire him. Thus, for example, temporary secretaries, receptionists, word processing personnel and similar office personnel who are subject to the day-to-day control of the employer in essentially the same manner as a common law employee are treated as leased employees if the period of service threshold is reached.

On the other hand, an individual who is a common-law employee of Company A who performs services for Company B on the business premises of the Company B under the supervision of Company A would generally not be considered to be under significant direction or control of Company B. The supervision by Company A must be more than nominal, however, and not merely a mechanism to avoid the literal language of the direction or control test.

An example of the situation in the preceding paragraph might be a work crew that comes into a factory to install, repair, maintain, or modify equipment or machinery at the factory, and that includes a supervisor who is an employee of the equipment (or equipment repair) company and who has the authority to direct and control the crew, and who actually does exercise such direction and control. In this situation, the supervisor and his or her crew are not the leased employees of the manufacturer, even if the supervisor is in frequent communication with the employees of the manufacturer and even if the supervisor and his or her crew are required to comply with the safety and environmental precautions of the manufacturer.

Under the direction or control test, clerical and similar support staff (e.g., secretaries and nurses in a doctor's office) generally would be considered to be subject to significant direction or control of the service recipient and would be leased employees provided the other requirements of section 414(n) are met. On the other hand, outside professionals who maintain their own businesses (e.g., lawyers and accountants) generally would not be considered to be subject to such primary control. However, the Secretary is encouraged to continue efforts to prevent abuses in the leased manager area.

In many cases, the "historically performed" test is overly broad, and results in the unintended treatment of individuals as leased employees. One of the principal purposes for changing the leased employee rules is to relieve the unnecessary hardship and uncertainty created for employers in these circumstances. However, it is not intended that the direction or control test enable employers to engage in abusive practices. Thus, it is intended that the Secretary interpret and apply the leased employee rules in a manner so as to prevent abuses. This ability to prevent abuses under the leasing rules is in addition to the present-law authority of the Secretary under section 414(o). For example, one potentially abusive situation exists where the benefit arrangements of the service recipient overwhelmingly favor its highly compensated employees, the employer has no or very few nonhighly compensated common-law employees, yet the employer makes substantial use of the services of nonhighly compensated individuals who are not its common-law employees.

Effective date.—The provision is effective for years beginning after December 31, 1992, except that the changes do not apply to relationships that have been previously determined by an IRS ruling not to involve leased employees. In applying the leased employee rules to years beginning before the effective date, it is intended that the Secretary use a reasonable interpretation of the statute to apply the leasing rules to prevent abuse. Relationships that would not be treated as involving leased employees under the standard adopted in the conference agreement are conclusively presumed to be nonabusive.

b. Cost-of-living adjustments

Present law

The rules relating to qualified plans contain a number of dollar limits that are indexed annually for cost-of-living adjustments (e.g., the dollar limit on benefits under a defined benefit plan (sec. 415(b)), the limit on elective deferrals under a qualified cash or deferred arrangement (sec. 402(g)), and the dollar amounts used in determining highly compensated employees (sec. 414(q)). The Secretary publishes annually a list of the amounts applicable under each provision for the year.

House bill

The House bill provides that the cost-of-living adjustment with respect to any calendar year is based on the increase in the applicable index as of the close of the calendar quarter ending September 30 of the preceding calendar year. Thus, adjusted dollar limits will be published before the beginning of the calendar year to which they apply.

In addition, the bill provides that the dollar limits determined after application of the cost-of-living adjustments are generally rounded to the nearest $1,000. Dollar limits relating to elective deferrals and elective contributions to simplified employee pensions (SEPs) are rounded to the nearest $100.

Effective date.—The provision is effective for years beginning after December 31, 1992.

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. Plans covering self-employed individuals

Present law

Prior to the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) different rules applied to retirement plans maintained by incorporated employers and unincorporated employers (such as partnerships and sole proprietors). In general, plans maintained by unincorporated employers were subject to special rules in addition to the other qualification requirements of the Code. Most, but not all, of this disparity was eliminated by TEFRA. Under present law, certain special aggregation rules apply to plans maintained by owner-employees that do not apply to other qualified plans (sec. 401(d) (1) and (2)).

House bill

The House bill eliminates the special aggregation rules that apply to plans maintained by self-employed individuals that do not apply to other qualified plans.

Effective date.—The provision is effective for years beginning after December 31, 1992.

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. Alternative full funding limitation

Present law

Under present law, subject to certain limitations, an employer may make deductible contributions to a defined benefit pension plan up to the full funding limitation. The full funding limitation is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 150 percent of the plan's current liability, over (2) the lesser of (a) the fair market value of the plan's assets, or (b) the actuarial value of the plan's assets (sec. 412(c)(7)).

The Secretary may, under regulations, adjust the 150-percent figure contained in the full funding limitation to take into account the average age (and length of service, if appropriate) of the participants in the plan (weighted by the value of their benefits under the plan). In addition, the Secretary is authorized to prescribe regulations that apply, in lieu of the 150 percent of current liability limitation, a different full funding limitation based on factors other than current liability. The Secretary may exercise this authority only in a manner so that in the aggregate, the effect on Federal budget receipts is substantially identical to the effect of the 150-percent full funding limitation.

House bill

In general

The House bill provides that an employer may elect to disregard the 150-percent limitation if each plan in the employer's control group is not top-heavy and the accrued liability of active participants is 90 percent of the plan's total accrued liability (the "alternative full funding limitation"). The Secretary is required to adjust the 150-percent full funding limitation (in the manner specified under the bill) for employers that do not use the alternative full funding limit to ensure that the election by employers to disregard the 150-percent limit does not result in a substantial reduction in Federal revenues for any fiscal year.

Notice requirement

The Secretary must be notified of the election to use the alternative limitation at least 425 days before the first day of the election period, so that the Secretary has an opportunity to make the adjustments to the 150-percent full funding limitation described above. Thus, the alternative limitation is available to electing employers no earlier than plan years beginning in mid-1993.

Effective date

The provision is effective on the date of enactment.

Senate amendment

In general

The Senate amendment is the same as the House bill, except that an employer may elect to apply the alternative if the average accrued liability of active participants under the plan for the immediately preceding 5 plan years is at least 80 percent of the plan's total accrued liability.

Notice requirement

Under the Senate amendment, employers electing to apply the alternative limitation must notify the Secretary by January 1 of the calendar year preceding the calendar year in which the election period begins. In addition, under a special transition rule, in the case of any election period beginning after December 31, 1991, and before January 1, 1994, the notice requirement is deemed satisfied if the Secretary is notified of the election by December 31, 1992. Thus, the alternative limitation is available to electing employers for plan years beginning in 1992 or thereafter.

Effective date

The provision is effective on the date of enactment.

Conference agreement

In general

The conference agreement follows the Senate amendment.

Notice requirement

The conference agreement follows the Senate amendment, except the special transition rule is modified. Under the conference agreement, in the case of any election period beginning on or after July 1, 1992, and before January 1, 1994, the notice requirement is deemed satisfied if the Secretary is notified of the election by October 31, 1992. In addition, the Secretary is required, by January 1, 1993, to notify defined benefit plans that have not made an election to apply the alternative limitation of any adjustment to the 150-percent full funding limitation required under the provision.

To the extent a defined benefit plan sponsor makes a contribution to a defined benefit plan with respect to the transition period that exceeds the full-funding limitation, as adjusted by the secretary for the transition period, the sponsor is required to offset the excess contribution against allowable contributions to the plan in subsequent quarters in the taxable year of the sponsor. If no subsequent contributions may be made for the taxable year, the trustee of the defined benefit plan must return the excess contribution to the sponsor in that taxable year or the subsequent taxable year.

Effective date

The conference agreement follows the House bill and the Senate amendment.

e. In-service distributions from rural cooperative plans

Present law

Under present law, a qualified cash or deferred arrangement can permit withdrawals by participants only after the earlier of (1) the participant's separation from service, death, or disability, (2) termination of the arrangement, (3) in the case of a profit-sharing or stock bonus plan, the attainment of age 59½, or (4) in the case of a profit-sharing or stock bonus plan to which section 402(a)(8) applies, upon hardship of the participant (sec. 401(k)(2)(B)). In the case of a rural cooperative qualified cash or deferred arrangement, which is part of a money purchase pension plan, withdrawals by participants cannot occur upon attainment of age 59½ or upon hardship.

House bill

The House bill provides that a rural cooperative plan that includes a qualified cash or deferred arrangement will not be treated as violating the qualification requirements merely because the plan permits distributions to plan participants after the attainment of age 59½.

Effective date.—The provision is effective for distributions after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill (age 59½ is changed to 59 under another provision of the Senate amendment).

Effective date.—The provision is effective as if included in section 1011(k)(5) of the Technical and Miscellaneous Revenue Act of 1988.

Conference agreement

The conference agreement follows the House bill.

f. Special rule for plans covering pilots

Present law

Under present law, for purposes of determining whether a qualified pension plan satisfies the minimum coverage requirements, in the case of trust established pursuant to a collective bargaining agreement between airline pilots and one or more employers, all employees not covered by the collective bargaining agreement are disregarded (sec. 410(b)(3)(B)). This provision applies only in the case of a plan that provides contributions or benefits for employees whose principal duties are customarily performed aboard aircraft in flight. Thus, a collectively bargained plan covering only airline pilots is tested separately for purposes of the minimum coverage requirements.

House bill

The House bill provides that, in the case of a plan established by one or more employers to provide contributions or benefits for air pilots employed by one or more common carriers engaged in interstate or foreign commerce or air pilots employed by carriers transporting mail for or under contract with the United States government, all employees who are not air pilots are excluded from consideration in testing whether the plan satisfies the minimum coverage requirements. In addition, the bill provides that this exception does not apply in the case of a plan that provides contributions or benefits for employees who are not air pilots or for air pilots whose principal duties are not customarily performed aboard aircraft in flight.

Effective date.—The provision is effective for years beginning after December 31, 1992.

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. *Elimination of special vesting rule for multiemployer plans*

Present law

Under present law, except in the case of multiemployer plans, a plan is not a qualified plan unless a participant's employer-provided benefit vests at least as rapidly as under 1 of 2 alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of the participant's accrued benefit derived from employer contributions upon the participant's completion of 5 years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to at least 20 percent of the participant's accrued benefit derived from employer contributions after 3 years of service, 40 percent at the end of 4 years of service, 60 percent at the end of 5 years of service, 80 percent at the end of 6 years of service, and 100 percent at the end of 7 years of service.

In the case of multiemployer plan, a participant's accrued benefit derived from employer contributions is required to be 100 percent vested no later than upon the participant's completion of 10 years of service. This special rule applies only to employees covered by the plan pursuant to a collective bargaining agreement.

House bill

The House bill conforms the vesting rules for multiemployer plans to the rules applicable to other qualified plans.

Effective date.—The provision is effective for plan years beginning on or after the earlier of (1) the later of January 1, 1993, or the date on which the last of the collective bargaining agreements pursuant to which the plan is maintained terminates, or (2) January 1, 1995, with respect to participants with an hour of service after the effective date.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House bill provision.

h. *Treatment of deferred compensation plans of State and local governments and tax-exempt organizations*

Present law

Under a general principle of the Federal income tax system, individuals are taxed currently not only on compensation actually received, but also on compensation constructively received during the taxable year. An individual is treated as having constructively received compensation during the current taxable year if the compensation would have been payable during the current taxable year but for the individual's election to defer receipt of the compensation to a later taxable year.

An exception to this rule applies to compensation deferred under an eligible unfunded deferred compensation plan (a sec. 457 plan) of a tax-exempt or State or local governmental employer.

Under a section 457 plan, an employee who elects to defer the receipt of current compensation will be taxed on the amounts deferred when such amounts are paid or made available. The maximum annual deferral under such a plan is the lesser of (1) $7,500 or (2) 33⅓ percent of compensation (net of the deferral).

In general, amounts deferred under a section 457 plan may not be made available to an employee before the earlier of (1) the calendar year in which the participant attains age 70½, (2) when the participant is separated from service with the employer, or' (3) when the participant is faced with an unforeseeable emergency. Amounts that are made available to an employee upon separation from service are includible in gross income in the taxable year in which they are made available.

Under present law, benefits under a section 457 plan are not treated as made available if the participant may elect to receive a lump sum payable after separation from service and within 60 days of the election. This exception to the general rules is available only if the total amount payable to the participant under the plan does not exceed $3,500 and no additional amounts may be deferred under the plan with respect to the participant.

House bill

The House bill makes three changes to the rules governing unfunded deferred compensation plans (sec. 457 plans) of tax-exempt and governmental employers.

First, the bill permits in-service distributions of accounts that do not exceed $3,500 if no amount has been deferred under the section 457 plan with respect to the account for 2 years and there has been no prior distribution under this cash-out rule.

Second, the bill increases the number of elections that can be made with respect to the time distributions must begin under a section 457 plan. The bill provides that the amount payable to a participant under a section 457 plan is not to be treated as made available merely because the participant may elect to defer commencement of distributions under the plan if (1) the election is made after amounts may be distributed under the plan but before the actual commencement of benefits, and (2) the participant makes only 1 such additional election. This additional election is permitted without the need for financial hardship, and the election can only be to a date that is after the date originally selected by the participant.

Finally, the bill provides for indexing of the dollar limit on deferrals.

Effective date.—The provisions are effective for taxable years beginning after the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

i. Limits on contributions and benefits under governmental plans

Present law

Present law imposes limits on contributions and benefits under qualified plans based on the type of plan (sec. 415). The limits apply to plans maintained by private and public employers. Certain special rules apply to governmental plans.

In the case of a defined contribution plan, the annual additions to the plan with respect to each plan participant are limited to the lesser of (1) 25 percent of compensation, or (2) $30,000. The limit on the annual benefits payable by a defined benefit pension plan is generally the lesser of (1) 100 percent of compensation, or (2) $112,221 for 1992. The dollar limit is increased annually for inflation. The dollar limit is reduced actuarially if payment of benefits is to begin before the social security retirement age, and increased if benefits are to begin after that age.

Under special rules for plans maintained by State or local governments, such plans may provide benefits greater than those permitted by the limits on benefits applicable to plans maintained by private employers.

House bill

The House bill makes the following modifications to the limits on contributions and benefits as applied to governmental plans: (1) compensation includes employer contributions to certain employee plans under a salary reduction arrangement; (2) the 100 percent of compensation limitation does not apply; and (3) the defined benefit pension plan limitation does not apply to certain disability and survivor benefits. The provision also permits State and local government employers to maintain excess benefit plans (i.e., plans that provide benefits that cannot be provided under a qualified plan due to the limits on contributions and benefits) without regard to the limits on unfunded deferred compensation arrangements of State and local government employers (sec. 457). Benefits provided by such plans are subject to the same tax rules applicable to excess plans maintained by private employers (e.g., sec. 83).

Effective date.—The provision is effective for years beginning after the date of enactment. Governmental plans are treated as if in compliance with the requirements of section 415 for years beginning on or before the date of enactment.

Senate amendment

The Senate amendment is generally the same as the House bill, with only minor technical differences.

Conference agreement

The conference agreement follows the House bill.

j. *Use of 501(c)(21) black lung trust assets to fund retiree health benefits*

Present law

A qualified black lung benefit trust described in section 501(c)(21) of the Internal Revenue Code is exempt from federal income taxation. In addition, a deduction is allowed for contributions to a qualified black lung benefit trust to the extent such contributions are necessary to fund the trust.

Under present law, no assets of a qualified black lung benefit trust may be used for, or diverted to, any purpose other than (i) to satisfy labilities, or pay insurance premiums to cover liabilities, arising under the Black Lung Acts, (ii) to pay administrative costs of operating the trust, or (iii) investment in U.S., State, or local securities and obligations, or in time demand deposits in a bank or insured credit union.

Under present law, excess trust assets may be paid into the national Black Lung Disability Trust Fund, or into the general fund of the U.S. Treasury.

House bill

The House bill allows excess assets in qualified black lung benefit trusts to be used to pay accident and health benefits or premiums for insurance for such benefits (including administrative and other incidental expenses relating to such benefits) for retired coal miners and their spouses and dependents. The amount of assets available for such purpose is subject to a yearly limit as well as an aggregate limit. The yearly limit is be the amount of assets in excess of 110 percent of the present value of the liability for black lung benefits determined as of the close of the preceding taxable year of the trust. The aggregate limit is the amount of assets in excess of 110 percent of the present value of the liability for black lung benefits determined as of the close of the taxable year of the trust ending prior to the effective date, plus earnings thereon. Each of these determinations is required to be made by an independent actuary.

The amounts used to pay retiree accident or health benefits are not includible in the income of the company, nor is a deduction allowed for such amounts.

Effective date.—The provision would be effective for taxable years beginning after December 31, 1991.

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.

k. Definition of employer reversion

Present law

Under present law, employer reversions from qualified pension plans are generally subject to an excise tax. In some cases, Federal regulations require that a portion of any reversion from a plan maintained by a government contractor be paid to the United States. Such amounts are subject to the excise tax on reversions.

House bill

The House bill provides that, for purposes of the excise tax, an employer reversion does not include certain amounts paid to the Federal government by reason of certain government contracting regulations.

Effective date.—The provision is effective on the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

l. Clarification of application of health care continuation rules to savings and loan associations

Present law

Under the health care continuation rules, persons who are covered under a group health plan are required to be offered the opportunity to continue to participate for a specified period of time in a group health plan of the employer (or a plan of successor employer) despite the occurrence of a qualifying event that otherwise would terminate such participation. Qualified beneficiaries are employees covered by the plan and the spouse and dependent children of a covered employee.

Qualifying events include termination of employment of a covered employee, the divorce or death of a covered employee, the covered employee becoming entitled to Medicare, and, in the case of a retired employee, the commencement of a bankruptcy proceeding under title 11 of the United States Code.

The period for which coverage is required to be continued depends on the qualifying event, and is generally either 18 months or 36 months. Persons electing continuation coverage can be required to pay for the coverage.

The health care continuation provisions are enforced under the Code by means of an excise tax (sec. 4980B).

The Federal Deposit Insurance Corporation Improvement Act of 1991 contained a provision clarifying the application of the health care continuation rules in the case of failed depository institutions. In general, the provision provides that the Federal Deposit Insurance Corporation (FDIC), a bridge bank, or any successor of a failed depository institution is required to provide continuation health care coverage to former employees of the failed institution. This provision is effective for plan years beginning on or after the date of enactment of the Act, regardless of whether the qualifying event occurred before, on, or after such date.

House bill

Under the House bill, the obligations of bridge banks and successors to failed institutions are incorporated into the health care continuation provisions of the Code. The provision also provides that retired employees of a failed depository institution are entitled to the same continuation coverage rights as retirees of a company in bankruptcy.

Effective date.—The provision is effective as if included in section 451 of the Federal Deposit Insurance Corporation Improvement Act of 1991.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

m. Elimination of half-year requirements

Present law

Under present law, a number of employee plan rules refer to the age of an individual at a certain time. For example, distributions under a qualified pension plan are generally required to begin no later than the April 1 following the year in which an individual attains age 70½ (sec. 401(a)(9)). Similarly, an additional income tax on early withdrawals applies to certain distributions from qualified pension plans and IRAs prior to the time the participant or IRA owner attains age 59-1/2 (sec. 72(t)).

House bill

No provision.

Senate amendment

The Senate amendment changes the half-year requirements to birthdate requirements. Those rules under present law that refer to age 59½ are changed to refer to age 59, and those that refer to age 70½ are changed to refer to age 70.

Effective date.—The provision applies to years beginning after December 31, 1992.

Conference agreement

The conference agreement does not include the Senate amendment.

n. Penalties for failure to provide reports relating to pension payments

Present law

Any person who fails to file an information report with the Internal Revenue Service on or before the prescribed filing date is subject to penalties for each failure. The general penalty structure provides that the amount of the penalty is to vary with the length of time within which the taxpayer corrects the failure, and allows taxpayers to correct a de minimis number of errors and avoid penalties entirely (sec. 6721). A different, flat-amount penalty applies for each failure to provide information reports to the IRS or statements to payees relating to pension payments (sec. 6652(e)).

House bill

The House bill incorporates into the general penalty structure the penalties for failure to provide information reports relating to pension payments to the IRS and to recipients. Thus, information reports with respect to pension payments would be treated in a similar fashion to other information reports.

Effective date.—The provision applies to returns and statements the due date for which is after December 31, 1992.

Senate amendment

The Senate amendment is generally the same as the House bill, except that the class of reports to which the Senate amendment applies is slightly different, and no reporting is required with respect to designated distributions of less than $10.

Conference agreement

The conference agreement follows the House bill.

o. Contributions on behalf of disabled employees

Present law

Under present law, an employer may elect to continue deductible contributions to a defined contribution plan on behalf of an employee who is permanently and totally disabled. For purposes of the limit on annual additions (sec. 415(c)), the compensation of a disabled employee is deemed to be equal to the annualized compensation of the employee prior to the employee's becoming disabled. Contributions are not permitted on behalf of disabled employees who were officers, owners, or highly compensated before they became disabled.

House bill

No provision.

Senate amendment

The Senate amendment provides that the special rule for contributions on behalf of disabled employees is applicable without an employer election and to highly compensated employees if the defined contribution plan provides for the continuation of contributions on behalf of all participants who are permanently and totally disabled.

Effective date.—The provision applies to years beginning after December 31, 1992.

Conference agreement

The conference agreement follows the Senate amendment.

p. Affiliation requirements for employers jointly maintaining a VEBA

Present law

A voluntary employees' beneficiary association (VEBA) that satisfies certain requirements is entitled to tax-exempt status. The Code generally describes a VEBA as an association that provides for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries, if no part of the net earnings of the association inures (other than through such payments) to the benefit of any private shareholder or individual. The requirements a VEBA must comply with in order to be tax exempt are further specified in regulations.

Under Treasury regulations, membership in a VEBA is required to be limited to individuals whose eligibility is determined by reference to objective standards that constitute an employment-related common bond. Such a common bond exists if eligibility is determined by the following standards: (1) employment by a common employer (or affiliated employers); (2) coverage under one or more collective bargaining agreements; (3) membership in a labor union (or in one or more locals of a national or international labor union); or (4) employment by one or more employers in the same line of business in the same geographic locale.

House bill

No provision.

Senate amendment

The Senate amendment provides that otherwise unrelated employers are treated as affiliated and, therefore, can maintain a tax-exempt VEBA if the employers (1) are in the same line of business, (2) act jointly to perform tasks which are integral to the activities of each of the employers, (3) act jointly to such an extent that the joint maintenance of a VEBA is not a major part of the joint activities, and (4) a substantial number of the employers are tax exempt.

Under the bill, employers are considered affiliated, for example, under the following circumstances. The employers participating in the VEBA are in the same line of business and belong to an association that provides to its members a significant amount of each of the following services: (1) research and development relating to the members' primary activity; (2) education and training of members' employees; and (3) public relations. In addition, the employers are sufficiently similar (e.g., subject to similar regulatory requirements) that the association's services provide material assistance to all of the employers. The employers also demonstrate the importance of their joint activities by having meetings at least annually attended by substantially all of the employers. Finally, the employers maintain a common retirement plan.

On the other hand, it is not intended that the mere existence of a trade association is a sufficient basis for the member-employers to be considered affiliated, even if they are in the same line of business. It is also not sufficient if the trade association publishes a newsletter and provides significant public relations services, but only provides nominal amounts, if any, of other services integral to the employers' primary activity.

A group of employers are also not considered affiliated under the bill by virtue of the membership of their employees in a professional association.

Effective date.—The provision applies to years beginning before, on, or after the date of enactment. The provision is intended as a clarification of present law. However, it is not intended to create any inference as to whether any part of the Treasury regulations affecting VEBAs, other than the affiliated employer rule, is or is not present law.

Conference agreement

The conference agreement follows the Senate amendment.

q. Disaggregation of union plans

Present law

Under present law, employees covered by a collective bargaining agreement are excluded from consideration in testing whether a qualified plan satisfies the minimum coverage and nondiscrimination tests. In addition, such employees are not counted for purposes of determining whether a line of business has at least 50 employees, the threshold number for designating a unit as a separate line of business for purposes of applying the coverage and nondiscrimination tests.

House bill

No provision.

Senate amendment

The Senate amendment provides that an employer can elect to include union employees who benefit under the plan on the same terms as other employees in testing whether a plan satisfies the minimum coverage and nondiscrimination tests, and in applying the 50-employee test under the line of business rules.

Effective date.—The provision applies to years beginning after December 31, 1992.

Conference agreement

The conference agreement does not include the Senate amendment.

r. Uniform retirement age

Present law

A qualified plan generally must provide that payment of benefits under the plan must begin no later than 60 days after the end of the plan year in which the participant reaches age 65. Also, for purpose of the vesting and benefit accrual rules, normal retirement age generally can be no later than age 65. For purposes of applying the limits on contributions and benefits (sec. 415), social security retirement age is generally used as retirement age. The social security retirement age as used for such purposes is presently age 65, but is scheduled to gradually increase.

House bill

No provision.

Senate amendment

The Senate amendment provides that for purposes of the general nondiscrimination rule (sec. 401(a)(4)) the social security retirement age (as defined in sec. 415) is a uniform retirement age and that subsidized early retirement benefits and joint and survivor annuities based on an employee's social security retirement age (as defined in sec. 415) are treated as being available to employees on the same terms.

Effective date.—The provision is effective for years beginning after December 31, 1992.

Conference agreement

The conference agreement follows the Senate amendment, with the clarification that subsidized early retirement benefits and joint and survivor annuities are not treated as not being available to employees on the same terms merely because they are based on an employee's social security retirement age.

s. National Commission on Private Pension Plans

Present law

None.

House bill

No provision.

Senate amendment

The provision establishes a National Commission on Private Pension Plans to study national retirement income policy. The Commission is directed to submit a report to the Congress by Labor Day 1994, the 20th anniversary of the enactment of the Employee Retirement Income Security Act of 1974, setting forth its findings and recommendations for increasing the level and security of private retirement savings.

The provision authorizes appropriations through fiscal year 1994 for such sums as may be necessary to carry out the provision.

Conference agreement

The conference agreement does not include the Senate amendment.

t. Date for adoption of plan amendments

Present law

Under regulations, plan amendments to reflect changes in the generally must be made within the remedial amendment period. Such period generally ends at the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs. The plan must be operated in accordance with the law at all times, and any plan amendment must apply retroactively to the period following the effective date of the change which it reflects.

House bill

No provision.

Senate amendment

The Senate amendment provides that any plan amendments required by the bill are not required to be made before the first plan year beginning on or after January 1, 1994, if the plan is operated in accordance with the applicable provision and the amendment is retroactive to the effective date of the applicable provision.

Effective date.—Date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

u. Full funding limitation of multiemployer plans

Present law

Under the Internal Revenue Code, subject to certain limitations, an employer may make deductible contributions to a defined benefit pension plan up to the full funding limitation. The full funding limitation is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 150 percent of the plan's current liability, over (2) the lesser of (a) the fair market value of the plan's assets, or (b) the actuarial value of the plan's assets (sec. 412(c)(7)).

Plans subject to the minimum funding rules are required to make an actuarial valuation of the plan not less frequently than annually.

House bill

No provision.

Senate amendment

The Senate amendment amends the Internal Revenue Code to provide that the 150 percent of current liability limitation does not apply to multiemployer plans. In addition, the bill repeals the Internal Revenue Code annual valuation requirement for multiemployer plans and applies the prior-law rule that valuations generally be performed at least every 3 years.

Effective date.—The provision applies to years beginning after December 31, 1991.

Conference agreement

The conference agreement does not include the Senate amendment.

C. Treatment of large partnerships

1. GENERAL PROVISIONS

a. Simplified flow-through for large partnerships

Present law

Treatment of partnerships in general

A partnership generally is treated as a conduit for Federal income tax purposes. Each partner takes into account separately his distributive share of the partnership's items of income, gain, loss, deduction or credit. The character of an item is the same as if it had been directly realized or incurred by the partner. Limitations affecting the computation of taxable income generally apply at the partner level.

The taxable income of a partnership is computed in the same manner as that of an individual except that no deduction is permitted for personal exemptions, foreign taxes, charitable contributions, net operating losses, certain itemized deductions, or depletion. Elections affecting the computation of taxable income derived from a partnership are made by the partnership, except for certain elections such as those relating to discharge of indebtedness income and the foreign tax credit.

Capital gains

The net capital gain of an individual is taxed generally at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent. Net capital gain is the excess of net long-term capital gain over net short-term capital loss. Individuals with a net capital loss generally may deduct up to $3,000 of the loss each year against ordinary income. Net capital losses in excess of the $3,000 limit may be carried forward indefinitely.

A special rule applies to gains and losses on the sale, exchange or involuntary conversion of certain trade or business assets (sec.

1231). In general, net gains from such assets are treated as long-term capital gains but net losses are treated as ordinary losses.

A partner's share of a partnership's net short-term capital gain or loss and net long-term capital gain or loss from portfolio investments is separately reported to the partner. A partner's share of a partnership's net gain or loss under section 1231 generally is also separately reported.

Deductions

Miscellaneous itemized deductions (e.g., certain investment expenses) are deductible only to the extent that, in the aggregate, they exceed two percent of the individual's adjusted gross income.

In general, taxpayers are allowed a deduction for charitable contributions, subject to certain limitations. The deduction allowed an individual generally cannot exceed 50 percent of the individual's adjusted gross income for the taxable year. The deduction allowed a corporation generally cannot exceed 10 percent of the corporation's taxable income. Excess contributions are carried forward for five years.

A partner's distributive share of a partnership's miscellaneous itemized deductions and charitable contributions are separately reported to the partner.

Credits in general

Each partner is allowed his distributive share of credits against his taxable income. A refundable credit for gasoline used for exempt purposes is allowed. Nonrefundable credits for clinical testing expenses for certain drugs for rare diseases, for producing fuel from nonconventional sources, and for the general business credit are also allowed. The general business credit includes the investment credit (which in turn includes the rehabilitation credit), the targeted jobs credit, the alcohol fuels credit, the research credit, and the low-income housing credit.

The credits for clinical testing expenses and for the production of fuel from nonconventional sources are limited to the excess of regular tax over tentative minimum tax. Excess credits generally cannot be carried to another taxable year. The amount of general business credit allowable in a taxable year is limited to the excess of a partner's net income tax over the greater of (1) the tentative minimum tax for the year or (2) 25 percent of the taxpayer's net regular tax liability in excess of $25,000. The general business credit in excess of this amount is carried back three years and forward 15 years.

The benefit of the investment credit and the low-income housing credit is recaptured if, within a specified time period, the partner transfers his partnership interest or the partnership converts or transfers the property for which the credit was allowed.

Foreign taxes

The foreign tax credit generally allows U.S. taxpayers to reduce U.S. income tax on foreign income by the amount of foreign income taxes paid or accrued with respect to that income. In lieu of electing the foreign tax credit, a taxpayer may deduct foreign taxes. The total amount of the credit may not exceed the same proportion of the taxpayer's U.S. tax which the taxpayer's foreign source taxable income bears to the taxpayer's worldwide taxable income for the taxable year.

Unrelated business taxable income

Tax-exempt organizations are subject to tax on income from unrelated businesses. Certain types of income (such as dividends, interest and certain rental income) are not treated as unrelated business taxable income. Thus, for a partner that is an exempt organization, whether partnership income is unrelated business taxable income depends on the character of the underlying income. Income from a publicly traded partnership, however, is treated as unrelated business taxable income regardless of the character of the underlying income.

Special rules related to oil and gas activities

Taxpayers involved in the search for and extraction of crude oil and natural gas are subject to certain special tax rules. As a result, in the case of partnerships engaged in such activities, certain specific information is separately reported to partners.

A taxpayer who owns an economic interest in a producing deposit of natural resources (including crude oil and natural gas) is permitted to claim a deduction for depletion of the deposit as the minerals are extracted. In the case of oil and gas produced in the United States, a taxpayer generally is permitted to claim the greater of a deduction for cost depletion or percentage depletion. Cost depletion is computed by multiplying a taxpayer's adjusted basis in the depletable property by a fraction, the numerator of which is the amount of current year production from the property and the denominator of which is the property's estimated reserves as of the beginning of that year. Percentage depletion is equal to a specified percentage (generally 15 percent in the case of oil and gas) of gross income from production. Cost depletion is limited to the taxpayer's basis in the depletable property; percentage depletion is not so limited. Once a taxpayer has exhausted its basis in the depletable property, it may continue to claim percentage depletion deductions (generally referred to as "excess percentage depletion").

Certain limitations apply to the deduction for oil and gas percentage depletion. First, percentage depletion is not available to oil and gas producers who also engage (directly or indirectly) in significant levels of oil and gas retailing or refining activities (so-called "integrated oil and gas companies"). Second, the deduction for percentage depletion may be claimed by a taxpayer only with respect to up to 1,000 barrels-per-day of production. Third, the percentage depletion deduction may not exceed 100 percent of the taxpayer's net income for the taxable year from the depletable oil and gas property. Fourth, a percentage depletion deduction may not be claimed to the extent that it exceeds 65 percent of the taxpayer's pre-percentage depletion taxable income.

In the case of a partnership that owns depletable oil and gas properties, the depletion allowance is computed separately by the partners and not by the partnership. In computing a partner's basis in his partnership interest, basis is increased by the partner's share of any partnership-related excess percentage depletion deductions and is decreased (but not below zero) by the partner's total amount of depletion deductions attributable to partnership property.

Intangible drilling and development costs (IDCs) incurred with respect to domestic oil and gas wells generally may be deducted at the election of the taxpayer. In the case of integrated oil companies, no more than 70 percent of IDCs incurred during a taxable year may be deducted. IDCs not deducted are capitalized and generally are either added to the property's basis and recovered through depletion deductions or amortized on a straight-line basis over a 60-month period.

The special treatment granted oil and gas activities through the percentage depletion rules and the election to deduct IDCs may give rise to items of tax preference or (in the case of corporate taxpayers) an adjusted current earnings ("ACE") adjustment for the alternative minimum tax. With respect to percentage depletion, any excess percentage depletion constitutes an amount of tax preference.

For IDCs, the tax preference item is based on a concept of "excess IDCs." In general, excess IDCs are the excess of IDCs deducted for the taxable year over the amount of those IDCs that would have been deducted had they been capitalized and amortized on a straight-line basis over 120 months commencing with the month production begins from the related well. The amount of tax preference is then computed as the difference between the excess IDC amount and 65 percent of the taxpayer's net income from oil and gas (computed without a deduction for excess IDCs).

Taxpayers other than integrated oil companies that incur oil and gas related amounts of tax preference and ACE adjustments are permitted a "special energy deduction" in computing alternative minimum taxable income. The special energy deduction generally is comprised of various specified percentages of IDC preference (and associated ACE adjustment) related to exploratory and development drilling and to a specified portion of percentage depletion preference (and associated ACE adjustment) related to marginally producing depletable properties. The cumulative special energy deduction may not offset more than 40 percent of pre-special energy deduction alternative minimum taxable income.

Passive losses

The passive loss rules generally disallow deductions and credits from passive activities to the extent they exceed income from passive activities. Losses not allowed in a taxable year are suspended and treated as current deductions from passive activities in the next taxable year. These losses are allowed in full when a taxpayer disposes of the entire interest in the passive activity to an unrelated person in a taxable transaction. Passive activities include trade or business activities in which the taxpayer does not materially participate. (Limited partners generally do not materially participate in the activities of a partnership.) Passive activities also include rental activities (regardless of the taxpayer's material participation).[1] Portfolio income (such as interest and dividends), and expenses allocable to such income, are not treated as income or loss from a passive activity.

A partnership's operations may be treated as multiple activities for purposes of the passive loss rules. In such case, the partnership must separately report items of income and deductions from each of its activities.

Income from a publicly traded partnership is treated as portfolio income under the passive loss rules. In addition, loss from such a partnership is treated as separate from income and loss from any other publicly traded partnership, and also as separate from any income or loss from passive activities.

REMICs

A tax is imposed on partnerships holding a residual interest in a real estate mortgage investment conduit (REMIC). The amount of the tax is the amount of excess inclusions allocable to partnership interests owned by certain tax-exempt organizations ("disqualified organizations") multiplied by the highest corporate tax rate.

Contribution of property to a partnership

In general, a partner recognizes no gain or loss upon the contribution of property to a partnership. However, income, gain, loss and deduction with respect to property contributed to a partnership by a partner must be allocated among the partners so as to take into account the difference between the basis of the property to the partnership and its fair market value at the time of contribution. In addition, the contributing partner must recognize gain or loss equal to such difference if the property is distributed to another partner within five years of its contribution (sec. 704(c)). Under regulations, the amount of depreciation and gain or loss that is allocated under these rules is limited to the depreciation allowable to, or gain or loss recognized by, the partnership for tax purposes with respect to the contributed property (the "ceiling rule").

Election of optional basis adjustments

In general, the transfer of a partnership interest or a distribution of partnership property does not affect the basis of partnership assets. A partnership, however, may elect to make certain adjustments in the basis of partnership property (sec. 754). Under a section 754 election, the transfer of a partnership interest generally results in an adjustment in the partnership's basis in its property for the benefit of the transferee partner only, to reflect the difference between that partner's basis for his interest and his propor-

[1] An individual who actively participates in a rental real estate activity and holds at least a 10 percent interest may deduct up to $25,000 of passive losses. The $25,000 amount phases out as the individual's income increases from $100,000 to $150,000.

The $25,000 allowance also applies to low-income housing and rehabilitation credits (on a deduction equivalent basis), regardless of whether the taxpayer claiming the credit actively participates in the rental real estate activity generating the credit. In addition, the income phaseout range for the $25,000 allowance for rehabilitation credits is $200,000 to $250,000 (rather than $100,000 to $150,000). For interests acquired after December 31, 1989 in partnerships holding property placed in service after that date, the $25,000 deduction-equivalent allowance is permitted for the low-income housing credit without regard to the taxpayer's income.

tionate share of the adjusted basis of partnership property (sec. 743(b)). Also under the election, a distribution of property to a partner in certain cases results in an adjustment in the basis of other partnership property (sec. 734(b)).

Terminations

A partnership terminates if (1) all partners cease carrying on the business, financial operation or venture of the partnership, or (2) within a 12-month period 50 percent or more of the total partnership interests are sold or exchanged (sec. 708).

House bill

In general

The House bill modifies the tax treatment of a large partnership (generally, a partnership with at least 250 partners, or an electing partnership with at least 100 partners) and its partners. The bill provides that each partner takes into account separately the partner's distributive share of the following items, which are determined at the partnership level: (1) taxable income or loss from passive loss limitation activities; (2) taxable income or loss from other activities (e.g., portfolio income or loss); (3) net capital gain or loss to the extent allocable to passive loss limitation activities and other activities; (4) tax-exempt interest; (5) net alternative minimum tax adjustment separately computed for passive loss limitation activities and other activities; (6) general credits; (7) low-income housing credit; (8) rehabilitation credit; (9) credit for producing fuel from a nonconventional source; and (10) creditable foreign taxes and foreign source items.[2]

Under the House bill, the taxable income of a large partnership is computed in the same manner as that of an individual, except that the items described above are separately stated and certain modifications are made. These modifications include disallowing the deduction for personal exemptions, the net operating loss deduction and certain itemized deductions.[3] All limitations and other provisions affecting the computation of taxable income or any credit (except for the at risk, passive loss and section 68 itemized deduction limitations, and any other provision specified in regulations) are applied at the partnership (and not the partner) level. Thus, for example, any investment interest of the partnership is limited at the partnership level, and any carryover is made at that level.

All elections affecting the computation of taxable income or any credit generally are made by the partnership.

[2] In determining the amounts required to be separately taken into account by a partner, those provisions of the large partnership rules governing computations of taxable income are applied separately with respect to that partner by taking into account that partner's distributive share of the partnership's items of income, gain, loss, deduction or credit. This rule permits partnerships to make otherwise valid special allocations of partnership items to partners.

[3] A large partnership is allowed a deduction under section 212 for expenses incurred for the production of income, subject to 70-percent disallowance, as described below. No income from a large partnership is treated as fishing or farming income.

Capital gains

Under the House bill, netting of capital gains and losses occurs at the partnership level. A partner in a large partnership takes into account separately his distributive share of the partnership's net capital gain or net capital loss.[4] Such net capital gain or loss is treated as long-term capital gain or loss.

A partner's distributive share of the partnership's net capital gain is allocated between passive loss limitation activities and other activities. The net capital gain is allocated to passive loss limitation activities to the extent of net capital gain from sales and exchanges of property used in connection with such activities, and any excess is allocated to other activities. A similar rule applies for purposes of allocating any net capital loss.

Any gains and losses of the partnership under section 1231 are netted at the partnership level. Net gain is treated as long-term capital gain and is subject to the rules described above. Net loss is treated as ordinary loss and consolidated with the partnership's other taxable income.

Deductions

The House bill contains two special rules for deductions. First, miscellaneous itemized deductions are not separately reported to partners. Instead, 70 percent of the amount of such deductions is disallowed at the partnership level;[5] the remaining 30 percent is allowed at the partnership level in determining taxable income, and is not subject to the two-percent floor at the partner level.

Second, charitable contributions are not separately reported to partners under the bill. Instead, the charitable contribution deduction is allowed at the partnership level in determining taxable income, subject to the limitations that apply to corporate donors.

Credits in general

Under the House bill, general credits are separately reported to partners as a single item. General credits are any credits other than the low-income housing credit, the rehabilitation credit and the credit for producing fuel from a nonconventional source. A partner's distributive share of general credits is taken into account as a current year general business credit. Thus, for example, the credit for clinical testing expenses is subject to the present law limitations on the general business credit. The refundable credit for gasoline used for exempt purposes and the refund or credit for undistributed capital gains of a regulated investment company are allowed to the partnership, and thus are not separately reported to partners.

In recognition of their special treatment under the passive loss rules, the low-income housing and rehabilitation credits are sepa-

[4] The term "net capital gain" has the same meaning as in section 1222(11). The term "net capital loss" means the excess of the losses from sales or exchanges of capital assets over the gains from sales or exchanges of capital assets. Thus, the partnership cannot offset any portion of capital losses against ordinary income.

Any excess of net short-term capital gain over net long-term capital loss is consolidated with the partnership's other taxable income and is not separately reported.

[5] The "70 percent" figure is intended to approximate the amount of such deductions that would be denied at the partner level as a result of the two-percent floor.

rately reported.[6] In addition, the credit for producing fuel from a nonconventional source is separately reported.

The House bill imposes credit recapture at the partnership level and determines the amount of recapture by assuming that the credit fully reduced taxes. Such recapture is applied first to reduce the partnership's current year credit, if any; the partnership is liable for any excess over that amount. Under the bill, the transfer of an interest in a large partnership does not trigger recapture.

Foreign taxes

The House bill retains present-law treatment of foreign taxes. The partnership reports to the partner creditable foreign taxes and the source of any income, gain, loss or deduction taken into account by the partnership. Elections, computations and limitations are made by the partner.

Tax-exempt interest

The House bill retains present-law treatment of tax-exempt interest. Interest on a State or local bond is separately reported to each partner.

Unrelated business taxable income

The House bill retains present-law treatment of unrelated business taxable income. Thus, a tax-exempt partner's distributive share of partnership items is taken into account separately to the extent necessary to comply with the rules governing such income.

Passive losses

Under the House bill, a partner in a large partnership takes into account separately his distributive share of the partnership's taxable income or loss from passive loss limitation activities. The term "passive loss limitation activity" means any activity involving the conduct of a trade or business (including any activity treated as a trade or business under sec. 469(c)(5) or (6)) and any rental activity. A partner's share of a large partnership's taxable income or loss from passive loss limitation activities is treated as an item of income or loss from the conduct of a trade or business which is a single passive activity, as defined in the passive loss rules. Thus, a large partnership generally is not required to separately report items from multiple activities.

A partner in a large partnership also takes into account separately his distributive share of the partnership's taxable income or loss from activities other than passive loss limitation activities. Such distributive share is treated as an item of income or expense with respect to property held for investment. Thus, portfolio income (e.g., interest and dividends) is reported separately and is reduced by portfolio deductions and allocable investment interest expense.

[6] It is understood that the rehabilitation and low-income housing credits which are subject to the same passive loss rules (i.e., in the case of the low-income housing credit, where the partnership interest was acquired or the property was placed in service before 1990) could be reported together on the same line.

In the case of a partner holding an interest in a large partnership which is not a limited partnership interest, such partner's distributive share of any items are taken into account separately to the extent necessary to comply with the passive loss rules. Thus, for example, income of a large partnership is not treated as passive income with respect to the general partnership interest of a partner who materially participates in the partnership's trade or business.

Under the bill, income from a publicly traded partnership continues to be treated as portfolio income.

Alternative minimum tax

Under the House bill, alternative minimum tax ("AMT") adjustments and preferences are combined at the partnership level. A large partnership would report to partners a net AMT adjustment separately computed for passive loss limitation activities and other activities. In determining a partner's alternative minimum taxable income, a partner's distributive share of any net AMT adjustment is taken into account instead of making separate AMT adjustments with respect to partnership items. The net AMT adjustment is determined by using the adjustments applicable to individuals (in the case of partners other than corporations), and by using the adjustments applicable to corporations (in the case of corporate partners). Except as provided in regulations, the net AMT adjustment is treated as a deferral preference for purposes of the section 53 minimum tax credit.

Discharge of indebtedness income

If a large partnership has income from the discharge of any indebtedness, such income is separately reported to each partner. In addition, the rules governing such income (sec. 108) are applied without regard to the large partnership rules. Thus, for example, the large partnership provisions do not affect section 108(d)(6), which provides that certain section 108 rules apply at the partner level, or section 108(b)(5), which provides for an election to reduce the basis of depreciable property.

REMICs

For purposes of the tax on partnerships holding residual interests in REMICs, all interests in a large partnership are treated as held by disqualified organizations. Thus, a large partnership holding a residual interest in a REMIC is subject to a tax equal to the excess inclusions multiplied by the highest corporate rate. The amount subject to tax is excluded from partnership income. The partner's adjusted basis in the partnership is increased by his distributive share of the amount subject to tax (under section 705(a)(1)(B)) and is decreased by his distributive share of the taxes paid by the partnership (under section 705(a)(2)(B)).

Deferred sale treatment for contributed property

In general

For all partners contributing property to a large partnership (including partners who are disqualified persons, as described below), the House bill replaces section 704(c) with a "deferred sale" approach. Under the bill, a large partnership is treated as if it had purchased the property from the contributing partner for its then fair market value, thus taking a fair market value basis in the property. The contributing partner's gain or loss on the contribution (the "precontribution gain or loss") [7] is deferred until the occurrence of specified recognition events. In general, the character of the precontribution gain or loss is the same as if the property had been sold to the partnership by the partner at the time of contribution. The contributing partner's basis in his partnership interest is adjusted for precontribution amounts recognized under the provision. These adjustments generally are made immediately before the recognition event.

The bill effectively repeals the ceiling rule for large partnerships, i.e., the amount of precontribution gain or loss recognized by the contributing partner under the provision is not limited to the overall gain or loss from the contributed property recognized by the partnership. In addition, the amount of depreciation allowable to the partnership is not limited to the contributing partner's basis in the property.

Recognition events

Certain events occurring at either the partnership or partner level cause recognition of precontribution gain or loss. Loss is not recognized, however, by reason of a disposition to a person related (within the meaning of sec. 267(b) or sec. 707(b)(1)) to the contributing partner.

Transactions at partnership level.—The contributing partner recognizes precontribution gain or loss as the partnership claims an amortization, depreciation, or depletion deduction with respect to the property. The amount of gain (or loss) recognized equals the increase (or decrease) in the deduction attributable to changes in basis of the property occurring by reason of its contribution. Any gain or loss so recognized is treated as ordinary.

The contributing partner also generally recognizes precontribution gain or loss if the partnership disposes of the contributed property to a person other than the contributing partner. If such property is distributed to the contributing partner, its basis in the hands of the contributing partner equals its basis immediately before the contribution, adjusted for any gain or loss previously recognized on account of the deferred sale. No adjustment is made to the basis of undistributed partnership property on account of a distribution to the contributing partner.[8]

A contributing partner's deferred gain or loss is not recognized if the partnership disposes of the property in certain nonrecognition transactions: a like-kind exchange (sec. 1031); an involuntary conversion (sec. 1033); or a contribution to a partnership (sec. 721), pro-

[7] Precontribution gain is the excess of the fair market value of the contributed property at the time of contribution over the adjusted basis of such property immediately before such contribution. Precontribution loss is the excess of the adjusted basis of such property over its fair market value.

[8] Amounts recognized by reason of these recognition events are taken into account in the partner's taxable year in which or with which ends the partnership taxable year of the deduction or disposition.

vided the contributing partnership owns more than 50 percent of the recipient partnership.

Transactions at partner level.—A contributing partner recognizes precontribution gain or loss to the extent that he disposes of his partnership interest other than at death.[9] Such partner also recognizes precontribution gain or loss to the extent that the cash and fair market value of property (other than the contributed property) distributed to him exceeds the adjusted basis of his partnership interest immediately before the distribution (determined without regard to any basis adjustment under the deemed sale rules resulting from the distribution).

It is intended that the Secretary of the Treasury have regulatory authority to apply the deferred sale rules in the case of so-called "reverse 704(c)" situations, i.e., in cases where a partnership revalues its assets. *See* Treas. Reg. sec. 1.704-1(b)(2)(iv)(*f*).

Election of optional basis adjustments

Under the House bill, a large partnership may still elect to adjust the basis of partnership assets with respect to transferee partners. The computation of a large partnership's taxable income is made without regard to the section 743(b) adjustment. As under present law, the section 743(b) adjustment is made only with respect to the transferee partner. In addition, a large partnership is permitted to adjust the basis of partnership property under section 734(b) if property is distributed to a partner, as under present law.

Terminations

The House bill provides that a large partnership does not terminate for tax purposes solely because 50 percent of its interests are sold or exchanged within a 12-month period.

Partnerships and partners subject to large partnership rules

Definition of large partnership

A "large partnership" is any partnership with at least 250 partners in a taxable year beginning after December 31, 1992.[10] Any partnership treated as a large partnership for a taxable year is so treated for all succeeding years, even if the number of partners falls below 250. Regulations may provide, however, that if the number of partners in any taxable year falls below 100, the partnership is not treated as a large partnership. Partnerships with at least 100 partners can elect to be treated as if they had 250 partners. The election applies to the year for which made and all subsequent years and cannot be revoked without the Secretary's consent.

Special rules for certain service partnerships

A large partnership does not include any partnership if substantially all the partners are: (1) individuals performing substantial

[9] It is intended that a deceased partner's successor in interest would not recognize any remaining precontribution gain or loss.

[10] The number of partners is determined by counting only persons directly holding partnership interests in the taxable year, including persons holding through nominees; persons holding indirectly (e.g., through another partnership) are not counted. It is not necessary for a partnership to have 250 or more partners at any one time in a taxable year for the partnership to constitute a large partnership.

services in connection with the partnership's activities, or personal service corporations the owner-employees of which perform such services; (2) retired partners who had performed such services; or (3) spouses of partners who had performed such services. In addition, the term "partner" does not include any individual performing substantial services in connection with the partnership's activities and holding a partnership interest, or an individual who formerly performed such services and who held a partnership interest at the time the individual performed such services.

Exclusion for commodity partnerships

The large partnership rules do not apply to any partnership the principal activity of which is the buying and selling of commodities (not described in section 1221(1)), or options, futures or forwards with respect to commodities.

Special rules for partnerships holding oil and gas properties

Election to use simplified reporting

In general, a large partnership that otherwise meets the qualifications for simplified reporting is not required to report information to its partners under the rules of that regime if it is substantially engaged in oil and gas related activities. Rather, such a partnership continues to report information to its partners as under present law. The House bill permits such a partnership, however, to elect to utilize the simplified reporting regime, as modified for oil and gas purposes. If an election is made for any taxable year, it will also apply for all subsequent taxable years unless revoked with the consent of the Secretary.

A partnership is considered to be substantially engaged in oil and gas activities if at least 25 percent of the average value of its assets during the taxable year consists of oil or gas properties.[11] In making this determination, a partnership is treated as owning its proportionate share of assets of any partnership in which it holds an interest.

Simplified reporting treatment of large partnerships with oil and gas activities

The House bill provides special rules for large partnerships with oil and gas activities that operate under the simplified reporting regime (i.e., either (1) large partnerships that are substantially engaged in oil and gas activities and which elect to use the regime, or (2) large partnerships that are not substantially engaged in oil and gas operations, but do have some oil and gas activities). These partnerships are collectively referred to herein as "oil and gas large partnerships." Generally, the House bill provides that an oil and gas large partnership reports information to its partners under the general simplified large partnership reporting regime described above. To prevent the extension of percentage depletion deductions to persons excluded therefrom under present law, however, certain partners are treated as disqualified persons under the bill.

[11] For this purpose, "oil or gas properties" means the mineral interests in oil or gas which are of a character with respect to which a deduction for depletion is allowable under section 611.

The treatment of a disqualified person's distributive share of any item of income, gain, loss, deduction, or credit attributable to any partnership oil or gas property is determined under the bill without regard to the special rules applicable to large partnerships. Thus, an oil and gas large partnership reports information related to oil and gas activities to a partner who is a disqualified person in the same manner and to the same extent that it reports such information to that partner under present law. The simplified reporting rules of the bill, however, apply with respect to reporting such a partner's share of items related to non-oil and gas activities.

The House bill defines two categories of taxpayers as disqualified persons. The first category encompasses taxpayers who do not qualify for the deduction for percentage depletion under section 613A (i.e., integrated oil and gas companies). The second category includes any person whose average daily production of oil and gas (for purposes of determining the depletable oil and natural gas quantity under section 613A(c)(2)) is at least 500 barrels for its taxable year in which (or with which) the partnership's taxable year ends. In making this computation, all production of domestic crude oil and natural gas attributable to the partner is taken into account, including such partner's proportionate share of any production of the large partnership.

A taxpayer that falls within a category of disqualified person has the responsibility of notifying any large partnership in which it holds a direct or indirect interest (e.g., through a pass-through entity) of its status as such. Thus, for example, if an integrated oil company owns an interest in a partnership which in turn owns an interest in an oil and gas large partnership, the company is responsible for providing the management of the large partnership information regarding its status as a disqualified person and details regarding its indirect interest in the large partnership.

Under the House bill, an oil and gas large partnership computes its deduction for oil and gas depletion under the general statutory rules (subject to certain exceptions described below) under the assumptions that it (the partnership) is the taxpayer and that it qualifies for the percentage depletion deduction. The amount of the depletion deduction, as well as other oil and gas related items, generally are reported to each partner (other than to partners who are disqualified persons) as components of that partner's distributive share of taxable income or loss from passive loss limitation activities.

The House bill provides that in computing the partnership's oil and gas percentage depletion deduction, the 1,000-barrel-per-day limitation does not apply. In addition, an oil and gas large partnership is allowed to compute percentage depletion under the bill without applying the 65-percent-of-taxable-income limitation under section 613A(d)(1).

As under present law, an election to deduct IDCs under section 263(c) is made at the partnership level. Since the bill treats those taxpayers required by the Code (sec. 291) to capitalize 30 percent of IDCs as disqualified persons, an oil and gas large partnership may pass through a full deduction of IDCs to its partners who are not disqualified persons. In contrast to present law, an oil and gas large partnership also has the responsibility with respect to its partners who are not disqualified persons for making an election under section 59(e) to capitalize and amortize certain specified IDCs. Partners who are disqualified persons are permitted to make their own separate section 59(e) elections under the bill.

Consistent with the general reporting regime for large partnerships, the House bill provides that a single AMT adjustment (under either corporate or non-corporate principles, as the case may be) is made and reported to the partners (other than disqualified persons) of an oil and gas large partnership as a separate item. This separately-reported item is affected by a number of oil-and-gas factors: the tax preference for excess percentage depletion, the tax preference for excess IDCs, the adjusted current earnings adjustment, and the special energy deduction.

Since an oil and gas large partnership computes a deduction for percentage depletion under the bill, it also is required to compute the amount of tax preference for excess percentage depletion. The preference item for excess IDCs also is computed by an oil and gas large partnership. In this case, the partnership compares the amount of excess IDCs it incurs with 65 percent of its net income from oil and gas. To the extent that the excess IDC amount exceeds the partnership's 65-percent-net-income-from-oil-and-gas amount, there is an amount of tax preference for excess IDCs which is factored into the amount reported as AMT adjustment to the partners.

Under the House bill, the AMT special energy deduction is computed by an oil and gas large partnership. The current-law special energy deduction is limited so that it may not reduce the taxpayer's pre-special energy deduction alternative minimum taxable income by more than 40 percent. Under the bill, an oil and gas large partnership is treated as the taxpayer for this purpose. Thus, the limitation on the special energy deduction is applied at the partnership level using the same 40-percent threshold.

The House bill provides that in making partnership-level computations, any item of income, gain, loss, deduction, or credit attributable to a partner who is a disqualified person is disregarded. For example, in computing the partnership's net income from oil and gas for purposes of determining the IDC preference to be reported to partners who are not disqualified persons as part of the AMT adjustment, disqualified persons' distributive shares of the partnership's net income from oil and gas are not to be taken into account.

Regulatory authority

The Secretary of the Treasury is granted authority to prescribe such regulations as may be appropriate to carry out the purposes of the provisions.

Effective date

The House bill generally applies to partnership taxable years ending on or after December 31, 1992. The deferred sale provision applies to any contribution of property (other than cash) made on or after the date of enactment to a partnership which is, or is reasonably expected to become, a large partnership. It is intended that no inference be drawn as to the proper treatment of contributions of appreciated or depreciated property to a partnership made prior to the effective 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.

b. Simplified audit procedures for large partnerships

Present law

In general

Prior to 1982, regardless of the size of a partnership, adjustments to a partnership's items of income, gain, loss, deduction, or credit had to be made in separate proceedings with respect to each partner individually. Because a large partnership sometimes had many partners located in different audit districts, adjustments to items of income, gains, losses, deductions, or credits of the partnership had to be made in numerous actions in several jurisdictions, sometimes with conflicting outcomes.

The Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") established unified audit rules applicable to all but certain small (10 or fewer partners) partnerships. These rules require the tax treatment of all "partnership items" to be determined at the partnership, rather than the partner, level. Partnership items are those items that are more appropriately determined at the partnership level than at the partner level, as provided by regulations.

Administrative proceedings

Under the TEFRA rules, a partner must report all partnership items consistently with the partnership return or must notify the IRS of any inconsistency. If a partner fails to report any partnership item consistently with the partnership return, the IRS may make a computational adjustment and immediately assess any additional tax that results.

The IRS may challenge the reporting position of a partnership by conducting a single administrative proceeding to resolve the issue with respect to all partners. But the IRS must still assess any resulting deficiency against each of the taxpayers who were partners in the year in which the understatement of tax liability arose.

Any partner of a partnership can request an administrative adjustment or a refund for his own separate tax liability. Any partner also has the right to participate in partnership-level administrative proceedings. A settlement agreement with respect to partnership items binds all parties to the settlement.

Tax Matters Partner

The TEFRA rules establish the "Tax Matters Partner" as the primary representative of a partnership in dealings with the IRS. The Tax Matters Partner is a general partner designated by the partnership or, in the absence of designation, the general partner with the largest profits interest at the close of the taxable year. If no Tax Matters Partner is designated, and it is impractical to apply the largest profits interest rule, the IRS may select any partner as the Tax Matters Partner.

Notice requirements

The IRS generally is required to give notice of the beginning of partnership-level administrative proceedings and any resulting administrative adjustment to all partners whose names and addresses are furnished to the IRS. For partnerships with more than 100 partners, however, the IRS generally is not required to give notice to any partner whose profits interest is less than one percent.

Adjudication of disputes concerning partnership items

After the IRS makes an administrative adjustment, the Tax Matters Partner (and, in limited circumstances, certain other partners) may file a petition for readjustment of partnership items in the Tax Court, the district court in which the partnership's principal place of business is located, or the Claims Court.

Statute of limitations

The IRS generally cannot adjust a partnership item for a partnership taxable year if more than 3 years have elapsed since the later of the filing of the partnership return or the last day for the filing of the partnership return.

House bill

In general

The House bill creates a new audit system for large partnerships. The bill defines "large partnership" the same way for audit and reporting purposes (generally partnerships with at least 250 partners) except that certain oil and gas partnerships exempted from the large partnership reporting requirements are large partnerships for the audit rules.

As under present law, large partnerships and their partners are subject to unified audit rules. The tax treatment of "partnership items" are determined at the partnership, rather than the partner, level. The term "partnership items" is defined as under present law.

Unlike present law, however, partnership adjustments generally will flow through to the partners for the year in which the adjustment takes effect. Thus, the current-year partners' share of current-year partnership items of income, gains, losses, deductions, or credits will be adjusted to reflect partnership adjustments that take effect in that year. The adjustments generally will not affect prior-year returns of any partners (except in the case of changes to any partner's distributive shares).

In lieu of flowing an adjustment through to its partners, the partnership may elect to pay an imputed underpayment. The imputed underpayment generally is calculated by netting the adjustments to the income and loss items of the partnership and multiplying that amount by the highest tax rate (whether individual or corporate). A partner may not file a claim for credit or refund of his allocable share of the payment.

Regardless of whether a partnership adjustment flows through to the partners, an adjustment must be offset if it requires another adjustment in a year after the adjusted year and before the year the offsetted adjustment takes effect. For example, if a partnership expensed a $1,000 item in year 1, and it was determined in year 4 that the item should have been capitalized and amortized ratably over 10 years, the adjustment in year 4 would be $700, apart from any interest or penalty. (The $900 adjustment for the improper deduction would be offset by $200 of adjustments for amortization deductions.) The year 4 partners would be required to include an additional $700 in income for that year. The partnership may ratably amortize the remaining $700 of expenses in years 4–10.

In addition, the partnership, rather than the partners individually, generally is liable for any interest and penalties that result from a partnership adjustment. Interest is computed for the period beginning on the return due date for the adjusted year and ending on the earlier of the return due date for the partnership taxable year in which the adjustment takes effect or the date the partnership pays the imputed underpayment. Thus, in the above example, the partnership would be liable for 4 years' worth of interest (on a declining principal amount).

Penalties (such as the accuracy and fraud penalties) are determined on a year-by-year basis (without offsets) based on an imputed underpayment. All accuracy penalty criteria and waiver criteria (such as reasonable cause, substantial authority, etc.) are determined as if the partnership were a taxable individual. Accuracy and fraud penalties are assessed and accrue interest in the same manner as if asserted against a taxable individual.

Any payment (for Federal income taxes, interest, or penalties) that a large partnership is required to make is non-deductible.

If a partnership ceases to exist before a partnership adjustment takes effect, the former partners are required to take the adjustment into account, as provided by regulations. Regulations are also authorized to prevent abuse and to enforce efficiently the audit rules in circumstances that present special enforcement considerations (such as partnership bankruptcy).

Administrative proceedings

Under the large partnership audit rules, a partner is not permitted to report any partnership items inconsistently with the partnership return, even if the partner notifies the IRS of the inconsistency. The IRS could treat a partnership item that was reported inconsistently by a partner as a mathematical or clerical error and immediately assess any additional tax against that partner.

As under present law, the IRS could challenge the reporting position of a partnership by conducting a single administrative proceeding to resolve the issue with respect to all partners. Unlike under present law, however, partners will have no right individually to participate in settlement conferences or to request a refund.

Partnership representative

The bill requires each large partnership to designate a partner or other person to act on its behalf. If a large partnership fails to designate such a person, the IRS is permitted to designate any one of the partners as the person authorized to act on the partnership's behalf. After the IRS's designation, a large partnership could still designate a replacement for the IRS-designated partner.

Notice requirements

Unlike under present law, the IRS is not required to give notice to individual partners of the commencement of an administrative proceeding or of a final adjustment. Instead, the IRS is authorized to send notice of a partnership adjustment to the partnership itself by certified or registered mail. The IRS could give proper notice by mailing the notice to the last known address of the partnership, even if the partnership had terminated its existence.

Adjudication of disputes concerning partnership items

As under present law, an administrative adjustment could be challenged in the Tax Court, the district court in which the partnership's principal place of business is located, or the Claims Court. However, only the partnership, and not partners individually, can petition for a readjustment of partnership items.

If a petition for readjustment of partnership items is filed by the partnership, the court with which the petition is filed will have jurisdiction to determine the tax treatment of all partnership items of the partnership for the partnership taxable year to which the notice of partnership adjustment relates, and the proper allocation of such items among the partners. Thus, the court's jurisdiction is not limited to the items adjusted in the notice.

Statute of limitations

Absent an agreement to extend the statute of limitations, the IRS generally could not adjust a partnership item of a large partnership more than 3 years after the later of the filing of the partnership return or the last day for the filing of the partnership return. Special rules apply to false or fraudulent returns, a substantial omission of income, or the failure to file a return. The IRS would assess and collect any deficiency of a partner that arises from any adjustment to a partnership item subject to the limitations period on assessments and collection applicable to the year the adjustment takes effect (secs. 6248, 6501 and 6502).

Regulatory authority

The Secretary of the Treasury is granted authority to prescribe regulations as may be necessary to carry out the simplified audit procedure provisions, including regulations to prevent abuse of the provisions through manipulation. The regulations may include rules that address transfers of partnership interests, in anticipation of a partnership adjustment, to persons who are tax-favored (e.g., corporations with net operating losses, tax-exempt organizations, and foreign partners) or persons who are expected to be unable to pay tax (e.g., shell corporations). For example, if prior to the time a partnership adjustment takes effect, a taxable partner transfers a partnership interest to a nonresident alien to avoid the tax effect of the partnership adjustment, the rules may provide, among other things, that income related to the partnership adjustment is treated as effectively connected taxable income, that the partnership adjustment is treated as taking effect before the partnership interest was transferred, or that the former partner is treated as a current partner to whom the partnership adjustment is allocated.

Effective date

The provision applies to partnership taxable years ending on or after December 31, 1992.

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. *Advance due date for furnishing information to partners*

Present law

A partnership required to file an income tax return with the IRS must also furnish an information return to each of its partners on or before the day on which the income tax return for the year is required to be filed, including extensions. Under regulations, a partnership must file its income tax return on or before the fifteenth day of the fourth month following the end of the partnership's taxable year (on or before April 15, for calendar year partnerships). This is the same deadline by which most individual partners must file their tax returns.

House bill

The House bill provides that a large partnership must furnish information returns to partners by the first March 15 following the close of the partnership's taxable year. Large partnerships would be only those partnerships subject to the simplified reporting rules for large partnerships, as described above.

The bill also provides that, if the partnership is required to provide copies of the information returns to the Internal Revenue Service on magnetic media, each schedule (such as each Schedule K-1) with respect to each partner is treated as a separate information return with respect to the corrective periods and penalties that are generally applicable to all information returns.

Effective date.—The provision is effective for taxable years ending on or after December 31, 1992.

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. Partnership returns on magnetic media

Present law

Partnerships are permitted, but not required, to provide the tax return of the partnership (Form 1065), as well as copies of the schedules sent to each partner (Form K-1), to the Internal Revenue Service on magnetic media.

House bill

The bill authorizes the Internal Revenue Service to require large partnerships and other partnerships with 250 or more partners to provide the tax return of the partnership (Form 1065), as well as copies of the schedules sent to each partner (Form K-1), to the Internal Revenue Service on magnetic media.

Effective date.—For partnerships that are large partnerships (as defined in the simplified reporting provision), the provision is effective for partnership taxable years ending on or after December 31, 1992. For partnerships that are not large partnerships (as defined) but that have 250 or more partners, the provision is effective for partnership taxable years ending on or after December 31, 1998.

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. PARTNERSHIP PROCEEDINGS UNDER THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982 (TEFRA)

a. Clarify the treatment of partnership items in deficiency proceedings

Present law

TEFRA partnership proceedings must be kept separate from deficiency proceedings involving the partners in their individual capacities. Prior to the Tax Court's opinion in *Munro v. Commissioner,* 92 T.C. 71 (1989), the IRS computed deficiencies by assuming that all items that were subject to the TEFRA partnership procedures were correctly reported on the taxpayer's return. However, where the losses claimed from TEFRA partnerships were so large that they offset any proposed adjustments to nonpartnership items, no deficiency could arise from a non-TEFRA proceeding, and if the partnership losses were subsequently disallowed in a partnership proceeding, the non-TEFRA adjustments might be uncollectible because of the expiration of the statute of limitations with respect to nonpartnership items.

Faced with this situation in *Munro*, the IRS issued a notice of deficiency to the taxpayer that presumptively disallowed the taxpayer's TEFRA partnership losses for computational purposes only. Although the Tax Court ruled that a deficiency existed and that the court had jurisdiction to hear the case, the court disapproved of the methodology used by the IRS to compute the deficiency. Specifically, the court held that partnership items (whether income, loss, deduction, or credit) included on a taxpayer's return must be completely ignored in determining whether a deficiency exists that is attributable to nonpartnership items.

House bill

The House bill overrules *Munro* and allows the IRS to return to its prior practice of computing deficiencies by assuming that all TEFRA items whose treatment has not been finally determined had been correctly reported on the taxpayer's return. This will eliminate the need to do special computations that involve the removal of TEFRA items from a taxpayer's return, and will restore to taxpayers a prepayment forum with respect to the TEFRA items. In addition, the bill provides a special rule to address the factual situation presented in *Munro*.

Specifically, the bill provides a declaratory judgment procedure in the Tax Court for adjustments to an oversheltered return. An oversheltered return is a return that shows no taxable income and a net loss from TEFRA partnerships. In such a case, the IRS is authorized to issue a notice of adjustment with respect to non-TEFRA items, notwithstanding that no deficiency would result from the adjustment. However, the IRS may only issue such a notice if a deficiency would have arisen in the absence of the net loss from TEFRA partnerships.

The Tax Court would be granted jurisdiction to determine the correctness of such an adjustment as well as to make a declaration with respect to any other item for the taxable year to which the notice of adjustment relates, except for partnership items and affected items which require partner-level determinations. No tax would be due upon such a determination, but a decision of the Tax Court would be treated as a final decision, permitting an appeal of the decision by either the taxpayer or the IRS. An adjustment determined to be correct would thus have the effect of increasing the taxable income that would be deemed to have been reported on the taxpayer's return. If the taxpayer's partnership items were then adjusted in a subsequent proceeding, the IRS would have preserved its ability to collect tax on any increased deficiency attributable to the nonpartnership items.

Alternatively, if the taxpayer chooses not to contest the notice of adjustment within the 90-day period, the bill provides that when the taxpayer's partnership items are finally determined, the taxpayer has the right to file a refund claim for tax attributable to the items adjusted by the earlier notice of adjustment for the taxable year. Although a refund claim is not generally permitted with respect to a deficiency arising from a TEFRA proceeding, such a rule is appropriate with respect to a defaulted notice of adjustment because taxpayers may not challenge such a notice when issued since it does not require the payment of additional tax.

In addition, the bill incorporates a number of provisions intended to clarify the coordination between TEFRA audit proceedings and individual deficiency proceedings. Under these provisions, any adjustment with respect to a non-partnership item that caused an increase in tax liability with respect to a partnership item would be treated as a computational adjustment and assessed after the conclusion of the TEFRA proceeding. Accordingly, deficiency procedures would not apply with respect to this increase in tax liability, and the statute of limitations applicable to TEFRA proceedings would be controlling.

Effective date.—The provision is effective for partnership taxable years ending 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. Permit the IRS to rely on partnership returns to determine the proper audit procedures

Present law

TEFRA established unified audit rules applicable to all partnerships, except for partnerships with 10 or fewer partners, each of whom is a natural person (other than a nonresident alien) or an estate, and for which each partner's share of each partnership item is the same as that partner's share of every other partnership item. Partners in the exempted partnerships are subject to regular deficiency procedures.

House bill

The House bill permits the IRS to apply the TEFRA audit procedures if, based on the partnership's return for the year, the IRS reasonably determines that those procedures should apply. Similarly, the bill permits the IRS to apply the normal deficiency procedures if, based on the partnership's return for the year, the IRS reasonably determines that those procedures should apply.

Effective date.—The provision is effective for partnership taxable years ending 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. Statute of limitations suspensions

i. Suspend statute when an untimely petition is filed

Present law

In a deficiency case, section 6503(a) provides that if a proceeding in respect of the deficiency is placed on the docket of the Tax Court, the period of limitations on assessment and collection is suspended until the decision of the Tax Court becomes final, and for 60 days thereafter. The counterpart to this provision with respect to TEFRA cases is contained in section 6229(d). That section provides that the period of limitations is suspended for the period during which an action may be brought under section 6226 and, if an action is brought during such period, until the decision of the court becomes final, and for 1 year thereafter. As a result of this difference in language, the running of the statute of limitations in a TEFRA case will only be tolled by the filing of a timely petition whereas in a deficiency case, the statute of limitations is tolled by the filing of any petition, regardless of whether the petition is timely.

House bill

The House bill conforms the suspension rule for the filing of petitions in TEFRA cases with the rule under section 6503(a) pertaining to deficiency cases. Under the provision, the statute of limitations in TEFRA cases would be suspended by the filing of any petition under section 6226, regardless of whether the petition is timely or valid, and the suspension will remain in effect until the decision of the court becomes final, and for one year thereafter. Hence, if the statute of limitations is open at the time that an untimely petition is filed, the limitations period will no longer continue to run and possibly expire while the action is pending before the court.

Effective date.—The provision is effective with respect to all cases in which the period of limitations has not expired under present law as of 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.

ii. Suspend statute of limitations during bankruptcy proceedings

Present law

The period for assessing tax with respect to partnership items generally is the longer of the periods provided by section 6229 or section 6501. For partnership items that convert to nonpartnership items, section 6229(f) provides that the period for assessing tax shall not expire before the date which is 1 year after the date that the items become nonpartnership items. Section 6503(h) provides for the suspension of the limitations period during the pendency of a bankruptcy proceeding. However, this provision only applies to the limitations periods provided in sections 6501 and 6502.

Under present law, because the suspension provision in section 6503(h) applies only to the limitations periods provided in section 6501 and 6502, some uncertainty exists as to whether section 6503(h) applies to suspend the limitations period pertaining to converted items provided in section 6229(f) when a petition naming a partner as a debtor in a bankruptcy proceeding is filed. As a result, the limitations period provided in section 6229(f) may continue to run during the pendency of the bankruptcy proceeding, notwithstanding that the IRS is prohibited from making an assessment against the debtor because of the automatic stay provisions of the Bankruptcy Code.

House bill

The House bill clarifies that the statute of limitations is suspended for a partner who is named in a bankruptcy petition. The suspension period is for the entire period during which the IRS is prohibited by reason of the bankruptcy proceeding from making an assessment, and for 60 days thereafter. The provision is not intended to create any inference as to the proper interpretation of present law.

Effective date.—The provision is effective with respect to all cases in which the period of limitations has not expired under present law as of 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.

iii. Extend statute of limitations for bankrupt TMPs

Present law

Section 6229(b)(1)(B) provides that the statute of limitations is extended with respect to all partners in the partnership by an agreement entered into between the tax matters partner (TMP) and the IRS. However, Temp. Treas. Reg. secs. 301.6231(a)(7)-1T(l)(4) and 301.6231(c)-7T(a) provide that upon the filing of a petition naming a partner as a debtor in a bankruptcy proceeding, that partner's partnership items convert to nonpartnership items, and if the debtor was the tax matters partner, such status terminates. These rules are necessary because of the automatic stay provision contained in 11 U.S.C. sec. 362(a)(8). As a result, if a consent to extend the statute of limitations is signed by a person who would be the TMP but for the fact that at the time that the agreement is executed the person was a debtor in a bankruptcy proceeding, the consent would not be binding on the other partners because the person signing the agreement was no longer the TMP at the time that the agreement was executed.

House bill

The House bill provides that unless the IRS is notified of a bankruptcy proceeding in accordance with regulations, the IRS can rely on a statute extension signed by a person who would be the tax matters partner but for the fact that said person was in bankruptcy at the time that the person signed the agreement. Statute extensions granted by a bankrupt TMP in these cases will be binding on all of the partners in the partnership. The provision is not intended to create any inference as to the proper interpretation of present law.

Effective date.—The provision is effective for extension agreements entered into 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. Expand small partnership exception from TEFRA

Present law

TEFRA established unified audit rules applicable to all partnerships, except for partnerships with 10 or fewer partners, each of whom is a natural person (other than a nonresident alien) or an estate, and for which each partner's share of each partnership item is the same as that partner's share of every other partnership item. Partners in the exempted partnerships are subject to regular deficiency procedures.

House bill

The House bill permits a small partnership to have a C corporation as a partner or to specially allocate items without jeopardizing its exception from the TEFRA rules. However, the bill retains the prohibition of present law against having a flow-through entity (other than an estate of a deceased partner) as a partner for purposes of qualifying for the small partnership exception.

Effective date.—The provision is effective for partnership taxable years ending 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.

e. Exclude partial settlements from 1-year assessment rule

Present law

The period for assessing tax with respect to partnership items generally is the longer of the periods provided by section 6229 or section 6501. For partnership items that convert to nonpartnership items, section 6229(f) provides that the period for assessing tax shall not expire before the date which is 1 year after the date that the items become nonpartnership items. Section 6231(b)(1)(C) provides that the partnership items of a partner for a partnership taxable year become nonpartnership items as of the date the partner enters into a settlement agreement with the IRS with respect to such items.

House bill

The House bill provides that if a partner and the IRS enter into a settlement agreement with respect to some but not all of the partnership items in dispute for a partnership taxable year and other partnership items remain in dispute, the period for assessing any tax attributable to the settled items would be determined as if such agreement had not been entered into. Consequently, the limitations period that is applicable to the last item to be resolved for the partnership taxable year shall be controlling with respect to all disputed partnership items for the partnership taxable year. The provision is not intended to create any inference as to the proper interpretation of present law.

Effective date.—The provision is effective for partnership taxable years ending 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.

f. Extend time for filing a request for administrative adjustment

Present law

If an agreement extending the statute is entered into with respect to a non-TEFRA statute of limitations, that agreement also extends the statute of limitations for filing refund claims (sec. 6511(c)). There is no comparable provision for extending the time for filing refund claims with respect to partnership items subject to the TEFRA partnership rules.

House bill

The House bill provides that if a TEFRA statute extension agreement is entered into, that agreement also extends the statute of limitations for filing refund claims attributable to partnership items or affected items until 6 months after the expiration of the limitations period for assessments.

Effective date.—The provision is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

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. Provide innocent spouse relief for TEFRA proceedings

Present law

In general, an innocent spouse may be relieved of liability for tax, penalties and interest if certain conditions are met (sec. 6013(e)). However, existing law does not provide the spouse of a partner in a TEFRA partnership with a judicial forum to raise the innocent spouse defense with respect to any tax or interest that relates to an investment in a TEFRA partnership.

House bill

The House bill provides both a prepayment forum and a refund forum for raising the innocent spouse defense in TEFRA cases.

With respect to a prepayment forum, the bill provides that within 60 days of the date that a notice and demand for payment (or notice of computational adjustment) relating to partnership items is mailed to the spouse of a partner, the spouse may request that the assessment be abated. Upon receipt of such a request, the assessment will be abated and any reassessment will be subject to the deficiency procedures. If an abatement is requested, the statute of limitations will not expire before the date which is 60 days after the date of the abatement. If the spouse files a petition with the Tax Court, the Tax Court will only have jurisdiction to determine whether the requirements of section 6013(e) have been satisfied. In making this determination, the treatment of the partnership items that gave rise to the liability in question will be conclusive.

Alternatively, the bill provides that the spouse of a partner may file a claim for refund to raise the innocent spouse defense. The claim must be filed within 6 months from the date that the notice and demand (or notice of computational adjustment) is mailed to the spouse. If the claim is not allowed the spouse may file a refund action. For purposes of any claim or suit under this provision, the treatment of the partnership items that gave rise to the liability in question will be conclusive.

Effective date.—The provision is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

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.

h. Determine penalties at the partnership level

Present law

Partnership items include only items that are required to be taken into account under the income tax subtitle. Penalties are not partnership items since they are contained in the procedure and administration subtitle. As a result, penalties may only be asserted against a partner through the application of the deficiency procedures following the completion of the partnership-level proceeding.

House bill

The House bill provides that the partnership level proceeding is to include a determination of the applicability of penalties at the partnership level. However, the bill allows partners to raise any partner-level defenses in a refund forum.

Effective date.—The provision is effective for partnership taxable years ending 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.

i. Clarify jurisdiction of the Tax Court

Present law

Improper assessment and collection activities by the IRS during the 150-day period for filing a petition or during the pendency of any Tax Court proceeding, "may be enjoined in the proper court." Present law may be unclear as to whether this includes the Tax Court.

For a partner other than the Tax Matters Partner to be eligible to file a petition for redetermination of partnership items in any court or to participate in an existing case, the period for assessing any tax attributable to the partnership items of that partner must not have expired. Since such a partner would only be treated as a party to the action if the statute of limitations with respect to them was still open, the law is unclear whether the partner would have standing to assert that the statute of limitations had expired with respect to them.

House bill

The House bill clarifies that an action to enjoin premature assessments of deficiencies attributable to partnership items may be brought in the Tax Court. The bill also permits a partner to participate in an action or file a petition for the sole purpose of asserting that the period of limitations for assessing any tax attributable to partnership items has expired for that person. Additionally, the bill clarifies that the Tax Court has overpayment jurisdiction with respect to affected items.

Effective date.—The provision is effective for partnership taxable years ending 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.

j. Treatment of premature petitions filed by certain partners

Present law

The Tax Matters Partner is given the exclusive right to file a petition for a readjustment of partnership items within the 90-day period after the issuance of the notice of a final partnership administrative adjustment (FPAA). If the Tax Matters Partner does not file a petition within the 90-day period, certain other partners are permitted to file a petition within the 60-day period after the close of the 90-day period. There are ordering rules for determining which action goes forward and for dismissing other actions.

House bill

The House bill treats premature petitions filed by certain partners within the 90-day period will be treated as being filed on the last day of the following 60-day period under specified circumstances, thus affording the partnership with an opportunity for judicial review that is not available under present law.

Effective date.—The provision is effective with respect to petitions filed 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.

k. Clarify bond requirement for appeals from TEFRA proceedings

Present law

A bond must be filed to stay the collection of deficiencies pending the appeal of the Tax Court's decision in a TEFRA proceeding. The amount of the bond must be based on the court's estimate of the aggregate deficiencies of the partners.

House bill

The House bill clarifies that the amount of the bond should be based on the Tax Court's estimate of the aggregate liability of the parties to the action (and not all of the partners in the partnership). For purposes of this provision, the amount of the bond may be estimated by applying the highest individual rate to the total adjustments determined by the Tax Court and doubling that amount to take into account interest and penalties.

Effective date.—The provision is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

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.

l. Suspend interest where there is a delay in computational adjustment resulting from TEFRA settlements

Present law

Interest on a deficiency generally is suspended when a taxpayer executes a settlement agreement with the IRS and waives the restrictions on assessments and collections, and the IRS does not issue a notice and demand for payment of such deficiency within 30 days. Interest on a deficiency that results from an adjustment of partnership items in TEFRA proceedings, however, is not suspended.

House bill

The House bill suspends interest where there is a delay in making a computational adjustment relating to a TEFRA settlement.

Effective date.—The provision is effective with respect to settlements entered into 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. Foreign Provisions

1. DEFERRAL OF TAX ON INCOME EARNED THROUGH FOREIGN CORPORATIONS AND EXCEPTIONS TO DEFERRAL

Present law

U.S. citizens and residents and U.S. corporations (collectively, "U.S. persons") generally are taxed currently by the United States on their worldwide income. Income earned by a foreign corporation, the stock of which is owned in whole or in part by U.S. persons, generally is not taxed by the United States until the foreign corporation repatriates those earnings by payment to its U.S. stockholders.

The Code sets forth several regimes providing exceptions to the general rule deferring U.S. tax on income earned indirectly through a foreign corporation: the controlled foreign corporation rules (secs. 951-964); the foreign personal holding company rules (secs. 551-558); passive foreign investment company (PFIC) rules (secs. 1291-1297); the personal holding company rules (secs. 541-547); the accumulated earnings tax (secs. 531-537); and rules for foreign investment companies (sec. 1246) and electing foreign investment companies (sec. 1247). These separate regimes have complex and overlapping application to foreign corporations with U.S. stockholders.

House bill

The House bill replaces the separate anti-deferral regimes of present law with a unified set of rules. The House bill retains the controlled foreign corporation rules as the foundation of its unified anti-deferral regime. It includes a modified version of the PFIC rules while eliminating the other regimes as redundant to one or the other.

The House bill creates a single definition of a passive foreign corporation (PFC) that will unify and replace the foreign personal holding company and PFIC definitions. The rules applicable to PFCs represent a hybrid of characteristics of the foreign personal holding company rules, the PFIC rules, and the controlled foreign corporation rules (subpart F), plus a new mark-to-market regime, as well as a variety of simplifying or technical changes to rules under the existing systems.

Effective date.—The provision generally applies to taxable years beginning after December 31, 1992.

Senate amendment

The Senate amendment is the same as the House bill.

In addition, the Technical Explanation of the Senate Finance Committee amendment to H.R. 4210 states that the committee intends that the Treasury Department conduct a certain study regarding the tax treatment of certain activities of securities dealers under the PFC rules.

Conference agreement

The conference agreement follows the House bill and the Senate amendment (with clerical and conforming amendments).

The conferees have been informed that dealers in stocks and securities engage in securities sale and repurchase transactions (so-called "repos" and "reverses") and securities lending and borrowing transactions. For example, the conferees have been informed that securities dealers may engage in offsetting repo and reverse transactions—i.e., may run a "matched book" with respect to such transactions. In addition, the conferees have been informed that securities dealers enter into reverse repos and securities borrowing transactions to cover short sales and failed deliveries of securities for settlement of trades, and use repos and securities loans to finance inventory positions.

The conferees have been informed that such transactions engaged in by regular dealers in stocks or securities may generate some income that is treated as passive under the PFIC rules of present law. The conferees intend that a study be conducted by the Treasury Department as to the tax treatment for purposes of the PFC rules of such transactions, and the consequences and merits of possible changes in such current-law tax treatment. The conferees intend that the Treasury study be completed within one year after the date of enactment of the bill.

2. TREATMENT OF CONTROLLED FOREIGN CORPORATIONS

Present law

Treatment of controlled foreign corporation earnings

In general

A U.S. shareholder generally treats dividends from a controlled foreign corporation as ordinary income from foreign sources that carries both direct and indirect foreign tax credits. Under look-through rules, the income and credits are subject to those foreign tax credit limitations which are consistent with the character of the income of the foreign corporation.

Several Code provisions result in similar tax treatment of a U.S. shareholder if it either disposes of the controlled foreign corporation stock, or the controlled foreign corporation realizes certain types of income (including income with respect to lower-tier controlled foreign corporations). First, under section 1248, gain resulting from the disposition by a U.S. person of stock in a foreign corporation that was a controlled foreign corporation with respect to which the U.S. person was a U.S. shareholder in the previous five years is treated as a dividend to the extent of allocable earnings.

Second, a controlled foreign corporation has subpart F income when it realizes gain on disposition of stock and, ordinarily, when it receives a dividend. Under sections 951 and 960, such subpart F income may result in taxation to the U.S. shareholder similar (but not identical) to that on a dividend from the controlled foreign corporation. In addition to provisions for characterizing income and credits in these situations, the Code also provides certain rules that adjust basis, or otherwise result in modifying the tax consequences of subsequent income, to account for these and other subpart F income inclusions.

Third, when in exchange for property any corporation (including a controlled foreign corporation) acquires stock in another corporation (including a controlled foreign corporation) controlled by the same persons that control the acquiring corporation, earnings of the acquiring corporation (and possibly the acquired corporation) may be treated under section 304 as having been distributed as a dividend to the seller.

For foreign tax credit separate limitation purposes, a controlled foreign corporation is not treated as a noncontrolled section 902 corporation with respect to any distribution out of its earnings and profits for periods during which it was a controlled foreign corporation and except as provided in regulations, the recipient of the distribution was a U.S. shareholder in such corporation. The consequence of not being treated as a section 902 corporation is application of the so-called "look-through" rule. That is, dividends paid by such controlled foreign corporation to its U.S. shareholder are characterized for separate limitation purposes by reference to the character of the underlying earnings of the controlled foreign corporation.

Lower-tier controlled foreign corporations

For purposes of applying the separate foreign tax credit limitations, receipt of a dividend from a lower-tier controlled foreign corporation by an upper-tier controlled foreign corporation may result in a subpart F income inclusion for the U.S. shareholder that is treated as income in the same limitation category as the income of the lower-tier controlled foreign corporation. The income inclusion of the U.S. shareholder may carry deemed-paid credits for foreign taxes paid by the lower-tier controlled foreign corporation, and the basis of the U.S. shareholder in the stock of the first-tier controlled foreign corporation is increased by the amount of the inclusion. If, on the other hand, the upper-tier controlled foreign corporation sells stock of a lower-tier controlled foreign corporation, then the gain generally is also included in the income of the U.S. shareholder as subpart F income and the U.S. shareholder's basis in the stock of the first-tier controlled foreign corporation is increased to account for the inclusion, but the inclusion is not treated for foreign tax credit limitation purposes by reference to the nature of the income of the lower-tier controlled foreign corporation. Instead it generally is treated as passive income.

If subpart F income of a lower-tier controlled foreign corporation is included in the gross income of a U.S. shareholder, no provision of present law allows adjustment of the basis of the upper-tier controlled foreign corporation's stock in the lower-tier controlled foreign corporation.

Subpart F inclusions in year of disposition

The subpart F income earned by a foreign corporation during its taxable year is taxed to the persons who are U.S. shareholders of the corporation on the last day, in that year, on which the corporation is a controlled foreign corporation. In the case of a U.S. shareholder who acquired stock in a controlled foreign corporation during the year, such inclusions are reduced by all or a portion of the amount of dividends paid in that year by the foreign corporation to any person other than the acquirer with respect to that stock. The reduction is the lesser of the amount of dividends with respect to such stock received by other persons during the year or the amount determined by multiplying the subpart F income for the year by the proportion of the year during which the acquiring shareholder did not own the stock.

Distributions of previously taxed income

If in a year after the year of a subpart F income inclusion, a U.S. shareholder in the controlled foreign corporation receives a distribution from the corporation, the distribution may be deemed to come first out of the corporation's previously taxed income and, therefore, may be excluded from the U.S. shareholder's income. However, a distribution by a foreign corporation to a domestic corporation of earnings and profits previously taxed under subpart F is treated as an actual dividend, solely for purposes of determining the indirect foreign tax credit available to the domestic corporation (sec. 960(a)(3)).

In addition, the domestic corporation is permitted to increase its foreign tax credit limitation in the year of the distribution of previously taxed earnings and profits in an amount equal to the excess of the amount by which its foreign tax credit limitation for the year of the subpart F inclusion was increased as a result of that inclusion, over the amount of foreign taxes which were allowable as a credit in that year and which would not have been so allowable but for the subpart F inclusion (sec. 960(b)). The increase in the foreign tax credit limitation may not, however, exceed the amount of the foreign taxes taken into account under this provision with respect to the distribution of previously taxed earnings and profits. In order for this rule to apply, the domestic corporation either must have elected to credit foreign taxes in the year of the subpart F inclusion or must not have paid or accrued any foreign taxes in such year, and it must elect the foreign tax credit in the year of the distribution of previously taxed earnings and profits.

Treatment of United States source income earned by a controlled foreign corporation

As a general rule, subpart F income does not include income earned from sources within the United States if the income is effectively connected with the conduct of a U.S. trade or business by the controlled foreign corporation. This general rule does not apply, however, if the income is exempt from, or subject to a reduced rate of, U.S. tax pursuant to a provision of a U.S. treaty.

Indirect foreign tax credits

A U.S. corporation owning at least 10 percent of the voting stock of a foreign corporation is treated as if it had paid a share of the foreign income taxes paid by the foreign corporation in the year in which the foreign corporation's earnings and profits become subject to U.S. tax as dividend income of the U.S. shareholder (sec. 902(a)).

A U.S. corporation may also be deemed to have paid taxes paid by a second- or third-tier foreign corporation. That is, where a first-tier foreign corporation pays a dividend to a 10-percent-or-more U.S. corporate shareholder, then for purposes of deeming the U.S. corporation to have paid foreign tax, the first-tier foreign corporation may be deemed to have paid a share of the foreign taxes paid by a second-tier foreign corporation of which the first-tier foreign corporation owns at least 10 percent of the voting stock, and from which the first-tier foreign corporation received dividends. The same principle applies to dividends from a second-tier or third-tier foreign corporation. No taxes paid by a second- or third-tier foreign corporation are deemed paid by the first- or second-tier foreign corporation, respectively, unless the product of the percentage ownership of voting stock at each level from the U.S. corporation down equals at least 5 percent (sec. 902(b)). Under present law, foreign taxes paid below the third tier of foreign corporations are not eligible for the indirect foreign tax credit.

An indirect foreign tax credit generally is also available to a U.S. corporate shareholder meeting the requisite ownership threshold with respect to inclusions of subpart F income from controlled foreign corporations (sec. 960(a)).[1] Moreover, an indirect foreign tax credit may also be available to U.S. corporate shareholders with respect to inclusions of income from passive foreign investment companies.

House bill

In general

The House bill makes a number of modifications in the treatment of income derived from the disposition of stock in a controlled foreign corporation. The House bill provides deemed dividend treatment for gains on dispositions of lower-tier controlled foreign corporations. Where the lower-tier controlled foreign corporation previously earned subpart F income, the House bill permits the amount of gain taxed to the U.S. shareholder to be adjusted for previous income inclusions. Where proceeds from the sale of stock to a controlled foreign corporation that previously has earned subpart F income would be treated as a dividend under the principles of section 304, the House bill expressly permits exclusion of the deemed section 304 dividend from taxation to the extent of the previously taxed earnings and profits of the controlled foreign corporation from which the property was deemed to be distributed. (Appropriate basis adjustments also are permitted to be made.) Where a controlled foreign corporation (whether or not it is a lower-tier controlled foreign corporation) earns subpart F income in a year in which a U.S. shareholder sells its stock, in a transaction that does not result in the foreign corporation ceasing to be a controlled foreign corporation, the House bill contains statutory language providing for a proportional reduction in the taxation of the subpart F income in that year to the acquiring U.S. shareholder.

The House bill contains four additional provisions related to controlled foreign corporations. First, the House bill repeals the limita-

[1] Unlike the indirect foreign tax credit for actual dividend distributions, the indirect credit for subpart F inclusions can be available to individual shareholders in certain circumstances if an election is made (sec. 962).

tion on look-through treatment (for foreign tax credit separate limitation purposes) of dividends from controlled foreign corporations to U.S. shareholders out of earnings from periods in which the payor was a controlled foreign corporation, but the dividend recipient was not a U.S. shareholder of the controlled foreign corporation. Second, the House bill provides regulatory authority to develop a simplified mechanism for computing indirect foreign tax credits and increases in foreign tax credit limitations resulting upon certain distributions by controlled foreign corporations of previously taxed earnings and profits. Third, the House bill clarifies the effect of a treaty exemption or reduction of the branch profits tax on the determination of subpart F income. Fourth, the House bill extends application of the indirect foreign tax credit to fourth-, fifth-, and sixth-tier controlled foreign corporations where the necessary ownership thresholds (as extended under the House bill to these tiers) are satisfied.

Lower-tier controlled foreign corporations

Characterization of gain on stock disposition

The House bill provides that if a controlled foreign corporation is treated as having gain from the sale or exchange of stock in a foreign corporation, the gain is treated as a dividend to the same extent that it would have been so treated under section 1248 if the controlled foreign corporation were a U.S. person. This provision, however, does not affect the determination of whether the corporation whose stock is sold or exchanged is a controlled foreign corporation.

Thus, for example, if a U.S. corporation owns 100 percent of the stock of a foreign corporation, which owns 100 percent of the stock of a second foreign corporation, then under the House bill, any gain of the first corporation upon a sale or exchange of stock of the second corporation is treated as a dividend for purposes of subpart F income inclusions to the U.S. shareholder, to the extent of earnings and profits of the second corporation attributable to periods in which the first foreign corporation owned the stock of the second foreign corporation while the latter was a controlled foreign corporation with respect to the U.S. shareholder.

As another example, assume that the U.S. corporation has always owned 40 percent of the voting stock and 60 percent of the value of all of the stock of a foreign corporation, which has always owned 40 percent of the voting stock and 60 percent of the value of all of the stock of a second foreign corporation. All the other stock of the foreign corporations has always been owned by foreign individuals unrelated to the U.S. corporation. In this case, the second foreign corporation has never been a controlled foreign corporation. Therefore, none of the gain of the first corporation upon a sale of stock of the second corporation is treated as a dividend.

Gain on disposition of stock in a related corporation created or organized under the laws of, and having substantial part of assets in a trade or business in, the same foreign country as the gain recipient, even if recharacterized as a dividend under the House bill, is not therefore excluded from foreign personal holding company income under the same-country exception that applies to actual dividends.

The House bill provides that for purposes of this provision, a controlled foreign corporation is treated as having sold or exchanged stock if, under any provision of subtitle A of the Code, the controlled foreign corporation is treated as having gain from the sale or exchange of such stock. Thus, for example, if a controlled foreign corporation distributes to its shareholder stock in a foreign corporation, and the distribution results in gain being recognized by the controlled foreign corporation under section 311(b) as if the stock were sold to the shareholder for fair market value, the House bill makes clear that for purposes of this provision, the controlled foreign corporation is treated as having sold or exchanged the stock.

The House bill also repeals a provision added to the Code by the Technical and Miscellaneous Revenue Act of 1988 [2] (the "1988 Act") which, except as provided by regulations, requires a recipient of a distribution from a controlled foreign corporation to have been a United States shareholder of that controlled foreign corporation for the period during which the earnings and profits which gave rise to the distribution were generated in order to avoid treating the distribution as one coming from a noncontrolled section 902 corporation. Thus, under the House bill, a controlled foreign corporation is not treated as a noncontrolled section 902 corporation with respect to any distribution out of its earnings and profits for periods during which it was a controlled foreign corporation, whether or not the recipient of the distribution was a U.S. shareholder of the corporation when the earnings and profits giving rise to the distribution were generated.

Adjustments to basis of stock

The House bill also provides that when a lower-tier controlled foreign corporation earns subpart F income, and stock in that corporation is later disposed of by an upper-tier controlled foreign corporation, the resulting income inclusion of the U.S. shareholders are, under regulations, adjusted to account for previous inclusions, in a manner similar to the adjustments currently provided to the basis of stock in a first-tier controlled foreign corporation. Thus, just as the basis of a U.S. shareholder in a first-tier controlled foreign corporation rises when subpart F income is earned and falls when previously taxed income is distributed, so as to avoid double taxation of the income on a later disposition, it is intended that by regulation the subpart F income from gain on the disposition of a lower-tier controlled foreign corporation generally would be reduced by income inclusions of earnings that were not subsequently distributed by the lower-tier controlled foreign corporation. It is intended that the Secretary will have sufficient flexibility in promulgating regulations under this provision to permit adjustments only in those cases where, by virtue of the historical ownership structure of the corporations involved, the Secretary is satisfied that the

[2] P.L. 100-647, sec. 1012(a)(10).

inclusions for which adjustments can be made can be clearly identified.

For example, assume that a U.S person is the owner of all of the stock of a first-tier controlled foreign corporation which, in turn, is the sole shareholder of a second-tier controlled foreign corporation. In year 1, the second-tier controlled foreign corporation earns $100 of subpart F income which is included in the U.S. person's gross income for that year. In year 2, the first-tier controlled foreign corporation disposes of the second-tier controlled foreign corporation's stock and recognizes $300 of income with respect to the disposition. All of that income would constitute subpart F foreign personal holding company income. Under the House bill, the Secretary is granted regulatory authority to reduce the U.S. person's year 2 subpart F inclusion by $100—the amount of year 1 subpart F income of the second-tier controlled foreign corporation that was included, in that year, in the U.S. person's gross income. Such an adjustment would, in effect, allow for a step-up in the basis of the stock of the second-tier controlled foreign corporation to the extent of its subpart F income previously included in the U.S. person's gross income.

As another example, assume the same facts as in the preceding paragraph except that in year 2, the first-tier controlled foreign corporation distributes the stock of the second-tier controlled foreign corporation to the U.S. person. Assume that as a result of the distribution, the first-tier controlled foreign corporation recognizes taxable income of $300 under section 311(b). This income represents subpart F income, $100 of which is due to no adjustment having been made to the basis of the second-tier controlled foreign corporation's stock for its year 1 subpart F income. The House bill contemplates that in such a situation, the $300 of subpart F income would be reduced under regulations to $200 to account for the year 1 subpart F income inclusion.

Subpart F inclusions in year of disposition

If a U.S. shareholder acquires the stock of a controlled foreign corporation from another U.S. shareholder during a taxable year of the controlled foreign corporation in which it earns subpart F income, the House bill reduces the acquirer's subpart F inclusion for that year by a portion of the amount of the dividend deemed (under sec. 1248) to be received by the transferor. The portion by which the inclusion is reduced (as is currently the case if a dividend was paid to the previous owner of the stock) would not exceed the lesser of the amount of dividends with respect to such stock deemed received (under sec. 1248) by other persons during the year or the amount determined by multiplying the subpart F income for the year by the proportion of the year during which the acquiring shareholder did not own the stock.

Avoiding double inclusions in other cases

The House bill clarifies the appropriate scope of regulatory authority with respect to the treatment of cross-chain section 304 dividends out of the earnings of controlled foreign corporations that were previously included in the income of a U.S. shareholder under subpart F. The House bill contemplates that in such a case, the Secretary in his discretion may by regulation treat such dividends as distributions of previously taxed income, with appropriate basis adjustments. It is also anticipated that other occasions may arise where the exercise of similar regulatory authority may be appropriate to avoid double income inclusions, or an inclusion or exclusion of income without a corresponding basis adjustment. Therefore, the House bill states that, in addition to cases involving section 304, the Secretary may by regulation modify the application of subpart F in any other case where there would otherwise be a multiple inclusion of any item of income (or an inclusion or exclusion without an appropriate basis adjustment) by reason of the structure of a U.S. shareholder's holdings in controlled foreign corporations or by reason of other circumstances. The House bill is not intended to create any inference as to the application of present law in these cases.

Foreign tax credit in year of receipt of previously taxed income

With respect to the present-law provisions which permit a foreign tax credit to be claimed in the case of a distribution of previously taxed income, the House bill provides authority for Treasury regulations to establish a simplified method for computing the increase in foreign tax credit limitation that results from the application of these provisions. It is understood that the Secretary has regulatory flexibility in the determination of the amount of creditable foreign taxes on or with respect to the accumulated earnings and profits of a foreign corporation from which a distribution of previously taxed income is made, which were not deemed paid by the domestic corporation in a prior taxable year.

The House bill makes clear that the regulations may require taxpayers to use any simplified methods so established, rather than making the use of such methods elective by taxpayers. The House bill does not mandate, however, that regulations provide such simplified methods, or in the case that such methods are provided, that they be made uniformly applicable to all taxpayers.

For example, in certain situations the Treasury Secretary might deem it appropriate not to require taxpayers to trace specific items of previously taxed income of specific controlled foreign corporations and to associate those items with specific amounts of excess foreign tax credit limitation. Rather, regulations might allow for some sort of simplified approach for accounting for excess limitation amounts (allocated to the various foreign tax credit separate limitation categories from which they originally arose) and for utilization of portions of these amounts upon distributions of previously taxed income from the same categories.

Treatment of United States income earned by a controlled foreign corporation

The House bill provides that an exemption or reduction by treaty of the branch profits tax that would be imposed under section 884 on a controlled foreign corporation does not affect the general statutory exemption from subpart F income that is granted for U.S. source effectively connected income. For example, assume a controlled foreign corporation earns income of a type that generally would be subpart F income, and that income is earned from sources within the United States in connection with business operations therein. Further assume that repatriation of that income is exempted from the U.S. branch profits tax under a provision of an applicable U.S. income tax treaty. The House bill provides that, notwithstanding the treaty's effect on the branch tax, the income is not treated as subpart F income as long as it is not exempt from U.S. taxation (or subject to a reduced rate of tax) under any other treaty provision.

Indirect foreign tax credit

The House bill extends the application of the indirect foreign tax credit (secs. 902 and 960) to certain taxes paid or accrued by certain fourth-, fifth-, and sixth-tier foreign corporations. In general, three requirements must be satisfied by a foreign company at any of these tiers to qualify for the credit. First, the company must be a controlled foreign corporation. Second, the domestic corporation referred to in section 902(a) must be a U.S. shareholder (as defined in section 951(b)) with respect to the foreign company. Third, the product of the percentage ownership of voting stock at each level from the U.S. corporation down must equal at least 5 percent. The House bill limits the application of the indirect foreign tax credit below the third tier to taxes paid or incurred in taxable years during which the payor is a controlled foreign corporation. No inference is intended as to the availability of indirect foreign tax credits, under present law, for taxes paid by foreign corporations in the first three tiers, for periods prior to the time when the present-law ownership requirements were met as to those corporations. All foreign taxes paid below the sixth tier of foreign corporations remain ineligible for the indirect foreign tax credit.

Effective dates

Lower-tier controlled foreign corporations

The provision of the House bill treating gains on dispositions of stock in lower-tier controlled foreign corporations as dividends under section 1248 principles applies to gains recognized on transactions occurring after date of enactment of the House bill. The provision of the House bill that expands look-through treatment, for foreign tax credit limitation purposes, of dividends from controlled foreign corporations, is effective for distributions after the date of the House bill's enactment.

The House bill's provision providing for regulatory adjustments to U.S. shareholder inclusions, with respect to gains of controlled foreign corporations from dispositions of stock in lower-tier controlled foreign corporations that previously had subpart F income, is effective for determining inclusions for taxable years of U.S. shareholders beginning after December 31, 1992. Thus, the House bill permits regulatory adjustments to an inclusion occurring after the effective date to account for previous subpart F income inclusions occurring both prior to and subsequent to the effective date of the provision.

Subpart F inclusions in year of disposition

The provision of the House bill permitting dispositions of stock to be taken into consideration in determining a U.S. shareholder's subpart F inclusion for a taxable year is effective with respect to dispositions occurring after the date of enactment of the House bill.

Distributions of previously taxed income

The provision of the House bill allowing the Secretary to make regulatory adjustments to avoid double inclusions in cases such as those to which section 304 applies takes effect on the date the House bill is enacted.

Foreign tax credit in year of receipt of previously taxed income

The provision of the House bill granting regulatory authority to establish simplified methods for determining the amount of increase in foreign tax credit limitation resulting from a distribution of previously taxed income is effective as of the date of enactment of the House bill.

Treatment of United States source income earned by a controlled foreign corporation

The provision of the House bill concerning the effect of treaty exemptions from or reductions of the branch profits tax on the determination of subpart F income is effective for taxable years beginning after December 31, 1986.

Indirect foreign tax credit

The provision of the House bill which extends application of the indirect foreign tax credit to certain controlled foreign corporations below the third tier is effective for foreign taxes paid or incurred by controlled foreign corporations for taxable years of such corporations beginning after the date of enactment of the House bill.

In the case of any chain of foreign corporations the taxes of which would be eligible for the indirect foreign tax credit, under present law or under the House bill, but for the denial of indirect credits below the third or sixth tier, as the case may be, no liquidation, reorganization, or similar transaction in a taxable year beginning after the date of enactment of the House bill shall have the effect of permitting taxes to be taken into account under the indirect foreign tax credit provisions of the Code which could not have been taken into account under those provisions but for such transaction. As one example, no such transaction shall have the effect of permitting credits for taxes which, but for such transaction, would have been noncreditable (given the effective date provisions of the House bill) because they are taxes of a fourth-, fifth-, or sixth-tier corporation for a year beginning *before* the date that the House bill is enacted. No inference is intended regarding the creditability or noncreditability of such taxes under present law.

Senate amendment

The Senate amendment is the same as the House bill, except that it does not include the provision of the House bill that extends the application of the indirect foreign tax credit to taxes paid by certain fourth-, fifth-, and sixth-tier controlled foreign corporations.

Conference agreement

The conference agreement follows the House bill.

3. TRANSLATION OF FOREIGN TAXES INTO U.S. DOLLAR AMOUNTS

Present law

Translation of foreign taxes

Foreign income taxes paid in foreign currencies are required to be translated into U.S. dollar amounts using the exchange rate as of the time such taxes are paid to the foreign country or U.S. possession (sec. 986(a)(1)). This rule applies equally to foreign taxes paid directly by U.S. taxpayers, which are creditable only in the year paid or accrued (or during a carryover period), and to foreign taxes paid by foreign corporations that are deemed paid by a U.S. corporation, and hence creditable, in the year that the U.S. corporation receives a dividend or income inclusion.

Redetermination of foreign taxes

For taxpayers who utilize the accrual basis of accounting for determining creditable foreign taxes, accrued and unpaid foreign tax liabilities denominated in foreign currencies are translated into U.S. dollar amounts at the exchange rate as of the last day of the taxable year of accrual.[1] In certain cases where a difference exists between the dollar value of accrued foreign taxes and the dollar value of those taxes when paid, a redetermination (or adjustment) of foreign taxes is required.[2] Generally, such an adjustment may be attributable to one of three causes. One such cause would be a refund of foreign taxes. Second, a foreign tax redetermination may be required because the amount of foreign currency units actually paid differs from the amount of foreign currency units accrued. These first two cases generally give rise to a so-called "section 905(c) regular adjustment." Third, a redetermination may arise due to fluctuations in the value of the foreign currency relative to the dollar between the date of accrual and the date of payment giving rise to a so-called "section 905(c) translation adjustment."

As a general matter, a redetermination of foreign tax paid or accrued directly by a U.S. person requires notification of the Internal Revenue Service and a redetermination of U.S tax liability for the taxable year for which the foreign tax was claimed as a credit. Exceptions to this rule apply for de minimis amounts of foreign tax redeterminations.[3] In the case of redeterminations of foreign taxes that qualify for the deemed-paid foreign tax credit under sections 902 and 960, taxpayers generally are required to make appropriate adjustments to the pools of earnings and profits and foreign taxes.[4]

[1] Temp. Treas. Reg. sec. 1.90-3T(b)(1).
[2] Temp. Treas. Reg. sec. 1.905-3T(c).
[3] Temp. Treas. Reg. sec. 1.905-3T(d)(1).
[4] Temp. Treas. Reg. sec. 1.905-3T(d)(2); Notice 90-26, 1990-1 C.B. 336.

House bill

In general

The House bill sets forth two sets of operating rules for the translation of foreign taxes. The first set establishes new rules for the translation of certain accrued foreign taxes. The other set modifies the rules of present law for translating all other foreign taxes.

Translation of foreign taxes

Translation of certain accrued foreign taxes

With respect to taxpayers who take foreign income taxes into account when accrued for purposes of determining the foreign tax credit, the House bill generally permits foreign taxes to be translated at the average exchange rate for the taxable year to which such taxes relate. If tax in excess of the accrued amount is actually paid, such excess amount would be translated using the exchange rate in effect as of the time of payment.

This set of rules does not apply (1) to taxpayers that are not on the accrual basis for determining creditable foreign taxes, (2) with respect to taxes of an accrual-basis taxpayer that are actually paid in a taxable year prior to the year to which they relate, or (3) to the extent provided in regulations, to tax payments denominated in a currency determined to be an inflationary currency in accordance with such regulations. It is intended that the Secretary will have discretion to define "inflationary" for this purpose so as to take into account the particular need under this provision to avoid distortions in the computation of the foreign tax credit. In addition, as discussed in detail below, this set of rules does not apply to, and thus a redetermination of foreign tax is required for, any foreign income tax paid after the date two years after the close of the taxable year to which such taxes relate.

For example, assume that in year 1 a taxpayer accrues 1,000 units of foreign tax that relate to year 1. Further assume that as of the end of year 1 the tax is unpaid and the currency involved is not treated as inflationary by the Secretary for translation purposes. In this case, the House bill provides that the taxpayer would translate 1,000 units of accrued foreign tax into U.S. dollars at the average exchange rate for year 1.[5] If the 1,000 units of tax were paid by the taxpayer in either year 2 or year 3, no redetermination of foreign tax would be required. If, any portion of the tax so accrued remained unpaid as of the end of year 3, however, the taxpayer would be required to redetermine its foreign tax accrued in year 1 to account for the accrued but unpaid tax.

As another example, assume a taxpayer accrues 1,000 units of foreign tax in year 2, but pays the tax in year 1. Also assume that the tax relates to year 2. In this case, the taxpayer would translate the tax using the exchange rate as of the time the tax is paid (i.e., using the applicable year 1 exchange rate) since the tax is paid in a year prior to the year to which it relates.

[5] The same result would occur if the 1,000 units of tax were both accrued and paid in year 1.

As an illustration of what is meant by the taxable year to which taxes relate, assume that a foreign corporation is charged by a foreign government with an income tax of 100 units for 1993. Assume that the currency involved is not treated as inflationary by the Secretary for translation purposes under the House bill. Due to a contest between the foreign government and the corporation that ends in 1994, the 100 units of tax are not paid until 1994. Assume that under the U.S. rules governing accrual, the foreign tax accrues *for* 1993 but does not do so *until* 1994.[6] Under the House bill, the taxes will be translated at the rate in effect for 1993, because the taxes relate to 1993, even though they did not accrue until 1994. If instead the contest was over, and the taxes were accrued and paid, in 1998, the translation rate used would be that of 1998, rather than 1993 because 1998 is more than 2 years after the end of 1993. Now assume that the contest was over in 1998, but the taxes were deposited in 1994 and not accrued until 1998. These taxes are paid before the beginning of the year in which the taxes were accrued (1998), but after the year to which the taxes relate (1993). Thus, under the House bill, the taxes may be translated at the rate for the year (1993) to which the taxes relate. If the taxes are instead paid in 1996, under the House bill they will be translated at the relevant rate for 1996 because 1996 is more than 2 years after the end of 1993. Finally, assume that under a long-term contract method of accounting, a foreign income tax liability accrues in 1998, but advance deposits are made in each of the years 1993 through 1997. Under the House bill, it is intended that the payments in 1993 through 1997 be treated as relating to 1998. Therefore these payments are translated at the relevant rates for 1993 through 1997.

Translation of all other foreign taxes

Foreign taxes not eligible for application of the preceding rules generally are translated into U.S. dollars using the exchange rates as of the time such taxes are paid. The House bill grants the Secretary of the Treasury authority to issue regulations that would allow foreign tax payments made by a foreign corporation or by a foreign branch of a U.S. person to be translated into U.S. dollar amounts using an average U.S. dollar exchange rate for a specified period. It is anticipated that the applicable average exchange rate would be the rate as published by a qualified source of exchange rate information for the period during which the tax payments were made.

Redetermination of foreign taxes

As revised by the House bill, section 905(c) requires foreign tax redeterminations to occur in three cases: (1) if accrued taxes when paid (in foreign currency) differ from the amounts claimed (in foreign currency) as credits by the taxpayer, (2) if accrued taxes are not paid before the date two years after the close of the taxable year to which such taxes relate, and (3) if any tax paid is refunded in whole or in part. Thus, for example, the House bill provides that if at the close of the second taxable year after the close of the ac-

[6] See, e.g., Rev. Rul. 84-125, 1984-2 C.B. 125.

crual year any tax so accrued has not yet been paid, a foreign tax redetermination under section 905(c) is required for the amount of such unpaid tax. That is, the accrual of any tax that is unpaid as of that date would be retroactively denied. In cases where a redetermination is required, as under present law, the House bill specifies that the taxpayer must notify the Secretary, who shall redetermine the amount of the tax for the year or years affected.

The House bill provides that in the case of accrued taxes not paid within the date two years after the close of the taxable year to which such taxes relate, whether or not such taxes were previously accrued, any such taxes if subsequently paid are taken into account for the taxable year in which paid, and no redetermination with respect to the original year of accrual is required on account of such payment. In such a case, those taxes would be translated into U.S. dollar amounts using the exchange rates in effect for the period during which such taxes are paid. Nothing in the House bill is intended to change present law as to the length of time after the year to which the redetermination relates within which redeterminations may be made or required.[7]

Effective date

Effective for taxes paid (in the case of taxpayers using the cash basis for determining the foreign tax credit) or accrued (in the case of taxpayers using the accrual basis for determining the foreign tax credit) in taxable years beginning after December 31, 1991.

Senate amendment

The Senate amendment is the same as the House bill, except that the Senate amendment clarifies the provision's application to certain foreign tax liabilities which accrue under a long-term contract method of accounting.

As an example of the treatment prescribed under the Senate amendment, assume that under foreign law, a foreign income tax liability accrues in 1998 under a long-term contract method of accounting, but advance deposits of that liability accruing in 1998 are made in each of the years 1993 through 1997. It is intended under the Senate amendment that if the payments in 1993 through 1997 are treated as relating to 1998, these payments are nevertheless to be translated at the relevant rates for 1993 through 1997. Although the Senate amendment provides a rule for the translation of the taxes in this case, no change is intended as to the application of present law accounting rules determining the year for which the taxes are eligible for credit or deduction for U.S. income tax purposes.

Conference agreement

The conference agreement follows the Senate amendment.

With respect to taxes of an accrual-basis taxpayer that relate to a taxable year beginning before January 1, 1992, the return for which (if one were due) would not yet be due on date of enactment

[7] See sec. 6501(c)(5). See also, e.g., *Pacific Metals Corp. v. Commissioner*, 1 T.C. 1028 (1943); *Texas Co. (Caribbean) Ltd. v. Commissioner*, 12 T.C. 925 (1949).

(taking into account extensions of time to file), the conferees contemplate that the Secretary would, in appropriate circumstances, provide taxpayers with a reasonable average-rate method for translating such taxes that are not paid until after the effective date of the Act.

As an additional illustration of what is meant by the conference agreement as the taxable year to which taxes relate, assume that a foreign corporation accrues a foreign income tax of 100 units of noninflationary currency for 1993. Further assume that the actual amount of foreign tax liability of the foreign corporation for 1993 is 110 units, all of which is paid in 1994. Under the conference agreement, the 110 units of foreign tax are translated at the rate in effect for 1993 because the taxes relate to 1993, even though the total tax liability for that year was not actually accrued by the taxpayer in 1993.

4. FOREIGN TAX CREDIT LIMITATION UNDER THE ALTERNATIVE MINIMUM TAX

Present law

Computing foreign tax credit limitations requires the allocation and apportionment of deductions between items of foreign source and U.S. source income. Foreign tax credit limitations must be computed both for regular tax purposes and for purposes of the alternative minimum tax (AMT). Consequently, after allocating and apportioning deductions for regular tax foreign tax credit limitation purposes, additional allocations and apportionments generally must be performed in order to compute the AMT foreign tax credit limitation.

House bill

The House bill permits taxpayers to elect to use as their AMT foreign tax credit limitation fraction the ratio of foreign source *regular* taxable income to entire alternative minimum taxable income, rather than the ratio of foreign source *alternative minimum* taxable income to entire alternative minimum taxable income. Foreign source regular taxable income may be used, however, only to the extent it does not exceed entire alternative minimum taxable income.

The election under the bill is available only in the first taxable year beginning after December 31, 1992, for which the taxpayer claims an AMT foreign tax credit. A taxpayer will be treated, for this purpose, as claiming an AMT foreign tax credit for any taxable year for which the taxpayer chooses to have the benefits of the foreign tax credit, and in which the taxpayer is subject to the alternative minimum tax or would be subject to the alternative minimum tax but for the availability of the AMT foreign tax credit. The election applies to all subsequent taxable years, and may be revoked only with the permission of the Secretary of the Treasury.

Effective date.—The provision applies to taxable years beginning after December 31, 1992.

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. INBOUND AND OUTBOUND TRANSFERS

Present law

Outbound transfers

Corporate nonrecognition provisions

Certain types of exchanges relating to the organization, reorganization, and liquidation of a corporation can be made without recognition of gain to the corporation involved or to its shareholders. In 1932 Congress enacted an exception to the nonrecognition rules, which became section 367 of the 1954 Code, for the case where such an exchange involves a foreign corporation. The legislative history indicates that the exception was enacted in order to prevent tax avoidance that might have otherwise occurred upon the transfer of appreciated property outside U.S. tax jurisdiction.[1] Under that provision, in determining the extent to which gain (but not loss) was recognized in these exchanges, a foreign corporation was not considered a corporation unless it was established to the satisfaction of the IRS that the exchange was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

The Code now provides that if a U.S. person transfers property to a foreign corporation in connection with certain corporate organizations, reorganizations, or liquidations, the foreign corporation will not, for purposes of determining the extent to which gain is recognized on such transfer, be considered to be a corporation (sec. 367(a)(1)). Various exceptions to the operation of this rule are provided, including a broad grant of authority to provide exceptions by regulation. The statutory language has changed substantially since 1932, but it has retained in large part its primary operative result—that of treating a foreign corporation as not a corporation. Since corporate status is essential to qualify for the tax-free organization, reorganization, and liquidation provisions, failure to satisfy the requirements of section 367 could result in the recognition of gain to the participant corporations and shareholders.

Excise tax on transfers to a foreign entity

At the same time that Congress enacted the original predecessor of current section 367, Congress also enacted an excise tax on outbound transfers that might not constitute income tax recognition events even after imposition of the anti-avoidance income tax rule adopted for corporate transactions. As in the case of the corporate nonrecognition override provision, the purpose of the excise tax

[1] H.R. Rep. No. 708, 72d Cong., 1st Sess. 20 (1932).

was to check transfers of property in which there was a large appreciation in value to foreign entities for the purpose of avoidance of taxes on capital gains.[2] Therefore, as in the case of the corporate provision, the excise tax generally has been imposed only in certain cases where it has been believed necessary or appropriate to preserve U.S. tax on appreciated assets.

Under present law, the excise tax generally applies on transfers of property by a U.S. person to a foreign corporation—as paid-in surplus or as a contribution to capital—or to a foreign estate, trust, or partnership. The tax is 35 percent of the amount of gain inherent in the property transferred, but not recognized for income tax purposes at the time of the transfer (sec. 1491). For income tax purposes, the basis of the property whose appreciation and transfer triggers the tax is not increased to account for imposition of the tax.

The excise tax does not apply in certain cases where the transferee is exempt from U.S. tax under Code sections 501–505 (sec. 1492(1)). In addition, the excise tax does not apply in some cases where income tax rules governing outbound transfers apply, either by their terms or by the election of the taxpayer. Thus, the excise tax does not apply to a transfer described in section 367, or to a transfer 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 (sec. 1492(2)).

In addition, a taxpayer may elect (under regulations prescribed by the Secretary) to treat a transfer described in section 1491 as a sale or exchange of the property transferred and to recognize as gain (but not loss) in the year of the transfer the excess of the fair market value of the property transferred over the adjusted basis (for determining gain) of the property in the hands of the transferor (sec. 1057; Treas. Reg. sec. 7.0). To the extent that gain is recognized pursuant to the election in the year of the transfer, the transfer is not subject to the excise tax, and the basis of the property in the hands of the transferee will be increased by the amount of gain received (sec. 1492(3)). The legislative history of the elective income recognition provision indicates that the making of an election which has as one of its principle purposes the avoidance of Federal income taxes is not permitted.[3]

The excise tax is due at the time of the transfer (sec. 1494(a)). Under regulations, the excise 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 (sec. 1494(b)).

Inbound corporate transfers

Although the legislative history of the 1932 Act indicated a concern with outbound transfers, the statutory standard for determining that a transaction did not have as one of its principal purposes tax avoidance evolved through administrative interpretation into a requirement that, in the case of transfers into the United States by a foreign corporation, tax-free treatment generally would be per-

[2] *Id.* at 52.

[3] Staff of the Joint Committee on Taxation, 94th Cong., 2d Sess., *General Explanation of the Tax Reform Act of 1976,* at 226 (1976).

mitted only if the U.S. tax on accumulated earnings and profits was paid. For example, in 1968, the IRS issued guidelines (Rev. Proc. 68-23, 1968-1 C.B. 821) as to when favorable rulings "ordinarily" would be issued. As a condition of obtaining a favorable ruling with respect to certain transactions, the section 367 guidelines required the taxpayer to agree to include certain items in income (the amount to be included was called the section 367 toll charge). For example, if the transaction involved the liquidation of a foreign corporation into a domestic parent corporation, a favorable ruling was issued if the domestic parent agreed to include in its income as a dividend for the taxable year in the which the liquidation occurred the portion of the accumulated earnings and profits of the foreign corporation which were properly attributable to the domestic corporation's stock interest in the foreign corporation (Rev. Proc. 68-23, sec. 3.01(1); see also sec. 3.03(1)(b)).

Absence of a toll charge on accumulated earnings of a foreign corporation upon liquidation or asset reorganization into a U.S. corporation clearly would permit avoidance of tax. For example, if a U.S. corporation owns 100 percent of the stock of a U.S. subsidiary, no tax is imposed either on a dividend from the subsidiary to the parent (sec. 243) or the liquidation of the subsidiary into the parent (secs. 332 and 337). In each case, the earnings of the subsidiary already have been subject to U.S. tax jurisdiction, and the liquidation provisions allow nonrecognition of gain inherent in appreciated property of the subsidiary. On the other hand, if a U.S. corporation owns 100 percent of the stock of a foreign subsidiary, earnings of the subsidiary generally are not subject to current U.S. tax. Instead, tax generally is imposed on a dividend from the subsidiary to the parent, net of creditable foreign taxes. If a liquidation of the subsidiary could be accomplished tax-free under the Code, U.S. tax on its earnings would be avoided; more generally, the parent would be able to succeed to the basis and other tax attributes of the foreign corporation without having subjected to U.S. tax jurisdiction the earnings that gave rise to those tax attributes.

Outbound transfers since the Tax Reform Act of 1976

For purposes of the transactions described above, section 367 (and its predecessors) remained largely unchanged between 1932 and 1976. In 1976, however, a number of problems caused Congress to revise section 367. One result of the 1976 revision was to separate the provision into 2 sets of rules: one set dealing with outbound transfers, where the statutory aim is to prevent the removal of appreciated assets or inventory from U.S. tax jurisdiction prior to their sale (sec. 367(a)), and the other set dealing with both transfers into the United States and those which are exclusively foreign (sec. 367(b)).

Section 367(b) now provides, in part, that in the case of certain exchanges in connection with which there is no transfer of property described in section 367(a)(1), a foreign corporation will be considered to be a corporation except to the extent provided in regulations which are necessary or appropriate to prevent the avoidance of Federal income taxes.

Although it is clear that absence of a toll charge on accumulated earnings of a foreign corporation upon liquidation or reorganization into a U.S. corporation leads to avoidance of tax, and Congress in 1976 noted without disapproval the adoption of IRS positions that would prevent the avoidance of tax in these cases,[4] neither section 367(b) as revised in 1976, nor its predecessors, were drafted in such a way that directly causes tax to be imposed on foreign earnings.

For example, assume that a U.S. corporation owns 100 percent of the stock of a liquidating foreign corporation, and, pursuant to regulations under section 367(b), the foreign corporation is not treated as a corporation for purposes of section 332. In that case, the U.S. corporation would be required under the Code to recognize the difference between the basis and the value of its stock in the foreign corporation. That gain, however, may be more or less than the accumulated earnings of the foreign corporation attributable to the period when the U.S. corporation owned the stock of the foreign corporation.

Perhaps as a result, neither the present temporary regulations nor the recently proposed regulations under section 367(b) mandate a tax based on the accumulated earnings of a foreign corporation that liquidates or reorganizes into a U.S. corporation. The temporary regulations allow the taxpayer to elect treatment of the foreign corporation as a corporation if the tax on earnings is paid. If the taxpayer chooses not to make the election, the foreign corporation is not treated as a corporation under the relevant nonrecognition provision (e.g., sec. 332, 354), but *is* treated as a corporation for other purposes, such as for purposes of the basis rules (secs. 334, 358, 362), and carryover provisions (sec. 381) (Temp. Treas. Reg. secs. 7.367(b)-5(b) and 7.367(b)-7(c)(2)). The proposed regulations generally require that the foreign corporation be treated as a corporation, and permit the taxpayer to elect either to pay the tax on earnings, or to pay tax on the gain; but if the latter option is chosen, adjustments must be made to either net operating loss carryovers, capital loss carryovers, or asset bases (Proposed Treas. Reg. sec. 1.367(b)-3(b)(2)).

House bill

Outbound transfers

The House bill repeals the excise tax on outbound transfers. In its place, the bill requires the full recognition of gain on a transfer of property by a U.S. person to a foreign corporation as paid-in surplus, or as a contribution to capital, or to a foreign estate, trust, or partnership. The Secretary may, however, in lieu of applying this full recognition rule, provide regulations under which principles similar to the principles of section 367 shall apply to any such transfer. Moreover, the Secretary may provide rules under which recognition of gain will not be triggered by section 1491 in cases where the Secretary is satisfied that application of other Code rules (such as those relating to partnerships or trusts) will prevent the avoidance of tax consistent with the purposes of the bill. Full recognition of gain can also be avoided in the case of a transfer de-

[4] E.g., Staff of the Joint Comm. on Taxation, 94th Cong., 2d Sess., *General Explanation of the Tax Reform Act of 1976*, at 264 (1976).

scribed in section 367. It is anticipated that prior to the promulgation of regulations, the Secretary generally will continue to permit taxpayers to elect the application of principles similar to the principles of section 367, provided the election is made by the time for filing the income tax return for the taxable year of the transfer.

Inbound transfers

The House bill provides that in the case of certain corporate organizations, reorganizations, and liquidations described in section 332, 351, 354, 355, 356, or 361 in which the status of a foreign corporation as a corporation is a condition for nonrecognition by a party to the transaction, income shall be recognized to the extent provided in regulations prescribed by the Secretary which are necessary or appropriate to prevent the avoidance of Federal income taxes. This provision is limited in its application, under the bill, so as not to apply to a transaction in which the foreign corporation is not treated as a corporation under section 367(a)(1). Thus, the bill permits the IRS to provide by regulations for recognition of income, without regard to the amount of gain that would be recognized in the absence of the relevant nonrecognition provision listed above. As under current law, such regulations will be subject to normal court review as to whether they are necessary or appropriate for the prevention of avoidance of Federal income taxes.

In addition, the bill clarifies that rules for income recognition under section 367(b) may also be applied in a case involving a transfer literally described in section 367(a)(1), where necessary or appropriate to prevent the avoidance of Federal income taxes.[5]

Effective date

The provision that amends the outbound rules and repeals the excise tax applies to transfers after date of enactment. The provision that amends section 367(b) applies to transfers after December 31, 1993.

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. Treatment of Intangibles

1. AMORTIZATION OF GOODWILL AND CERTAIN OTHER INTANGIBLES

Present law

In determining taxable income for Federal income tax purposes, a taxpayer is allowed depreciation or amortization deductions for the cost or other basis of intangible property that is used in a trade or business or held for the production of income if the property has a limited useful life that may be determined with reasonable accu-

[5] See Temp. Treas. Reg. sec. 7.367(b)-4(b); Proposed Treas. Reg. sec. 1.367(a)-3(a).

racy. No depreciation or amortization deductions are allowed with respect to goodwill or going concern value.

House bill

In general

The House bill allows an amortization deduction with respect to the capitalized costs of certain intangible property (defined as a "section 197 intangible") that is acquired by a taxpayer and that is held by the taxpayer in connection with the conduct of a trade or business or an activity engaged in for the production of income. The amount of the deduction is determined by amortizing the adjusted basis (for purposes of determining gain) of the intangible ratably over a 14-year period that begins with the month that the intangible is acquired.[1] No other depreciation or amortization deduction is allowed with respect to a section 197 intangible that is acquired by a taxpayer.

In general, the House bill applies to a section 197 intangible acquired by a taxpayer regardless of whether it is acquired as part of a trade or business. In addition, the House bill generally applies to a section 197 intangible that is treated as acquired under section 338 of the Code. The House bill generally does not apply to a section 197 intangible that is created by the taxpayer if the intangible is not created in connection with a transaction (or series of related transactions) that involves the acquisition of a trade or business or a substantial portion thereof.

Except in the case of amounts paid or incurred under certain covenants not to compete (or under certain other arrangements that have substantially the same effect as covenants not to compete) and certain amounts paid or incurred on account of the transfer of a franchise, trademark, or trade name, the House bill generally does not apply to any amount that is otherwise currently deductible (*i.e.*, not capitalized) under present law.

No inference is intended as to whether a depreciation or amortization deduction is allowed under present law with respect to any intangible property that is either included in, or excluded from, the definition of a section 197 intangible. In addition, no inference is intended as to whether an asset is to be considered tangible or intangible property for any other purpose of the Internal Revenue Code.

Definition of section 197 intangible

In general

The term "section 197 intangible" is defined as any property that is included in any one or more of the following categories: (1) goodwill and going concern value; (2) certain specified types of intangible property that generally relate to workforce, information base, know-how, customers, suppliers, or other similar items; (3) any license, permit, or other right granted by a governmental unit or an agency or instrumentality thereof; (4) any covenant not to compete

[1] In the case of a short taxable year, the amortization deduction is to be based on the number of months in such taxable year.

(or other arrangement to the extent that the arrangement has substantially the same effect as a covenant not to compete) entered into in connection with the direct or indirect acquisition of an interest in a trade or business (or a substantial portion thereof); and (5) any franchise, trademark, or trade name.

Certain types of property, however, are specifically excluded from the definition of the term "section 197 intangible." The term "section 197 intangible" does not include: (1) any interest in a corporation, partnership, trust, or estate; (2) any interest under an existing futures contract, foreign currency contract, notional principal contract, interest rate swap, or other similar financial contract; (3) any interest in land; (4) certain computer software; (5) certain interests in films, sound recordings, video tapes, books, or other similar property; (6) certain rights to receive tangible property or services; (7) certain interests in patents or copyrights; (8) any interest under an existing lease of tangible property; (9) any interest under an existing indebtedness (except for the deposit base and similar items of a financial institution); and (10) a franchise to engage in any professional sport, and any item acquired in connection with such a franchise.

Goodwill and going concern value

For purposes of the bill, goodwill is the value of a trade or business that is attributable to the expectancy of continued customer patronage, whether due to the name of a trade or business, the reputation of a trade or business, or any other factor.

In addition, for purposes of the bill, going concern value is the additional element of value of a trade or business that attaches to property by reason of its existence as an integral part of a going concern. Going concern value includes the value that is attributable to the ability of a trade or business to continue to function and generate income without interruption notwithstanding a change in ownership. Going concern value also includes the value that is attributable to the use or availability of an acquired trade or business (for example, the net earnings that otherwise would not be received during any period were the acquired trade or business not available or operational).

Workforce, information base, know-how, customer-based intangibles, supplier-based intangibles and other similar items

Workforce.—The term "section 197 intangible" includes workforce in place (which is sometimes referred to as agency force or assembled workforce), the composition of a workforce (for example, the experience, education, or training of a workforce), the terms and conditions of employment whether contractual or otherwise, and any other value placed on employees or any of their attributes. Thus, for example, the portion (if any) of the purchase price of an acquired trade or business that is attributable to the existence of a highly-skilled workforce is to be amortized over the 14-year period specified in the bill. As a further example, the cost of acquiring an existing employment contract (or contracts) or a relationship with employees or consultants (including but not limited to any "key employee" contract or relationship) as part of the acquisition of a trade or business is to be amortized over the 14-year period specified in the bill.

Information base.—The term "section 197 intangible" includes business books and records, operating systems, and any other information base including lists or other information with respect to current or prospective customers (regardless of the method of recording such information). Thus, for example, the portion (if any) of the purchase price of an acquired trade or business that is attributable to the intangible value of technical manuals, training manuals or programs, data files, and accounting or inventory control systems is to be amortized over the 14-year period specified in the bill. As a further example, the cost of acquiring customer lists, subscription lists, insurance expirations,[2] patient or client files, or lists of newspaper, magazine, radio or television advertisers is to be amortized over the 14-year period specified in the bill.

Know-how.—The term "section 197 intangible" includes any patent, copyright, formula, process, design, pattern, know-how, format, or other similar item. For this purpose, the term "section 197 intangible" is to include package designs, computer software, and any interest in a film, sound recording, video tape, book, or other similar property, except as specifically provided otherwise in the bill.[3]

Customer-based intangibles.—The term "section 197 intangible" includes any customer-based intangible, which is defined as the composition of market, market share, and any other value resulting from the future provision of goods or services pursuant to relationships with customers (contractual or otherwise) in the ordinary course of business. Thus, for example, the portion (if any) of the purchase price of an acquired trade or business that is attributable to the existence of customer base, circulation base, undeveloped market or market growth, insurance in force, mortgage servicing contracts, investment management contracts, or other relationships with customers that involve the future provision of goods or services, is to be amortized over the 14-year period specified in the bill. On the other hand, the portion (if any) of the purchase price of an acquired trade or business that is attributable to accounts receivable or other similar rights to income for those goods or services that have been provided to customers prior to the acquisition of a trade or business is not to be taken into account under the bill.[4]

In addition, the bill specifically provides that the term "customer-based intangible" includes the deposit base and any similar asset of a financial institution. Thus, for example, the portion (if any) of the purchase price of an acquired financial institution that is attributable to the checking accounts, savings accounts, escrow ac-

[2] Insurance expirations are records that are maintained by insurance agents with respect to insurance customers. These records generally include information relating to the type of insurance, the amount of insurance, and the expiration date of the insurance.

[3] See below for a description of the exceptions for certain patents, certain computer software, and certain interests in films, sound recordings, video tapes, books, or other similar property.

[4] As under present law, the portion of the purchase price of an acquired trade or business that is attributable to accounts receivable is to be allocated among such receivables and is to be taken into account as payment is received under each receivable or at the time that a receivable becomes worthless.

counts and other similar items of the financial institution is to be amortized over the 14-year period specified in the bill.

Supplier-based intangibles.—The term "section 197 intangible" includes any supplier-based intangible, which is defined as the value resulting from the future acquisition of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with suppliers of goods or services to be used or sold by the taxpayer. Thus, for example, the portion (if any) of the purchase price of an acquired trade or business that is attributable to the existence of a favorable relationship with persons that provide distribution services (for example, favorable shelf or display space at a retail outlet), the existence of a favorable credit rating, or the existence of favorable supply contracts, is to be amortized over the 14-year period specified in the bill.[5]

Other similar items.—The term "section 197 intangible" also includes any other intangible property that is similar to workforce, information base, know-how, customer-based intangibles, or supplier-based intangibles.

Licenses, permits, and other rights granted by governmental units

The term "section 197 intangible" also includes any license, permit, or other right granted by a governmental unit or any agency or instrumentality thereof (even if the right is granted for an indefinite period or the right is reasonably expected to be renewed for an indefinite period).[6] Thus, for example, the capitalized cost of acquiring from any person a liquor license, a taxi-cab medallion (or license), an airport landing or takeoff right (which is sometimes referred to as a slot), a regulated airline route, or a television or radio broadcasting license is to be amortized over the 14-year period specified in the bill. For purposes of the bill, the issuance or renewal of a license, permit, or other right granted by a governmental unit or an agency or instrumentality thereof is to be considered an acquisition of such license, permit, or other right.

Covenants not to compete and other similar arrangements

The term "section 197 intangible" also includes any covenant not to compete (or other arrangement to the extent that the arrangement has substantially the same effect as a covenant not to compete; hereafter "other similar arrangement") entered into in connection with the direct or indirect acquisition of an interest in a trade or business (or a substantial portion thereof). For this purpose, an interest in a trade or business includes not only the assets of a trade or business, but also stock in a corporation that is engaged in a trade or business or an interest in a partnership that is engaged in a trade or business.

Any amount that is paid or incurred under a covenant not to compete (or other similar arrangement) entered into in connection

[5] See below, however, for a description of the exception for certain rights to receive tangible property or services from another person.

[6] A right granted by a governmental unit or an agency or instrumentality thereof that constitutes an interest in land or an interest under a lease of tangible property is excluded from the definition of a section 197 intangible. See below for a description of the exceptions for interests in land and for interests under leases of tangible property.

with the direct or indirect acquisition of an interest in a trade or business (or a substantial portion thereof) is chargeable to capital account and is to be amortized ratably over the 14-year period specified in the bill. In addition, any amount that is paid or incurred under a covenant not to compete (or other similar arrangement) after the taxable year in which the covenant (or other similar arrangement) was entered into is to be amortized ratably over the remaining months in the 14-year amortization period that applies to the covenant (or other similar arrangement) as of the beginning of the month that the amount is paid or incurred.

For purposes of this provision, an arrangement that requires the former owner of an interest in a trade or business to continue to perform services (or to provide property or the use of property) that benefit the trade or business is considered to have substantially the same effect as a covenant not to compete to the extent that the amount paid to the former owner under the arrangement exceeds the amount that represents reasonable compensation for the services actually rendered (or for the property or use of property actually provided) by the former owner. As under present law, to the extent that the amount paid or incurred under a covenant not to compete (or other similar arrangement) represents additional consideration for the acquisition of stock in a corporation, such amount is not to be taken into account under this provision but, instead, is to be included as part of the acquirer's basis in the stock.

Franchises, trademarks, and trade names

The term "section 197 intangible" also includes any franchise, trademark, or trade name. For this purpose, the term "franchise" is defined, as under present law, to include any agreement that provides one of the parties to the agreement the right to distribute, sell, or provide goods, services, or facilities, within a specified area.[7] In addition, as provided under present law, the renewal of a franchise, trademark, or trade name is to be treated as an acquisition of such franchise, trademark, or trade name.[8]

The bill continues the present-law treatment of certain contingent amounts that are paid or incurred on account of the transfer of a franchise, trademark, or trade name. Under these rules, a deduction is allowed for amounts that are contingent on the productivity, use, or disposition of a franchise, trademark, or trade name only if (1) the contingent amounts are paid as part of a series of payments that are payable at least annually throughout the term of the transfer agreement, and (2) the payments are substantially equal in amount or payable under a fixed formula.[9] Any other amount, whether fixed or contingent, that is paid or incurred on account of the transfer of a franchise, trademark, or trade name is

[7] Section 1253(b)(1) of the Code.

[8] Only the costs incurred in connection with the renewal, however, are to be amortized over the 14-year period that begins with the month that the franchise, trademark, or trade name is renewed. Any costs incurred in connection with the issuance (or an earlier renewal) of a franchise, trademark, or trade name are to continue to be taken into account over the remaining portion of the amortization period that began at the time of such issuance (or earlier renewal).

[9] Section 1253(d)(1) of the Code.

chargeable to capital account and is to be amortized ratably over the 14-year period specified in the bill.

Exceptions to the definition of a section 197 intangible

In general.—The bill contains several exceptions to the definition of the term "section 197 intangible." Several of the exceptions contained in the bill apply only if the intangible property is not acquired in a transaction (or series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion of a trade or business. It is anticipated that the Treasury Department will exercise its regulatory authority to require any intangible property that would otherwise be excluded from the definition of the term "section 197 intangible" to be taken into account under the bill under circumstances where the acquisition of the intangible property is, in and of itself, the acquisition of an asset which constitutes a trade or business or a substantial portion of a trade or business.

The determination of whether acquired assets constitute a substantial portion of a trade or business is to be based on all of the facts and circumstances, including the nature and the amount of the assets acquired as well as the nature and the amount of the assets retained by the transferor. It is not intended, however, that the value of the assets acquired relative to the value of the assets retained by the transferor is determinative of whether the acquired assets constitute a substantial portion of a trade or business.

For purposes of the bill, a group of assets is to constitute a trade or business if the use of such assets would constitute a trade or business for purposes of section 1060 of the Code (*i.e.*, if the assets are of such a character that goodwill or going concern value could under any circumstances attach to the assets). In addition, the acquisition of a franchise, trademark or trade name is to constitute the acquisition of a trade or business or a substantial portion of a trade or business.

In determining whether a taxpayer has acquired an intangible asset in a transaction (or series of related transactions) that involves the acquisition of assets that constitute a trade or business or a substantial portion of a trade or business, only those assets acquired in a transaction (or a series of related transactions) by a taxpayer (and persons related to the taxpayer) from the same person (and any related person) are to be taken into account. In addition, any employee relationships that continue (or covenants not to compete that are entered into) as part of the transfer of assets are to be taken into account in determining whether the transferred assets constitute a trade or business or a substantial portion of a trade or business.

Interests in a corporation, partnership, trust, or estate.—The term "section 197 intangible" does not include any interest in a corporation, partnership, trust, or estate. Thus, for example, the bill does not apply to the cost of acquiring stock, partnership interests, or interests in a trust or estate, whether or not such interests are regularly traded on an established market.[10]

Interests under certain financial contracts.—The term "section 197 intangible" does not include any interest under an existing futures contract, foreign currency contract, notional principal contract, interest rate swap, or other similar financial contract, whether or not such interest is regularly traded on an established market. Any interest under a mortgage servicing contract, credit card servicing contract or other contract to service indebtedness issued by another person, and any interest under an assumption reinsurance contract [11] is not excluded from the definition of the term "section 197 intangible" by reason of the exception for interests under certain financial contracts.

Interests in land.—The term "section 197 intangible" does not include any interest in land. Thus, the cost of acquiring an interest in land is to be taken into account under present law rather than under the bill. For this purpose, an interest in land includes a fee interest, life estate, remainder, easement, mineral rights, timber rights, grazing rights, riparian rights, air rights, zoning variances, and any other similar rights with respect to land. An interest in land is not to include an airport landing or takeoff right, a regulated airline route, or a franchise to provide cable television services.

Certain computer software.—The term "section 197 intangible" does not include computer software (whether acquired as part of a trade or business or otherwise) that (1) is readily available for purchase by the general public; (2) is subject to a non-exclusive license; and (3) has not been substantially modified. In addition, the term "section 197 intangible" does not include computer software which is not acquired in a transaction (or a series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion of a trade or business.

For purposes of the bill, the term "computer software" is defined as any program (*i.e.*, any sequence of machine-readable code) that is designed to cause a computer to perform a desired function. The term "computer software" includes any incidental and ancillary rights with respect to computer software that (1) are necessary to effect the legal acquisition of the title to, and the ownership of, the computer software, and (2) are used only in connection with the computer software. The term "computer software" does not include any data base or other similar item regardless of the form in which it is maintained or stored.

If a depreciation deduction is allowed with respect to any computer software that is not a section 197 intangible, the amount of the deduction is to be determined by amortizing the adjusted basis of the computer software ratably over a 36-month period that begins with the month that the computer software is placed in service. For this purpose, the cost of any computer software that is taken into account as part of the cost of computer hardware or other tangible property under present law is to continue to be

[10] A temporal interest in property, outright or in trust, may not be used to convert a section 197 intangible into property that is amortizable more rapidly than ratably over the 14-year period specified in the bill.

[11] See below for a description of the treatment of assumption reinsurance contracts.

taken into account in such manner under the bill. In addition, the cost of any computer software that is currently deductible (*i.e.*, not capitalized) under present law is to continue to be taken into account in such manner under the bill.

Certain interests in films, sound recordings, video tapes, books, or other similar property.—The term "section 197 intangible" does not include any interest (including an interest as a licensee) in a film, sound recording, video tape, book, or other similar property if the interest is not acquired in a transaction (or a series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion of a trade or business.

Certain rights to receive tangible property or services.—The term "section 197 intangible" does not include any right to receive tangible property or services under a contract (or any right to receive tangible property or services granted by a governmental unit or an agency or instrumentality thereof) if the right is not acquired in a transaction (or a series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion of a trade or business.

If a depreciation deduction is allowed with respect to a right to receive tangible property or services that is not a section 197 intangible, the amount of the deduction is to be determined in accordance with regulations to be promulgated by the Treasury Department. It is anticipated that the regulations may provide that in the case of an amortizable right to receive tangible property or services in substantially equal amounts over a fixed period that is not renewable, the cost of acquiring the right will be taken into account ratably over such fixed period. It is also anticipated that the regulations may provide that in the case of a right to receive a fixed amount of tangible property or services over an unspecified period, the cost of acquiring such right will be taken into account under a method that allows a deduction based on the amount of tangible property or services received during a taxable year compared to the total amount of tangible property or services to be received.

For example, assume that a taxpayer acquires from another person a favorable contract right of such person to receive a specified amount of raw materials each month for the next three years (which is the remaining life of the contract) and that the right to receive such raw materials is not acquired as part of the acquisition of assets that constitute a trade or business or a substantial portion thereof (*i.e.*, such contract right is not a section 197 intangible). It is anticipated that the taxpayer may be required to amortize the cost of acquiring the contract right ratably over the three-year remaining life of the contract. Alternatively, if the favorable contract right is to receive a specified amount of raw materials during an unspecified period, it is anticipated that the taxpayer may be required to amortize the cost of acquiring the contract right by multiplying such cost by a fraction, the numerator of which is the amount of raw materials received under the contract during any taxable year and the denominator of which is the total amount of raw materials to be received under the contract.

It is also anticipated that the regulations may require a taxpayer under appropriate circumstances to amortize the cost of acquiring a renewable right to receive tangible property or services over a period that includes all renewal options exercisable by the taxpayer at less than fair market value.

Certain interests in patents or copyrights.—The term "section 197 intangible" does not include any interest in a patent or copyright which is not acquired in a transaction (or a series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion of a trade or business. If a depreciation deduction is allowed with respect to an interest in a patent or copyright and the interest is not a section 197 intangible, then the amount of the deduction is to be determined in accordance with regulations to be promulgated by the Treasury Department. It is expected that the regulations may provide that if the purchase price of a patent is payable on an annual basis as a fixed percentage of the revenue derived from the use of the patent, then the amount of the depreciation deduction allowed for any taxable year with respect to the patent equals the amount of the royalty paid or incurred during such year.[12]

Interests under leases of tangible property.—The term "section 197 intangible" does not include any interest as a lessor or lessee under an existing lease of tangible property (whether real or personal).[13] The cost of acquiring an interest as a lessor under a lease of tangible property where the interest as lessor is acquired in connection with the acquisition of the tangible property is to be taken into account as part of the cost of the tangible property. For example, if a taxpayer acquires a shopping center that is leased to tenants operating retail stores, the portion (if any) of the purchase price of the shopping center that is attributable to the favorable attributes of the leases is to be taken into account as a part of the basis of the shopping center and is to be taken into account in determining the depreciation deduction allowed with respect to the shopping center.

The cost of acquiring an interest as a lessee under an existing lease of tangible property is to be taken into account under present law (see section 178 of the Code and Treas. Reg. sec. 1.162–11(a)) rather than under the provisions of the bill.[14] In the case of any interest as a lessee under a lease of tangible property that is acquired with any other intangible property (either in the same transaction or series of related transactions), however, the portion of the total purchase price that is allocable to the interest as a lessee is not to exceed the excess of (1) the present value of the fair market value rent for the use of the tangible property for the term of the lease,[15] over (2) the present value of the rent reasonably ex-

[12] *See Associated Patentees, Inc.*, 4 T.C. 979 (1945); and Rev. Rul. 67–136, 1967–1 C.B. 58.

[13] The bill provides that a sublease is to be treated in the same manner as a lease of the underlying property. Thus, the term "section 197 intangible" does not include any interest as a sublessor or sublessee of tangible property.

[14] The lease of a gate at an airport for the purpose of loading and unloading passengers and cargo is a lease of tangible property for this purpose. It is anticipated that such treatment will serve as guidance to the Internal Revenue Service and taxpayers in resolving past disputes.

[15] In no event is the present value of the fair market value rent for the use of the tangible property for the term of the lease to exceed the fair market value of the tangible property as of the date of acquisition. The present value of such rent is presumed to be less than the value of the tangible property if the duration of the lease is less than the economic useful life of the property.

pected to be paid for the use of the tangible property for the term of the lease.

Interests under indebtedness.—The term "section 197 intangible" does not include any interest (whether as a creditor or debtor) under any indebtedness that was in existence on the date that the interest was acquired.[16] Thus, for example, the value of assuming an existing indebtedness with a below-market interest rate is to be taken into account under present law rather than under the bill. In addition, the premium paid for acquiring the right to receive an above-market rate of interest under a debt instrument may be taken into account under section 171 of the Code, which generally allows the amount of the premium to be amortized on a yield-to-maturity basis over the remaining term of the debt instrument. This exception for interests under existing indebtedness does not apply to the deposit base and other similar items of a financial institution.

Professional sports franchises.—The term "section 197 intangible" does not include a franchise to engage in professional baseball, basketball, football, or other professional sport, and any item acquired in connection with such a franchise. Consequently, the cost of acquiring a professional sports franchise and related assets (including any goodwill, going concern value, or other section 197 intangibles) is to be allocated among the assets acquired as provided under present law (see, for example, section 1056 of the Code) and is to be taken into account under the provisions of present law.

Exception for certain self-created intangibles

The bill generally does not apply to any section 197 intangible that is created by the taxpayer if the section 197 intangible is not created in connection with a transaction (or a series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion thereof.

For purposes of this exception, a section 197 intangible that is owned by a taxpayer is to be considered created by the taxpayer if the intangible is produced for the taxpayer by another person under a contract with the taxpayer that is entered into prior to the production of the intangible. For example, a technological process or other know-how that is developed specifically for a taxpayer under an arrangement with another person pursuant to which the taxpayer retains all rights to the process or know-how is to be considered created by the taxpayer.

The exception for "self-created" intangibles does not apply to the entering into (or renewal of) a contract for the use of a section 197 intangible. Thus, for example, the exception does not apply to the capitalized costs incurred by a licensee in connection with the entering into (or renewal of) a contract for the use of know-how or other section 197 intangible. These capitalized costs are to be amortized over the 14-year period specified in the bill.

In addition, the exception for "self-created" intangibles does not apply to: (1) any license, permit, or other right that is granted by a

[16] For purposes of this exception, the term "interest under any existing indebtedness" is to include mortgage servicing rights to the extent that the rights are stripped coupons under section 1286 of the Code. See Rev. Rul. 91-46, 1991-34 I.R.B. 5 (August 26, 1991).

governmental unit or an agency or instrumentality thereof; (2) any covenant not to compete (or other similar arrangement) entered into in connection with the direct or indirect acquisition of an interest in a trade or business (or a substantial portion thereof); and (3) any franchise, trademark, or trade name. Thus, for example, the capitalized costs incurred in connection with the development or registration of a trademark or trade name are to be amortized over the 14-year period specified in the bill.

Special rules

Determination of adjusted basis

The adjusted basis of a section 197 intangible that is acquired from another person generally is to be determined under the principles of present law that apply to tangible property that is acquired from another person. Thus, for example, if a portion of the cost of acquiring an amortizable section 197 intangible is contingent, the adjusted basis of the section 197 intangible is to be increased as of the beginning of the month that the contingent amount is paid or incurred. This additional amount is to be amortized ratably over the remaining months in the 14-year amortization period that applies to the intangible as of the beginning of the month that the contingent amount is paid or incurred.

Treatment of certain dispositions of amortizable section 197 intangibles

Special rules apply if a taxpayer disposes of a section 197 intangible that was acquired in a transaction or series of related transactions and, after the disposition,[17] the taxpayer retains other section 197 intangibles that were acquired in such transaction or series of related transactions.[18] First, no loss is to be recognized by reason of such a disposition. Second, the adjusted bases of the retained section 197 intangibles that were acquired in connection with such transaction or series of related transactions are to be increased by the amount of any loss that is not recognized. The adjusted basis of any such retained section 197 intangible is increased by the product of (1) the amount of the loss that is not recognized solely by reason of this provision, and (2) a fraction, the numerator of which is the adjusted basis of the intangible as of the date of the disposition and the denominator of which is the total adjusted bases of all such retained section 197 intangibles as of the date of the disposition.

For purposes of these rules, all persons treated as a single taxpayer under section 41(f) of the Code are treated as a single taxpay-

[17] For this purpose, the abandonment of a section 197 intangible or any other event that renders a section 197 intangible worthless is to be considered a disposition of a section 197 intangible.

[18] These special rules do not apply to a section 197 intangible that is separately acquired (*i.e.*, a section 197 intangible that is acquired other than in a transaction or a series of related transactions that involve the acquisition of other section 197 intangibles). Consequently, a loss may be recognized upon the disposition of a separately acquired section 197 intangible. In no event, however, is the termination or worthlessness of a portion of a section 197 intangible to be considered the disposition of a separately acquired section 197 intangible. For example, the termination of one or more customers from an acquired customer list or the worthlessness of some information from an acquired data base is not to be considered the disposition of a separately acquired section 197 intangible.

er. Thus, for example, a loss is not to be recognized by a corporation upon the disposition of a section 197 intangible if after the disposition a member of the same controlled group as the corporation retains other section 197 intangibles that were acquired in the same transaction (or a series of related transactions) as the section 197 intangible that was disposed of. It is anticipated that the Treasury Department will provide rules for taking into account the amount of any loss that is not recognized due to this rule (for example, by allowing the corporation that disposed of the section 197 intangible to amortize the loss over the remaining portion of the 14-year amortization period).

Treatment of certain nonrecognition transactions

If any section 197 intangible is acquired in a transaction to which section 332, 351, 361, 721, 731, 1031, or 1033 of the Code applies (or any transaction between members of the same affiliated group during any taxable year for which a consolidated return is filed),[19] the transferee is to be treated as the transferor for purposes of applying this provision with respect to the amount of the adjusted basis of the transferee that does not exceed the adjusted basis of the transferor.

For example, assume that an individual owns an amortizable section 197 intangible that has been amortized under section 197 for 4 full years and has a remaining unamortized basis of $300,000. In addition, assume that the individual exchanges the asset and $100,000 for a like-kind amortizable section 197 intangible in a transaction to which section 1031 applies. Under the bill, $300,000 of the basis of the acquired amortizable section 197 intangible is to be amortized over the 10 years remaining in the original 14-year amortization period for the transferred asset and the other $100,000 of basis is to be amortized over the 14-year period specified in the bill.[20]

Treatment of certain partnership transactions

Generally, consistent with the rules described above for certain nonrecognition transactions, a transaction in which a taxpayer acquires an interest in an intangible held through a partnership (either before or after the transaction) will be treated as an acquisition to which the bill applies only if, and to the extent that, the acquiring taxpayer obtains, as a result of the transaction, an increased basis for such intangible.[21]

For example, assume that A, B, and C each contribute $700 for equal shares in partnership P, which on January 1, 1993, acquires as its sole asset an amortizable section 197 intangible for $2,100. Assume that on January 1, 1997, (1) the sole asset of P is the intangible acquired in 1993, (2) the intangible has an unamortized basis

[19] The termination of a partnership under section 708(b)(1)(B) of the Code is a transaction to which this rule applies. In such a case, the bill applies only to the extent that the adjusted basis of the section 197 intangibles before the termination exceeds the adjusted basis of the section 197 intangibles after the termination. *See* the example below in the discussion of "Treatment of Certain Partnership Transactions."

[20] No inference is intended whether any asset treated as a section 197 intangible under the bill is eligible for like kind exchange treatment.

[21] This discussion is subject to the application of the anti-churning rules which are discussed below.

of $1,500 and A, B, and C each have a basis of $500 in their partnership interests, and (3) D (who is not related to A, B, or C) acquires A's interest in P for $800. Under the bill, if there is no section 754 election in effect for 1997, there will be no change in the basis or amortization of the intangible and D will merely step into the shoes of A with respect to the intangible. D's share of the basis in the intangible will be $500, which will be amortized over the 10 years remaining in the amortization period for the intangible.

On the other hand, if a section 754 election is in effect for 1997, then D will be treated as having an $800 basis for its share of P's intangible. Under section 197, D's share of income and loss will be determined as if P owns two intangible assets. D will be treated as having a basis of $500 in one asset, which will continue to be amortized over the 10 remaining years of the original 14-year life. With respect to the other asset, D will be treated as having a basis of $300 (the amount of step-up obtained by D under section 743 as a result of the section 754 election) which will be amortized over a 14-year period starting with January of 1997. B and C will each continue to share equally in a $1,000 basis in the intangible and amortize that amount over the remaining 10-year life.

As an additional example, assume the same facts as described above, except that D acquires both A's and B's interests in P for $1,600. Under section 708, the transaction is treated as if P is liquidated immediately after the transfer, with C and D each receiving their pro rata share of P's assets which they then immediately contribute to a new partnership. The distributions in liquidation are governed by section 731. Under the bill, C's interest in the intangible will be treated as having a $500 basis, with a remaining amortization period of 10 years. D will be treated as having an interest in two assets: one with a basis of $1,000 and a remaining amortization period of 10 years, and the other with a basis of $600 and a new amortization period of 14 years.

As discussed more fully below, the bill also changes the treatment of payments made in liquidation of the interest of a deceased or retired partner in exchange for goodwill. Except in the case of payments made on the retirement or death of a general partner of a partnership for which capital is not a material income-producing factor, such payments will not be treated as a distribution of partnership income. Under the bill, however, if the partnership makes an election under section 754, section 734 will generally provide the partnership the benefit of a stepped-up basis for the retiring or deceased partner's share of partnership goodwill and an amortization deduction for the increase in basis under section 197.

For example, using the facts from the preceding examples, assume that on January 1, 1997, A retires from the partnership in exchange for a payment from the partnership of $800, all of which is in exchange for A's interest in the intangible asset owned by P. Under the bill, if there is a section 754 election in effect for 1997, P will be treated as having two amortizable section 197 intangibles: one with a basis of $1,500 and a remaining life of 10 years, and the other with a basis of $300 and a new life of 14 years.

Treatment of certain reinsurance transactions

The bill applies to any insurance contract that is acquired from another person through an assumption reinsurance transaction (but not through an indemnity reinsurance transaction).[22] The amount taken into account as the adjusted basis of such a section 197 intangible, however, is to equal the excess of (1) the amount paid or incurred by the acquirer/reinsurer under the assumption reinsurance transaction,[23] over (2) the amount of the specified policy acquisition expenses (as determined under section 848 of the Code) that is attributable to premiums received under the assumption reinsurance transaction. The amount of the specified policy acquisition expenses of an insurance company that is attributable to premiums received under an assumption reinsurance transaction is to be amortized over the period specified in section 848 of the Code.

Treatment of amortizable section 197 intangible as depreciable property

For purposes of chapter 1 of the Internal Revenue Code, an amortizable section 197 intangible is to be treated as property of a character which is subject to the allowance for depreciation provided in section 167. Thus, for example, an amortizable section 197 intangible is not a capital asset for purposes of section 1221 of the Code, but an amortizable section 197 intangible held for more than one year generally qualifies as property used in a trade or business for purposes of section 1231 of the Code. As further examples, an amortizable section 197 intangible is to constitute section 1245 property, and section 1239 of the Code is to apply to any gain recognized upon the sale or exchange of an amortizable section 197 intangible, directly or indirectly, between related persons.

Treatment of certain amounts that are properly taken into account in determining the cost of property that is not a section 197 intangible

The bill does not apply to any amount that is properly taken into account under present law in determining the cost of property that is not a section 197 intangible. Thus, for example, no portion of the cost of acquiring real property that is held for the production of rental income (for example, an office building, apartment building or shopping center) is to be taken into account under the bill (*i.e.*, no goodwill, going concern value or any other section 197 intangible is to arise in connection with the acquisition of such real property). Instead, the entire cost of acquiring such real property is to be included in the basis of the real property and is to be recovered under the principles of present law applicable to such property.

[22] An assumption reinsurance transaction is an arrangement whereby one insurance company (the reinsurer) becomes solely liable to policyholders on contracts transferred by another insurance company (the ceding company). In addition, for purposes of the bill, an assumption reinsurance transaction is to include any acquisition of an insurance contract that is treated as occurring by reason of an election under section 338 of the Code.

[23] The amount paid or incurred by the acquirer/reinsurer under an assumption reinsurance transaction is to be determined under the principles of present law. See Treas. Reg. sec. 1.817-4(d)(2).

Modification of purchase price allocation and reporting rules for certain asset acquisitions

Sections 338(b)(5) and 1060 of the Code authorize the Treasury Department to promulgate regulations that provide for the allocation of purchase price among assets in the case of certain asset acquisitions. Under regulations that have been promulgated pursuant to this authority, the purchase price of an acquired trade or business must be allocated among the assets of the trade or business using the "residual method."

Under the residual method specified in the Treasury regulations, all assets of an acquired trade or business are divided into the following four classes: (1) Class I assets, which generally include cash and cash equivalents; (2) Class II assets, which generally include certificates of deposit, U.S. government securities, readily marketable stock or securities, and foreign currency; (3) Class III assets, which generally include all assets other than those included in Class I, II, or IV (generally all furniture, fixtures, land, buildings, equipment, other tangible property, accounts receivable, covenants not to compete, and other amortizable intangible assets); and (4) Class IV assets, which include intangible assets in the nature of goodwill or going concern value. The purchase price of an acquired trade or business (as first reduced by the amount of the assets included in Class I) is allocated to the assets included in Class II and Class III based on the value of the assets included in each class. To the extent that the purchase price (as reduced by the amount of the assets in Class I) exceeds the value of the assets included in Class II and Class III, the excess is allocable to assets included in Class IV.

It is expected that the present Treasury regulations which provide for the allocation of purchase price in the case of certain asset acquisitions will be amended to reflect the fact that the bill allows an amortization deduction with respect to intangible assets in the nature of goodwill and going concern value. It is anticipated that the residual method specified in the regulations will be modified to treat all amortizable section 197 intangibles as Class IV assets and that this modification will apply to any acquisition of property to which the bill applies.

Section 1060 also authorizes the Treasury Department to require the transferor and transferee in certain asset acquisitions to furnish information to the Treasury Department concerning the amount of any purchase price that is allocable to goodwill or going concern value. The bill provides that the information furnished to the Treasury Department with respect to certain asset acquisitions is to specify the amount of purchase price that is allocable to amortizable section 197 intangibles rather than the amount of purchase price that is allocable to goodwill or going concern value. In addition, it is anticipated that the Treasury Department will exercise its existing regulatory authority to require taxpayers to furnish such additional information as may be necessary or appropriate to carry out the provisions of the bill, including the amount of purchase price that is allocable to intangible assets that are not amortizable section 197 intangibles.

Regulatory authority

The Treasury Department is authorized to prescribe such regulations as may be appropriate to carry out the purposes of the bill including such regulations as may be appropriate to prevent avoidance of the purposes of the bill through related persons or otherwise. It is anticipated that the Treasury Department will exercise its regulatory authority where appropriate to clarify the types of intangible property that constitute section 197 intangibles.

Effective date

In general

The provision generally applies to property acquired after the date of enactment of the bill. As more fully described below, however, a taxpayer may elect to apply the bill to either (1) all property acquired after July 25, 1991, or (2) all property acquired in certain taxable years for which the statute of limitations has not expired. In addition, a taxpayer may elect to apply present law (rather than the provisions of the bill) to property that is acquired after the date of enactment of the bill pursuant to a binding written contract in effect on February 14, 1992. Finally, special "anti-churning" rules may apply to prevent taxpayers from converting existing goodwill, going concern value, or any other section 197 intangible for which a depreciation or amortization deduction would not have been allowable under present law into amortizable property to which the bill applies.

Election to apply bill to property acquired after July 25, 1992

A taxpayer may elect to apply the bill to all property acquired by the taxpayer after July 25, 1991. If a taxpayer makes this election, the bill also applies to all property acquired after July 25, 1991, by any taxpayer that is under common control with the electing taxpayer (within the meaning of subparagraphs (A) and (B) of section 41(f)(1) of the Code) at any time during the period that begins on November 22, 1991, and that ends on the date that the election is made.[24]

The election is to be made at such time and in such manner as may be specified by the Treasury Department,[25] and the election may be revoked only with the consent of the Treasury Department.

Election to apply bill to property acquired during certain open taxable years

A taxpayer may elect to apply the bill to all property acquired by the taxpayer in any taxable year for which the statute of limita-

[24] An amortization deduction is not to be allowed under the bill, however, for goodwill, going concern value, or any other section 197 intangible for which a depreciation or amortization deduction would not be allowable but for the provisions of the bill if: (1) the section 197 intangible is acquired after July 25, 1991; and (2) either (a) the taxpayer or a related person held or used the intangible on July 25, 1991; (b) the taxpayer acquired the intangible from a person that held such intangible on July 25, 1991, and, as part of the transaction, the user of the intangible does not change; or (c) the taxpayer grants the right to use the intangible to a person (or a person related to such person) that held or used the intangible on July 25, 1991. See below for a more detailed description of these "anti-churning" rules.

[25] It is anticipated that the Treasury Department will require the election to be made on the timely filed Federal income tax return of the taxpayer for the taxable year that includes the date of enactment of the bill.

tions for the assessment of tax has not expired as of July 25, 1991 (other than a taxable year that occurs before a taxable year for which the statute of limitations for the assessment of tax has expired as of July 25, 1991).[26] If a taxpayer makes this election, the bill also applies to all property acquired during any such open taxable year of any other taxpayer that is under common control with the electing taxpayer (within the meaning of subparagraphs (A) and (B) of section 41(f)(1) of the Code) at any time during the period that begins on November 22, 1991, and that ends on the date that the election is made.

In the case of any section 197 intangible that was acquired by an electing taxpayer (or a person under common control with the electing taxpayer) on or before the date of enactment of the bill, the adjusted basis of the intangible is to be amortized ratably over a 17-year period that begins with the month that the intangible was acquired.[27] An electing taxpayer (as well a person under common control with an electing taxpayer) is required to pay interest on any deficiency that arises as a result of the election. The Internal Revenue Service, however, is not required to pay interest on any refund that is payable as a result of the election. In addition, the statute of limitations on the assessment of tax and a claim for refund of tax for any open taxable year to which the election applies does not expire any sooner than two years after the date of the election.

The bill also provides a special rule for property that is acquired by certain electing taxpayers in certain taxable years for which the statute of limitations has expired as of July 25, 1991. If (1) an "open taxable year" election applies to a taxpayer, (2) the taxpayer and the Internal Revenue Service have agreed on the treatment of an acquired intangible for a taxable year to which the "open taxable year" election does not apply, and (3) as of February 14, 1992, there was a dispute between the taxpayer and the Internal Revenue Service that arose because the Internal Revenue Service took a position with respect to an open taxable year that was contrary to that specified in the agreement with respect to the treatment of the acquired intangible, then the taxpayer is to be allowed to amortize such intangible in accordance with the agreement between the taxpayer and the Internal Revenue Service.

The "open taxable year" election is to be made at such time and in such manner as may be specified by the Treasury Department,[28]

[26] The statute of limitations for a taxable year is to be treated as expired for purposes of this election if, as of July 25, 1991, the statute of limitations for such taxable year is extended solely with respect to issues that do not involve the proper treatment for Federal income tax purposes of acquired intangibles that are defined as section 197 intangibles under the bill.

[27] An amortization deduction is not to be allowed under the bill, however, for goodwill, going concern value, or any other section 197 intangible for which a depreciation or amortization deduction would not be allowable but for the provisions of the bill if: (1) the section 197 intangible is acquired after July 25, 1991; and (2) either (a) the taxpayer or a related person held or used the intangible on July 25, 1991; (b) the taxpayer acquired the intangible from a person that held such intangible on July 25, 1991, and, as part of the transaction, the user of the intangible did not change; or (c) the taxpayer granted the right to use the intangible to a person (or a person related to such person) that held or used the intangible on July 25, 1991. See below for a more detailed description of these "anti-churning" rules.

[28] It is anticipated that Treasury Department will require the election to be made by the due date of the return for the taxable year that includes the date of enactment of the bill.

and the election may be revoked only with the consent of the Treasury Department.

Elective binding contract exception

A taxpayer may also elect to apply present law (rather than the provisions of the bill) to property that is acquired after the date of enactment of the bill if the property is acquired pursuant to a binding written contract that was in effect on February 14, 1992, and at all times thereafter until the property is acquired. This election may not be made by any taxpayer that is subject to either of the elections described above that apply the provisions of the bill to property acquired before the date of enactment of the bill.

The election is to be made at such time and in such manner as may be specified by the Treasury Department,[29] and the election may be revoked only with the consent of the Treasury Department.

Anti-churning rules

Special rules are provided by the bill to prevent taxpayers from converting existing goodwill, going concern value, or any other section 197 intangible for which a depreciation or amortization deduction would not have been allowable under present law into amortizable property to which the bill applies.

Under these "anti-churning" rules, goodwill, going concern value, or any other section 197 intangible for which a depreciation or amortization deduction would not be allowable but for the provisions of the bill may not be amortized as an amortizable section 197 intangible if: (1) the section 197 intangible is acquired by a taxpayer after the date of enactment of the bill; and (2) either (a) the taxpayer or a related person held or used the intangible at any time during the period that begins on July 25, 1991, and that ends on the date of enactment of the bill; (b) the taxpayer acquired the intangible from a person that held such intangible at any time during the period that begins on July 25, 1991, and that ends on the date of enactment of the bill and, as part of the transaction, the user of the intangible does not change; or (c) the taxpayer grants the right to use the intangible to a person (or a person related to such person) that held or used the intangible at any time during the period that begins on July 25, 1991, and that ends on the date of enactment of the bill. The anti-churning rules, however, do not apply to the acquisition of any intangible by a taxpayer if the basis of the intangible in the hands of the taxpayer is determined under section 1014(a) (relating to property acquired from a decedent).

For purposes of the anti-churning rules, a person is related to another person if: (1) the person bears a relationship to that person which would be specified in section 267(b)(1) or 707(b)(1) of the Code if those sections were amended by substituting 20 percent for 50 percent; or (2) the persons are engaged in trades or businesses under common control (within the meaning of subparagraphs (A) and (B) of section 41(f)(1) of the Code). A person is treated as relat-

[29] It is anticipated that the Treasury Department will require the election to be made on the timely filed Federal income tax return of the taxpayer for the taxable year that includes the date of enactment of the bill.

ed to another person if such relationship exists immediately before or immediately after the acquisition of the intangible involved.

In addition, in determining whether the anti-churning rules apply with respect to any increase in the basis of partnership property under section 732, 734, or 743 of the Code, the determinations are to be made at the partner level and each partner is to be treated as having owned or used the partner's proportionate share of the partnership property. Thus, for example, the anti-churning rules do not apply to any increase in the basis of partnership property that occurs upon the acquisition of an interest in a partnership that has made a section 754 election if the person acquiring the partnership interest is not related to the person selling the partnership interest.[30]

The bill also contains a general anti-abuse rule that applies to any section 197 intangible that is acquired by a taxpayer from another person. Under this rule, a section 197 intangible may not be amortized under the provisions of the bill if the taxpayer acquired the intangible in a transaction one of the principal purposes of which is to (1) avoid the requirement that the intangible be acquired after the date of enactment of the bill or (2) avoid any of the anti-churning rules described above that are applicable to goodwill, going concern value, or any other section 197 intangible for which a depreciation or amortization deduction would not be allowable but for the provisions of the bill.

Finally, the special rules described above that apply in the case of a transactions described in section 332, 351, 361, 721, 731, 1031, or 1033 of the Code also apply for purposes of the effective date. Consequently, if the transferor of any section 197 property is not allowed an amortization deduction with respect to such property under this provision, then the transferee is not allowed an amortization deduction under this provision to the extent of the adjusted basis of the transferee that does not exceed the adjusted basis of the transferor. In addition, this provision is to apply to any subsequent transfers of any such property in a transaction described in section 332, 351, 361, 721, 731, 1031, or 1033.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

[30] In addition to these rules, it is anticipated that rules similar to the anti-churning rules under section 168 of the Code will apply in determining whether persons are related. *See* Prop. Treas. Reg. 1.168-4 (February 16, 1984). For example, it is anticipated that a corporation, partnership, or trust that owned or used property at any time during the period that begins on July 25, 1991, and that ends on the date of enactment of the bill and that is no longer in existence will be considered to be in existence for purposes of determining whether the taxpayer that acquired the property is related to such corporation, partnership, or trust.

As a further example, it is anticipated that in the case of a transaction to which section 338 of the Code applies, the corporation that is treated as selling its assets will not to be considered related to the corporation that is treated as purchasing the assets if at least 80 percent of the stock of the corporation that is treated as selling its assets is acquired by purchase after July 25, 1991.

2. MODIFY SPECIAL TREATMENT OF CERTAIN LIQUIDATION PAYMENTS

Present law

Payments for purchase of goodwill and accounts receivable

A current deduction generally is not allowed for a capital expenditure (*i.e.*, an expenditure that yields benefits beyond the current taxable year). The cost of goodwill acquired in connection with the assets of a going concern normally is a capital expenditure, as is the cost of acquiring accounts receivable. The cost of acquiring goodwill is recovered only when the goodwill is disposed of, while the cost of acquiring accounts receivable is taken into account only when the receivable is disposed of or becomes worthless.

Payments made in liquidation of partnership interest

The tax treatment of a payment made in liquidation of the interest of a retiring or deceased partner depends upon whether the payment is made in exchange for the partner's interest in partnership property. A liquidating payment made in exchange for such property is treated as a distribution by the partnership (sec. 736(b)). Such distribution generally results in gain to the retiring partner only to the extent that the cash distributed exceeds the partner's adjusted basis in his partnership interest.

A liquidating payment not made in exchange for the partner's interest in partnership property receives either of two possible treatments. If the amount of the payment is determined without reference to partnership income, it is treated as a guaranteed payment and is generally deductible (sec. 736(a)(2)). If the amount of payment is determined by reference to partnership income, the payment is treated as a distributive share of partnership income, thereby reducing the distributive shares of other partners (which is equivalent to a deduction) (sec. 736(a)(2)).

A special rule treats amounts paid for goodwill of the partnership (except to the extent provided in the partnership agreement) and unrealized receivables as not made in exchange for an interest in partnership property (sec. 736(b)(2)(B)). Thus, such amounts may be deductible. Unrealized receivables include unbilled amounts, accounts receivable, depreciation recapture, market discount, and certain other items (sec. 751(c)).

Sale or exchange of a partnership interest

The sale or exchange of a partnership interest results in capital gain or loss to the transferor partner, except to the extent that ordinary income or loss is recognized with respect to the partner's share of the partnership's unrealized receivables and substantially appreciated inventory items (sec. 741). It is often unclear whether a payment by a partnership to a retiring partner is made in sale or exchange of, or in liquidation of, a partnership interest.

House bill

In general

The House bill generally repeals the special treatment of liquidation payments made for goodwill and unrealized receivables. Thus, such payments would be treated as made in exchange for the partner's interest in partnership property, and not as a distributive share or guaranteed payment that could give rise to a deduction or its equivalent. The House bill does not change present law with respect to payments made to a general partner in a partnership in which capital is not a material income-producing factor.[31] In addition, the House bill does not affect the deductibility of compensation paid to a retiring partner for past services.

Unrealized receivables

The House bill also repeals the special treatment of payments made for unrealized receivables (other than unbilled amounts and accounts receivable) for all partners. Such amounts would be treated as made in exchange for the partner's interest in partnership property. Thus, for example, a payment for depreciation recapture would be treated as made in exchange for an interest in partnership property, and not as a distributive share or guaranteed payment that could give rise to a deduction or its equivalent.

Effective date

The provision generally applies to partners retiring or dying after February 14, 1992. The provision does not apply to any partner who retires after February 14, 1992, if a written contract to purchase the partner's interest in the partnership was binding on February 14, 1992, and at all times thereafter until such purchase. For this purpose, a written contract is to be considered binding only if the contract specifies the amount to be paid for the partnership interest and the timing of any such payments.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

F. Provisions Relating to Subchapter S Corporations

1. DETERMINATION OF WHETHER AN S CORPORATION HAS ONE CLASS OF STOCK

Present law

Under present law, a small business corporation eligible to be an S corporation may not have more than one class of stock. Differences in voting rights are disregarded in determining whether a corporation has more than one class of stock. In addition, certain debt instruments may not be treated as a second class of stock for purposes of this rule.

On October 5, 1990, the Treasury Department issued proposed regulations [1] providing that a corporation has more than one class

[31] The determination of whether capital is a material income-producing factor would be made under principles of present and prior law (*e.g.*, sections 401(c)(2) and 911(d) of the Code and old section 1348(b)(1)(A) of the Code).

[1] Proposed Treasury Regulation sec. 1.1361-1(l)(2).

of stock if all of the outstanding shares of stock do not confer identical rights to distribution and liquidation proceeds, regardless of whether any differences in rights occur pursuant to the corporate charter, articles or bylaws, by operation of State law, by administrative action, or by agreement. The proposed regulations also provided that, notwithstanding that all outstanding shares of stock confer identical rights to distribution and liquidation proceeds, a corporation has more than one class of stock if the corporation makes non-conforming distributions (i.e., distributions that differ with respect to timing or amount with respect to each share of stock), with limited exceptions for certain redemptions and certain differences in the timing of distributions. The proposed regulations were to apply to taxable years beginning after December 31, 1982.

On August 8, 1991, the Treasury Department issued revised proposed regulations replacing the proposed regulations described above. The revised proposed regulations provide that a corporation is treated as having only one class of stock if all outstanding shares of stock confer identical rights to distribution and liquidation proceeds. Under the revised proposed regulations, any distributions that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances. These proposed regulations generally apply to taxable years beginning after December 31, 1991.

House bill

The House bill provides that a corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds. Applicable State law, taking into account legally enforceable rights under the corporate charter, articles or bylaws, administrative action, and agreements relating to distributions or liquidation proceeds with respect to shares, determines whether the outstanding shares confer different rights to distributions or liquidation proceeds.

Where an S corporation in fact makes distributions which differ as to timing or amount, the bill in no way limits the Internal Revenue Service from properly characterizing the transaction for tax purposes. For example, if a distribution is properly characterized as compensation, the Service could require it to be so treated for tax purposes. Similarly, if a payment appearing as compensation should be properly characterized as a distribution, the Service could require it to be so treated for purposes of computing taxable income.

Effective date.—The provision applies to taxable years beginning after December 31, 1982.

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. AUTHORITY TO VALIDATE CERTAIN INVALID ELECTIONS

Present law

Under present law, if the Internal Revenue Service determines that a corporation's Subchapter S election is inadvertently terminated, the Service can waive the effect of the terminating event for any period if the corporation timely corrects the event and if the corporation and shareholders agree to be treated as if the election had been in effect for that period. Present law does not grant the Internal Revenue Service the ability to waive the effect of an inadvertent invalid Subchapter S election.

In addition, under present law, a small business corporation must elect to be an S corporation no later than the 15th day of the third month of the taxable year for which the election is effective. The Internal Revenue Service may not validate a late election.

House bill

Under the House bill, the authority of the Internal Revenue Service to waive the effect of an inadvertent termination is extended to allow the Service to waive the effect of an invalid election caused by an inadvertent failure to qualify as a small business corporation or to obtain the required shareholder consents (including elections regarding qualified subchapter S trusts), or both.

The bill also allows the Internal Revenue Service to treat a late Subchapter S election as timely where the Service determines that there was reasonable cause for the failure to make the election timely.

Effective date.—The provision applies to taxable years beginning after December 31, 1982.

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. TREATMENT OF DISTRIBUTIONS BY S CORPORATIONS DURING LOSS YEAR

Present law

Under present law, the amount of loss an S corporation shareholder may take into account for a taxable year cannot exceed the sum of shareholder's adjusted basis in his or her stock of the corporation and the adjusted basis in any indebtedness of the corporation to the shareholder. Any excess loss is carried forward.

Any distribution to a shareholder by an S corporation generally is tax-free to the shareholder to the extent of the shareholder's adjusted basis of his or her stock. The shareholder's adjusted basis is reduced by the tax-free amount of the distribution. Any distribution in excess of the shareholder's adjusted basis is treated as gain from the sale or exchange of the stock.

Under present law, income (whether or not taxable) and expenses (whether or not deductible) serve, respectively, to increase and decrease an S corporation shareholder's basis in the stock of the corporation. These rules appear to require that the adjustments to basis for items of both income and loss for any taxable year apply before the adjustment for distributions applies.[2]

These rules limiting losses and allowing tax-free distributions up to the amount of the shareholder's adjusted basis are similar in certain respects to the rules governing the treatment of losses and cash distributions by partnerships. Under the partnership rules (unlike the S corporation rules), for any taxable year, a partner's basis is first increased by items of income, then decreased by distributions, and finally is decreased by losses for that year.[3]

In addition, if the S corporation has accumulated earnings and profits,[4] any distribution in excess of the amount in an "accumulated adjustments account" will be treated as a dividend (to the extent of the accumulated earnings and profits). A dividend distribution does not reduce the adjusted basis of the shareholder's stock. The "accumulated adjustments account" generally is the amount of the accumulated undistributed post-1982 gross income less deductions.

House bill

The House bill provides that the adjustments for distributions made by an S corporation during a taxable year are taken into account before applying the loss limitation for the year. Thus, distributions during a year reduce the adjusted basis for purposes of determining the allowable loss for the year, but the loss for a year does not reduce the adjusted basis for purposes of determining the tax status of the distributions made during that year.

The bill also provides that in determining the amount in the accumulated adjustment account for purposes of determining the tax treatment of distributions made during a taxable year by an S corporation having accumulated earnings and profits, net negative adjustments (i.e., the excess of losses and deductions over income) for that taxable year are disregarded.

The following examples illustrate the application of these provisions:

Example 1.—X is the sole shareholder of A, a calendar year S corporation with no accumulated earnings and profits. X's adjusted basis in the stock of A on January 1, 1992, is $1,000 and X holds no debt of A. During the taxable year, A makes a distribution to X of $600, recognizes a capital gain of $200 and sustains an operating loss of $900. Under the bill, X's adjusted basis in the A stock is increased to $1,200 ($1,000 plus $200 capital gain recognized) pursuant to section 1368(d) to determine the effect of the distribution. X's adjusted basis is then reduced by the amount of the distribution to $600 ($1,200 less $600) to determine the application of the loss limitation of section 1366(d)(1). X is allowed to take into ac-

[2] *See* section 1366(d)(1)(A); H. Rep. 97-826, p. 17; S. Rep. 97-640, p. 18.

[3] Treas. Reg. sec. 1.704-1(d)(2); Rev. Rul. 66-94, 1966-1 C.B. 166.

[4] An S corporation may have earnings and profits from years prior to its subchapter S election or from pre-1983 subchapter S years.

count $600 of A's operating loss, which reduces X's adjusted basis to zero. The remaining $300 loss is carried forward pursuant to section 1366(d)(2).

Example 2.—The facts are the same as in Example 1, except that on January 1, 1992, A has accumulated earnings and profits of $500 and an accumulated adjustments account of $200. Under the bill, because there is a net negative adjustment for the year, no adjustment is made to the accumulated adjustments account before determining the effect of the distribution under section 1368(c).

As to A, $200 of the $600 distribution is a distribution of A's accumulated adjustments account, reducing the accumulated adjustments account to zero. The remaining $400 of the distribution is a distribution of accumulated earnings and profits ("E&P") and reduces A's E&P to $100. A's accumulated adjustments account is then increased by $200 to reflect the recognized capital gain and reduced by $900 to reflect the operating loss, leaving a negative balance in the accumulated adjustment account on January 1, 1993, of $700 (zero plus $200 less $900).

As to X, $200 of the distribution is applied against A's adjusted basis of $1,200 ($1,000 plus $200 capital gain recognized), reducing X's adjusted basis to $1,000. The remaining $400 of the distribution is taxable as a dividend and does not reduce X's adjusted basis. Because X's adjusted basis is $1,000, the loss limitation does not apply to X, who may deduct the entire $900 operating loss. X's adjusted basis is then decreased to reflect the $900 operating loss. Accordingly, X's adjusted basis on January 1, 1993, is $100 ($1,000 plus $200 less $200 less $900).

Effective date.—These provisions apply to distributions made in taxable years beginning after December 31, 1991.

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.

4. TREATMENT OF S CORPORATIONS AS SHAREHOLDERS IN C CORPORATIONS

Present law

Present law contains several provisions relating to the treatment of S corporations as corporations generally for purposes of the Internal Revenue Code.

First, under present law, the taxable income of an S corporation is computed in the same manner as in the case of an individual (sec. 1363(b)). Under this rule, the provisions of the Code governing the computation of taxable income which are applicable only to corporations, such as the dividends received deduction, do not apply to S corporations.

Second, except as otherwise provided by the Internal Revenue Code and except to the extent inconsistent with subchapter S, subchapter C (i.e., the rules relating to corporate distributions and adjustments) applies to an S corporation and its shareholders (sec. 1371(a)(1)). Under this second rule, provisions such as the corporate reorganization provisions apply to S corporations. Thus, a C corporation may merge into an S corporation tax-free.

Finally, an S corporation in its capacity as a shareholder of another corporation is treated as an individual for purposes of subchapter C (sec. 1371(a)(2)). The Internal Revenue Service has taken the position that this rule prevents the tax-free liquidation of a C corporation into an S corporation because a C corporation cannot liquidate tax-free when owned by an individual shareholder.[5] Thus, a C corporation may elect S corporation status tax-free or may merge into an S corporation tax-free, but may not liquidate into an S corporation tax-free.[6] Also, the Service's reasoning would also prevent an S corporation from making an election under section 338 where a C corporation was acquired by an S corporation.

House bill

The House bill repeals the rule that treats an S corporation in its capacity as a shareholder of another corporation as an individual. Thus, the liquidation of a C corporation into an S corporation will be governed by the generally applicable subchapter C rules, including the provisions of sections 332 and 337 allowing the tax-free liquidation of a corporation into its parent corporation. Following a tax-free liquidation, the built-in gains of the liquidating corporation may later be subject to tax under section 1374 upon a subsequent disposition. An S corporation will also be eligible to make a section 338 election (assuming all the requirements are otherwise met), resulting in immediate recognition of all the acquired C corporation's gains and losses (and the resulting imposition of a tax).

The repeal of this rule does not change the general rule governing the computation of income of an S corporation. For example, it does not allow an S corporation, or its shareholders, to claim a dividends received deduction with respect to dividends received by the S corporation, or to treat any item of income or deduction in a manner inconsistent with the treatment accorded to individual taxpayers.

No inference is intended regarding the present-law treatment of these transactions.

Effective date.—The provision applies to taxable years beginning after December 31, 1991.

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] *See* PLR 8818049, (Feb. 10, 1988).

[6] A tax is imposed with respect to LIFO inventory held by a C corporation becoming an S corporation.

5. S CORPORATIONS PERMITTED TO HOLD SUBSIDIARIES

Present law

Under present law, an S corporation may not be a member of an affiliated group of corporations (other than by reason of ownership in certain inactive corporations). The legislative history indicates that this rule was adopted to prevent the filing of consolidated returns by a group which includes an S corporation.[7]

House bill

The House bill repeals the rule that an S corporation may not be a member of an affiliated group of corporations. Thus, an S corporation will be allowed to own up to 100 percent of the stock of a C corporation. However, an S corporation cannot be included in a group filing a consolidated return.

Under the bill, if an S corporation holds 100 percent of the stock of a C corporation that, in turn, holds 100 percent of the stock of another C corporation, the two C corporations may elect to file a consolidated return (if otherwise eligible), but the S corporation may not join in the election.

Effective date.—The provision applies to taxable years beginning after December 31, 1991.

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. ELIMINATION OF PRE-1983 EARNINGS AND PROFITS OF S CORPORATIONS

Present law

Under present law, the accumulated earnings and profits of a corporation are not increased for any year in which an election to be treated as an S corporation is in effect. However, under the subchapter S rules in effect before revision in 1982, a corporation electing subchapter S for a taxable year increased its accumulated earnings and profits if its earnings and profits for the year exceeded both its taxable income for the year and its distributions out of that year's earnings and profits. As a result of this rule, a shareholder may later be required to include in his income the accumulated earnings and profits when it is distributed by the corporation. The 1982 revision to subchapter S repealed this rule for earnings attributable to taxable years beginning after 1982 but did not do so for previously accumulated S corporation earnings and profits.

[7] *See* S. Rpt. No. 1983 (85th Cong., 2d Sess., 1958), p. 88.

House bill

The House bill provides that if a corporation is an S corporation for its first taxable year beginning after December 31, 1991, the accumulated earnings and profits of the corporation as of the beginning of that year are reduced by the accumulated earnings and profits (if any) accumulated in any taxable year beginning before January 1, 1983, for which the corporation was an electing small business corporation under subchapter S. Thus, such a corporation's accumulated earnings and profits will be solely attributable to taxable years for which an S election was not in effect. This rule is generally consistent with the change adopted in 1982 limiting the S shareholder's taxable income attributable to S corporation earnings to his share of the taxable income of the S corporation.

Effective date.—The provision applies to taxable years beginning after December 31, 1991.

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. TREATMENT OF ITEMS OF INCOME IN RESPECT OF A DECEDENT HELD BY AN S CORPORATION

Present law

Income in respect of a decedent (IRD) generally consists of items of gross income that accrued during the decedent's lifetime but were not yet includible in the decedent's income before his death under his method of accounting. IRD is includible in the income of the person acquiring the right to receive such item. A deduction for the estate tax attributable to an item of IRD is allowed to the person who includes the item in gross income (sec. 691(c)).

The cost or basis of property acquired from a decedent is its fair market value at the date of death (or alternate valuation date if that date is elected for estate tax purposes). This basis often is referred to as a "stepped-up basis". Property that constitutes a right to receive IRD does not receive a stepped-up basis.

The basis of a partnership interest or corporate stock acquired from a decedent generally is stepped-up at death. Under Treasury regulations, the basis of a partnership interest acquired from a decedent is reduced to the extent that its value is attributable to items constituting IRD.[8] Although S corporation income is included in the income of the shareholders in a manner similar to the inclusion of partnership income in the income of the partners, no comparable regulation provides for a reduction in the basis of stock of an S corporation acquired from a decedent where the S corporation holds items of IRD on the date of death of a shareholder. Thus,

[8] Treas. Reg. sec. 1.742-1.

under present law, the treatment of an item of IRD held by an S corporation is unclear.

House bill

The House bill provides that a person acquiring stock in an S corporation from a decedent will treat as IRD his pro rata share of any item of income of the corporation which would have been IRD if that item had been acquired directly from the decedent. Where an item is treated as IRD, a deduction for the estate tax attributable to the item generally will be allowed under the provisions of section 691(c). The stepped-up basis in the stock will be reduced by the extent to which the value of the stock is attributable to items consisting of IRD. This basis rule is comparable to the present-law partnership rule.

No inference is intended regarding the present-law treatment of IRD in the case of S corporations.

Effective date.—The provision applies with respect to decedents dying after date of enactment of 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.

G. Accounting Provisions

1. MODIFICATIONS TO THE LOOK-BACK METHOD FOR LONG-TERM CONTRACTS

Present law

Taxpayers engaged in the production of property under a long-term contract generally must compute income from the contract under the percentage of completion method. Under the percentage of completion method, a taxpayer must include in gross income for any taxable year an amount that is based on the product of (1) the gross contract price and (2) the percentage of the contract completed as of the end of the year. The percentage of the contract completed as of the end of the year is determined by comparing costs incurred with respect to the contract as of the end of the year with the estimated total contract costs.

Because the percentage of completion method relies upon estimated, rather than actual, contract price and costs to determine gross income for any taxable year, a "look-back method" is applied in the year a contract is completed in order to compensate the taxpayer (or the Internal Revenue Service) for the acceleration (or deferral) of taxes paid over the contract term. The first step of the look-back method is to reapply the percentage of completion method using actual contract price and costs rather than estimated contract price and costs. The second step generally requires the taxpayer to recompute its tax liability for each year of the contract using gross income as reallocated under the look-back method. If there is any difference between the recomputed tax liability and the tax liability as previously determined for a year, such difference is treated as a hypothetical underpayment or overpayment of tax to which the taxpayer applies a rate of interest equal to the overpayment rate, compounded daily.[1] The taxpayer receives (or pays) interest if the net amount of interest applicable to hypothetical overpayments exceeds (or is less than) the amount of interest applicable to hypothetical underpayments.

The look-back method must be reapplied for any item of income or cost that is properly taken into account after the completion of the contract.

The look-back method does not apply to any contract that is completed within two taxable years of the contract commencement date and if the gross contract price does not exceed the lesser of (1) $1 million or (2) one percent of the average gross receipts of the taxpayer for the preceding three taxable years. In addition, a simplified look-back method is available to certain pass-through entities and, pursuant to Treasury regulations, to certain other taxpayers. Under the simplified look-back method, the hypothetical underpayment or overpayment of tax for a contract year generally is determined by applying the highest rate of tax applicable to such taxpayer to the change in gross income as recomputed under the look-back method.

House bill

Election not to apply the look-back method for de minimis amounts

The House bill provides that a taxpayer may elect not to apply the look-back method with respect to a long-term contract if for each prior contract year, the cumulative taxable income (or loss) under the contract as determined using estimated contract price and costs is within 10 percent of the cumulative taxable income (or loss) as determined using actual contract price and costs.

Thus, under the election, upon completion of a long-term contract, a taxpayer would be required to apply the first step of the look-back method (the reallocation of gross income using actual, rather than estimated, contract price and costs), but would not be required to apply the additional steps of the look-back method if the application of the first step resulted in de minimis changes to the amount of income previously taken into account for each prior contract year.

The election applies to all long-term contracts completed during the taxable year for which the election is made and to all long-term contracts completed during subsequent taxable years, unless the election is revoked with the consent of the Secretary of the Treasury.

Example 1.—A taxpayer enters into a three-year contract and upon completion of the contract, determines that annual net income under the contract using actual contract price and costs is $100,000, $150,000, and $250,000, respectively, for Years 1, 2, and 3

[1] The overpayment rate equals the applicable Federal short-term rate plus two percentage points. This rate is adjusted quarterly by the IRS. Thus, in applying the look-back method for a contract year, a taxpayer may be required to use five different interest rates.

under the percentage of completion method. An electing taxpayer need not apply the look-back method to the contract if it had reported cumulative net taxable income under the contract using estimated contract price and costs of between $90,000 and $110,000 as of the end of Year 1; and between $225,000 and $275,000 as of the end of Year 2.

Election not to reapply the look-back method

The bill provides that a taxpayer may elect not to reapply the look-back method with respect to a contract if, as of the close of any taxable year after the year the contract is completed, the cumulative taxable income (or loss) under the contract is within 10 percent of the cumulative look-back income (or loss) as of the close of the most recent year in which the look-back method was applied (or would have applied but for the other de minimis exception described above). In applying this rule, amounts that are taken into account after completion of the contract are not discounted.

Thus, an electing taxpayer need not apply or reapply the look-back method if amounts that are taken into account after the completion of the contract are de minimis.

The election applies to all long-term contracts completed during the taxable year for which the election is made and to all long-term contracts completed during subsequent taxable years, unless the election is revoked with the consent of the Secretary of the Treasury.

Example 2.—A taxpayer enters into a three-year contract and reports taxable income of $12,250, $15,000 and $12,750, respectively, for Years 1 through 3 with respect to the contract. Upon completion of the contract, cumulative look-back income with respect to the contract is $40,000, and 10 percent of such amount is $4,000. After the completion of the contract, the taxpayer incurs additional costs of $2,500 in each of the next three succeeding years (Years 4, 5, and 6) with respect to the contract. Under the bill, an electing taxpayer does not reapply the look-back method for Year 4 because the cumulative amount of contract taxable income ($37,500) is within 10 percent of contract look-back income as of the completion of the contract ($40,000). However, the look-back method must be applied for Year 5 because the cumulative amount of contract taxable income ($35,000) is not within 10 percent of contract look-back income as of the completion of the contract ($40,000). Finally, the taxpayer does not reapply the look-back method for Year 6 because the cumulative amount of contract taxable income ($32,500) is within 10 percent of contract look-back income as of the last application of the look-back method ($35,000).

Interest rates used for purposes of the look-back method

The bill provides that for purposes of the look-back method, only one rate of interest is to apply for each accrual period. An accrual period with respect to a taxable year begins on the day after the return due date (determined without regard to extensions) for the taxable year and ends on such return due date for the following taxable year. The applicable rate of interest is the overpayment rate in effect for the calendar quarter in which the accrual period begins.

Effective date

The provisions apply to contracts completed in taxable years ending 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.

2. SIMPLIFIED METHOD FOR APPLYING UNIFORM COST CAPITALIZATION RULES

Present law

In general, the uniform cost capitalization rules require taxpayers that are engaged in the production of real or tangible personal property or in the purchase and holding of property for resale to capitalize or include in inventory the direct costs of the property and the indirect costs that are allocable to the property. In determining whether indirect costs are allocable to production or resale activities, taxpayers are allowed to use various methods so long as the method employed reasonably allocates indirect costs to production and resale activities.

House bill

The House bill authorizes (but does not require) the Treasury Department to issue regulations that allow taxpayers in appropriate circumstances to determine the costs of any administrative, service, or support function or department that are allocable to production or resale activities by multiplying the total amount of costs of any such function or department by a fraction, the numerator of which is the amount of costs of the function or department that was allocable to production or resale activities for a base period and the denominator of which is the total amount of costs of the function or department for the base period. It is anticipated that the regulations will provide that the base period is to begin no earlier than 4 taxable years prior to the taxable year with respect to which this simplified method applies.

Effective date

The provision applies to taxable years beginning after the date of enactment of the bill. Thus, the regulations may permit the use of the simplified method for taxable years beginning after this date. The simplified method, however, may not be used for any taxable year that begins prior to the date that the Treasury Department publishes regulations that authorize the use of the simplified method and set forth the requirements that must be satisfied in order for the method to be used.

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.

H. Provisions Relating to Regulated Investment Companies

1. REPEAL THE SHORT-SHORT TEST FOR REGULATED INVESTMENT COMPANIES

Present law

A regulated investment company ("RIC") generally is treated as a conduit for Federal income tax purposes. The Code provides conduit treatment by permitting a RIC to deduct dividends paid to its shareholders in computing its taxable income.

A RIC is a domestic corporation that, at all times during the taxable year, is registered under the Investment Company Act of 1940 as a management company or as a unit investment trust, or has elected to be treated as a business development company under that Act (sec. 851(a)).

In addition, to qualify as a RIC, a corporation must elect such status and must satisfy certain tests (sec. 851(b)). In particular, a corporation must derive less than 30 percent of its gross income from the sale or disposition of certain investments (including stock, securities, options, futures, and forward contracts) held less than 3 months (the "short-short test") (sec. 851(b)(3)).

House bill

The House bill repeals the short-short test.

Effective date.—The provision is effective for taxable years ending after the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

2. REQUIRE BROKERS AND MUTUAL FUNDS TO REPORT BASIS TO CUSTOMERS

Present law

Information returns

Brokers [1] are required to report to the Internal Revenue Service the gross proceeds from sales and exchanges by customers (sec. 6045(a)). Brokers also must give each customer a written statement

[1] Under section 6045, "broker" is defined to include dealers, barter exchanges, and any other person who, for a consideration, regularly acts as a middleman with respect to property or services. Under the regulations, the term is defined to include mutual funds that deal directly with customers (i.e., mutual funds that stand ready to redeem their shares). The term "broker" has this meaning for purposes of this section.

containing that information by January 31 of the year following the calendar year the transaction occurred (sec. 6045(b)).[2]

Gain or loss from the sale of mutual fund shares

A taxpayer who sells or exchanges mutual fund shares is required to report the gain or loss along with any other capital gains or losses. A taxable sale or exchange includes a direct redemption or sale, a check written on a fund, or exchanges from one fund into another fund.

The amount of gain or loss is the difference between the amount the taxpayer realized from the sale or exchange and the taxpayer's adjusted basis in the shares (sec. 1001). In general, the amount a taxpayer realizes from a sale or exchange of shares is the money and value of any property received for the shares minus expenses (such as sales commissions, sales charges, or exit fees). A taxpayer's adjusted basis generally is his original cost (including any sales charges or "load") or other basis adjusted for such things as wash sales and return of capital distributions.

A taxpayer who sells any of his shares may choose one of three methods to determine the adjusted basis of the shares that were sold (Treas. Reg. secs. 1.1012–1(c) and (e)):

(1) the first-in, first-out (FIFO) method which requires the taxpayer to assume that the first shares sold were the first ones purchased by the taxpayer;

(2) the specific identification method which permits the taxpayer to identify exactly which shares were sold—but the method is available only if, at the time of sale, the taxpayer specified to the broker the particular shares to be sold and the broker confirms such specification in a written document within a reasonable time after the sale; or

(3) the average cost method which permits the taxpayer to calculate his gain or loss based on the average price he paid for his shares. The average cost method may be determined either by the single category method (which uses the average cost of all of the taxpayer's shares and determines the holding period for the shares that are sold on a first-in first-out basis) or the double category method (which separates the taxpayer's shares into long-term and short-term holdings and provides a separate average cost for each category). A taxpayer may elect the average cost method by attaching a statement to his return. Once the taxpayer elects the average cost method, the taxpayer must use that method for all of his accounts in that fund.

House bill

Information returns

In general.—The House bill requires brokers that are currently required to report gross proceeds on sales or exchanges of mutual fund shares to report basis and holding-period information on the

[2] Brokers are required to use Form 1099–B, Statement for Recipients of Proceeds From Broker and Barter Exchange Transactions (or an IRS-authorized substitute) for these reporting purposes.

same information return. Those brokers that are not currently required to report gross proceeds, such as money market mutual funds, are not required by the bill to report basis information.

Required basis information.—For each sale or exchange, a broker is required to report the basis of the shares that have been sold and the portion of the gross proceeds for the shares that have been held for more than 1 year. Basis is determined using the single-category average cost basis method (and not the double-category). The bill also provides the Secretary of the Treasury authority to determine the manner in which basis and holding period are to be reported. Such authority includes the authority to require brokers to take into account wash sales, return of capital distributions, and other events that might affect a basis calculation.

Multiple accounts.—The bill requires the basis calculation to be done on an account-by-account basis. If an individual holds shares in two separate accounts with a mutual fund, then a separate basis calculation must be done for each account. In addition, if a customer holds shares in two mutual funds through a securities broker (rather than directly through the mutual funds themselves), the shares for each mutual fund (i.e., for each position) must be considered separate accounts for purposes of these rules.

Due date of returns.—Under the bill, information returns are required to be sent to shareholders by January 31, which is, under present law, the same date by which the information returns for gross proceeds must be provided to taxpayers. The bill contemplates that amended basis information returns may be necessary in certain cases (such as certain wash sales).

Treasury is authorized to promulgate regulations to require a transfer of information between brokers (including RICs) where the transfer is necessary to comply with the reporting requirements of this section. For example, if a broker holds shares in a mutual fund as a nominee for another person and the shares are transferred to another broker, the old broker would be required to furnish the new broker the information necessary for the new broker to meet the information-reporting requirements.

Gain or loss from the sale of mutual fund shares

The House bill generally requires a taxpayer to calculate basis and adjustments to basis as under present law. However, unless a taxpayer elects otherwise, a taxpayer must determine basis for mutual fund shares by using the single-category average basis of all of the shares of the account from which a sale or exchange was made (which generally is the amount required to be reported by the broker).

Under the bill, a taxpayer can elect a method other than the single-category average basis (i.e., FIFO or specific identification) if he made such an election on his return for the first taxable year in which a sale from the account occurs (and he satisfied present law requirements). In addition, under the bill, a taxpayer can elect different methods for different accounts in the same fund.

Effective date.—The provision is effective for mutual fund shares held in accounts opened on or after January 1, 1994. For example, if prior to the effective date a taxpayer holds shares in mutual fund B in an account maintained by a securities broker and holds shares in mutual fund F directly from the fund, additions to either of those positions after January 1, 1994, would not trigger the basis reporting requirement. If, however, after January 1, 1994, the taxpayer purchased shares in mutual fund F through the securities broker, or through a new account opened with mutual fund F, a new position would have been opened and basis reporting would be required on that new position.

The provision is not applicable, however, to shares in an account that includes shares not acquired by purchase. Thus, the provision does not apply to shares in an account opened after January 1, 1994, that includes shares that had been acquired by gift. The basis in such shares is determined as under present law.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with a modification that a broker is required to report the portion of the gross proceeds for the shares that have been sold that have been held for more than 2 years (rather than for more than 1 year). The conferees expect that the Internal Revenue Service will consult with representatives of the industries affected by the basis reporting provision to develop the regulations necessary to implement the provision.

3. PERMIT COMMON TRUST FUNDS TO CONVERT TO REGULATED INVESTMENT COMPANIES WITHOUT TAXATION

Present law

A common trust fund is a fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, guardian, or custodian of certain accounts and in conformity with rules and regulations of the Board of Governors of the Federal Reserve System or the Comptroller of the Currency pertaining to the collective investment of trust funds by national banks (sec. 584(a)).

The common trust fund of a bank is not subject to tax and is not treated as a corporation (sec. 584(b)). Each participant in a common trust fund includes his proportional share of common trust fund income, whether or not the income is distributed or distributable (sec. 584(c)).

No gain or loss is realized by the fund upon admission or withdrawal of a participant. Participants generally treat their admission to the fund as the purchase of such interest. Withdrawals from the fund generally are treated as the sale of such interest by the participant (sec. 584(e)).

A regulated investment company (RIC) also is treated as a conduit for Federal income tax purposes. Present law is unclear as to the tax consequences when a common trust fund transfers its assets, or converts its status, to a RIC.

House bill

In general, the House bill permits a common trust fund to transfer substantially all of its assets to a RIC without gain or loss being recognized by the fund or its participants. The fund must transfer its assets to the RIC solely in exchange for shares of the RIC, and the fund must then distribute the RIC shares to the fund's participants in exchange for the participant's interests in the fund.

The basis of any asset that is received by the RIC will be the basis of the asset in the hands of the fund prior to transfer. In addition, the basis of any RIC shares that are received by a fund participant will be the participant's basis in the interests exchanged. If the interests exchanged have different bases, then the RIC shares received by the participant will have different bases.

The tax-free transfer is not available to a common trust fund with assets that are not diversified. This rule assures that a fund participant will not change the nature of his investment without recognizing gain.

Effective date.—The provision is effective for transfers after the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

I. Tax-Exempt Bond Provisions

Overview

Interest on State and local government bonds generally is excluded from gross income for purposes of the regular individual and corporate income taxes if the proceeds of the bonds are used to finance direct activities of these governmental units (sec. 103).

Unlike the interest on governmental bonds, described above, interest on private activity bonds generally is taxable. A private activity bond is a bond issued by a State or local governmental unit acting as a conduit to provide financing for private parties in a manner violating either (a) a private business use and payment test or (b) a private loan restriction. However, interest on private activity bonds is not taxable if (a) the financed activity is specified in the Code and (b) at least 95 percent of the net proceeds of the bond issue is used to finance the specified activity.

Issuers of State and local government bonds must satisfy numerous other requirements, including arbitrage restrictions (for all such bonds) and annual State volume limitations (for most private activity bonds) for the interest on their bonds to be excluded from gross income.

1. SIMPLIFICATION OF ARBITRAGE REBATE REQUIREMENT FOR GOVERNMENTAL BONDS

Present law

Subject to limited exceptions, arbitrage profits from investing bond proceeds in investments unrelated to the governmental purpose of the borrowing must be rebated to the Federal Government. No rebate is required if the gross proceeds of an issue are spent for the governmental purpose of the borrowing within six months after issuance.

This six-month exception is deemed to be satisfied by issuers of governmental bonds (other than tax and revenue anticipation notes) and qualified 501(c)(3) bonds if (1) all proceeds other than an amount not exceeding the lesser of five percent or $100,000 are so spent within six months and (2) the remaining proceeds are spent within one year after the bonds are issued.

House bill

The $100,000 limit on proceeds that may remain unspent after six months for certain governmental and qualified 501(c)(3) bonds otherwise exempt from the rebate requirement is deleted. Thus, if at least 95 percent of the proceeds of these bonds is spent within six months after their issuance, and the remainder is spent within one year, the six-month exception is deemed to be satisfied.

Effective date.—This provision applies to bonds issued 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.

2. SIMPLIFICATION OF COMPLIANCE WITH 24-MONTH ARBITRAGE REBATE EXCEPTION FOR CONSTRUCTION BONDS

Present law

In general, arbitrage profits from investing bond proceeds in investments unrelated to the governmental purpose of the borrowing must be rebated to the Federal Government. An exception is provided for certain construction bond issues if the bonds are governmental bonds, qualified 501(c)(3) bonds, or exempt-facility private activity bonds for governmentally owned property.

This exception is satisfied only if the available construction proceeds of the issue are spent at least at specified rates during the 24-month period after the bonds are issued. The exception does not apply to bond proceeds invested after the 24-month expenditure period as part of a reasonably required reserve or replacement fund, a bona fide debt service fund, or to certain other investments (e.g., sinking funds). Issuers of these construction bonds also may elect to comply with a penalty regime in lieu of rebating if they fail to satisfy the exception's spending requirements.

House bill

The House bill exempts earnings on bond proceeds invested in bona fide debt service funds from the arbitrage rebate requirement and the penalty requirement of the 24-month exception if the spending requirements of that exception are otherwise satisfied.

Effective date.—This provision applies to bonds issued 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.

3. AUTOMATIC EXTENSION OF INITIAL TEMPORARY PERIOD FOR CERTAIN CONSTRUCTION BONDS

Present law

Issuers of all tax-exempt bonds generally are subject to two sets of arbitrage restrictions with respect to investment of their bond proceeds. First, a yield restriction requirement provides that tax-exempt bond proceeds generally may not be invested at a yield materially higher (generally defined as 0.125 percentage points) than the bond yield. Exceptions are provided to this restriction for investments during any of several "temporary periods" pending use of the proceeds, and throughout the term of the issue, for proceeds invested as part of a reasonably required reserve or replacement fund or a "minor" portion of the issue proceeds.

Second, in general, all arbitrage profits earned on investments unrelated to the governmental purpose (i.e., principally earnings on investments not subject to the yield restriction requirement) of the borrowing must be rebated to the Federal Government. Arbitrage profits include all such earnings (in excess of bond yield) derived from the investment of bond proceeds (and subsequent earnings on any such earnings).

House bill

The House bill provides that the initial temporary period for construction bonds is automatically extended for a period of 12 months if at least 85 percent of the available construction proceeds are spent within the original initial temporary period and the issuer reasonably expects to spend the remaining proceeds within the 12-month extension period. Construction bonds eligible for this automatic extension include only those bonds currently eligible for the 24-month arbitrage rebate expenditure exception, described above. Thus, these bond proceeds may be invested without yield restriction during this additional period; however, the arbitrage rebate or alternative penalty requirements for certain construction bonds will continue to apply during the extension period.

Effective date.—This provision applies to bonds issued 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.

4. SIMULTANEOUS ISSUANCE OF CERTAIN DISCRETE ISSUES NOT AGGREGATED

Present law

In certain cases, the Treasury Department treats multiple issues of tax-exempt bonds paid from substantially the same source of funds as a single issue in applying the Code's tax-exempt bond restrictions when the bonds are issued within a relatively short period of time.

House bill

The House bill provides that discrete issues of governmental bonds issued simultaneously will not be treated as a single issue in cases where one of the issues is a TRAN reasonably expected to satisfy the arbitrage rebate safe harbor of Code section 148(f)(4)(B)(iii).

Effective date.—This provision applies to bonds issued after the date of enactment; no inference language is included with respect to bonds issued on or before 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.

5. REPEAL OF UNRELATED AND DISPROPORTIONATE USE LIMIT

Present law

Bonds issued by States and local governments are private activity bonds if (1) more than ten percent of the proceeds of the issue of which they are part satisfies a private business use and payment test or (2) more than five percent ($5 million, if less) of the proceeds is used to finance loans to persons other than States or local governments. The ten-percent private business limits are reduced to five percent in the case of uses that are unrelated to a governmental use also being financed with the proceeds of the issue (the "unrelated and disproportionate use limit").

House bill

The House bill repeals the five-percent unrelated and disproportionate use limit.

Effective date.—This provision applies to bonds issued after the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the provision of the House bill.

6. SIMPLIFICATION OF ARBITRAGE REBATE REQUIREMENT FOR SMALLER ISSUERS OF GOVERNMENTAL BONDS

Present law

Subject to limited exceptions, arbitrage profits earned by investing bond proceeds in investments unrelated to the governmental purpose of the borrowing must be rebated to the Federal Government. The rebate requirement does not apply to governmental bonds issued by issuers with general taxing powers if they issue $5 million or fewer of such bonds during the calendar year when the bonds are issued.

House bill

The House bill increases the $5 million annual issuance limit for small issuers whose governmental bonds are not subject to rebate to $10 million.

Effective date.—This provision applies to bonds issued in calendar years beginning after the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

7. REPEAL OF 150-PERCENT OF DEBT SERVICE LIMIT

Present law

Issuers of all tax-exempt bonds generally are subject to two sets of arbitrage restrictions on investment of their bond proceeds. The first set requires that tax-exempt bond proceeds be invested at a yield that is not materially higher (generally defined as 0.125 percentage points) than the bond yield. Exceptions are provided to this restriction for investments during any of several "temporary periods" pending use of the proceeds and, throughout the term of the issue, for proceeds invested as part of a reasonably required reserve or replacement fund or a "minor" portion of the issue proceeds.

Except for temporary periods and amounts held pending use to pay current debt service, present law also limits the amount of the proceeds of private activity bonds (other than qualified 501(c)(3) bonds) that may be invested at materially higher yields at any time during a bond year to 150 percent of the debt service for that bond year. This restriction affects primarily investments in reasonably required reserve or replacement funds. Present law further restricts the amount of proceeds from the sale of bonds that may be invested in these reserve funds to ten percent of such proceeds.

The second set of arbitrage restrictions requires generally that all arbitrage profits earned on investments unrelated to the governmental purpose of the borrowing be rebated to the Federal Government. Arbitrage profits include all earnings (in excess of bond yield) derived from the investment of bond proceeds (and subsequent earnings on any such earnings).

House bill

The House bill repeals the 150-percent of debt service yield restriction.

Effective date.—This provision applies to bonds issued after the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

8. CLARIFICATION OF DEFINITION OF "INVESTMENT-TYPE PROPERTY"

Present law

Interest on State and local government bonds is not tax-exempt if the bonds are arbitrage bonds. A bond generally is an arbitrage bond if the proceeds are invested in materially higher yielding "investment-type property," other than during prescribed temporary periods or as a part of a reasonably required reserve or replacement fund. Additionally, all profits earned on investment of bond proceeds other than for the governmental purpose of the borrowing generally must be rebated to the Federal Government.

If issuers of tax-exempt bonds prepay amounts for activities being financed with the bonds, arbitrage profits may be indirectly earned and retained by the issuers. Therefore, present law provides that property or services acquired pursuant to most transactions involving prepayments is investment-type property, and is subject to either yield restriction or arbitrage rebate requirements.

House bill

The House bill deletes and reinserts the term "investment-type property" in the Code arbitrage restrictions to clarify the original intent as to the meaning of that term. The House bill states that, as was stated in the legislative history accompanying the Tax Reform Act of 1986, absent restrictions, issuers might use bond proceeds to prepay items in such a manner that the tax-exempt bond arbitrage restrictions would be avoided and the issuers would retain the economic benefit of arbitrage profits. The expansion of property subject to the Code arbitrage restrictions to include all "investment-type property" was intended to preclude such arrangements.

In certain circumstances, however, advance payments for property or services may be made because of non-arbitrage-motivated business customs. For example, a governmental unit may decide to purchase property (e.g., a government office building or equipment) with an accompanying bond-financed up-front payment rather than lease the property without such an initial debt issuance. The House bill clarifies that it is not intended that the fact that an issuer purchases, rather than leases, property should necessarily be construed as giving rise to investment-type property.

Similarly, certain services (e.g., bond insurance for the entire term of the bonds) may be available only in exchange for a lump-sum payment made in advance, or the credit standing of an issuer may be such that vendors will not supply property or services before receiving payment. The House bill clarifies that, as was indicated in 1986, the term investment-type property is not intended to include property or services acquired in exchange for debt-financed lump-sum payments, whether or not discounted, that are dictated by independent, non-arbitrage-motivated business customs governing availability of the property or services to all similarly-situated persons (whether or not State or local governmental units).

Further, the House bill clarifies the application of these restrictions to certain governmental procurement activities. When States and local governments purchase property and services for use in carrying out their governmental activities, they may be offered discounts on the same terms as nongovernmental purchasers for prompt or early payment or for volume purchases. Availability of these discounts presents an opportunity for economic arbitrage, and by taking advantage of the discounts, States and local governments could be viewed as acquiring investment-type property. The House bill provides, however, that acquisition at a discounted price of property or services to be used in carrying out a governmental activity should not be treated as the acquisition of investment-type property if—

(a) the trade discount is available on the same terms to all purchasers of the property or services (both governmental and nongovernmental entities); [1] and

(b) the scheduled or actual timing of any early payment or the volume of any purchase by a governmental unit is not substantially different from the comparable timing of payments or volume of purchases by similarly situated nongovernmental purchasers of the same property or services.

Effective date.—This provision is effective as if included in Title XIII of the Tax Reform Act of 1986.

[1] Any trade discount which is structured differently for governmental and nongovernmental purchasers or which is set at a level such that issuers of tax-exempt bonds are more likely to take advantage of the discount than nongovernmental purchasers (e.g., in a manner related to the tax-exempt borrowing costs of the governmental unit) does not qualify as a trade discount that is available on the same terms to all purchasers of the property or services.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill with three clarifications. First, the conferees wish to clarify that the rules governing trade discounts described above in the fourth paragraph of the House bill description are not intended to clarify, not to modify, the other present-law rules described in the first three paragraphs of that description and in the legislative history accompanying the Tax Reform Act of 1986.

Second, the conferees wish to clarify the requirement that trade discounts be set at a level such that issuers of tax-exempt bonds are not more likely to take advantage of the discounts than are nongovernmental purchasers using taxable financing. The conferees recognize that the implicit discount rate in any purchase arrangement is related to borrowing costs, and that therefore, tax-exempt borrowers should benefit economically more from any uniform discount rate than comparable taxable borrowers. This fact alone is not to be construed as violating the requirement, provided the discount rate is uniform for governmental and nongovernmental purchasers and is set at a sufficient level to be taken advantage of generally by nongovernmental purchasers using taxable financing as well as by issuers of tax-exempt bonds.

Third, the conferees wish to clarify that the trade discount discussion applies to procurement activities of section 501(c)(3) organizations as well as those of governmental units.

9. EXPAND EXCEPTION TO PRO RATA DISALLOWANCE OF BANK INTEREST EXPENSE RELATED TO INVESTMENT IN TAX-EXEMPT BONDS

Present law

Banks and other financial institutions generally are denied a deduction for the portion of their interest expense (e.g., interest paid to depositors) that is attributable to investment in tax-exempt bonds acquired after August 7, 1986. This disallowance is computed using a pro-rata formula that compares the institution's average adjusted basis in tax-exempt bonds acquired after that date with the average adjusted basis of all assets of the institution.

An exception to the pro-rata disallowance rule is permitted for governmental bonds and qualified 501(c)(3) bonds issued by or on behalf of governmental units that issue no more than $10 million of such bonds during a calendar year (the "small-issuer exception").

House bill

No provision.

Senate amendment

The Senate amendment increases from $10 million to $25 million the amount of governmental and qualified 501(c)(3) bonds that an entity may issue annually while qualifying those bonds for the small-issuer exception to the general bank interest disallowance rule.

The amendment also provides that pooled financing tax-exempt bonds (other than private activity bonds) may qualify for the small-issuer exception if—

(a) all of the proceeds of the pooled financing bonds (net of issuance costs associated with the bonds) are used exclusively to acquire from the issuer thereof bonds ("acquired bonds") eligible for the small-issuer exception,

(b) the acquired bonds are not designated under section 265(b)(3)(B)(i)(III) as "bank qualified" for purposes of the small-issuer exception; [2]

(c) the weighted average maturity of the pooled financing bonds does not exceed the weighted average maturity of the acquired bonds; and

(d) the issuer of the pooled financing bonds designates those bonds as "bank qualified" under section 265(b)(3)(i)(B)(III).

Effective date.—The provision is effective for bonds issued and acquired in calendar years beginning after December 31, 1992.

Conference agreement

The conference agreement follows the Senate amendment with two modifications. First, the conference agreement increases the small-issuer exception from $10 million to $20 million (rather than $25 million). Second, the conference agreement does not include the expansion of the exception to pooled financing bonds.

10. MODIFICATION OF RULES GOVERNING QUALIFIED 501(C)(3) BONDS

Present law

Interest on State and local government bonds generally is excluded from income if the bonds are issued to finance direct activities of these governments (sec. 103). Interest on bonds issued by these governments to finance activities of other persons, e.g., private activity bonds, is taxable unless a specific exception is included in the Code. One such exception is for private activity bonds issued to finance activities of private, charitable organizations described in Code section 501(c)(3) ("section 501(c)(3) organizations") when the activities do not constitute an unrelated trade or business (sec. 141(e)(1)(G)).

Classification of section 501(c)(3) organization bonds as private activity bonds

Before enactment of the Tax Reform Act of 1986, States and local governments and section 501(c)(3) organizations both were defined as "exempt persons," under the Code bond provisions, and their bonds generally were subject to the same requirements. As exempt persons, section 501(c)(3) organizations were not treated as "private" persons, and their bonds were not "industrial development

[2] The acquired bonds are taken into account in determining how many bonds are reasonably expected to be issued by the borrowers from the pool in the calendar year in which they are issued.

bonds" or "private loan bonds" (the predecessor categories to current private activity bonds).

Under present law, a bond is a private activity bond if its proceeds are used in a manner violating either (a) a private business test or (b) a private loan test. The private business test is a conjunctive two-pronged test. First, the test limits private business use of governmental bonds to no more than ten percent of the proceeds.[3] Second, no more than ten percent of the debt service on the bonds may be derived from private business users of the proceeds. The private loan test limits to the lesser of five percent or $5 million the amount of governmental bond proceeds that may be used to finance loans to persons other than governmental units.

Special restrictions on tax-exemption for section 501(c)(3) organization bonds

As stated above, present law treats section 501(c)(3) organizations as private persons; thus, bonds for their use may only be issued as private activity "qualified 501(1)(3) bonds," subject to the restrictions of Code section 145. The most significant of these restrictions limits the amount of outstanding bonds from which a section 501(c)(3) organization may benefit to $150 million. In applying this "$150 million limit," all section 501(c)(3) organizations under common management or control are treated as a single organization. The limit does not apply to bonds for hospital facilities, defined to include only acute care, primarily inpatient, organizations. A second restriction limits to no more than five percent the amount of the net proceeds of a bond issue that may be used to finance any activities (including all costs of issuing the bonds) other than the exempt purposes of the section 501(c)(3) organization.

Legislation enacted in 1988 imposed low-income tenant occupancy restrictions on existing residential rental property that is acquired by section 501(c)(3) organizations in tax-exempt-bond-financed transactions. These restrictions require that a minimum number of the housing units comprising the property be continuously occupied by tenants having family incomes of 50 percent (60 percent in certain cases) of area median income for periods of up to 15 years. These same low-income tenant occupancy requirements apply to for-profit developers receiving tax-exempt private activity bond financing.

Other restrictions

Several restrictions are imposed on private activity bonds generally that do not apply to bonds used to finance State and local government activities. Many of these restrictions also apply to qualified 501(c)(3) bonds.

No more than two percent of the net proceeds of a bond issue may be used to finance the costs of issuing the bonds, and these monies are not counted in determining whether the bonds satisfy

[3] No more than five percent of bond proceeds may be used in a private business use that is unrelated to the governmental purpose of the bond issue. The ten percent debt service test, described below, likewise is reduced to five percent in the case of such "disproportionate" private business use.

the requirement that at least 95 percent of the net proceeds of each bond issue be used for the exempt activities qualifying the bonds for tax-exemption.

The weighted average maturity of a bond issue may not exceed 120 percent of the average economic life of the property financed with the proceeds.

A public hearing must be held and an elected public official must approve the bonds before they are issued (or the bonds must be approved by voter referendum).

If property financed with private activity bonds is converted to a use not qualifying for tax-exempt financing, certain loan interest penalties are imposed.

House bill

No provision.

Senate amendment

The Senate amendment changes the tax-exempt bond provisions of the Code to conform generally the treatment of bonds for section 501(c)(3) organizations to that provided for bonds issued to finance direct State or local government activities. Certain restrictions, described below, that have been imposed on qualified 501(c)(3) bonds (but not on governmental bonds) since 1986, and that address specialized policy concerns, are retained.

Repeal of private activity bond classification for bonds for section 501(c)(3) organizations

The concept of an "exempt person" that existed in the bond provisions before 1986, is reenacted. An exempt person is defined as (a) a State or local governmental unit or (b) a section 501(c)(3) organization, when carrying out its exempt activities under Code section 501(a). Thus, bonds for section 501(c)(3) organizations would no longer be classified as private activity bonds. However, financing for unrelated business activities of such organizations would continue to be treated as a private activity for which tax-exempt financing is not authorized.

As exempt persons, section 501(c)(3) organizations would be subject to the same limits as States and local governments on using their bond proceeds to finance private business activities or to make private loans. Thus, no more than ten percent of the bond proceeds [4] could be used in a business use of a person other than an exempt person if the Code security interest test is satisfied, and no more than five percent ($5 million if less) could be used to make loans to such "nonexempt" persons.

Repeal of most additional special restrictions on section 501(c)(3) organization bonds

Present Code section 145, which establishes additional restrictions on qualified 501(c)(3) bonds, is repealed, along with the restriction on bond-financed costs of issuance for section 501(c)(3) or-

[4] This limit is reduced to five percent in the case of disproportionate private use as under the present-law governmental bond disproportionate private use limit.

ganization bonds (sec. 147(h)). This eliminates the $150-million-per-organization limit on nonhospital bonds for section 501(c)(3) organizations.

Retention of certain specialized requirements for section 501(c)(3) organization bonds

As stated above, the Senate amendment retains certain specialized restrictions on bonds for section 501(c)(3) organizations. First, the bill retains the requirement that existing residential rental property acquired by a section 501(c)(3) organization in a tax-exempt-bond-financed transaction satisfy the same low-income tenant requirements as similar housing financing for for-profit developers. Second, the amendment retains the present-law maturity limitations applicable to bonds for section 501(c)(3) organizations, and the public approval requirements applicable generally to private activity bonds. Third, the amendment continues to apply the penalties on changes in use of tax-exempt-bond-financed section 501(c)(3) organization property to a use not qualified for such financing.

Finally, the Senate amendment makes no amendments, other than technical conforming amendments, to the tax-exempt arbitrage restrictions, the alternative minimum tax tax-exempt bond preference, or the provisions generally disallowing interest paid by banks on monies used to acquire or carry tax-exempt bonds.

Effective date

The Senate amendment applies to bonds issued after December 31, 1992.

Conference agreement

The conference agreement does not include the provision of the Senate amendment.

11. AUTHORITY FOR TREASURY DEPARTMENT TO EXEMPT CERTAIN TAXPAYERS FROM TAX-EXEMPT INTEREST REPORTING REQUIREMENT

Present law

Present law requires all individuals to report on their income tax returns the amount of interest on State and local government bonds they receive.

House bill

No provision.

Senate amendment

The Senate amendment authorizes the Treasury Department to provide exceptions to the requirement that taxpayers report interest on State and local government bonds on their Federal income tax returns in cases where the Secretary determines that such information is not useful to the administration of the tax laws.

Effective date.—This provision is effective for taxable years beginning after the date of enactment.

Conference agreement

The conference agreement does not include the provision of the Senate amendment.

12. REPEAL OF EXPIRED PROVISIONS

Present law

Present law includes two special exceptions to the arbitrage rebate and pooled financing temporary period rules for certain qualified student loan bonds. This exception applied only to bonds issued before January 1, 1989.

House bill

These special exceptions are deleted as "deadwood."

Effective date.—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.

J. Taxable Year Election for Partnerships, S Corporations, and Personal Service Corporations

Present law

In general

A partnership is generally required for Federal income tax purposes to use the taxable year that is used by a majority of its partners. An S corporation is generally required for Federal income tax purposes to use the calendar year as its taxable year. A personal service corporation also is generally required for Federal income tax purposes to use the calendar year as its taxable year.[1]

A partnership, S corporation, or personal service corporation, however, may elect to use a taxable year other than the required taxable year. In the case of a partnership, S corporation, or personal service corporation that is adopting a taxable year or changing a taxable year, the taxable year that may be elected generally may not result in a deferral period of more than three months. For this purpose, the deferral period generally is the number of months between (1) the beginning of the taxable year of the partnership, S corporation, or personal service corporation, and (2) the close of the first required taxable year that ends within such year.

A partnership, S corporation, or personal service corporation is required to obtain the approval of the Internal Revenue Service in

[1] For this purpose, a personal service corporation is defined as a C corporation the principal activity of which is the performance of services if (1) the services are substantially performed by employee-owners, and (2) more than 10 percent of the stock of the corporation is owned by employee-owners.

order to change to a taxable year other than the required taxable year. A partnership, S corporation, or personal service corporation that terminates an election to use a taxable year other than the required taxable year may not make an election for any subsequent taxable year.

An election may not be made by a partnership, S corporation, or personal service corporation that is part of a tiered structure other than a tiered structure that is comprised of one or more partnerships or S corporations, all of which have the same taxable year. An electing partnership, S corporation, or personal service corporation that becomes part of a proscribed tiered structure is considered to have terminated its election.

Required payment for electing partnerships and S corporations

A partnership or S corporation that elects a taxable year other than the required taxable year is required to make a payment to the Internal Revenue Service (a "required payment") that is designed to compensate the Federal government for the deferral of tax that results from the use of a taxable year other than the required taxable year. The amount of the required payment for any taxable year for which an election is in effect (an "applicable election year") equals the excess (if any) of (1) the highest rate of tax in effect under section 1 of the Code plus 1 percentage point multiplied by the net base year income of the partnership or S corporation, over (2) the net required payment balance. The net required payment balance is the aggregate amount of required payments less refunds of required payments for all preceding taxable years for which an election was in effect.

The required payment is due on May 15 of the calendar year that follows the calendar year in which the applicable election year began. The required payment is required to be refunded by the Internal Revenue Service if certain conditions are satisfied. No interest is to be paid by the Internal Revenue Service with respect to a refund of a required payment.

Minimum distribution requirement for electing personal service corporations

A personal service corporation that elects a taxable year other than the required taxable year is required to satisfy a minimum distribution requirement that applies to applicable amounts paid by the personal service corporation.[2] If the minimum distribution requirement is not satisfied for any taxable year for which a taxable year election is in effect, the deduction otherwise allowed for applicable amounts paid or incurred during such taxable year is limited to the applicable amounts paid during the deferral period of the taxable year multiplied by a ratio, the numerator of which is the number of months in the taxable year and the denominator of which is the number of months in the deferral period of the taxable year.

[2] The term "applicable amount" generally is defined as any amount paid to an employee-owner that is includible in the gross income of the employee-owner other than any dividend paid by the personal service corporation or any gain from the sale or exchange of property by the employee-owner to the personal service corporation.

The minimum distribution requirement is satisfied with respect to a taxable year only if the applicable amounts paid or incurred during the deferral period of the taxable year equal or exceed the lesser of (1) the applicable amounts paid during the preceding taxable year multiplied by a ratio, the numerator of which is the number of months in the deferral period of the taxable year and the denominator of which is the number of months in the taxable year, or (2) the applicable percentage of the adjusted taxable income for the deferral period of the taxable year.

A net operating loss carryback is not allowed to or from a taxable year of a personal service corporation for which a taxable year election is in effect.

House bill

In general

The House bill allows a partnership, S corporation, or personal service corporation to elect any taxable year without regard to the length of the deferral period of the taxable year elected. A partnership, S corporation, or personal service corporation, however, is allowed to elect a taxable year other than the required taxable year only if the taxable year elected covers the same period as any annual financial reports or statements of the entity used for credit purposes or provided to the partners, shareholders, or other proprietors of the entity.

The House bill repeals the provision of present law that prohibits a partnership, S corporation, or personal service corporation from electing a taxable year other than the required taxable year if an earlier taxable year election has been terminated. In addition, the House bill provides that a partnership, S corporation, or personal service corporation is not to be considered part of a tiered structure merely because a trust that uses the calendar year owns an interest in the partnership, S corporation, or personal service corporation.

Required payment for electing partnerships and S corporations

The House bill increases the amount of the required payment that must be made by a partnership or S corporation that elects a taxable year other than the required taxable year (including any partnership or S corporation that has an election in effect on the date of enactment of the bill). Under the House bill, the amount of the required payment for any applicable election year equals the excess (if any) of (1) the highest rate of tax in effect under section 1 of the Code as of the close of the first required taxable year ending within the applicable election year plus 2 percentage points, multiplied by the net base year income of the partnership or S corporation,[3] over (2) the net required payment balance.

[3] In determining the net base year income of the partnership or S corporation for this purpose, the base year is defined as the first 12-month (or 52-53 week) taxable year of the partnership or S corporation that precedes the applicable election year. The Treasury Department is authorized to promulgate regulations that provide for the application of the required payment rules if there is no 12-month (or 52-53 week) taxable year of the partnership or S corporation that precedes the applicable election year. It is anticipated that these regulations will annualize the results of any short taxable year that is used as the base year.

The House bill also requires an additional payment for any taxable year that a partnership or S corporation first makes a taxable year election or changes a taxable year election to increase the deferral period. This additional payment is required to be made on or before September 15 of the calendar year in which the applicable election year begins.

The House bill requires interest to be paid by the Internal Revenue Service with respect to a refund of a required payment but only for the period that begins on the date that the refund is payable and that ends on the date of the payment of the refund.

Minimum distribution requirement for electing personal service corporations

The House bill modifies the minimum distribution requirement that must be satisfied by a personal service corporation that elects a taxable year other than the required taxable year (including a personal service corporation that has an election in effect on the date of enactment of the bill). The minimum distribution requirement is satisfied with respect to a taxable year only if the applicable amounts paid during the deferral period of the taxable year equal or exceed the lesser of (1) 110 percent of the applicable amounts paid during the preceding taxable year multiplied by a ratio, the numerator of which is the number of months in the deferral period of the taxable year and the denominator of which is the number of months in the taxable year, or (2) 110 percent of the applicable percentage of the adjusted taxable income for the deferral period of the taxable year.

The House bill also permits a personal service corporation to carry back a net operating loss from a taxable year for which a taxable year election was not in effect to a taxable year for which a taxable year election was in effect.

Effective date

The provisions of the House bill relating to the taxable year election apply to taxable years beginning after December 31, 1991.

Senate amendment

The Senate amendment is the same as the House bill, except as follows.

In general

The Senate amendment continues to require a partnership, S corporation, or personal service corporation to obtain the approval of the Internal Revenue Service in order to change a taxable year (including, unlike present law, a change to the required taxable year). Under the Senate amendment, it is anticipated that the Internal Revenue Service will provide a procedure by which a partnership, S corporation, or personal service corporation may expeditiously obtain the approval of the Internal Revenue Service in order to change a taxable year (for example, by timely filing a form with the Internal Revenue Service). It is anticipated that this "automatic consent" procedure will only apply to a partnership, S corporation, or personal service corporation that has not changed its taxable year within the past 6 calendar years, except that the 6-year limitation will not apply to any partnership, S corporation, or personal service corporation that has changed its taxable year in order to comply with the taxable year requirements contained in the Tax Reform Act of 1986.

It is also anticipated that the "automatic consent" procedure will require any net operating loss of a personal service corporation that arises in a short period required to effect a change in taxable year to be deducted ratably over a 6-year period beginning with the first taxable year after the short period. In addition, it is anticipated that the "automatic consent" procedure will require any excess of deductions over income of a partnership or S corporation that arises in a short period required to effect a change in taxable year to be taken into account by the partners or shareholders over a 6-year period beginning with the taxable year of the partners or shareholders that includes the last day of the first taxable year of the partnership or S corporation that occurs after the short period.

The Senate amendment also provides that a taxable year election is to remain in effect until the partnership, S corporation, or personal service corporation terminates its election and changes to the required taxable year.[4] A change from a taxable year that is not a required taxable year to another taxable year that is not a required taxable year is not treated as a termination of the taxable year election unless the taxable year is allowable by reason of a business purpose.

The Senate amendment provides that a partnership, S corporation, or personal service corporation is not to be considered part of a tiered structure solely because a trust, the beneficiaries of which use the calendar year, owns an interest in the partnership, S corporation, or personal service corporation. Consequently, an election of a taxable year other than the required taxable year may be made by a partnership, S corporation, or personal service corporation with respect to which a trust owns an interest if all of the beneficiaries of the trust use the calendar year and the partnership, S corporation, or personal service corporation is not otherwise considered to be part of a proscribed tiered structure.

Required payment for electing partnerships and S corporations

The Senate amendment requires an additional required payment for any new applicable election year of a partnership or S corporation. For this purpose, a new applicable election year is defined as any applicable election year that either (1) immediately follows a taxable year for which a taxable year election was not in effect, or (2) covers a different period than the preceding taxable year by reason of a change in the taxable year elected. If, however, the applicable election year described in the preceding sentence is a short taxable year that does not include the last day of a required taxable year, then the new applicable election year is the taxable year immediately following the short taxable year.

[4] As under present law, a taxable year election is also terminated if: (1) the entity becomes part of a proscribed tiered structure; or (2) a partnership or S corporation willfully fails to comply with the required payment rules. In addition, the Senate amendment authorizes the Treasury Department to issue regulations which provide for the termination of a taxable year election if the entity does not comply with the annual financial statement requirement.

In the case of a new applicable election year that does not result from a change in the taxable year elected, the amount of the additional required payment equals 75 percent of the amount of the required payment for such applicable election year (determined without regard to the additional required payment). In the case of a new applicable election year that results from a change in the taxable year elected, the amount of the additional required payment equals 75 percent of the excess (if any) of (1) the amount of the required payment for such applicable election year (determined without regard to the additional required payment), over (2) the amount of the required payment for such applicable election year (determined without regard to the additional required payment) determined by using the deferral ratio and the deferral period that applied to the taxable year that was used prior to the change.[5]

In addition, in the case of a new applicable election year, the net income for the base year is to be increased by the excess (if any) of (1) the applicable payments taken into account in determining net income for the base year, over (2) 120 percent of the average amount of applicable payments made during the three taxable years immediately preceding the base year.[6] A partnership or S corporation that fails to make the additional required payment by the due date of such payment is treated as having terminated the taxable year election and changed to the required taxable year.

Minimum distribution requirement for electing personal service corporations

Under the Senate amendment, the minimum distribution requirement is satisfied with respect to a taxable year only if the applicable amounts paid during the deferral period of the taxable year equal or exceed the lesser of (1) 110 percent of the applicable amounts paid during the first preceding taxable year of 12 months (or 52-53 weeks) [7] multiplied by a ratio, the numerator of which is the number of months in the deferral period of the taxable year and the denominator of which is 12, or (2) 110 percent of the applicable percentage of the adjusted taxable income for the deferral period of the taxable year.

Conference agreement

The conference agreement follows the Senate amendment.

[5] In the case of a new applicable election year that results from a change in the taxable year elected, an additional required payment is required only if the deferral period of the new applicable election year exceeds the deferral period of the former applicable election year.

[6] In the event that there are not three taxable years immediately preceding the base year, the provision is to apply based on the number of taxable years immediately preceding the base year.

[7] The Treasury Department is authorized to promulgate regulations that provide for the application of the minimum distribution requirement if there is no preceding taxable year of 12 months (or 52-53 weeks) of the personal service corporation. It is anticipated that these regulations will annualize the results of any short year that is taken into account for purposes of these rules.

K. Provisions Relating to Cooperatives

1. DISCHARGE OF INDEBTEDNESS INCOME FROM PREPAYMENT OF REA LOANS AT A DISCOUNT

Present law

Internal Revenue Code

Section 501(c)(12) of the Internal Revenue Code provides an income tax exemption for rural electric cooperatives if at least 85 percent of the cooperative's income is derived from member sources. Income from cancellation of indebtedness generally is not derived from member sources. Nonetheless, section 501(c)(12)(B)(iv) provides that the 85-percent test is determined without regard to any discharge of indebtedness income arising from prepayment of loans of the Rural Electrification Administration (REA) pursuant to sections 306A, 306B, or 311 of the Rural Electrification Act (as in effect on January 1, 1987).

1990 Farm Act

Section 2387 of the Food, Agriculture, Conservation, and Trade Act of 1990 ("1990 Farm Act") amended section 306B of the Rural Electrification Act to provide that rural electric cooperatives that merge with another rural electric cooperative that previously had prepaid REA loans under the 1988 or 1989 Budget Reconciliation Acts also could prepay REA loans at a discount.

House bill

No provision.

Senate amendment

The Senate amendment provides that the 85-percent test of section 501(c)(12) would be determined without regard to discharge of indebtedness income from the prepayment of loans of the Rural Electrification Administration under section 2387 of the 1990 Farm Act.

Effective date.—The provision applies to taxable years beginning before, on, or after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

2. PRIVATE FOUNDATION COMMON INVESTMENT FUND

Present law

Section 501(c)(3) requires that an organization be organized and operated exclusively for an exempt purpose in order to qualify for tax-exempt status under that section.

Section 501(f) provides that an organization is treated as organized and operated exclusively for charitable purposes if it is comprised solely of members that are educational institutions and is organized and operated solely to hold, commingle, and collectively invest (including arranging for investment services by independent contractors) in stocks and securities, the moneys contributed thereto by the members, and to collect income therefrom and turn over the entire amount thereof, less expenses, to such members.

House bill

No provision.

Senate amendment

The Senate amendment provides that a cooperative service organization comprised solely of members that are tax-exempt private foundations and community foundations [1] shall be treated as organized and operated exclusively for charitable purposes if: (1) it has at least 20 members; (2) no one member holds (after the organization's second taxable year) more than 10 percent (by value) of the interests in the organization; (3) no one member controls the organization or any other member; (4) the members are permitted to dismiss any of the organization's investment advisors (following reasonable notice) upon a vote of members holding a majority of interest in the account managed by such advisor; (5) the organization is organized and operated solely to hold, commingle, and collectively invest (including arranging for investment services by independent contractors) in stocks and securities, the monies contributed by the members, and to collect income therefrom and turn over the entire amount thereof, less expenses, to such members.[2]

A cooperative service organization meeting the criteria of the proposed modification would be subject to the present-law excise tax provisions applicable to private foundations (e.g., sec. 4941 rules governing self-dealing arrangements), other than sections 4940 and 4942. In addition, each member's allocable share (whether or not distributed) of the capital gain net income and gross investment income of the organization for any taxable year of the organization is treated, for purposes of the excise tax imposed under present-law section 4940, as capital gain net income and gross investment income of the member for the taxable year of such member in which the taxable year of the organization ends.

Effective date.—The provision applies to taxable years ending after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

[1] For purposes of the provision, "community foundations" are a form of charitable trust or fund (which generally are established to attract large contributions of a capital or endowment nature for the benefit of a particular community or area) as to which section 170(b)(1)(A)(vi) applies. See Treas. Reg. sec. 1.170A-9(e)(10).

It is expected that members will present the organization with verification of their status as tax-exempt private foundations or community foundations at the time they become members (i.e., when they make an initial investment). Further, it is intended that a reasonable time period should be allowed for withdrawal by a member that subsequently ceases to qualify as a tax-exempt private foundation or community foundation.

[2] It is intended that an organization will be deemed to be organized and operated solely to collectively invest in stocks and securities if its income is derived solely from investing in stocks and securities, and ordinary and routine investments in connection with a stock and securities portfolio.

A cooperative service organization described in the provision qualifies for tax-exempt status under section 501(c)(3) only if the other applicable requirements of that section (e.g., prohibition of private inurement, political activities, and substantial lobbying) are satisfied.

3. TREATMENT OF AMOUNTS RECEIVED BY TELEPHONE COOPERATIVES

Present law

Mutual or cooperative telephone companies ("telephone cooperatives") are exempt from Federal income tax if 85 percent or more of their income consists of amounts collected from members for the sole purpose of meeting losses and expenses (sec. 501(c)(12)(A)). In applying this 85-percent test, certain income received by a telephone cooperative is disregarded, including income received from a nonmember telephone company for the performance of communication services which involve members of the telephone cooperative, certain pole rental income, and income from the sale of display listings in a telephone directory sold to members of the telephone cooperative (sec. 501(c)(12)(B)).

Tax-exempt organizations generally are subject to the unrelated business income tax (UBIT) on income from a trade or business that is not substantially related to the organization's tax-exempt purposes. Under special rules, certain investment income (e.g., interest, dividends, royalties, and certain rents) generally is exempt from UBIT, although some tax-exempt organizations, such as social clubs described in section 501(c)(7) and certain mutual benefit organizations, are subject to UBIT on their investment income.

House bill

No provision.

Senate amendment

Amounts received from other telephone companies

The Senate amendment provides that, for purposes of section 501(c)(12), 50 percent of the income received by a telephone cooperative from a nonmember telephone company for performing communication services—e.g., fees received for originating (or terminating) a long-distance call placed by (or to) a member—are treated as collected from members of the telephone cooperative for the sole purpose of meeting the losses and expenses of the telephone cooperative.[1] The remaining 50 percent of income received by a telephone cooperative from a nonmember telephone company is, as under present law, excluded from the 85-percent test under section 501(c)(12)(B)(i).

The Senate amendment also excludes from the 85-percent test under section 501(c)(12) amounts received by a telephone cooperative from billing and collection services performed for another telephone company.[2]

[1] Amounts received by a telephone cooperative for performing communication services for a nonmember telephone company (e.g., long-distance carrier) often are referred to as "access charges." Thus, under the Senate amendment, 50 percent of such access charges received by a telephone cooperative from another telecommunications company are treated as member-source income for purposes of the 85-percent test of section 501(c)(12).

[2] Telephone cooperatives (and other local telephone companies) often serve as billing and collection agents for other telecommunications companies. (That is, a telephone cooperative bills, and collects from, its members not only charges for local phone service provided by the cooperative but also charges for amounts owed to a long-distance carrier for the member's long-distance calls.) Telephone cooperatives are compensated for performing billing and collection services,

Continued

Effective date.—This provision is effective for taxable years beginning before, on, or after the date of enactment.

Excess investment income

In addition, the Senate amendment provides that telephone cooperatives will not lose their tax-exempt status under section 501(c)(12) if they earn certain investment "reserve income" in excess of 15 percent of their total income, but only if such reserve income (when added to other income not collected from members) does not exceed 35 percent of the cooperative's total income. For purposes of this provision, "reserve income" is defined as income that otherwise would be excluded from UBIT under section 512(b) (e.g., interest and dividends) and that is set aside for the repair or replacement of telephone facilities of the cooperative. Under the provision, tax-exempt telephone cooperatives are subject to the UBIT on such reserve income between the 15-percent and 35-percent range.

Effective date.—This provision is effective for taxable years beginning after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

4. TREATMENT OF HOUSING COOPERATIVES

Present law

Treatment of cooperatives generally

A cooperative association is an organization, usually a corporation, which benefits its members and patrons by selling goods to them and purchasing products from them and returning to them any income in excess of costs. Unlike other corporations, a cooperative association may exclude from its taxable income patronage dividends paid to its members or patrons. For a cooperative subject to tax under subchapter T of the Code (secs. 1381–88), a patronage dividend must be determined by reference to the net earnings of the organization from business done with or for its patrons and cannot include any earnings other than from such business.

Deductions by membership organizations

A membership organization operated primarily to furnish services or goods to its members may deduct costs attributable to such operation only to the extent of income derived from the members (sec. 277). The Internal Revenue Service has ruled that section 277

generally by retaining a portion of the long-distance charges collected from members. Similar to the present-law treatment of certain pole rental income and directory listing (e.g., "yellow pages") revenue, the Senate amendment treats such billing and collection revenues as excluded from the 85-percent test under section 501(c)(12).

applies to housing cooperatives.[1] Two courts have refused to apply section 277 to cooperatives subject to tax under subchapter T.[2]

House bill

No provision.

Senate amendment

The Senate amendment provides that section 277 does not apply to a cooperative housing corporation [3] and that patronage losses of the corporation cannot offset earnings that are not patronage earnings.

Patronage earnings and losses generally include earnings and losses derived from business done with or for patrons of the corporation. In addition, the bill treats the following as patronage sourced: (1) interest on reasonable reserves established in connection with the corporation, including reserves required by a government agency or lender, (2) rents from laundry and parking to the extent attributable to use of the facilities by tenant-stockholders [4] and their guests, and (3) in the case of a limited equity cooperative housing corporation,[5] rental income attributable to a housing project operated by the corporation.

It is intended that no inference be drawn from the provision regarding the deductibility of patronage losses under present law.

Effective date.—The Senate amendment applies to taxable years beginning after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

5. TREATMENT OF SAFE HARBOR LEASES OF MEMBERSHIP ORGANIZATIONS

Present law

Deductions of membership organizations

A membership organization operated primarily to furnish services or goods to its members may deduct costs attributable to such operations only to the extent of income derived from the members (sec. 277). In essence, section 277 prohibits using losses incurred

[1] *See* Rev. Rul. 90-36, 1990-1 C.B. 59.

[2] *See* Landmark v. United States, 92-1 Tax Cas. (CCH) para. 50,058 (Cl. Ct. 1992); Farm Service Cooperative v. Commissioner, 70 T.C. 145, 155-57 (1978), *rev'd on other grounds*, 611 F.2d 1270 (9th Cir. 1980).

[3] A cooperative housing corporation generally is a corporation (1) that has one class of stock, (2) each of the stockholders of which is entitled, solely by reason of ownership of stock, to occupy a dwelling owned or leased by the cooperative, (3) no stockholder of which is entitled to receive any distribution not out of earnings and profits of the cooperative, and (4) 80 percent or more of the gross income for the taxable year of which is derived from tenant-stockholders.

[4] A tenant-stockholder generally is a person owning fully paid-up stock in the cooperative corporation, the purchase price of which bore a reasonable relationship to the value of the cooperative's equity in land and buildings attributable to the dwelling unit occupied by such person.

[5] Generally, a cooperative housing corporation is a limited equity cooperative housing corporation if the amount paid by a tenant-stockholder for stock in the corporation cannot exceed the sum of (1) the consideration paid by the first tenant-stockholder adjusted for cost of living, (2) payments for improvements to the dwelling unit, and (3) payments to amortize corporate indebtedness arising from the acquisition or development of real property.

from transactions with members to offset income derived from transactions with nonmembers.

Safe harbor leases

The Economic Recovery Tax Act of 1981 ("ERTA") contained rules designed to permit full utilization of tax benefits. Under these so-called "safe harbor lease rules," a lease meeting certain requirements was respected for Federal income tax purposes notwithstanding other legal principles. Thus, the lessor under the safe harbor lease was treated as the property owner, and accordingly, entitled to cost recovery deductions and investment credits. The safe harbor lease rules were repealed by the Tax Equity and Fiscal Responsibility Act of 1982.

House bill

No provision.

Senate amendment

The Senate amendment provides that the interest income and rental expense from the sale and leaseback of the property under a safe harbor lease are to be first netted and the difference allocated between members and nonmembers in proportion to the business done with each group.

Effective date.—The amendment applies to taxable years beginning before, on, or after the date of enactment.

Conference agreement

The conference agreement does not include the Senate amendment.

L. Provisions Relating to Employment

1. EMPLOYER TAX CREDIT FOR FICA PAID ON TIP INCOME (SEC. 4551 OF THE SENATE AMENDMENT)

Present law

Under present law, all employee tip income is treated as employer-provided wages for purposes of the Federal Unemployment Tax Act (FUTA) and the Federal Insurance Contributions Act (FICA). For purposes of the minimum wage provisions of the Fair Labor Standards Act (FLSA), reported tips are treated as employer-provided wages to the extent they do not exceed one-half of such minimum wage.

House bill

No provision.

Senate amendment

The Senate amendment provides a business tax credit in an amount equal to the employer's FICA tax obligation (7.65 percent) attributable to reported tips in excess of those treated as wages for purposes of satisfying the minimum wage provisions of the FLSA.

To prevent double dipping, no deduction is allowed for any amount taken into account in determining the credit. The bill prohibits carryback of unused FICA credits to a taxable year ending before the date of enactment.

Effective date.—The provision is effective for tips received and wages paid after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

2. DENY DEDUCTION FOR CLUB DUES

Present law

No deduction is permitted for club dues unless the taxpayer establishes that his or her use of the club was primarily for the furtherance of the taxpayer's trade or business and the specific expense was directly related to the active conduct of that trade or business. Luncheon club dues are deductible to the same extent and subject to the same rules as business meals in a restaurant and are not subject to these special rules for club dues. No deduction is permitted for an initiation or similar fee that is payable only upon joining a club if the useful life of the fee extends over more than one year. Such initiation fees are nondeductible capital expenditures.

House bill

No provision.

Senate amendment

No deduction is permitted for club dues. This rule applies to all types of clubs: business, social, athletic, luncheon, or sporting clubs. Specific business expenses (e.g. meals) incurred at a club would be deductible only to the extent they otherwise satisfy present-law standards for deductibility.

Effective date.—The provision is effective for club dues paid on or after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

3. EMPLOYMENT TAX STATUS OF FISHERMEN

Present law

Under present law, service as a crew member on a fishing vessel is generally excluded from the definition of employment for purposes of income tax withholding on wages and for purposes of the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA) taxes if the operating crew of the boat normally consists of fewer than 10 individuals, the individual receives a share of the catch based on the total catch, and the individual does not receive cash remuneration other than proceeds from the sale of the individual's share of the catch.

House bill

No provision.

Senate amendment

The operating crew of a boat is to be treated as normally made up of fewer than 10 individuals if the average size of the operating crew on trips made during the preceding 4 calendar quarters consisted of 10 or fewer individuals. In addition, the exemption applies if the crew member receives, in addition to the cash remuneration permitted under present law, cash remuneration which does not exceed $100 per trip, is contingent on a minimum catch, and is paid solely for additional duties (e.g., mate, engineer, or cook) for which additional cash remuneration is traditional.

Effective date.—The provision applies to remuneration paid after December 31, 1992. In addition, the provision applies to remuneration paid after December 31, 1984, and before January 1, 1993, unless the payor treated such remuneration when paid as being subject to wage withholding and employment taxes.

Conference agreement

The conference agreement follows the Senate amendment.

M. Miscellaneous Simplification Provisions

1. TREATMENT OF CERTAIN REVOCABLE TRUSTS AS ESTATES

Present law

A grantor trust is treated as owned by the grantor, who is taxed on its income and is entitled to its deductions. A grantor trust includes a revocable trust, one in which the grantor retains the power to revest the title of the trust property in himself (sec. 676).

Trusts and estates are subject to different income tax rules. An estate receives a deduction for amounts permanently set aside for charity (sec. 642(c)), and, for two years after the decedents death, a $25,000 offset for rental real estate activities (sec. 469(i)). Trusts but not estates are subject to the so-called throwback rules, under which beneficiaries are taxed on distributions of previously accumulated income from trusts in substantially the same manner as if the income had been distributed to the beneficiaries when collected, instead of being accumulated in the trust (secs. 665–67).

Trusts and estates generally are required to pay estimated taxes in the same manner as individuals. A special rule exempts estates from estimated taxes for taxable years ending within two years of the decedent's death. This exemption also applies to a grantor trust that either receives the residue of the probate estate under the grantor's will, or, if there is no such trust, is the trust primarily responsible for paying taxes, debts and expenses of administration.

House bill

For limited purposes, the House bill treats as an estate a grantor trust receiving the residue of the probate estate under the grantor's will. If there is no such trust, the grantor trust that is primarily responsible for paying taxes, debts and expenses of administration is treated as an estate. The bill applies only for years ending after the decedent's death and beginning within three years, nine months of the decedent's death. As a conforming amendment, the bill adopts the same definition of trust for applying the special rule regarding estimated taxes.

The House bill applies for three purposes. First, it allows a trust described within its terms a deduction for an amount set aside for charity. Second, it allows the trust the $25,000 offset for rental real estate activities to the extent the offset is not utilized by the estate. Third, accumulations by the trust during the period of estate treatment are exempted from the throwback rules.

Effective date.—The provision applies to decedents dying after the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House bill provision.

2. CLOSE PARTNERSHIP TAXABLE YEAR WITH RESPECT TO DECEASED PARTNER

Present law

The partnership taxable year closes with respect to a partner whose entire interest is sold, exchanged, or liquidated. Such year, however, generally does not close upon the death of a partner. Thus, a decedent's entire share of items of income, gain, loss, deduction and credit for the partnership year in which death occurs is taxed to the estate or successor in interest rather than to the decedent on his or her final income tax return. See *Estate of Hesse v. Commissioner*, 74 T.C. 1307, 1311 (1980).

House bill

The House bill provides that the taxable year of a partnership closes with respect to a partner whose entire interest in the partnership terminates, whether by death, liquidation or otherwise.

Effective date.—The House bill applies to partnership taxable years beginning after December 31, 1991.

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 do not intend to change present law with respect to the effect of a transfer of a partnership interest by a debtor to the debtor's estate (under Chapters 7 or 11 of Title 11, relating to bankruptcy) upon the partnership taxable year.

3. TREATMENT OF BUILT-IN LOSSES FOR PURPOSES OF THE CORPORATE ALTERNATIVE MINIMUM TAX

Present law

For purposes of the regular corporate tax, if at the time of an ownership change, a corporation has a net operating loss or a net unrealized built-in loss, the use of such losses in post-change periods is limited. A corporation has a net unrealized built-in loss if the aggregate adjusted bases of the assets of the corporation exceed the fair market value of the assets immediately before the change of ownership (sec. 382).

For purposes of the adjusted current earnings (ACE) component of the corporate alternative minimum tax (AMT), if a corporation with a net unrealized built-in loss undergoes an ownership change in a taxable year beginning after 1989, the adjusted basis of each asset of such corporation generally is adjusted to each asset's fair market value (sec. 56(g)(4)(G)). This rule essentially eliminates, rather than limits, the use of built-in losses for ACE purposes. The net operating loss of a corporation, on the other hand, is not eliminated for AMT purposes after a change of ownership.

House bill

The House bill repeals the ACE rule relating to the treatment of built-in losses after a change of ownership. Thus, for ACE purposes, the treatment of built-in losses would be similar to the treatment of net operating loss carryovers (in the same way that the treatment of built-in losses is similar to the treatment of net operating losses for regular tax purposes).

Effective date.—The provision is effective for changes of ownership occurring after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill, except that the Senate amendment is effective for changes of ownership occurring after December 31, 1991.

Conference agreement

The conference agreement follows the Senate amendment.

4. AUTHORIZATION FOR BUREAU OF LAND MANAGEMENT TO USE PROCEEDS OF REFORESTATION TRUST FUND

Present law

The United States Treasury contains a Reforestation Trust Fund the proceeds of which are used by the Department of Agriculture for reforestation and timber stand improvement of lands in the national forest system and for related administrative costs. The amount transferred to the Reforestation Trust Fund for any fiscal year equals the amount collected during such year from custom tariffs on certain wood products, except that the maximum amount transferred for any fiscal year may not exceed $30 million.

House bill

No provision.

Senate amendment

The Senate amendment increases from $30 million to $45 million the maximum amount that may be transferred to the Reforestation Trust Fund for any fiscal year. The additional $15 million that is transferred to the Reforestation Trust Fund for any fiscal year is to be allocated and made available to the Department of the Interior for the reforestation, forest development, and forest conservation activities of the Bureau of Land Management and for related administrative costs.

Of the additional $15 million that is transferred to the Reforestation Trust Fund for any fiscal year, $14 million is to be allocated for Oregon and California Railroad and Coos Bay Wagon Road grant lands in Oregon. The remaining $1 million is to be allocated for public domain lands located in any State based on (in order of priority): (1) the level of timber sales (measured in board feet) during the previous calendar year from public domain lands located within the State; (2) the amount of reforestation backlog in the State; (3) the need for planting as part of the reforestation program; and (4) the need for forest development as part of the reforestation program.

The Senate amendment also provides that if the wood product tariffs are insufficient to provide an additional $15 million for any fiscal year, the Treasury Department is required to transfer to the Reforestation Trust Fund an amount equal to the shortfall in the wood product tariffs. In the case of any such shortfall in the wood product tariffs, 93⅓ percent of the amount of the shortfall is to be taken from the Federal portion of the Bureau of Land Management timber receipt payments from the Coos Bay Wagon Road grant lands in Oregon and the remainder of the shortfall is to be taken from the Federal portion of the Bureau of Land Management timber receipt payments from public domain lands in the States.

Effective date.—The provision is effective on October 1, 1992.

Conference agreement

The conference agreement does not include the provision of the Senate amendment.

5. REPEAL OF INVESTMENT RESTRICTIONS APPLICABLE TO NUCLEAR DECOMMISSIONING FUNDS

Present law

A taxpayer that is required to decommission a nuclear power plant may elect to deduct certain contributions that are made to a nuclear decommissioning fund. A nuclear decommissioning fund is a segregated fund the assets of which are to be used exclusively to pay nuclear decommissioning costs, taxes on fund income, and certain administrative costs. The assets of a nuclear decommissioning fund that are not currently required for these purposes must be invested in (1) public debt securities of the United States, (2) obligations of a State or local government that are not in default as to principal or interest, or (3) time or demand deposits in a bank or an insured credit union located in the United States. These investment restrictions are the same restrictions which apply to black lung trusts that are established under section 501(c)(21) of the Code.

House bill

No provision.

Senate amendment

The Senate amendment repeals the present-law investment restrictions that apply to nuclear decommissioning funds.

Effective date.—The provision applies to taxable years beginning after December 31, 1991.

Conference agreement

The conference agreement follows the Senate amendment.

6. DETERMINATIONS OF GAS PRODUCED FROM QUALIFYING SOURCES UNDER THE NONCONVENTIONAL FUELS PRODUCTION CREDIT

Present law

Nonconventional fuels are eligible for a production credit ("the section 29 credit") equal to $3 per barrel or Btu oil barrel equivalent [1] (the credit amount generally is adjusted for inflation, except for gas produced from a tight formation). Qualified fuels must be produced domestically from a well drilled, or a facility placed in service, before January 1, 1993. The production credit is available for qualified fuels sold before January 1, 2003.

Qualified fuels include (1) oil produced from shale and tar sands, (2) gas produced from geopressured brine, Devonian shale, coal seams, a tight formation, or biomass (i.e., any organic material other than oil, natural gas, or coal (or any product thereof), and (3) liquid, gaseous, or solid synthetic fuels produced from coal (including lignite), including such fuels when used as feedstocks. The amount of the credit is determined without regard to any production attributable to a property from which gas from Devonian shale, coal seams, geopressured brine, or a tight formation was produced in marketable quantities before 1980.

As a general rule, the determination of whether any gas is produced from geopressured brine, Devonian shale, coal seams, or a tight formation is made in accordance with section 503 of the Natural Gas Policy Act of 1978 (the "NGPA").[2] The term "gas from a tight formation" means only gas from a tight formation which either, as of April 20, 1977, was committed or dedicated to interstate commerce (as defined in section 2(18) of the NGPA, as in effect on the date of enactment of the Omnibus Budget Reconcilia-

[1] A barrel-of-oil equivalent generally means that amount of the qualifying fuel which has a Btu content of 5.8 million.

[2] P.L. 95-621, Nov. 9, 1978.

tion Act of 1990, or is produced from a well drilled after November 5, 1990.

Under section 503 of the NGPA,[3] if any State or Federal agency[4] makes any final determination that a well produces certain "high-cost natural gas,"[5] that determination is applicable unless it is reversed by the Federal Energy Regulatory Commission (FERC) under special procedures established under the NGPA.[6]

Under the regulatory authority granted to it by the NGPA, FERC has established the following definitions of certain types of high-cost natural gas. Natural gas produced from geopressured brine is natural gas which is dissolved before initial production of the natural gas in subsurface brine aquifers with at least 10,000 parts of dissolved solids per million parts of water and with an initial reservoir geopressure gradient in excess of 0.465 pounds per square inch for each vertical foot of depth.[7]

Occluded natural gas produced from coal seams means naturally occurring natural gas from entrapment from the fractures, pores and bedding planes of coal seams.[8]

Natural gas produced from Devonian shale means natural gas produced from fractures, micropores and bedding planes of shales deposited during the Paleozoic Devonian Period. Shales deposited during such period are defined as either (1) the gross Devonian age stratigraphic interval encountered by a well bore, at least 95 percent of which has a gamma ray index of 0.7 or greater; or (2) generally, one continuous interval within the gross Devonian age stratigraphic interval, encountered by a well bore, as long as at least 95 percent of the selected Devonian shale interval has a gamma ray index of 0.7 or greater.[9] When measuring the Devonian age stratigraphic interval, the gamma ray index at any point is calculated by dividing the gamma ray log value at that point by the gamma log value at the shale base line established over the entire Devonian age interval penetrated by the well bore.

In general, guidelines for making a determination that a formation is a tight formation are as follows: (1) The estimated average *in situ* gas permeability, throughout the pay section, is expected to be 0.1 millidarcy or less; (2) the stabilized production rate, against atmospheric pressure, of wells completed for production in the formation, without stimulation, is not expected to exceed the production rate set forth by FERC in regulations;[10] and (3) no well

[3] 15 U.S.C. sec. 3413 (1988).

[4] Under the NGPA, a State or Federal agency having regulatory jurisdiction with respect to the production of natural gas is authorized to make determinations for qualifying under certain categories of natural gas. Such an agency, however, may waive its authority to make such determinations by entering into an agreement with FERC allowing FERC to be the determination-making body. (15 U.S.C. sec. 3413(c) (1988).)

[5] Under the NGPA, high-cost natural gas includes gas produced from geopressured brine, coal seams, or Devonian shale. In addition, the NGPA grants FERC the authority to treat other types of natural gas as high-cost natural gas if the gas is produced under such other conditions that FERC determines to present extraordinary risks or costs. Under this authority, FERC treats gas produced from a tight formation as high-cost natural gas. (15 U.S.C. sec. 3317(c) (1988).)

[6] 15 U.S.C. sec. 3413(a)(1) (1988).

[7] 18 C.F.R. sec. 272.103(c).

[8] 18 C.F.R. sec. 272.103(d).

[9] 18 C.F.R. sec. 272.103(e).

[10] See table in 18 C.F.R. sec. 271.703(c)(1)(B).

drilled into the recommended tight formation is expected to produce, without stimulation, more than 5 barrels of crude oil per day.[11] The FERC regulations establishing a definition of tight formation also set forth determination and review requirements similar to those provided by the NGPA for high-cost natural gas.

Any Federal or State agency that makes a determination that a formation is a tight formation or that a well produces high-cost natural gas is required to provide timely notice in writing of such determination to FERC.[12] The notice must include such substantiation and be in such a manner as FERC may, by ruling, require.

The NGPA provides that FERC will reverse any final State or Federal agency determination that a formation is a tight formation or that a well produces high-cost natural gas if (1) FERC finds that such determination is not supported by substantial evidence in the record upon which such determination was made; and (2) the preliminary finding and required notice thereof is made within 45 days after the date on which FERC received notice of the determination by the State or Federal agency and the final finding is made within 120 days after the date of the preliminary finding.[13] If (1) FERC finds that a State or Federal agency determination is not consistent with information contained in FERC's public records, and which is not part of the record upon which the State or Federal agency's determination was made, and (2) the preliminary finding by FERC and required notice thereof is made within 45 days after the date on which FERC received notice of the determination and the final finding is made within 120 days after the date of the preliminary finding, FERC may remand the matter to the State or Federal agency for consideration of such information.[14] If the agency, after consideration of the information transmitted to it by FERC, affirms its previous determination, such determination, as so affirmed, is subject to additional review by FERC. Such findings and remands by FERC may be subject to judicial review.[15]

In general, any final determination by a State or Federal agency (or by FERC) that a formation is a tight formation or that a well produces high-cost natural gas which is no longer subject to FERC or judicial review is thereafter binding with respect to such natural gas.[16]

In 1989, the Natural Gas Wellhead Decontrol Act [17] was enacted. That Act repealed Title I of the NGPA, effective on January 1, 1993. It also repealed FERC's determination review responsibility under section 503 of the NGPA. The legislative history to the 1989 legislation stated that the Senate Committee on Energy and Natural Resources did not intend, by repealing sections of the NGPA referenced in section 29 of the Internal Revenue Code, to reflect an adverse judgment as to the merits of the tax credits for any categories of natural gas production that might be affected by such action.[18] In view of this indication that Congress did not intend the

[11] 18 C.F.R. sec. 271.703(c).
[12] 15 U.S.C. sec. 3413(a)(2) (1988).
[13] 15 U.S.C. sec. 3413(b)(1) (1988).
[14] 15 U.S.C. sec. 3413(b)(2) (1988).
[15] 15 U.S.C. sec. 3413(b)(4) (1988).
[16] 15 U.S.C. sec. 3413(d) (1988).
[17] P.L. 101-60, July 26, 1989.
[18] S. Rep. No. 101-39, 101st Cong., 1st Sess. 9 (1989).

1989 legislation to limit the availability of the section 29 credit, FERC announced that it will continue to process well determinations until January 1, 1993, in order to allow producers to obtain tax credits that are dependent upon such determinations even if the gas has been otherwise decontrolled.[19]

House bill

No provision.

Senate amendment

The Senate amendment provides that with respect to determinations required under the Internal Revenue Code of whether gas is produced from geopressured brine, Devonian shale, coal seams, or from a tight formation, in the event that such a determination is not made by the Federal Energy Regulatory Commission in accordance with section 503 of the Natural Gas Policy Act of 1978 due to the expiration of that statute, the Secretary of Treasury is required to make such determinations. For this purpose, the Senate amendment mandates that any such determination by the Treasury Department be based on the guidelines for making determinations set forth in the Natural Gas Policy Act of 1978 (and in regulations thereunder) prior to its repeal.

In addition, the Senate amendment clarifies that for purposes of the section 29 credit, the definitions of gas produced from geopressured brine, Devonian shale, coal seams, or from a tight formation are as established by the Federal Energy Regulatory Commission under the Natural Gas Policy Act of 1978 prior to repeal of provisions of that statute relating to such definitions.

Effective date.—The provision is effective for determinations not made by the Federal Energy Regulatory Commission as a result of the repeal of relevant provisions of the Natural Gas Policy Act of 1978.

Conference agreement

The conference agreement follows the Senate amendment.

N. Estate and Gift Tax Provisions

1. WAIVER OF RIGHT OF RECOVERY FOR CERTAIN MARITAL DEDUCTION PROPERTY

Present law

For estate and gift tax purposes, a marital deduction is allowed for qualified terminable interest property (QTIP). Such property generally is included in the surviving spouse's gross estate. The surviving spouse's estate is entitled to recover the portion of the estate tax attributable to such inclusion from the person receiving the property, unless the spouse directs otherwise by will (sec. 2207A). A will provision specifying that all taxes be paid by the estate may waive the right of recovery.

[19] F.E.R.C. Order No. 523, 55 Fed. Reg. 17425, April 25, 1990.

The gross estate includes the value of previously transferred property in which the decedent retains enjoyment or the right to income (sec. 2036). The estate is entitled to recover from the person receiving the property a portion of the estate tax attributable to the inclusion (sec. 2207B). This right may be waived only by a provision in the will (or revocable trust) specifically referring to section 2207B.

House bill

The House bill provides that the right of recovery with respect to QTIP is waived to the extent that language in the decedent's will or revocable trust specifically so indicates. The bill also provides that the right of contribution for property over which the decedent retained enjoyment or the right to income is waived by such indication.

Effective date.—The provision applies to decedents dying 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.

2. INCLUSION IN GROSS ESTATE OF CERTAIN GIFTS MADE WITHIN THREE YEARS OF DEATH

Present law

The first $10,000 of gifts of present interests to each donee during any one calendar year are excluded from Federal gift tax.

The value of the gross estate includes the value of any previously transferred property if the decedent retained the power to revoke the transfer (sec. 2038). The gross estate also includes the value of any property with respect to which such power is relinquished during the three years before death (sec. 2035). This rule has been interpreted to include in the gross estate certain transfers made from a revocable trust within three years of death.[1] Such inclusion subjects gifts that would otherwise qualify under the annual $10,000 exclusion to estate tax.

House bill

The House bill provides that a transfer from a trust over which the grantor held the power to revoke would be treated as if made directly by the grantor. Thus, an annual exclusion gift from such trust is not included in the gross estate.

The bill also revises section 2035 to improve its clarity.

[1] See, e.g., *Jalkut Estate v. Commissioner*. 96 T.C. 675 (1991) (transfers from revocable trust to permissible beneficiaries of the trust includible in the grantor's gross estate); LTR 9117003 (same).

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 no inference be drawn from the provision with respect to the treatment of transfers from revocable trusts under present law.

Effective date.—The provision applies to decedents dying after the date of enactment.

3. DEFINITION OF QUALIFIED TERMINABLE INTEREST PROPERTY

Present law

A marital deduction is allowed for qualified terminable interest property (QTIP). Property is QTIP only if the surviving spouse has a qualifying income interest for life (e.g., the spouse is entitled to all of the income from the property, payable at least annually). QTIP generally is includible in the surviving spouse's gross estate.

Under proposed Treasury regulations, an income interest may constitute a qualifying income interest for life even if income accumulating between the last distribution date and the date of the surviving spouse's death (the "accumulated income") is not required to be distributed to the surviving spouse or the surviving spouse's estate. See Prop. Treas. Reg. secs. 20.2056(b)-7(c)(1), 25.2523(f)-1(b). Contrary to the proposed regulations, the United States Tax Court has held that in order to satisfy the QTIP requirements, the accumulated income must be paid to the spouse's estate or be subject to a power of appointment held by the spouse. See *Estate of Howard v. Commissioner*, 91 T.C. 329, 338 (1988), *rev'd*, 910 F.2d 633 (9th Cir. 1990).

House bill

Under the House bill, an income interest does not fail to be a qualified income interest for life solely because the accumulated income is not required to be distributed to the surviving spouse. Such income is includible in the surviving spouse's gross estate.

Effective date.—The House bill applies to decedents dying, and gifts made, after date of enactment. However, the bill does not include in the surviving spouse's gross estate property transferred before the date of enactment for which no marital deduction was claimed.

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 no inference be drawn from the provision with respect to the definition of a qualified income interest for life under present law.

4. INCLUDE FRACTIONAL SHARE OF PROPERTY QUALIFYING FOR THE MARITAL DEDUCTION IN THE GROSS ESTATE

Present law

A marital deduction against the estate and gift tax generally is permitted for the value of property passing between spouses. No marital deduction is permitted, however, if, upon termination of the spouse's interest, possession or enjoyment of the property passes to another person (the "terminable interest rule"). Certain exceptions to this rule may apply if the spouse receives a general power of appointment over, or an income interest in, a "specific portion" of property (sec. 2056(b) (5), (6), (7)). The spouse is subject to transfer tax on property over which he or she holds a general power of appointment.

A Treasury regulation defines a "specific portion" to be a fractional or percentile share of a property interest (Treas. Reg. sec. 20.2056(b)-5(c)). Finding this regulation invalid, courts have held that the term "specific portion" includes a fixed dollar amount. See *Northeastern Pennsylvania National Bank & Trust Co. v. United States*, 387 U.S. 213 (1967); *Estate of Alexander v. Commissioner*, 82 T.C. 34 (1984), aff'd, No. 8401600 (4th Cir. April 3, 1985). Under the court holdings, appreciation in certain marital deduction property may be includible in neither spouse's estate.

House bill

The House bill provides that, for purposes of the marital deduction, a "specific portion" only includes a portion determined on a fractional or percentage basis. Thus, a trust does not qualify under the exceptions to the terminable interest rule unless the required income interest and general power of appointment are expressed as a fraction or a percentage of the property. The bill thereby reverses the court holdings and codifies the position of the Treasury regulations. The bill does not generally affect the marital deduction allowed for a pecuniary formula marital deduction bequest. See, e.g., Rev. Rul. 64-19, 1964-1 C.B. 682.

Effective date.—The House bill generally applies to gifts made, and decedents dying, after date of enactment. The bill does not apply to a transfer under a will or revocable trust executed before the date of enactment if either (1) on that date the decedent was under a mental disability to change the disposition of his property and did not regain his competence to dispose of such property before the date of death, or (2) the decedent dies within three years after the date of enactment. The bill applies, however, if the will or trust is amended after the date of enactment in any respect that increases the amount of the transfer qualifying for the marital deduction or alters the terms by which the interest passes.

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 no inference be drawn from the provision with respect to definition of "specific portion" under present law.

5. REQUIREMENTS FOR QUALIFIED DOMESTIC TRUST

Present law

A deduction generally is allowed for Federal estate tax purposes for the value of property passing to a spouse. The Technical and Miscellaneous Revenue Act of 1988 ("TAMRA") denied the marital deduction for property passing to a noncitizen spouse outside a qualified domestic trust ("QDT"). An estate tax is imposed on corpus distributions from a QDT.

TAMRA defined a QDT as a trust that, among other things, required all trustees be U.S. citizens or domestic corporations. This provision was modified in the Omnibus Budget Reconciliation Acts of 1989 and 1990 to require that at least one trustee be a U.S. citizen or domestic corporation and that no corpus distribution be made unless such trustee has the right to withhold any estate tax imposed on the distribution (the "withholding requirement").

House bill

The House bill treats a trust created before the enactment of the Omnibus Budget Reconciliation Act of 1990 as satisfying the withholding requirement if its governing instrument requires that all trustees be U.S. citizens or domestic corporations.

Effective date.—The bill applies as if included in the Omnibus Budget Reconciliation Act of 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. ELECTION OF SPECIAL USE VALUATION OF FARM PROPERTY FOR ESTATE TAX PURPOSES

Present law

For estate tax purposes, an executor may elect to value certain real property used in farming or other closely held business operations at its current use value rather than its highest and best use (sec. 2032A). A written agreement signed by each person with an interest in the property must be filed with the election.

Treasury regulations require that a notice of election and certain information be filed with the Federal estate tax return (Treas. Reg. sec. 20.2032A–8). The administrative policy of the Treasury Department is to disallow current use valuation elections unless the required information is supplied.

Under procedures prescribed by the Secretary of the Treasury, an executor who makes the election and substantially complies with the regulations but fails to provide all required information or the signatures of all persons with an interest in the property may supply the missing information within a reasonable period of time (not exceeding 90 days) after notification by the Secretary.

House bill

The House bill extends the procedures allowing subsequent submission of information to any executor who makes the election and submits the recapture agreement, without regard to compliance with the Treasury regulations. Thus, the bill allows the current use valuation election if the executor supplies the required information within a reasonable period of time (not exceeding 90 days) after notification by the IRS. During that time period, the bill also allows addition of signatures to a previously filed agreement.

Effective date.—The House bill applies to decedents dying 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. INCOME TAXATION OF ACCUMULATION TRUSTS

Present law

In general

A nongrantor trust is treated as a separate taxpayer for Federal income tax purposes. Such trust is generally treated as a conduit with respect to amounts distributed currently and taxed as an individual with respect to undistributed income. The conduit treatment is achieved by allowing the trust a deduction for amounts distributed to beneficiaries during the taxable year to the extent of distributable net income and by including the distributions in the beneficiaries' income.

Distributions of accumulated income

A distribution of previously accumulated income is taxed under the so-called throwback rules, which provide that beneficiaries are taxed on distributions of previously accumulated income from trusts in substantially the same manner as if the income had been distributed in the year received.

Distributions of appreciated property

If property is sold within two years of its contribution to a trust, the gain that would have been recognized had the contributor sold the property is taxed at the contributor's marginal tax rates (sec. 644). In effect, section 644 treats such gains as if the contributor had realized the gain and then transferred the net after-tax proceeds from the sale to the trust as corpus.

Treatment of multiple trusts

Effective March 1, 1984, two or more trusts are 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 (sec. 643(f)). For trusts that were irrevocable as of that date, section 643(f) applies only to subsequent contributions to corpus.

House bill

No provision.

Senate amendment

The Senate amendment exempts amounts accumulated in domestic trusts after December 31, 1992, from "throwback rules." It also provides that precontribution gain on property sold by a domestic trust is no longer taxed at the contributor's marginal tax rates. The amendment does not apply to a trust created before March 1, 1984, unless the taxpayer establishes that the trust would not have been aggregated under the standard contained in section 643(f).

Effective date.—The change in the throwback rules applies to taxable years beginning after the December 31, 1992. The modification in section 644 applies to sales or exchanges after December 31, 1992.

Conference agreement

The conference agreement does not include the Senate amendment.

O. Excise Tax Simplification

1. FUELS TAX PROVISIONS

a. Consolidate provisions imposing diesel and aviation fuel excise taxes

Present law

Code section 4091 imposes a tax on the sale of diesel and aviation fuel by a "producer." The term producer generally includes refiners, compounders, blenders, and wholesalers who are registered with the Internal Revenue Service. The term also includes persons to whom diesel or aviation fuel has been sold tax-free.

As a backup, section 4041 imposes a tax on certain sales or uses of diesel and aviation fuel if a taxable sale of such fuel does not occur under section 4091.

House bill

The House bill combines the diesel and aviation fuel tax provisions currently divided between Code sections 4041 and 4091 into a revised section 4091. The use of diesel and aviation fuel in a taxable use by producers will be taxed under section 4091, and the definition of producer is clarified to include purchasers in tax-reduced sales.

The bill also simplifies the Code by eliminating two unnecessary provisions, sections 4041(b)(1)(B) and (j) of the Code. These provisions are redundant.

Effective date.—The provision is effective for sales or uses on or after January 1, 1993.

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. Permit refund of tax to taxpayer for diesel and aviation fuel resold to certain exempt purchasers

Present law

As a general matter, purchasers who use tax-paid fuels for an exempt use are entitled to a refund or credit. Purchasers of tax-paid fuels generally are not permitted a refund or credit if they resell the fuels to another person who subsequently uses them in an exempt use.

However, persons who buy and then resell (a) fuel subject to the special motor fuel or gasoline taxes or (b) certain other articles are permitted a refund or credit (in place of the ultimate users claiming the credit or refund) if they resell the fuel or article for use in the following exempt uses: (1) export, (2) supplies for aircraft or vessels, (3) use by a State or local government, or (4) use by a nonprofit educational organization for its exclusive use.

House bill

The House bill allows a refund or credit to sellers of diesel and aviation fuel who purchase the fuels tax-paid and re-sell the fuels without payment of tax for any of the four exempt uses described above.

Effective date.—The provision is effective for sales on or after January 1, 1993.

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. Consolidate refund provisions for fuel excise taxes

Present law

As a general matter, purchasers who use fuels for exempt uses are entitled to a refund if the fuels have been purchased tax-paid. The refund provisions for the fuels excise taxes are found in several sections of the Code.

In general, a purchaser entitled to a refund may file a quarterly refund claim for any of the first three quarters of the purchaser's tax year, if the claim exceeds a threshold dollar amount (with the lowest threshold being $750). The threshold amounts differ for different fuels and different exempt uses. A purchaser cannot file a quarterly claim for refund for its fourth quarter, but must file the claim as a credit on that year's income tax return.

There is an expedited procedure for gasohol blenders claiming a refund of part of the excise tax included in the price of the gasoline used for blending into gasohol.

Finally, only an income tax credit, and not a refund, may be claimed for excise taxes on gasoline and special motor fuel used on a farm for farming purposes.

House bill

The House bill consolidates the user credit and refund provisions for the fuels excise taxes into one section of the Code. The bill also combines the three refund procedures for fuels taxes into a uniform refund procedure. The new uniform refund procedure permits an exempt user to aggregate its refund claims for all fuels taxes and file for a refund in any calendar quarter in which the amount of the aggregate claim exceeds $750. The uniform refund procedure also permits such a user to file for a refund for its fourth quarter rather than apply for a credit.

The special expedited procedure for gasohol blenders is unchanged.

Effective date.—The provision is effective for sales on or after January 1, 1993.

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. Repeal waiver requirement for fuel tax refunds for cropdusters and other fertilizer applicators

Present law

In general, farmers who use gasoline and aviation fuel on farms are entitled to refunds of the taxes that have been paid on that fuel. Cropdusters and other fertilizer applicators that use gasoline and aviation fuel on farms are entitled to refunds of the taxes paid on that fuel in lieu of the farmers, but only if the owners or operators of the farms waive their right to refunds for such fuel.

House bill

The House bill eliminates the waiver requirement for fuels tax refunds for cropdusters and other fertilizer applicators.

Effective date.—The provision is effective for fuels purchased on or after January 1, 1993.

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. *Authorize exceptions from information reporting for certain sales of diesel and aviation fuel*

Present law

Certain producers and importers and purchasers are required to file information returns for reduced-tax sales of diesel and aviation fuel.

House bill

The House bill permits the Internal Revenue Service by regulation to provide exceptions to the mandatory information return requirement for certain sales of diesel and aviation fuel.

Effective date.—The provision applies to sales on or after January 1, 1993.

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. PROVISIONS RELATING TO DISTILLED SPIRITS, WINES, AND BEER

Present law

Refund on return to bonded premises of imported bottled distilled spirits

Present law provides that when tax-paid distilled spirits which have been withdrawn from bonded premises of a distilled spirits plant are returned for destruction or redistilling, the excise taxes are refunded (sec. 5008(c)). This provision does not apply to imported bottled distilled spirits because they are withdrawn from customs custody and not from bonded premises.

Bond for exported distilled spirits

Bond generally must be furnished to the Treasury Department when distilled spirits are removed from bonded premises for exportation without payment of tax. These bonds are cancelled or credited when evidence is submitted to the Department of the Treasury that the distilled spirits have been exported (sec. 5175(c)).

Distilled spirits plant records

Distilled spirits plant proprietors are required to maintain records of their production, storage, denaturation, and other processing activities on the premises where the operations covered by the records are carried on (sec. 5207(c)).

Transfers from breweries to distilled spirits plants

Under present law, beer may be transferred without payment of tax from a brewery to a distilled spirits plant to be used in the production of distilled spirits, but only if the brewery is contiguous to the distilled spirits plant (sec. 5222(b)).

Posting of sign by wholesale liquor dealers

Wholesale liquor dealers (i.e., dealers, other than wholesale dealers in beer alone, who sell distilled spirits, wines, or beer to other persons who re-sell such products) are required to post a sign conspicuously on the outside of their place of business indicating that they are wholesale liquor dealers (sec. 5115).

Refund of tax for wine returned to bond

Under present law, when unmerchantable wine is returned to bonded production premises, tax that has been paid is returned or credited to the proprietor of the bonded wine cellar to which the wine is delivered (sec. 5044). In contrast, when beer is returned to a brewery, tax that has been paid is returned or credited, regardless of whether the beer is unmerchantable (sec. 5056(a)).

Use of ameliorating material in certain wines

The Code contains rules governing the extent to which ameliorating material (e.g., sugar) may be added to wines made from high acid fruits and the product still be labelled as a standard, natural wine. In general, ameliorating material may not exceed 35 percent of the volume of juice and ameliorating material combined (sec. 5383(b)(1)). However, wines made exclusively from loganberries, currants, or gooseberries are permitted a volume of ameliorating material of up to 60 percent (sec. 5384(b)(2)(D)).

Domestically produced beer for use by foreign embassies, etc.

Under present law, domestically produced distilled spirits and wine may be removed from bond, without payment of tax, for transfer to any customs bonded warehouse for storage pending removal for the official or family use of representatives of foreign governments or public international organizations (secs. 5066 and 5362(e)). (A similar rule also applies to imported distilled spirits, wine, and beer.) No such provision exists under present law for domestically produced beer.

Withdrawal of beer for destruction

Present law does not specifically permit beer to be removed from a brewery for destruction without payment of tax.

Records of exportation of beer

Present law provides that a brewer is allowed a refund of tax paid on exported beer upon submission to Treasury Department of certain records indicating that the beer has been exported (sec. 5055).

Transfer to brewery of beer imported in bulk

Imported beer brought into the United States in bulk containers may not be transferred from customs custody to brewery premises without payment of tax. Under certain circumstances, distilled spirits imported into the United States in bulk containers may be transferred from customs custody to bonded premises of a distilled spirits plant without payment of tax (sec. 5232).

House bill

Return of imported bottled distilled spirits

The procedures for refunds of tax collected on imported bottled distilled spirits returned to bonded premises are conformed to the rules for domestically produced and imported bulk distilled spirits. Thus, refunds are available for all distilled spirits on their return to a bonded distilled spirits plant.

Bond for exported distilled spirits

For purposes of cancelling or crediting bonds furnished when distilled spirits are removed from bonded premises for exportation, the Treasury Department is authorized to permit records of exportation to be maintained by the exporter, rather than requiring submission of proof of exportation to Treasury in all cases.

Distilled spirits plant records

Distilled spirits plant proprietors are permitted to maintain records of their activities at locations other than the premises where the operations covered by the records are carried on (e.g., corporate headquarters), provided that the records are available for inspection by the Treasury Department during business hours.

Transfers from breweries to distilled spirits plants

The House bill allows beer to be transferred without payment of tax from a brewery to a distilled spirits plant to be used in the production of distilled spirits, regardless of whether the brewery is contiguous to the distilled spirits plant.

Posting of sign by wholesale liquor dealers

The requirement that wholesale liquor dealers post a sign outside their place of business indicating that they are wholesale liquor dealers is repealed.

Refund of tax for wine returned to bond

The House bill deletes the requirement that wine returned to bonded premises be "unmerchantable" in order for tax to be refunded to the proprietor of the bonded wine cellar to which the wine is delivered.

Use of ameliorating material in certain wines

The wine labelling restrictions are modified to allow any wine made exclusively from a fruit or berry with a natural fixed acid of 20 parts per thousand or more (before any correction of such fruit or berry) to contain a volume of ameliorating material not in excess of 60 percent.

Domestically produced beer for use by foreign embassies, etc.

The House bill extends to domestically produced beer the present-law rule applicable to domestically produced distilled spirits and wine (and imported distilled spirits, wine, and beer) which permits these products to be withdrawn without payment of tax for the official or family use of representatives of foreign governments or public international organizations.

Withdrawal of beer for destruction

The House bill allows beer to be removed from a brewery without payment of tax for destruction, subject to Treasury Department regulations.

Records of exportation of beer

The House bill repeals the requirement that proof of exportation be submitted to the Treasury Department in all cases as a condition of receiving a refund of tax. This proof will continue to be required to be maintained at the exporter's place of business.

Transfer to brewery of beer imported in bulk

The House bill extends the present-law rule applicable to distilled spirits imported into the United States in bulk containers to beer imported into the United States in bulk containers, so that imported beer may, subject to Treasury regulations, be withdrawn from customs custody for transfer to a brewery without payment of tax.

Effective date

These provisions of the bill generally are effective beginning 180 days after the date of enactment. The provision deleting the requirement that wholesale liquor dealers post a sign outside their place of business is effective on the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill, except the Senate amendment also allows brewers to receive credit or refund for tax paid on beer that is transferred to a distilled spirits plant for use in the production of distilled spirits after having been removed from a brewery without such beer first being required to be returned to a brewery for the transfer.

Conference agreement

The conference agreement follows the House bill and the Senate amendment, including the Senate amendment's provision related to tax-paid beer transferred to distilled spirits plants without first being returned to a brewery.

3. OTHER EXCISE TAX PROVISIONS

a. Authority for IRS to grant exemptions from registration requirements

Present law

Under section 4222, certain sales of articles subject to Federal excise taxes may not be made without payment of tax unless the manufacturer, the first purchaser, and the second purchaser (if any) are all registered under regulations prescribed by the Secretary.

House bill

The House bill allows the IRS to provide exemption from generally applicable excise tax registration requirements for certain classes of taxpayers.

Effective date.—The provision applies to sales after the 180th day 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. Repeal temporary reduction in tax on piggyback trailers

Present law

Piggyback trailers and semitrailers sold within the one-year period beginning on July 18, 1984 were permitted a temporary reduction in the retail excise tax on trailers.

House bill

The House bill repeals the temporary reduction in tax on piggyback trailers as "deadwood."

Effective date.—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.

c. Expiration of excise tax on deep seabed minerals

Present law

The Deep Seabed Mineral Resources Act (the "Resources Act," P.L. 96–283), imposed an excise tax on certain hard minerals mined on the deep seabed. The tax revenues were intended to fund obligations of the United States under a contemplated Law of the Sea Convention.

The tax was scheduled to terminate on the earlier of the date on which a U.N. international deep seabed treaty took effect with respect to the United States, or June 28, 1990 (10 years after the date of enactment of the tax). Because the United States did not sign the treaty, the excise tax provisions expired on June 28, 1990.

House bill

The House bill deletes the deep seabed hard minerals excise tax provisions as "deadwood."

Effective date.—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.

d. Firearms excise tax exemption for small manufacturers

Present law

Present law imposes an 11-percent excise tax on the manufacture or importation of rifles and shotguns and on ammunition (shells and cartridges). Present law also imposes a 10-percent excise tax on the manufacture or importation of pistols and revolvers (sec. 4181).

Revenues from these taxes are appropriated, in the fiscal year following receipt, to the Federal Aid to Wildlife Program for support of State wildlife programs.

House bill

No provision.

Senate amendment

The Senate amendment exempts small manufacturers and importers from the 11-percent excise tax on firearms (rifles and shotguns) and ammunition and the 10-percent excise tax on pistols and revolvers, if the manufacturer or importer manufactures or imports fewer than 50 such articles per year.

Effective date.—The provision is effective for articles sold after September 30, 1983. In the case of any taxable year ending before the date of enactment, the period for claiming a credit or refund of any overpayment of tax resulting from the proposed exemption from tax will not expire before one year after the date of enactment.

Conference agreement

The conference agreement does not include the provision of the Senate amendment.

P. Administrative Provisions

1. GENERAL PROVISIONS

a. Simplify payroll tax deposit requirements

Present law

The Code provides that the Secretary of the Treasury ("Secretary") may establish the mode or time for collecting any tax if the mode or time is not specified in the Code (sec. 6302(a)). In general, Treasury regulations have established the system under which employers deposit income taxes withheld from employees' wages and FICA taxes. The frequency with which these taxes must be deposited increases as the amount required to be deposited increases.

Employers are required to deposit these taxes as frequently as eight times per month, provided that the amount to be deposited equals or exceeds $3,000. These deposits must be made within three banking days after the end of each eighth-monthly period. Monthly or quarterly deposits are required for smaller amounts.

In addition, the Code requires employers who are on this eighth-monthly system to deposit income taxes withheld from employees' wages and FICA taxes by the close of the next banking day (instead of by the close of the third banking day) after any day on which the business cumulates an amount to be deposited equal to or greater than $100,000 (regardless of whether that day is the last day of an eighth-monthly period).

House bill

In general

The House bill replaces the entire payroll tax deposit system with a new system that is clearer and easier to understand. In general, the new system consists of three basic deposit timetables. The first, which replaces the eighth-monthly system, requires deposits twice a week, on Tuesdays and Fridays. The second, which applies to large depositors, retains the requirement of present law that cumulations of an amount to be deposited of $100,000 or more must be deposited on or before the next day. The third, which applies to many small depositors, provides generally that if the amount required to be deposited was $12,000 or less per quarter for a previous one-year base period, deposits must be made only once a month, on or before the fifteenth day of the following month.

Tuesday, Friday deposit rule

The Tuesday/Friday rule operates in the following manner. Amounts attributable to wage payments made on Wednesday, Thursday, or Friday are to be deposited on or before the following

Tuesday. Amounts attributable to wage payments made on Saturday, Sunday, Monday, or Tuesday are to be deposited on or before the following Friday. Utilizing Tuesday and Friday as both the final days of the portion of the week with respect to which amounts to be deposited are cumulated as well as the days on which deposits must be made will provide a simple, easily remembered rule that will simplify the administration of these deposit requirements for both employers and the IRS.

Small depositor rules

The small depositor rules operate as follows. If an employer is a small depositor, deposits of employment taxes attributable to wage payments during a month must be made on or before the fifteenth day of the following month.

A person is a small depositor for a calendar quarter if, for each calendar quarter in the base period, the amount of employment taxes attributable to payments in each of those calendar quarters was $12,000 or less. The base period is defined to be the four calendar quarters ending with the second preceding calendar quarter before the quarter with respect to which the deposit requirements are being determined. For example, the base period for the calendar quarter of April through June 1993 is January 1992 through December 1992. If with respect to each of the calendar quarters in that one-year base period, the amount of employment taxes was $12,000 or less, then the employer is a small depositor for the April through June 1993 calendar quarter and is required to make monthly deposits of employment taxes for that quarter. This is true regardless of the amount of employment taxes for the April through June 1993 quarter. The only exception to this is that the $100,000 rule applies to all depositors, including small depositors. This application of the $100,000 rule should have no impact on small employers; it is designed to prevent very large new companies from making deposits only once a month.

New companies will initially be treated as small depositors. For purposes of performing the base period determination, a company is considered to have employment taxes of zero for any calendar quarter in which a company did not exist. Consequently, new companies will, for at least the first two calendar quarters of their existence, be required to deposit only once a month (unless they fall within the $100,000 rule).

The small depositor rule is designed to provide certainty to small employers with respect to their current deposit requirements. Most employers will be able to examine their quarterly employment tax returns (Form 941) for the one year in the base period and readily determine on that basis whether they are small depositors or must deposit on the Tuesday/Friday system. The "second preceding quarter" provision is designed to provide employers with ample lead time to make this determination prior to the start of a calendar quarter.

Safe harbor

The bill provides a statutory safe harbor with respect to certain shortfalls in deposits. An employer will be treated as having deposited the required amount of employment taxes in any deposit if the shortfall does not exceed the greater of $100 or two percent of the amount of employment taxes otherwise required to be deposited. A shortfall is the excess of the amount required to be deposited (without regard to this rule) over the amount actually deposited on or before the last day on which that deposit is required. Any shortfall is to be deposited as required by Treasury regulations.

Definitions and other rules

The bill provides that deposits are required only on banking days. (This rule is also contained in present law.) If a deposit is required to be made on or before a day that is not a banking day, the deposit is considered to have been made on a timely basis if it is made on or before the close of the next banking day. It is anticipated that the substance of Treasury regulations defining the term "banking day" will not be changed. For example, if a deposit is required to be made on a Friday which is also the July 4 holiday, that deposit would be considered to be made on a timely basis if it is made on or before the following Monday.

The bill defines "employment taxes" to mean FICA taxes (both the employer and employee portions), Railroad Retirement Tax Act taxes, and withheld income taxes (as well as similar withheld taxes under chapter 24 of the Code).

These provisions generally do not apply to employment taxes that are not required to be deposited pursuant to Treasury regulations issued pursuant to section 6302. Under present law, employers with less than $500 of employment taxes for a calendar quarter are not required to deposit those taxes. They are instead permitted to remit those taxes with the quarterly employment tax return (Form 941). It is anticipated that a similar system permitting remittance (rather than requiring deposit) of these small amounts will be continued.

Treasury regulations

The bill provides that the Secretary may prescribe regulations relating to specific issues (in addition to the general authority to issue regulations with respect to collecting tax in sec. 6302 or generally in sec. 7805). First, the regulations may specify alternate employment tax requirements for employers who fail to comply with the requirements of this provision. This would enable the IRS to continue its practice (currently authorized by regulations issued pursuant to sec. 6302(a)) of specifying more frequent deposit requirements or alternate payment mechanisms for employers who have seriously violated the established deposit requirements.

The bill also permits the Secretary to issue regulations specifying the additional circumstances (beyond those provided in the bill) under which an employer may be treated as a small depositor. This in effect permits the Treasury to expand (but not contract) the definition of small depositors.

In addition, the bill permits the Secretary to issue regulations modifying these provisions for end-of-quarter periods. This is designed to permit the IRS to require appropriate treatment of amounts that overlap two quarters. For example, assume that a quarter ends on Wednesday. The deposit normally required to be made on or before the following Tuesday could include amounts attributable to the previous quarter (with respect to Wednesday) as well as amounts attributable to the current quarter (with respect to Thursday and Friday). Treasury regulations can specify an alternate rule to distinguish amounts relating to the two quarters.

Finally, the bill permits the Secretary to issue regulations establishing different deposit requirements for amounts withheld pursuant to the backup withholding requirements of section 3406. Under present law, these amounts are treated the same as amounts withheld from income taxes. Because amounts withheld pursuant to the backup withholding requirements are often relatively small and are not generally handled by payroll offices, it is appropriate for Treasury to provide alternate deposit rules with respect to these amounts.

Effective date

The provision is effective for amounts attributable to payments made after December 31, 1992.

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. Simplify employment tax reporting for household employees

Present law

An employer who pays a household employee wages of $50 or more in a calendar quarter for household work must withhold social security taxes (including medicare taxes) from wages paid to the employee during the quarter. The employer must also pay an amount of tax that matches the tax withheld from the employee's wages. The employer must file an Employer's Quarterly Tax Return (Form 942) each quarter and a Wage and Tax Statement (Form W-2) at the end of the year.

In addition, an employer must pay Federal unemployment taxes if he or she paid cash wages to household employees totalling $1,000 or more in a calendar quarter in the current or preceding year. The employer must file an Employer's Annual Federal Unemployment Tax Return (Form 940 or Form 940-EZ) at the end of the year.

House bill

The House bill changes the threshold for withholding and paying social security taxes with respect to domestic service employment from $50 a quarter to $300 a year. The bill requires an individual who employs only household employees (regardless of the amount of the remuneration) to report any social security or Federal unemployment tax obligation for wages paid to such employees on his or her income tax return for the year. The bill includes a household employer's social security and unemployment taxes in the estimated tax provisions. The bill also authorizes the Secretary to enter into agreements with States to collect State unemployment taxes in the same manner.

Effective date.—The provision is effective for remuneration paid in calendar years beginning after December 31, 1992.

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. *Simplify estimated tax payment rules for small corporations*

Present law

A corporation is subject to an addition to tax for any underpayment of estimated tax. A corporation does not have an underpayment of estimated tax if it makes four timely estimated tax payments each equal to at least 22.5 percent of its tax liability for the current taxable year. In addition, a corporation that is not a "large corporation" may avoid the addition to tax if it makes four timely estimated tax payments each equal to at least 25 percent of its tax liability for the preceding taxable year, so long as the preceding year was not a short taxable year and corporation filed a return showing a tax liability for such year. A large corporation may use this second rule only with respect to its estimated tax payment for the first quarter of its current taxable year. A large corporation is one that had taxable income of $1 million or more for any of the three preceding taxable years.

House bill

The House bill provides that a small corporation (i.e., a corporation that is not a "large corporation" under present law) with no tax liability in the preceding taxable year may avoid the addition to tax if it makes four timely estimated tax payments each equal to at least 25 percent of its tax liability for the second preceding taxable year.[1] This rule will apply so long as (1) neither the preceding taxable year nor the second preceding taxable year was a short tax year, and (2) the corporation filed tax returns for both years. If the corporation satisfies these two requirements and did not have a tax liability for either of the two preceding taxable years, the corporation will not be required to make estimated tax payments for the current taxable year.

A large corporation may use this expanded safe harbor with respect to its estimated tax payment for the first quarter of its taxable year, as under present law.

Effective date.—The provision is effective for taxable years beginning after the date of enactment of this Act.

[1] As under present law, a small corporation may continue to use the current taxable year rule for estimated tax purposes.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House bill.

d. Interest rate on large corporate underpayments

Present law

The interest rate on a large corporate underpayment of tax is the Federal short-term rate plus five percentage points. A large corporate underpayment is any underpayment by a subchapter C corporation of any tax imposed for any taxable period, if the amount of such underpayment for such period exceeds $100,000. The large corporate underpayment rate generally applies to periods beginning 30 days after the earlier of the date on which the first letter of proposed deficiency, a statutory notice of deficiency, or a nondeficiency letter or notice of assessment or proposed assessment is sent. For this purpose, a letter or notice is disregarded if the taxpayer makes a payment equal to the amount shown on the letter or notice within that 30 day period.

House bill

For purposes of determining the period to which the large corporate underpayment rate applies, any letter or notice will be disregarded if the amount of the deficiency, proposed deficiency, assessment, or proposed assessment set forth in the letter or notice is not greater than $100,000 (determined by not taking into account any interest, penalties, or additions to tax).

Effective date.—The provision is effective for purposes of determining interest for periods after December 31, 1990.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

e. Clarify that reproductions from digital images are reproductions for recordkeeping purposes

Present law

Reproductions of á return, document, and certain other matters have the same legal status as the original for purposes of judicial and administrative proceedings. It is unclear whether reproductions made from digital images are also accorded the same legal status as originals.

House bill

The House bill provides that the term reproduction includes a reproduction from a digital image. The bill also requires the Comptroller General to conduct a study of available digital image technology for the purpose of determining the extent to which reproductions of documents stored using that technology accurately reflect the data on the original document and the appropriate period for retaining the original document.

Effective date.—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.

f. Repeal tax shelter registration requirements

Present law

Organizers of tax shelters must register their shelters with the IRS before offering any interests for sale.

House bill

The House bill repeals the tax shelter registration requirements.

Effective date.—The provision is effective on the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House bill provision.

g. Repeal of authority to disclose whether a prospective juror has been audited

Present law

In connection with a civil or criminal tax proceeding to which the United States is a party, the Secretary must disclose, upon the written request of either party to the lawsuit, whether an individual who is a prospective juror has or has not been the subject of an audit or other tax investigation by the Internal Revenue Service (sec. 6103(h)(5)).

House bill

The House bill repeals the requirement that the Secretary disclose, upon the written request of either party to the lawsuit, whether an individual who is a prospective juror has or has not been the subject of an audit or other tax investigation by the Internal Revenue Service.

Effective date.—The provision is effective for judicial proceedings pending on, or commenced 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.

h. Repeal TEFRA audit rules for S corporations

Present law

An S corporation generally is not subject to income tax on its taxable income. Instead, it files an information return and the shareholders report their pro rata share of the S corporation's income and deductions on their own tax returns.

The Subchapter S Revision Act of 1982 generally made the TEFRA partnership audit and litigation rules applicable to S corporations. These rules require the determination of all "Subchapter S items" at the corporate, rather than the shareholder, level. These rules also require a shareholder to report all Subchapter S items consistently with the corporation's information return or to notify the IRS of any inconsistency. Temporary regulations contain an exception from these rules for "small S corporations," i.e., those with five or fewer shareholders, each of whom is a natural person or an estate.

House bill

The House bill repeals the unified audit procedures for S corporations. The bill retains, however, the requirement that shareholders report items in a manner consistent with the corporation's return.

Effective date.—The 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.

i. Clarify statute of limitations for items from passthrough entities

Present law

Passthrough entities (such as S corporations, partnerships, and certain trusts) generally are not subject to income tax on their taxable income. Instead, these entities file information returns and the entities' shareholders (or beneficial owners) report their pro rata share of the gross income and are liable for any taxes due.

Some believe that present law may be unclear as to whether the statute of limitations for adjustments that arise from distributions from passthrough entities should be applied at the entity or individual level (i.e., whether the 3-year statute of limitations for assessments runs from the time that the entity files its information return or from the time that a shareholder timely files his or her income tax return). (Compare *Fehlhaber v. Comm.*, 94 TC 863 (1990) and *Alan F. Bartol, et ux. v. Commissioner*, T.C. Memo 1992–141, with *Kelly v. Comm.*, 877 F.2d 7567 (9th Cir. 1989)).

House bill

The House bill clarifies that the return that starts the running of the statute of limitations for a taxpayer is the return of the taxpayer and not the return of another person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit. The provision is not intended to create any inference as to the proper interpretation of present law.

Effective date.—The 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.

2. TAX COURT PROVISIONS

a. Clarify jurisdiction of Tax Court with respect to overpayment determinations

Present law

The Tax Court may order the refund of an overpayment determined by the Court, plus interest, if the IRS fails to refund such overpayment and interest within 120 days after the Court's decision becomes final. Whether such an order is appealable is uncertain.

In addition, it is unclear whether the Tax Court has jurisdiction over the validity or merits of certain credits or offsets (e.g., providing for collection of student loans, child support, etc.) made by the IRS that reduce or eliminate the refund to which the taxpayer was otherwise entitled.

House bill

The House bill clarifies that an order to refund an overpayment is appealable in the same manner as a decision of the Tax Court. The bill also clarifies that the Tax Court does not have jurisdiction over the validity or merits of the credits or offsets that reduce or eliminate the refund to which the taxpayer was otherwise entitled.

Effective date.—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.

b. Clarify procedures for administrative cost awards

Present law

Any person who substantially prevails in any action brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty may be awarded reasonable administrative costs incurred before the IRS and reasonable litigation costs incurred in connection with any court proceeding.

No time limit is specified for the taxpayer to apply to the IRS for an award of administrative costs. In addition, no time limit is specified for a taxpayer to appeal to the Tax Court an IRS decision denying an award of administrative costs. Finally, the procedural rules for adjudicating a denial of administrative costs are unclear.

House bill

The House bill provides that a taxpayer who seeks an award of administrative costs must apply for such costs within 90 days of the date on which the taxpayer was determined to be a prevailing party. The bill also provides that a taxpayer who seeks to appeal an IRS denial of an administrative cost award must petition the Tax Court within 90 days after the date that the IRS mails the denial notice.

The bill clarifies that dispositions by the Tax Court of petitions relating only to administrative costs are to be reviewed in the same manner as other decisions of the Tax Court.

Effective date.—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.

c. Clarify Tax Court jurisdiction over interest determinations

Present law

A taxpayer may seek a redetermination of interest after certain decisions of the Tax Court have become final by filing a petition with the Tax Court.

House bill

The House bill provides that a taxpayer must file a "motion" (rather than a "petition") to seek a redetermination of interest in the Tax Court.

Effective date.—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.

d. Clarify net worth requirements for awards of administrative or litigation costs

Present law

Any person who substantially prevails in any action brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty may be awarded reasonable administrative costs incurred before the IRS and reasonable litigation costs incurred in connection with any court proceeding.

A person who substantially prevails must meet certain net worth requirements to be eligible for an award of administrative or litigation costs. In general, only an individual whose net worth does not exceed $2,000,000 is eligible for an award, and only a corporation or partnership whose net worth does not exceed $7,000,000 is eligible for an award. (The net worth determination with respect to a partnership or S corporation applies to all actions that are in substance partnership actions or S corporation actions, including unified entity-level proceedings under sections 6226 or 6228, that are nominally brought in the name of a partner or a shareholder.)

House bill

The House bill provides that the net worth limitations currently applicable to individuals also apply to estates and trusts. The bill also provides that individuals who file a joint tax return shall be treated as one individual for purposes of computing the net worth limitations. Consequently, the net worths of both spouses are aggregated for purposes of this computation. An exception to this rule is provided in the case of a spouse otherwise qualifying for innocent spouse relief.

Effective date.—The provision applies to proceedings commenced 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.

3. PERMIT IRS TO ENTER INTO COOPERATIVE AGREEMENTS WITH STATE TAX AUTHORITIES

Present law

The IRS is generally not authorized to provide services to non-Federal agencies even if the cost is reimbursed (62 Comp. Gen. 323,335 (1983)).

House bill

The House bill provides that the Secretary is authorized to enter into cooperative agreements with State tax authorities to enhance joint tax administration. These agreements may include (1) joint filing of Federal and State income tax returns, (2) single processing of these returns, and (3) joint collection of taxes (other than Federal income taxes).

The bill provides that these agreements may require reimbursement for services provided by either party to the agreement. Any funds appropriated for tax administration may be used to carry out the responsibilities of the IRS under these agreements, and any reimbursement received under an agreement shall be credited to the amount appropriated.

No agreement may be entered into that does not provide for the protection of confidentiality of taxpayer information that is required by section 6103.

Effective date.—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.

V. TAXPAYER BILL OF RIGHTS 2

A. Taxpayer Advocate

1. ESTABLISHMENT OF POSITION OF TAXPAYER ADVOCATE WITHIN INTERNAL REVENUE SERVICE

Present law

The Office of the Taxpayer Ombudsman was created by the IRS in 1979. The Taxpayer Ombudsman's duties are to serve as the primary advocate, within the IRS, for taxpayers. As the taxpayers' advocate, the Taxpayer Ombudsman participates in an ongoing review of IRS policies and procedures to determine their impact on taxpayers, receives ideas from the public concerning tax administration, identifies areas of the tax law that confuse or create an inequity for taxpayers, and supervises cases handled under the Problem Resolution Program. Under current procedures, the Taxpayer Ombudsman is selected by the Commissioner of the IRS and serves at his discretion.

House bill

The House bill establishes a new position, Taxpayers' Advocate, within the IRS. This replaces the position of Taxpayer Ombudsman. Compensation is at a level equal to that of the IRS Chief Counsel. The person is to be nominated by the President, by and with the advice and consent of the Senate. The Taxpayers' Advocate is required to make an annual report to the tax-writing Committees to identify the 20 most serious problems which taxpayers have in dealing with the IRS, to include recommendations for such administrative and legislative action as may be appropriate to resolve such problems, and to include other such information as the Taxpayers' Advocate may deem advisable. This report is also to include changes recommended by the Taxpayers' Advocate that have not been implemented and the reasons for the lack of implementation. This report is also to include a list of the recommendations the Taxpayers' Advocate received from Problem Resolution Officers or other IRS employees. The Commissioner is required to establish internal procedures that will ensure a formal IRS response to all recommendations submitted to the Commissioner by the Taxpayers' Advocate.

Effective date.—The provision is effective on the date of enactment. The bill provides that the first appointment by the President of the Taxpayers' Advocate shall be made without regard to the requirement for advice and consent of the Senate if the individual so appointed is the head of the Office of Taxpayer Ombudsman on the date of enactment. The first annual report of the Taxpayers' Advocate is due not later than December 31, 1992.

Senate amendment

The Senate amendment establishes a new position, Taxpayer Advocate, within the IRS. This replaces the position of Taxpayer Ombudsman. The Advocate is appointed by the IRS Commissioner and reports directly to the Commissioner. Compensation of the Advocate is at a level equal to that of the IRS Chief Counsel.

The Senate amendment also establishes the Office of Taxpayer Advocate within the IRS. All problem resolution officers are part of that office, and are under the supervision and direction of the Taxpayer Advocate. The functions of the office are (1) to assist taxpayers in resolving problems with the IRS, (2) to identify areas in which taxpayers have problems in dealings with the IRS, (3) to propose changes (to the extent possible) in the administrative practices of the IRS that will mitigate those problems, and (4) to identify potential legislative changes that may mitigate those problems.

The Taxpayer Advocate is required to make two annual reports to the tax-writing Committees. The first report is to contain the objectives of the Taxpayer Advocate for the next calendar year. This report is to contain full and next calendar year. This report is to contain full and substantive analysis, in addition to statistical information. This report is due not later than October 31 of each year. The second report is on the activities of the Taxpayer Advocate during the previous fiscal year. The report must identify the initiatives the Taxpayer Advocate has taken to improve taxpayer services and IRS responsiveness, contain recommendations received from individuals who have the authority to issue a TAO, contain a summary of at least 20 of the most serious problems which taxpayers have in dealing with the IRS, describe in detail the progress made in implementing these recommendations, include recommendations for such administrative and legislative action as may be appropriate to resolve such problems, and to include other such information as the Taxpayer Advocate may deem advisable. The Commissioner is required to establish internal procedures that will ensure a formal IRS response to all recommendations submitted to the Commissioner by the Taxpayer Advocate.

Effective date.—The provision is effective on the date of enactment. The first annual reports of the Taxpayer Advocate are due in 1992.

Conference agreement

The conference agreement follows the Senate amendment, except that it follows the House bill in requiring the Advocate to be nominated by the President, by and with the advice and consent of the Senate.

2. EXPANSION OF AUTHORITY TO ISSUE TAXPAYER ASSISTANCE ORDERS

Present law

Section 7811(a) authorizes the Taxpayer Ombudsman to issue a Taxpayer Assistance Order (TAO). TAOs may order the release of taxpayer property levied upon by the IRS and may require the IRS to cease any action, or refrain from taking any action if, in the determination of the Taxpayer Ombudsman, the taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered.

House bill

The House bill provides the Taxpayers' Advocate with broader authority to affirmatively take any action with respect to taxpayers who would otherwise suffer a significant hardship as a result of the manner in which the IRS is administering the tax laws.

Effective date.—The provision is effective on the date of enactment.

Senate amendment

The Senate amendment eliminates the requirement that the hardship experienced by the taxpayer be significant as a condition for the issuance of a TAO. The Senate amendment also provides the Taxpayer Advocate with broader authority to affirmatively take any action with respect to taxpayers who would otherwise suffer a hardship as a result of the manner in which the IRS is administering the tax laws. The Senate amendment provides that a TAO may specify a time period within which the TAO must be followed. Finally, the Senate amendment provides that only the Taxpayer Advocate, the Commissioner of the IRS, or a superior of those two positions, as well as a delegate of the Taxpayer Advocate, may modify or rescind a TAO.

Effective date.—The provision is effective on the date of enactment.

Conference agreement

The conference agreement follows the House bill. In addition, the conference agreement follows the Senate amendment on (1) specifying a time period within which the TAO must be followed, and (2) the limitations on who may modify or rescind a TAO.

B. Modifications to Installment Agreement Provisions

1. NOTIFICATION OF REASONS FOR TERMINATION OR DENIAL OF INSTALLMENT AGREEMENTS

Present law

Section 6159 authorizes the IRS to enter into written installment agreements with taxpayers to facilitate the collection of tax liabilities. In general, the IRS has the right to terminate (or in some instances, alter or modify) such agreements if the taxpayer provided inaccurate or incomplete information before the agreement was entered into, if the taxpayer fails to make a timely payment of an installment or another tax liability, if the taxpayer fails to provide the IRS with a requested update of financial condition, if the IRS determines that the financial condition of the taxpayer has changed significantly, or if the IRS believes collection of the tax liability is in jeopardy. If the IRS determines that the financial condition of a taxpayer that has entered into an installment agreement has changed significantly, the IRS must provide the taxpayer with a written notice that explains the IRS determination at least 30 days before altering, modifying or terminating the installment agreement. No notice is statutorily required if the installment agreement is altered, modified, or terminated for other reasons.

House bill

The House bill requires the IRS to notify taxpayers 30 days before altering, modifying, or terminating any installment agreement for any reason other than that the collection of tax is determined to be in jeopardy. The IRS must include in the notification an explanation of why the IRS intends to take this action.

Effective date.—The provision is effective six months after the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill. In addition, it requires that the IRS notify taxpayers 30 days before denying any installment agreement for any reason other than that the collection of tax is determined to be in jeopardy.

Effective date.—The provision is effective six months after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment. The conferees intend that notice of denial of an installment agreement be given to a taxpayer so that the taxpayer can discuss the denial with the IRS before it is formalized. Any insufficiency in the explanation of the denial has no effect on the availability of an installment agreement to the taxpayer.

2. ADMINISTRATIVE REVIEW OF DENIAL OF REQUESTS FOR, OR TERMINATION OF, INSTALLMENT AGREEMENTS

Present law

A taxpayer whose request for an installment agreement is denied can appeal to successively higher levels of Collection Division management, including the District Director. The IRS is currently testing an appeal process for various collection actions, including installment agreements, that will permit taxpayers to appeal these collection actions to Appeals Division personnel.

House bill

The House bill requires the IRS to establish additional procedures for administrative review by the Appeals Division of denials of requests for installment agreements.

Effective date.—The provision is effective on the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill. In addition, the administrative review must also include terminations of installment agreements.

Effective date.—The provision is effective on the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

3. RUNNING OF FAILURE TO PAY PENALTY SUSPENDED DURING THE PERIOD AN INSTALLMENT AGREEMENT IS IN EFFECT

Present law

Section 6651 provides that a taxpayer is liable for a "failure to pay" penalty on late payments of tax. The penalty is imposed on the unpaid tax at the rate of one-half percent per month up to a maximum of 25 percent. The penalty applies to unpaid amounts without regard to whether the taxpayer is making payments pursuant to an installment agreement.

House bill

The House bill suspends the application of the failure to pay penalty with respect to taxpayers who have installment agreements in effect and are meeting the conditions of the agreements.

Effective date.—The provision is effective for installment agreements entered into after the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

C. Interest

1. EXTENSION OF INTEREST-FREE PERIOD FOR PAYMENT OF TAX AFTER NOTICE AND DEMAND

Present law

In general, a taxpayer must pay interest on late payments of tax. An interest-free period of ten days is provided to taxpayers who pay the tax due within ten days of notice and demand.

House bill

The House bill extends the interest-free period provided to taxpayers for the payment of the tax liability reflected in the notice from 10 days to 21 days, provided that the total tax liability shown on the notice of deficiency is less than $100,000.

Effective date.—The provision applies in the case of any notice and demand given after the date six months 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.

2. EXPANSION OF AUTHORITY TO ABATE INTEREST

Present law

Any assessment of interest on any deficiency attributable in whole or in part to any error or delay by an officer or employee of the IRS (acting in his official capacity) in performing a ministerial act may be abated.

House bill

The House bill expands the authority to abate interest to managerial acts as well as ministerial acts.

Effective date.—The provision applies to interest accruing with respect to deficiencies or payments for taxable years beginning after the date of enactment.

Senate amendment

The Senate amendment requires the IRS to abate interest in any case in which the taxpayer establishes that there was an unreasonable and excessive IRS error or delay and the taxpayer has fully cooperated in resolving outstanding issues. To allow the taxpayer to develop the facts of the error or delay, the IRS is required to provide to the taxpayer, within 30 days of the taxpayer's written request (which is to be made in the form the Secretary prescribes), all information and copies of relevant records in the possession of the IRS with respect to the taxpayer's case.

Effective date.—The provision applies to interest accruing with respect to deficiencies or payments for taxable years beginning after the date of enactment.

Conference agreement

The conference agreement follows the House bill.

D. Joint Returns

1. REQUIREMENT OF SEPARATE DEFICIENCY NOTICES IN CERTAIN CASES

The IRS may send a single notice of deficiency with respect to a joint return unless a spouse has notified the IRS that separate residences have been established, in which case the IRS must send a copy of the notice to each spouse at his or her last known address.

House bill

No provision.

Senate amendment

The Senate amendment requires the IRS to send each spouse a copy of the notice of deficiency if the spouses have not filed a joint return for the most recent taxable year for which the IRS's master files have been updated or if the IRS has been notified by either spouse that separate residences have been established.

Effective date.—The provision is effective on the date six months after the date of enactment.

Conference agreement

The conference agreement follows the House bill.

2. DISCLOSURE OF COLLECTION ACTIVITIES WITH RESPECT TO JOINT RETURNS

Present law

The IRS does not disclose collection information to spouses that have filed a joint return.

House bill

If a tax deficiency with respect to a joint return is assessed, and the individuals filing the return are no longer married or no longer reside in the same household, the House bill permits the IRS to disclose in writing (in response to a written request by one of the individuals) to that individual whether the IRS has attempted to collect the deficiency from the other individual, the general nature of the collection activities, and the amount (if any) collected.

Effective date.—The provision is effective on the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill, except that the IRS is required to disclose the information.

Effective date.—The provision is effective on the date of enactment.

Conference agreement

The conference agreement follows the House bill.

3. JOINT RETURN MAY BE MADE AFTER SEPARATE RETURNS WITHOUT FULL PAYMENT OF TAX

Present law

Taxpayers who file separate returns and subsequently determine that their tax liability would have been less if they had filed a joint return are precluded by statute from reducing their tax liability by filing jointly if they are unable to pay the entire amount of the joint return liability before the expiration of the three-year period for making the election to file jointly.

House bill

The House bill repeals the requirement of full payment of tax liability as a precondition to switching from married filing separately status to married filing jointly status.

Effective date.—The provision applies to taxable years beginning after the date of the 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.

4. REPRESENTATION OF ABSENT DIVORCED OR SEPARATED SPOUSE BY OTHER SPOUSE

Present law

A taxpayer that has joined in the filing of a joint return may represent the taxpayer's spouse with respect to a deficiency assessed for the taxable year to which the return applies. Current IRS procedures allow each spouse to separately appeal the statutory notice of deficiency.

House bill

No provision.

Senate amendment

The Senate amendment provides that an individual who had filed a joint return with a spouse but who is no longer married to that spouse (or no longer resides in the same household) and that spouse is absent from the examination of that return may not represent that absent spouse at the examination unless the absent spouse permits it in writing.

Effective date.—The provision is effective on the date of enactment.

Conference agreement

The conference agreement follows the House bill.

E. Collection Activities

1. NOTICE OF PROPOSED DEFICIENCY

Present law

The IRS generally issues a notice of proposed deficiency prior to issuing a notice of deficiency. The notice of proposed deficiency, commonly referred to as the "30-day letter," offers a taxpayer the opportunity for review of the case by the IRS Appeals Office. The IRS is not required to issue a 30-day letter, but generally does unless the statute of limitations on assessment will expire within six months. If a 30-day letter is not issued and the taxpayer files a petition in the Tax Court, the taxpayer is permitted to have the case reviewed by Appeals after it is docketed.

House bill

No provision.

Senate amendment

The IRS is required to issue a notice of proposed deficiency in every case (other than jeopardy assessment cases). The mailing of the notice of proposed deficiency must precede the mailing of the notice of deficiency by at least 60 days. If the statute of limitations would expire within six months, the IRS may ask the taxpayer to extend the statute of limitations so that the IRS may issue a notice of proposed deficiency. Failure to issue a notice of proposed deficiency would invalidate the notice of deficiency.

Effective date.—The provision is effective with respect to deficiencies determined on or after 1 year after the date of enactment.

Conference agreement

The conference agreement follows the House bill.

2. MODIFICATIONS TO LIEN AND LEVY PROVISIONS

a. Withdrawal of public notice of lien

Present law

The IRS must file a notice of lien in the public record, in order to protect the priority of a tax lien. A notice of tax lien provides public notice that a taxpayer owes the Government money. The IRS has discretion in filing such a notice, but may withdraw a filed notice only if the notice (and the underlying lien) was erroneously filed or if the underlying lien has been paid, bonded, or become unenforceable.

House bill

The House bill allows the IRS to withdraw a public notice of tax lien prior to payment in full by the indebted taxpayer when it is in the best interest of the taxpayer and the Government. The bill also requires that, at the written request of the taxpayer, the IRS make reasonable efforts to give notice of the withdrawal of a lien to credit reporting agencies or financial institutions specified by the taxpayer.

Effective date.—The provisions are effective on the date of enactment.

Senate amendment

The Senate amendment allows the IRS to withdraw a public notice of tax lien prior to payment in full by the indebted taxpayer if the Secretary determines that (1) the filing of the notice was premature or otherwise not in accordance with the administration procedures of the IRS, (2) the taxpayer has entered into an installment agreement to satisfy the tax liability, (3) the withdrawal of the lien will facilitate collection of the tax liability, or (4) the withdrawal of the lien would be in the best interests of the taxpayer and the Government (with the consent of the taxpayer or the Taxpayer Advocate). The bill also requires that, at the written request of the taxpayer, the IRS make reasonable efforts to give notice of the withdrawal of a lien to credit reporting agencies or financial institutions specified by the taxpayer.

Effective date.—The provisions are effective on the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

b. Return of levied property

Present law

The IRS is authorized to return levied property to a taxpayer only when the taxpayer has overpaid its liability to tax, interest, and penalty.

House bill

The House bill allows the IRS to return property (including money deposited in the Treasury) that has been levied upon if doing so is in the best interest of the taxpayer and the United States.

Effective date.—The provision is effective on the date of enactment.

Senate amendment

The Senate amendment allows the IRS to return property (including money deposited in the Treasury) that has been levied upon if the Secretary determines that (1) the levy was premature or otherwise not in accordance with the administrative procedures of the IRS, (2) the taxpayer has entered into an installment agreement to satisfy the tax liability, (3) the return of the property will facilitate collection of the tax liability, or (4) the return of the property would be in the best interests of the taxpayer and the United States (with the consent of the taxpayer or the Taxpayer Advocate).

Effective date.—The provisions are effective on the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

c. Modifications in certain levy exemption amounts

Present law

Property exempt from levy includes personal property with a value of up to $1,650, and books and tools necessary for the taxpayer's trade, business, or profession with a value of up to $1,100.

House bill

No provision.

Senate amendment

The Senate amendment increases the exemption amounts to $1,700 for personal property and $1,200 for books and tools. Both these amounts are indexed for inflation commencing with calendar year 1994.

Effective date.—The provisions are effective on the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

3. OFFERS-IN-COMPROMISE

Present law

The IRS has the authority to settle a tax debt pursuant to an offer-in-compromise. IRS regulations provide that such offers can be accepted if: the taxpayer is unable to pay the full amount of the tax liability and it is doubtful that the tax, interest, and penalties can be collected or there is doubt as to the validity of the actual tax liability. Amounts over $500 can only be accepted if the reasons for the acceptance are documented in detail and supported by an opinion of the IRS Chief Counsel.

House bill

The House bill allows acceptance of an offer-in-compromise where the compromise would be in the best interest of the Government. The bill also increases from $500 to $50,000 the amount requiring a written opinion from the Office of Chief Counsel.

Effective date.—The provision is effective on the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill. In addition, compromises below the $50,000 threshold must be subject to continuing quality review by the IRS.

Effective date.—The provision is effective on the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

4. NOTIFICATION OF EXAMINATION

Present law

In general, the IRS notifies taxpayers in writing prior to commencing an examination and encloses a copy of Publication 1, "Your Rights as a Taxpayer," with the notice. Sometimes, however, the IRS uses the telephone to schedule an examination.

House bill

No provision.

Senate amendment

The Senate amendment requires the IRS to notify a taxpayer in writing prior to commencing an examination and to provide the taxpayer with an explanation of the examination process prior to commencing the examination.

Effective date.—The provision is effective on the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment, with a modification exempting from this requirement any examination with respect to which the Secretary determines (1) that it is in connection with a criminal investigation, (2) that the collection of the tax is in jeopardy, (3) that the requirements are inconsistent with national security needs, or (4) that the requirements would interfere with the effective conduct of a confidential law enforcement or foreign counterintelligence activity. The conferees intend that this provision not preclude the IRS from using the telephone to attempt to schedule an examination, so long as the written notice required by this provision is given.

5. MODIFICATION OF CERTAIN LIMITS ON RECOVERY OF CIVIL DAMAGES FOR UNAUTHORIZED COLLECTION ACTIVITIES

Present law

A taxpayer may sue the United States for up to $100,000 of damages caused by an officer or employee of the IRS who recklessly or intentionally disregards provisions of the Internal Revenue Code or the Treasury regulations promulgated thereunder.

House bill

No provision.

Senate amendment

The Senate amendment increases the cap to $1 million with respect to reckless or intentional acts. In addition, it permits a taxpayer to sue the United States for damages caused by an IRS employee who negligently disregards the provisions of the Code or regulations, subject to a cap of $100,000 in damages.

Effective date.—The provision applies to actions by IRS employees that occur after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment as to increasing the cap to $1 million with respect to reckless or intentional acts, and otherwise follows the House bill.

6. DESIGNATED SUMMONS

Present law

The period for assessment of additional tax with respect to most tax returns, corporate or otherwise, is three years. The IRS and the taxpayer can together agree to extend the period, either for a specified period of time or indefinitely. The taxpayer may terminate an indefinite agreement to extend the period by providing notice to the IRS.

During an audit, the IRS may informally request that the taxpayer provide additional information necessary to arrive at a fair and accurate audit adjustment, if any adjustment is warranted. Not all taxpayers cooperate by providing the requested information on a timely basis. In some cases the IRS seeks information by issuing an administrative summons. Such a summons will not be judicially enforced unless the Government (as a practical matter, the Department of Justice) seeks and obtains an order for enforcement in Federal court. In addition, a taxpayer may petition the court to quash an administrative summons where this is permitted by statute.[1]

In certain cases the running of the assessment period is suspended during the period when the parties are in court to obtain or avoid judicial enforcement of an administrative summons. Such a suspension is provided in the case of litigation over a third-party summons (sec. 7609(e)) or litigation over a summons regarding the examination of a related party transaction. Such a suspension can also occur with respect to a corporate tax return if a summons is issued at least 60 days before the day on which the assessment period (as extended) is scheduled to expire. In this case, suspension is only permitted if the summons clearly states that it is a "designated summons" for this purpose. Only one summons may be treated as a designated summons for purposes of any one tax return. The limitations period is suspended during the judicial enforcement period of the designated summons and of any other summons relating to the same tax return that is issued within 30 days after the designated summons is issued.

Under current internal procedures of the IRS, no designated summons is issued unless first reviewed by the Office of Chief Counsel to the IRS, including review by an IRS Deputy Regional Counsel for the Region in which the examination of the corporation's return is being conducted.

House bill

No provision.

Senate amendment

The Senate amendment requires that issuance of any designated summons with respect to a corporation's tax return must be preceded by review of such issuance by the Regional Counsel, Office of Chief Counsel to the IRS, for the Region in which the examination of the corporation's return is being conducted.

In addition, the Senate amendment requires that the corporation whose return is in issue be promptly notified in writing in any case where the Secretary issues a designated summons (or another summons, the litigation over which suspends the running of the assessment period under the designated summons procedure) to a third party. It is expected that the IRS generally will meet this requirement by issuing such notice on the same day that it issues such summons, and by transmitting such notice to the corporation in a manner reasonably designed to bring it to the prompt attention of an agent of the corporation responsible for communicating with the IRS in connection with the examination.

[1] Petitions to quash are permitted, for example, in connection with the examination of certain related party transactions under section 6038A(e)(4), and in the case of certain third-party summonses under section 7609(b)(2).

Effective date.—This provision of the Senate amendment applies to summonses issued after date of enactment.

Conference agreement

The conference agreement follows the Senate amendment. The conferees do not intend the notice requirement in the conference agreement to imply that any summons issued to an unrelated third party, the purpose of which is to obtain information regarding comparable transactions involving unrelated parties, would require disclosure to the taxpayer of any information relating to the unrelated third party that would otherwise remain confidential under any other provision of the law.

F. Information Returns

1. PHONE NUMBERS OF PERSON PROVIDING PAYEE STATEMENT REQUIRED TO BE SHOWN ON SUCH STATEMENT

Present law

Information returns must contain the name and address of the payor.

House bill

The House bill requires that information returns also contain the payor's phone number.

Effective date.—The provision applies to statements required to be furnished after December 31, 1992 (determined without regard to any extension).

Senate amendment

The Senate amendment requires that information returns contain the name, address, and phone number of the payor's information contact.

Effective date.—The provision applies to statements required to be furnished after December 31, 1992 (determined without regard to any extension).

Conference agreement

The conference agreement follows the Senate amendment.

2. CIVIL DAMAGES FOR FRAUDULENT FILING OF INFORMATION RETURNS

Present law

Federal law provides no private cause of action to a taxpayer who is injured because a false or fraudulent information return has been filed with the IRS asserting that payments have been made to the taxpayer.

House bill

The House bill provides that, if any person willfully files a false or fraudulent information return with respect to payments purported to have been made to another person, the other person may bring a civil action for damages against the person filing that return. Recoverable damages are the greater of $5,000 or the amount of actual damages (including the costs of the action). An action seeking damages under this provision must be brought within six years after the filing of the false or fraudulent information return.

Effective date.—The provision applies to false or fraudulent information returns filed 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.

3. REQUIREMENT TO VERIFY ACCURACY OF INFORMATION RETURNS

Present law

Deficiencies determined by the IRS are generally afforded a presumption of correctness.

House bill

The House bill requires that the IRS, when making a determination of a tax deficiency based on an information return, take reasonable steps to corroborate the accuracy of the information return, when the return is disputed by the taxpayer. The reasonable steps which the IRS must take to corroborate the disputed information return would vary in response to the facts and circumstances of each case. Failure by the IRS to corroborate the disputed information return shall not invalidate any notice of a deficiency or any assessment of a deficiency.

Effective date.—The provision is effective on the date of enactment.

Senate amendment

The Senate amendment provides that, in any court proceeding, if a taxpayer asserts a reasonable dispute with respect to any item of income reported on an information return filed by a third party and the taxpayer has fully cooperated with the IRS, the Government must, in presenting evidence of the deficiency based on the information return, present reasonable evidence of the deficiency (in addition to the information return itself). One way in which the taxpayer must cooperate with the IRS is to bring the reasonable dispute over the item of income to the attention of the IRS at the earliest possible time.

Effective date.—The provision is effective on the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

G. Modification To Penalty For Failure To Collect and Pay Over Tax

1. PRELIMINARY NOTICE REQUIREMENTS

Present law

A "responsible person" is subject to a penalty equal to the amount of trust fund taxes that are not collected or paid to the government on a timely basis. An individual the IRS has identified as a responsible person is permitted an administrative appeal on the question of responsibility.

House bill

No provision.

Senate amendment

The IRS is required to issue a notice to an individual the IRS had determined to be a responsible person with respect to unpaid trust fund taxes at least 60 days prior to issuing a notice and demand for the penalty. After exhausting the administrative remedies available within the IRS, the recipient could seek a declaratory judgment from the Tax Court prior to assessment. The statute of limitations for the collection of the penalty is suspended during the periods that these rules preclude the IRS from collecting the penalty. The provision does not apply if the Secretary finds that the collection of the penalty is in jeopardy.

Effective date.—The provision applies to failures occurring after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment with respect to the notice requirement. It follows the House bill with respect to declaratory judgments. It modifies the Senate amendment with respect to the statute of limitations by providing that the statute of limitations shall not expire before the date 60 days after the date on which the notice was mailed. The conference agreement follows the Senate amendment with respect to jeopardy.

2. NO PENALTY IF PROMPT NOTIFICATION OF IRS

Present law

A responsible person may be subject to a penalty equal to 100 percent of the amount of trust fund taxes that are not collected and paid to the Government on a timely basis.

House bill

The House bill provides that a responsible person who notifies the IRS within 10 days of the failure to pay over trust fund taxes to the Government is not liable for this penalty, so long as the notification is made prior to the IRS's contacting the business about the failure to pay over the taxes, and provided that the person is not a significant owner (of a 5-percent or more interest) or a highly compensated employee (with compensation in excess of $75,000).

Effective date.—The provision applies in the case of failures to collect and pay over tax that occur after the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

3. DISCLOSURE OF CERTAIN INFORMATION WHERE MORE THAN ONE PERSON SUBJECT TO PENALTY

Present law

The IRS may not disclose to a responsible person the IRS's efforts to collect unpaid trust fund taxes from other responsible persons, who may also be liable for the same tax liability.

House bill

The House bill authorizes the IRS, if requested in writing by a person considered by the IRS to be a responsible person, to disclose in writing to that person the name of any other person the IRS has determined to be a responsible person with respect to the tax liability. The IRS would be permitted to disclose in writing whether it has attempted to collect this penalty from other responsible persons, the general nature of those collection activities, and the amount (if any) collected.

Effective date.—The provision is effective on the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill, except that the IRS is required to disclose the information.

Effective date.—The provision is effective on the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment. The conferees intend that failure by the IRS to follow this provision does not absolve any individual for any liability for this penalty.

H. Awarding of Costs and Certain Fees

1. IRS EMPLOYEES PERSONALLY LIABLE IN CERTAIN CASES

Present law

IRS employees are not personally liable for the payment of any litigation costs under section 7430.

House bill

The House bill gives discretion to the court in tax cases to assess all or a portion of any award under section 7430 against an IRS employee, if the court determines that the proceeding resulted from any arbitrary, capricious, or malicious act of the employee.

Effective date.—The provision applies to proceedings commenced after the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

2. COMMENCEMENT DATE OF REASONABLE ADMINISTRATIVE COSTS

Present law

A taxpayer that successfully challenges a determination of deficiency by the IRS may recover attorneys' fees and other administrative and litigation costs if the taxpayer qualifies as a "prevailing party." These costs are recoverable to the extent incurred on or after the earlier of (i) the date of the receipt by the taxpayer of the notice of decision of the IRS Office of Appeals, or (ii) the date of the notice of deficiency.

House bill

No provision.

Senate amendment

Attorney's fees and other administrative costs are recoverable to the extent incurred after the earlier of the date of the notice of proposed deficiency or the date of the notice of deficiency.

Effective date.—The provision is effective for notices made and proceedings commenced after the date of enactment.

Conference agreement

The conference agreement follows the House bill.

3. MOTION FOR DISCLOSURE OF INFORMATION

Present law

A taxpayer that successfully challenges a determination of deficiency by the IRS may recover attorneys' fees and other administrative and litigation costs if the taxpayer qualifies as a "prevailing party." A taxpayer qualifies as a prevailing party if it (1) establishes that the position of the United States was not substantially justified; (2) substantially prevails with respect to the amount in controversy or with respect to the most significant issue or set of issues presented; and (3) meets certain net worth and (if the taxpayer is a business) size requirements.

House bill

No provision.

Senate amendment

Once a taxpayer has substantially prevailed, the IRS must provide to the taxpayer all information and copies of relevant records in the possession of the IRS with respect to the taxpayer's case and the substantial justification for the position taken by the IRS. Disclosure under this provision is subject to the confidentiality restrictions of section 6103.

Effective date.—The provision is effective for notices made and proceedings commenced after the date of enactment.

Conference agreement

The conference agreement generally follows the Senate amendment, by providing that once a taxpayer has substantially prevailed, the taxpayer may file a motion for an order requiring the disclosure (within a specified period) of all information and copies of relevant records in the possession of the IRS with respect to the taxpayer's case and the substantial justification for the position taken by the IRS. Disclosure under this provision is subject to the confidentiality restrictions of section 6103. The conferees intend that relevant records be disclosed as quickly as practicable, and that courts conform their rules to this provision. The conferees do not intend to require the disclosure of privileged or otherwise nondisclosable information.

4. INCREASED LIMIT ON ATTORNEY FEES

Present law

Attorneys' fees recoverable by prevailing parties as litigation or administrative costs are limited to a maximum of $75 per hour.

House bill

No provision.

Senate amendment

The maximum recoverable rate for attorneys' fees is indexed for inflation occurring since 1981.

Effective date.—The provision applies to notices made and proceedings commenced after the date of enactment.

Conference agreement

The conference agreement generally follows the Senate amendment by raising the statutory rate to $110 per hour, indexed for inflation beginning after 1992.

5. FAILURE TO AGREE TO EXTENSION NOT TAKEN INTO ACCOUNT

Present law

To qualify for an award of attorney's fees, the taxpayer must have exhausted the administrative remedies available within the IRS. The IRS has taken the position in regulations that attorney's fees cannot be awarded if the taxpayer has not agreed to extend the statute of limitations. In *Minahan v. Commissioner*, 88 T.C. 492 (1987), the Tax Court held that regulation invalid insofar as it provides that a taxpayer's refusal to consent to extend the statute of limitations is to be taken into account in determining whether the taxpayer has exhausted administrative remedies available to the taxpayer.

House bill

The House bill provides that any failure to agree to an extension of the statute of limitations cannot be taken into account for purposes of determining whether a taxpayer has exhausted the administrative remedies for purposes of determining eligibility for an award of attorney's fees.

Effective date.—The provision applies to proceedings commenced 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.

I. Other Provisions

1. RELIEF FROM RETROACTIVE APPLICATION OF TREASURY DEPARTMENT REGULATIONS

Present law

Treasury may prescribe the extent (if any) to which regulations shall be applied without retroactive effect.

House bill

No provision.

Senate amendment

Temporary and proposed regulations are required to have an effective date no earlier than the date of publication in the Federal Register. This provision may be superseded by a legislative grant authorizing the Treasury to prescribe the effective date with respect to a statutory provision. In addition, the Treasury may provide that taxpayers may elect to apply a temporary or proposed regulation retroactively from the date of publication of the regulation. Final regulations may take effect from the date of publication of the temporary or proposed regulation to which they relate.

Effective date.—The provision applies with respect to any temporary or proposed regulation published on or after February 20, 1992, and any temporary or proposed regulation published before February 20, 1992, and published as a final regulation after that date.

Conference agreement

The conference agreement follows the Senate amendment, with modifications (1) permitting the Treasury to issue retroactive temporary or proposed regulations to prevent abuse of the statute and (2) permitting the Treasury to issue retroactive temporary, proposed, or final regulations to correct a procedural defect in the issuance of a regulation. The conference agreement does not apply to regulations prescribed under Code section 986(a)(1)(C) or 986(a)(3) (as amended by the conference agreement).

The conferees recognize that there may be additional instances in which retroactive application of Treasury regulations has created undue hardship. The conference agreement does not preclude the tax-writing committees from both examining these cases and providing any appropriate relief in the future.

2. REQUIRED CONTENT OF CERTAIN NOTICES

Present law

The Code requires the IRS to describe the basis for and identify the amounts of tax due, interest, penalties, and any other additional amounts owed in the notice of deficiency sent to taxpayers.

House bill

The House bill requires that the IRS set forth the components of and explanation for each specific adjustment that is the basis for the total tax deficiency. An inadequate description does not invalidate the notice.

Effective date.—The provision applies to notices sent after the date six months 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.

3. TREATMENT OF SUBSTITUTE RETURNS FOR PURPOSES OF THE PENALTY FOR FAILURE TO PAY TAXES

Present law

Section 6651(a)(2) provides that the IRS may assess a penalty for failure to pay tax from the due date of the return until the tax is paid. If no return is filed by the taxpayer and the IRS files a substitute return under section 6020, the tax on which the penalty is measured is considered a deficiency assessable under section 6212 or 6213, and the failure to pay penalty begins to accumulate ten days after the IRS sends the taxpayer a notice and demand for payment of the tax.

House bill

The House bill applies the failure to file penalty to substitute returns in the same manner as the penalty applies to delinquent filers.

Effective date.—The provision applies in the case of any return the due date for which (determined without regard to extensions) is after the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

4. UNAUTHORIZED ENTICEMENT OF INFORMATION DISCLOSURE

Present law

There is no criminal penalty for enticing a tax professional to disclose information about clients in exchange for forgiving the taxes of the professional.

House bill

No provision.

Senate amendment

The Senate amendment provides that a Government employee who defers or offers to defer (or forgives or offers to forgive) the determination or collection of any tax due to a tax professional in exchange for information concerning the professional's clients shall (upon conviction) be guilty of a felony.

Effective date.—The provision applies to actions taken after the date of enactment.

Conference agreement

The conference agreement follows the Senate amendment.

J. Form Modifications

1. EXPLANATION OF CERTAIN PROVISIONS

Present law

Section 6159 authorizes the IRS to enter into written installment agreements with any taxpayer. Section 7122 authorizes the IRS to accept offers in compromise from taxpayers in certain situations.

Section 6161 authorizes the IRS to extend the time for payment of tax.

House bill

The House bill requires the IRS to take such actions as may be appropriate (including improved publicity) to ensure that taxpayers are aware of the availability of installment agreements, offers in compromise, and the extension of time to pay tax. The IRS must do so in both the income tax return instructions and collection notices.

Effective date.—The provision is effective on the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

2. IMPROVED PROCEDURES FOR NOTIFYING IRS OF CHANGE OF ADDRESS OR NAME

Present law

Generally, the IRS posts the new address of a taxpayer only upon the filing of the subsequent tax return which contains a new address or if the taxpayer submits a Form 8822, *Change of Address*, to the IRS.

House bill

The House bill requires the IRS to provide improved procedures for taxpayers to notify the IRS of changes in names or addresses. In addition, the House bill requires that the IRS institute procedures before 1993 for the timely updating of all IRS records with change of address information provided to the IRS by taxpayers.

Effective date.—The provision is effective on the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

3. RIGHTS AND RESPONSIBILITIES OF DIVORCED INDIVIDUALS

Present law

The IRS provides information on the rights and responsibilities of divorced individuals in Publication 504, *Tax Information for Divorced or Separated Individuals*. This publication is not as widely utilized as Publication 1, *Your Rights As a Taxpayer*.

House bill

The House bill requires the IRS to include a section on the rights and responsibilities of divorced individuals in Publication 1, *Your Rights As a Taxpayer.*

Effective date.—The provision is effective on the date of enactment.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

4. PENALTIES RELATING TO FAILURE TO COLLECT AND PAY OVER TAX

a. Public information requirements

Present law

Under section 6672, a "responsible person" is subject to a penalty equal to the amount of trust fund taxes that are not collected and paid to the Government on a timely basis.

House bill

The House bill requires the IRS to print warnings on payroll tax deposit coupon books and appropriate tax returns indicating that certain employees may be liable for this penalty, and to develop a special information packet relating to this penalty.

Effective date.—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.

b. Board members of tax-exempt organizations

Present law

Under section 6672, "responsible persons" of tax-exempt organizations are subject to a penalty equal to the amount of trust fund taxes that are not collected and paid to the Government on a timely basis.

House bill

The House bill clarifies that the section 6672 responsible person penalty is not to be imposed on volunteer members of any board of trustees or directors of a tax-exempt organization to the extent such members are solely serving in an honorary capacity and do not participate in the day-to-day or financial activities of the organization. The House bill requires the IRS to develop materials to better inform board members of tax-exempt organizations (including voluntary or honorary members) that they may be treated as responsible persons. The IRS must make such materials routinely available to tax-exempt organizations. The House bill also requires the IRS to clarify its instructions to IRS employees on application of the responsible person penalty with regard to honorary or volunteer members of boards of trustees or directors of tax-exempt organizations.

Effective date.—The provision is effective on the date of enactment.

Senate amendment

The Senate amendment is the same as the House bill, except that (1) the board members are required to be unpaid, and (2) the requirement that they serve in an honorary capacity is deleted.

Conference agreement

The conference agreement follows the House bill, with the additional requirement that board members be unpaid.

c. *Prompt notification*

Present law

The IRS is not required to notify promptly taxpayers who fall behind in depositing trust fund taxes.

House bill

The House bill requires the IRS, to the maximum extent practicable, to notify all taxpayers with delinquent trust fund deposits within 30 days of the first indication that there has been a failure to make a timely and complete deposit.

Effective date.—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. The conferees intend that failure to provide this notice does not absolve any individual from any liability for this penalty.

5. REQUIRED NOTICE TO TAXPAYERS OF CERTAIN PAYMENTS

Present law

If the IRS receives a payment without sufficient information to properly credit it to a taxpayer's account, the IRS may attempt to contact the taxpayer. If contact cannot be made, the IRS places the payment in an unidentified remittance file.

House bill

The House bill requires the IRS to make reasonable efforts to notify, within 60 days, those taxpayers who have made payments which the IRS cannot associate with any outstanding tax liability.

Effective date.—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.

K. Studies

1. PILOT PROGRAM FOR APPEAL OF ENFORCEMENT ACTIONS

Present law

A taxpayer who disagrees with an IRS collection action generally can only appeal to successively higher levels of management in the Collection Division. Certain cases involving the 6672 penalty, offers-in-compromise, and employment tax issues may, however, be appealed to the Appeals Division.

House bill

The House bill requires the IRS to establish a one-year pilot program to evaluate the merits of allowing an independent appeal, by the taxpayer, to the Appeals Division of enforcement actions (including lien, levy, and seizure actions) where the deficiency was assessed without the actual knowledge of the taxpayer, where the deficiency was assessed without an opportunity for administrative appeal, and in other appropriate circumstances.

Effective date.—The IRS is required to report to the tax-writing committees by December 31, 1992, on the effectiveness of this pilot program.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

2. STUDY ON TAXPAYERS WITH SPECIAL NEEDS

Present law

The IRS is responsible for providing timely and accurate assistance to taxpayers who want to comply with Federal tax laws.

House bill

The House bill requires the IRS to conduct a study of ways to assist the elderly, physically impaired, foreign-language speaking, and other taxpayers with special needs to comply with the tax laws.

Effective date.—The report (and any recommendations) must be submitted to the tax-writing committees by December 31, 1992.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

3. REPORTS ON TAXPAYER RIGHTS EDUCATION PROGRAM

Present law

The IRS is currently conducting a program to educate revenue officers concerning the rights of taxpayers.

House bill

The House bill requires the IRS to report to the tax-writing Committees on its taxpayer rights education program for its officers and employees, including the scope and content of the program, and on the effectiveness of the program.

Effective date.—The report on the scope and content of the taxpayer-rights education program must be submitted to the tax-writing committees by August 1, 1992, and the report on the effectiveness of the program must be submitted by December 31, 1992.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

4. BIENNIAL REPORTS ON MISCONDUCT BY IRS EMPLOYEES

Present law

As mandated by the Inspector General Act, every six months the Inspector General of the Department of the Treasury receives information from the IRS for the Secretary of the Treasury's semiannual report to Congress on employee misconduct. The Inspector General Act, in part, requires that these reports include summary information and descriptions of significant investigative activities and a summary of matters referred to prosecuting authorities and the prosecutions and convictions that have resulted.

House bill

The House bill requires the IRS to report to the tax-writing committees every two years on all cases involving complaints about

IRS employee misconduct and on the disposition of those complaints.

Effective date.—The first report is required to be submitted during December 1992.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

5. STUDY OF NOTICES OF DEFICIENCY

Present law

Under section 6212, the IRS is required to send a notice of tax deficiency to taxpayers by registered or certified mail.

House bill

The House bill requires the GAO to study the effectiveness of current IRS efforts to notify taxpayers with regard to tax deficiencies under section 6212, the number of registered or certified letters and other notices returned to the IRS as undeliverable, any follow-up action taken by the IRS to locate the taxpayers, the effect that failures to receive actual notice have on taxpayers, and recommendations on how the IRS can better notify taxpayers of tax deficiencies.

Effective date.—The report and recommendations are required to be furnished by December 31, 1992.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

6. NOTICE AND FORM ACCURACY STUDY

Present law

The IRS is responsible for providing accurate and instructive notices, forms, and instructions to taxpayers to assist them in complying with Federal tax laws.

House bill

The House bill requires the GAO to study annually the accuracy of 25 of the most commonly used IRS forms, notices, and publications. In conducting its review, the GAO is to seek and consider the comments of organizations representing taxpayers, employers, and tax professionals.

Effective date. The initial report (and any recommendations) must be submitted to the tax-writing committees by December 31, 1992.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

7. IRS EMPLOYEES' SUGGESTIONS STUDY

Present law

The IRS maintains several programs to encourage and reward employees who make suggestions for improving the administration of the tax system.

House bill

The House bill requires the GAO to conduct a review of the IRS employee suggestion programs. The study is to include a review of all suggestions that were accepted and rewarded by the IRS, an analysis as to how many of these suggestions were implemented, and why the remaining suggestions were not implemented.

Effective date. The report (and any recommendations) must be submitted to the tax-writing committees by December 31, 1992.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

VI. OTHER PROVISIONS

1. BUDGET COMPLIANCE PROVISION

Present law

The Budget Enforcement Act of 1990 ("1990 Act") amended the 1985 Balanced Budget and Emergency Deficit Control Act to establish new budget scorekeeping rules for legislation with budgetary consequences. The 1990 Act subjects discretionary spending for 1991 through 1995 to specified dollar maximums. Increases in discretionary spending may not be offset by higher taxes or fees under the new budget rules.

Direct spending programs (entitlements and other mandatory spending) may be increased only if the increases are offset in each year by lower direct spending in other programs or by higher taxes or fees ("pay-as-you-go accounting"). Under the pay-as-you-go accounting regime, if direct spending increases or revenue losses are not offset within the pay-as-you-go accounts, a sequester (automatic reduction) in these accounts will occur at the end of the fiscal year.

House bill

Any changes in budget authority, outlays, or receipts resulting from the provisions of the bill are not to be considered for sequester calculations under section 252 or 253 of the 1985 Balanced Budget and Emergency Deficit Control Act, as amended by the 1990 Budget Enforcement Act, including the pay-as-you-go accounting regime. This will prevent a sequester of entitlement accounts in years in which the bill increases the deficit, and will reserve excess revenues for deficit reduction in years in which the bill reduces the deficit.

Senate amendment

No provision.

Conference agreement

The conference agreement does not include the House provision.

2. SENSE OF THE SENATE RESOLUTION ON NOT ESTABLISHING A SENATE BANK

Present law

No provision.

House bill

No provision.

Senate amendment

The Senate amendment provides that it is the sense of the Senate that no Senate bank with characteristics similar to those of the former House bank should ever be established.

Conference agreement

The conference agreement does not include the Senate amendment.

3. WORKFARE REQUIREMENT FOR RECIPIENTS OF GENERAL ASSISTANCE

Present law

About 30 States have general assistance programs which provide cash benefits to needy individuals. These programs are funded out of State revenues. States determine who is eligible for benefits, the level of benefits, and the conditions under which benefits are payable.

House bill

No provision.

Senate amendment

If the Secretary of Health and Human Services certifies that a State has a general assistance program that (1) provides benefits to an able bodied individual (as determined by the Secretary) who is age 18 or above and who has no dependents, and (2) does not require such individual to participate in a State workfare program, the Secretary must reduce by 10 percent the amount the State would otherwise receive in aid to families with dependent children. A State's workfare program must meet requirements of the Secretary as provided in regulations to be issued by October 1, 1992.

Effective date.—For calendar quarters beginning on or after January 1, 1994.

Conference agreement

The conference agreement does not include the Senate provisions.

4. LIMIT ON AMOUNT OF AFDC BENEFITS FOR INDIVIDUALS WHO MOVE TO ANOTHER STATE

Present law

States must determine need and the amount of assistance for all applicants and recipients on an objective and equitable basis. There must be a statewide standard (uniformly applied) that is used in determining the need of applicants and recipients and the mount of the assistance payment. There is no variation in the amount of the payment for individuals who have recently moved into the State.

House bill

No provision.

Senate amendment

A State's AFDC plan must provide that for a period of 1 year from the date an individual becomes a new resident in a State, the individual is eligible to receive AFDC in an amount that is the lower of (1) the amount the individual received or could have received in the former State of residence, or (2) the amount the individual could receive in the new State of residence.

Effective date.—Thirty days after enactment.

Conference agreement

The conference agreement does not include the Senate provisions.

5. SENSE OF SENATE RESOLUTION SUPPORTING TAX CREDITS FOR RENEWABLE ENERGY TECHNOLOGIES

Present law

Renewable energy production tax credit

No provision.

Business energy tax credits

Nonrefundable business energy tax credits are allowed for ten percent of the cost of qualified solar and geothermal energy property (sec. 48(a)). The business energy tax credits are scheduled to expire with respect to property placed in service after June 30, 1992.

House bill

No provision.

Senate amendment

The Senate amendment states that it is the sense of the Senate that the national energy tax policy include a production tax credit for renewable energy in conjunction with a permanent business energy tax credit.

Conference agreement

The conference agreement does not include the Senate amendment.

6. STATE TAXATION OF NONRESIDENT RETIREMENT BENEFITS

Present law

Currently, a number of States impose income tax on retirement income earned in the State but paid to individuals who are no longer residents of the State. These States impose income tax on such income because the States provide a deferral of tax on retirement income earned in the State, not an exclusion. This is consistent with the treatment of such income under the Internal Revenue Code.

House bill

No provision.

Senate amendment

The Senate amendment prohibits a State from imposing income tax on the pension or retirement income of any individual who is not a resident or domiciliary of such State. The term "State" includes any political subdivision of a State, the District of Columbia, and any U.S. possession.

Effective date.—Taxable years beginning after December 31, 1991.

Conference agreement

The conference agreement does not include the Senate amendment.

DAN ROSTENKOWSKI,
SAM GIBBONS,
J.J. PICKLE,
CHARLES B. RANGEL,
PETE STARK,
Managers on the Part of the House.

LLOYD BENTSEN,
GEORGE MITCHELL,
DANIEL PATRICK MOYNIHAN,
Managers on the Part of the Senate.

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